INVESTMENT COMPANY INSTITUTE

The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

BOARD UPDATE

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Board Update July 2020

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IDC News

IDC Invites Directors to the First Virtual 2020 Fund Directors Conference

We are pleased to announce that the 2020 Fund Directors Conference, the premier annual gathering of the independent director community, will take place virtually October 21–22. IDC's Fund Directors Conference offers directors a prime opportunity to catch up on the latest developments in fund board oversight and to connect with each other. With state-of-the-art conferencing technology, the event promises to be as effective and productive as ever with a platform that will enable chat among attendees, a networking lounge, and other features to keep directors engaged and learning. In addition, an optional preconference webinar session of our popular Core Responsibilities of Fund Directors will be held October 14–16. We will be announcing keynote speakers featuring government and industry leaders soon, and registration will open in early August.

Foundations for Fund Directors® Goes Live Online

IDC's popular orientation program, *Foundations for Fund Directors*, is also going virtual, starting with the next session, September 16–17. Designed for directors with five years or less on their fund boards, the program also welcomes directors of all experience levels to refresh their skills. *Foundations* provides a solid base for directors to gain clarity about their role and responsibilities. The topics will include how mutual funds work and how they are regulated; how to protect shareholder interests and oversee advisers; and how to oversee valuation, liquidity, compliance, and risk management. Please register here and encourage your newer colleagues to join!

IDC Commends SEC's Fair Valuation Framework and Recommends Modifications

IDC applauds the Securities and Exchange Commission (SEC) for providing welcome clarity on the oversight role of fund directors in its fair valuation proposal. The Investment Company Act of 1940 requires fund boards to determine in good faith the fair value of securities without readily available market quotations. In a comment letter, IDC supported the SEC for giving fund boards the option to assign determinations of fair value to investment advisers, but urged modifications of the proposal's prescriptive, one-size-fits-all elements.

Among the modifications requested are to frame the fair valuation rule as a safe harbor; modify the board reporting requirements to promote more efficient and effective board oversight; clarify the appropriate oversight role of fund boards; modify the rule to better reflect the role of pricing services; allow fund boards to assign fair value determinations to the fund administrator, in addition to an investment adviser of the fund; and extend the compliance period to 18 months.

Regulatory News

ESG-Related Developments at the SEC

SEC Chairman Jay Clayton recently participated in a webinar on long-term investing, sustainability, and the role of disclosures. Clayton said that in evaluating the need for ESG-related disclosure, an issuer should analyze each of "E" (environmental), "S" (social), and "G" (governance) separately. Depending on the circumstances, nonfinancial information may be material from a reasonable investor's perspective.

Clayton noted that the SEC staff is reviewing, and commenting on, public company disclosure related to environmental issues and "at some point" the SEC's 2010 guidance regarding disclosure related to climate change might be updated.

Clayton noted that the SEC already requires disclosure around governance and that disclosure makes it easy for investors to understand the governance structure of US public companies. He also referred to SEC guidance around disclosing diversity in the boardroom as relating to "social" issues. Clayton then pointed out that US issuers have greater liability risk for material misstatements or omissions than issuers outside of the United States.

SEC Commissioner Elad Roisman recently set forth, for the first time, his views on ESG matters, particularly on ESG disclosure for public companies and asset managers' ESG disclosure. Roisman indicated that he has serious reservations about imposing prescriptive disclosure requirements on public companies, stating that "this type of mandated disclosure is often fraught with personal views, subjectivity, and agendas that are often unrelated to 'investor welfare.'" He went on to say, however, "For the avoidance of doubt, ESG issues can be material and necessitate disclosure." He also asserted that the SEC would be well within its authority to elicit more ESG disclosure from asset managers. He explained that more asset managers are urging public companies to enhance their disclosure and that ESG metrics are driving their investment decisions. He said retail investors deserve clarity to understand that some funds may be prioritizing environmental or social goals, possibly at the expense of investment returns.

Roisman also referenced the recent SEC request for comment on fund names and indicated that he hopes that "the Commission can set forth clearer parameters around how investment products, such as 'ESG' mutual funds and ETFs, are named."

