

MEMO# 32646

July 29, 2020

SEC Investment Management Director Blass Addresses COVID-19 Impact on Industry and Retail Access to Private Markets

[32646]

July 29, 2020 TO: ICI Members
Investment Company Directors
Advertising Compliance Advisory Committee
Chief Compliance Officer Committee
Chief Risk Officer Committee
Closed-End Investment Company Committee
Derivatives Markets Advisory Committee
Disclosure Working Group
Fixed-Income Advisory Committee
Money Market Funds Advisory Committee
Operations Committee
SEC Rules Committee
Small Funds Committee SUBJECTS: Advertising
Alternative Investments
Closed-End Funds
Compliance
COVID-19
Derivatives
Disclosure
Financial Stability
Fixed Income Securities
Money Market Funds
Risk Oversight RE: SEC Investment Management Director Blass Addresses COVID-19 Impact on Industry and Retail Access to Private Markets

On July 28, SEC Division of Investment Management Director Dalia Blass delivered remarks to the PLI Investment Management Institute on both the effect of the COVID-19 crisis on the investment management industry and the Division's priorities for the remainder of the year.[\[1\]](#) The speech touched on a broad set of issues including fund liquidity during the crisis, e-delivery, virtual board meetings, and public access to private markets, as discussed

in further detail below.

Director Blass also discussed her thoughts on whether the COVID-19 crisis should lead to significant policy changes, particularly regarding money market funds, liquidity, and operational risk. In her view, drawing conclusions about significant policy changes would be premature during an ongoing pandemic. She recommended that policy changes be guided by rigorous data analysis as well as consideration of the fiscal and monetary responses and the perspectives of other regulators and market participants.

COVID-19 Crisis and Fund Liquidity

Director Blass discussed activity during recent months as investors sought to shift long-term assets into short-term, highly liquid instruments, creating the potential for fund liquidity challenges or dilution for a fund's remaining shareholders.

Liquidity Rule

Director Blass promoted the steps the Commission took to address fund liquidity risks by adopting Investment Company Act rule 22e-4 and a modernized framework for liquidity risk management. She believed the rule's requirement that funds consider stressed market conditions in assessing liquidity, along with the rule's risk management framework, improved the resilience of funds ahead of recent events. She also invited feedback on whether the rule effectively achieved its purpose, specifically:

- The stress testing elements [of rule 22e-4] are not a requirement to conduct a full portfolio stress test; should there be such a requirement?
- Do funds generally include stress tests in their programs? If not, how effective are the programs in anticipating market dislocations?
- How useful was information about a fund's liquidity classifications to its risk and compliance officers?
- Did the models underlying the classifications need to be adjusted and, if so, how?

Swing Pricing

Director Blass also considered whether other liquidity tools available to funds, such as swing pricing and redemption fees, have been underutilized. She sought feedback on whether swing pricing had been effective during the recent market disruptions in jurisdictions that have put it into practice, specifically:

- If it had a proven effect, what concrete steps could or should the Commission and other regulators take to ensure swing pricing can be operationalized in the US?
- If that is not possible, should funds instead be required to impose redemption fees to protect the interests of remaining shareholders?
- Are there other approaches [the Commission] should consider to protect remaining shareholders?

COVID-19 Crisis and Regulatory Relief for Funds

Director Blass lauded the targeted, temporary relief that the Commission and Division of Investment Management provided during the crisis, including relief regarding filing and delivery challenges, providing additional tools for obtaining credit, and permitting fund

boards to meet virtually.^[2] She also delivered additional remarks on e-delivery and virtual board meetings.

E-Delivery

Noting that the Commission's most recent comprehensive guidance on e-delivery is 20 years old, Director Blass thought shareholder and client communication merited reconsideration. While not wanting to override expressed delivery preference, she recommended considering guidance that would treat physical and electronic delivery as equal. She specifically asked:

- Where an investor has not expressed a preference, could [the Commission] open the door to allowing funds and advisers to communicate with shareholders and clients using electronic contact information?
- What standards should apply for when that contact information can be relied on? Could [the Commission], for example, use the framework in the staff's recent international mail delivery no-action position?
- Are there other regulatory approaches in use from which [the Commission] can learn?

Virtual Board Meetings

Director Blass remarked that virtual board meetings have been both effective and a way to address health concerns. Further, she had received interest in extending the temporary exemptive relief that permitted virtual board meetings permanently. She sought feedback on what limitations, if any, would be needed to extend the temporary relief, specifically:

- Are there conditions the Commission should require?
- Can a meeting meet the in-person requirement if it is largely in-person but with some board members attending virtually?
- The current exemptive order requires that a virtual vote be ratified at the next in-person board meeting. Is that requirement necessary in light of boards' experiences?
- Should there be certain technology and security requirement?

Retail Access to Private Markets

Director Blass noted that private investments have the potential to provide stronger returns and diversification for investors but come with both performance and liquidity risks. She considered exploring two potential 1940 Act-registered fund structures to provide enhanced access for retail investors to private markets: target date funds and closed-end funds. She thought both structures could provide convenient, professionally managed means for retail investors to invest in these markets.

Target Date Funds

Director Blass believed that target date funds, given their longer investment horizon, could invest in private markets to diversify risk and potentially enhance portfolio returns. As open-end funds, private investments would be capped to 15% of the fund's portfolio.

Closed-End Funds

Director Blass also discussed closed-end funds. She stated that while a few closed-end funds of private funds exist in today's marketplace, Commission staff have historically raised investor protection concerns if these products were to be offered to retail investors. For this reason, closed-end funds with more than 15% of their assets in private funds have limited their offerings to accredited investors. She sought feedback regarding closed-end funds, specifically:

- What criteria would promote access to high quality private market investments? For example, should closed-end funds of private funds invest with fund managers that meet certain experience and scale criteria?
- What closed-end fund structures would be most appropriate for Main Street investors? For example, would an interval fund or tender offer fund provide the right mix of liquidity and access? If so, are there any limitations on an interval fund of private funds strategy given the liquidity requirements in the interval fund rule? Should [the Commission] consider changes to existing rules to make these funds a more viable option in this context?
- What types of advisory compensation arrangements would result in the most optimal alignment of economic interests between Main Street investors and the fund adviser? For example, would performance-based compensation better serve this goal? Or perhaps compensation in the form of fund shares? If so, how should [the Commission] structure such relief?
- Should registered funds limit exposure to private funds that are sponsored or advised by a single adviser? Would allocating assets across multiple advisers promote competition and minimize the risk of unattractive or unsuitable investments? What other risk measures could be put in place by closed-end funds of private funds that would diminish incentives for advisers to take undue risks?
- How can the structure be shaped in a manner that would not involve an extra layer of fees and expenses?

Upcoming Division Priorities

Director Blass stated that the Division of Investment Management plans to make recommendations for next steps to the Commission for outstanding proposals on fund of funds arrangements, funds' use of derivatives, fund valuation practices, and investment adviser advertising and solicitation. In addition, the Division continues to work on the investor experience initiative, and in particular on how to make disclosure more accessible to Main Street investors. Currently, the investor experience team is working on a recommendation for a streamlined shareholder report.

Bridget Farrell
Assistant General Counsel

endnotes

[\[1\]](#) See Director Dalia Blass, Speech: PLI Investment Management Institute (Jul. 28, 2020),

available at

<https://www.sec.gov/news/speech/blass-speech-ipl-investment-management-institute>.

[2] See ICI's COVID-19 Resource Center for member resources on SEC and staff relief granted during the COVID-19 crisis: <https://www.ici.org/covid19>.

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