SEC Spring Regulatory Agenda

The Office of Management and Budget released the regulatory agendas for spring 2020. Consistent with previous SEC agendas under Clayton, the spring 2020 agenda is quite ambitious, with several rule proposals and 13 final rules expected by October 2020. Expected rule proposals include those covering a new investment company summary shareholder report, modernization of certain investment company disclosure, and proxy process amendments. Final rules and rule amendments are anticipated on the proxy process, the use of derivatives by registered investment companies and business development companies, fund of funds arrangements, amendments to the auditor independence rules, and investment company fair valuation.

Labor Department Issues Fiduciary Rulemaking Package

On June 29, 2020—one day before the SEC's Regulation Best Interest took effect—the DOL finally revealed its proposed prohibited transaction exemption (Proposed PTE) that would permit investment advice fiduciaries to receive compensation for their advice. While this latest effort from the DOL represents an important step toward aligning standards of care for all investors, whether they are saving in a retirement account or other investment accounts, there are questions to be worked out and conditions that would benefit from additional clarification. Comments on the Proposed PTE are due August 6 and ICI plans to submit a letter.

In conjunction with issuing the Proposed PTE, the DOL also reinstated its five-part test to determine whether a person is an investment advice fiduciary. The DOL also restored several exemptions that were modified by its 2016 rulemaking to their pre-2016 content. As such, the proposal is dramatically narrower in scope than the 2016 fiduciary rulemaking, which significantly expanded the range of persons who would be treated as fiduciaries to retirement plans or IRAs, and which was vacated after a legal challenge in 2018.

SEC Adopts Proxy Advice Rule Amendments and New Guidance for Investment Advisers

The SEC adopted final amendments to its rules related to proxy voting advice. The SEC proposed the amendments in November. The proposal included a set of provisions that would grant companies the right to review and comment on draft advice from a proxy voting advice business (PVAB) before fund complexes and other clients receive it. PVABs provide proxy voting advice to institutional investors, including investment advisers and funds.

The SEC also published a Summary of Supplemental Guidance to Investment Advisers. This new guidance is meant to complement the rule amendments. The guidance assists investment advisers in assessing how to consider responses to PVAB recommendations that may now become more readily available. The SEC encouraged investment advisers to review their policies and procedures in light of the guidance.

ICI News

ICI Board Endorses Fund Industry ESG Roadmap

The Board of Governors of the Investment Company Institute (ICI) unanimously endorsed *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction*, a white paper written by ICI's Environmental, Social, and Governance (ESG) Working Group. The working group, which consists of senior executives from ICI member firms with more than $13.7 trillion in combined mutual fund assets under management, created this introduction to ESG investing strategies to encourage the use of consistent terminology when describing ESG integration and sustainable investing strategies. By providing a simple, consistent terminology, the working group hopes the document will also help improve the public's understanding of ESG investing and help inform those who are interested in ESG investing about the many choices that funds provide. ICI's Board strongly endorsed the recommendations of the working group and urged all ICI members to take appropriate actions to implement the terminology recommended as soon as reasonably practicable.

The publication describes in detail how funds commonly pursue sustainable investing strategies using three nonexclusive approaches:

- ESG exclusionary investing may exclude companies or sectors that do not meet certain sustainability criteria or do not align with investors' objectives.
- ESG inclusionary investing generally seeks positive sustainability-related outcomes by pursuing and focusing on portfolios that fundamentally or systematically tilt a portfolio based on ESG factors alongside financial return.
- Impact investing seek to generate positive, measurable, and reportable social and environmental impact alongside a financial return. Measurement, management, and reporting of impact is a defining feature of impact investing.

For more information, see ICI's ESG Investing Resource Center, and look out for webinars for members and their counsel in August.

ICI's COVID-19 Resource Center

ICI invites the regulated fund industry and its independent directors to stay abreast of pandemic-related concerns and developments through its COVID-19 Resource Center. The resource page provides a wealth of information, including special reports that ICI President and CEO Paul Schott Stevens has communicated directly via email to fund directors and other members with updates on regulatory and other developments related to the COVID-19.

Upcoming Events

Foundations for Fund Directors®

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Virtual September 16–17

Conference

2020 Fund Directors Conference
Virtual October 21–22
