OVERSIGHT OF THE SEC'S DIVISION OF INVESTMENT MANAGEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES, AND INVESTMENT

OF THE

COMMITTEE ON FINANCIAL SERVICES

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OVERSIGHT OF THE SEC'S DIVISION OF INVESTMENT MANAGEMENT

Wednesday, September 26, 2018

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
SECURITIES, AND INVESTMENT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:16 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Present: Representatives Huizenga, Hultgren, Stivers, Hill, Emmer, Mooney, Davidson, Budd, Hollingsworth, Maloney, Sherman, Lynch, Vargas, Gottheimer, and Gonzalez.

Chairman HUIZENGA. The committee will come to order. The Chair is authorized to declare a recess of the committee at any time. The hearing is entitled, "Oversight of the SEC's Division of Investment Management." And I will now recognize myself for 3 minutes to give an opening statement.

Hardworking families in West Michigan and across the Nation rely on the capital markets to save for each stage of life, whether it is saving for college, home ownership or retirement, the capital markets play an integral part in each of these milestones. In order to help more Americans achieve financial security in the future, we must continually improve our capital markets so they are as efficient as possible.

By focusing on this priority, investors will have a better opportunity to receive the greatest return on their investment. Additionally, we must continue to expand access for Main Street investors and ensure that they are able to invest in a better future, not only for themselves, but for their children and grandchildren as well.

Today's hearing will focus on the policies and procedures of the SEC's (Securities and Exchange Commission's) Division of Investment Management (I.M.). The role of this Division is to protect investors, promote informed decisionmaking, and facilitate appropriate innovation in investment products and services through regulating the asset management industry.

The I.M. Division is also responsible for the Commission's regulation of investment companies, variable insurance products, and federally registered investment advisers. These types of investment companies include mutual funds, closed-end funds, business development companies, unit investment trusts and exchange traded funds.

Over 100 million individuals, representing nearly 60 million households, or roughly 45 percent of U.S. households, own funds that fall under the purview of the Division of Investment Management.

Additionally, of the over 13,000 registered investment advisers, approximately half of those advisers served 35 million retail investor clients with over 12 trillion in retail client assets under management. Because of the significant role the I.M. Division plays in the capital markets, I am pleased to see the Commission is working diligently on several initiatives to improve investment options and experience for Mr. and Mrs. 401(k).

Main street investors should have the tools they need in order make informed investment decisions and build a better financial future. Now more than ever, sound financial advice has become critical for every individual looking to invest and save for their future.

I was pleased that the SEC finally assumed leadership as the expert regulator and crafting regulations for the standard of care for broker-dealers and disclosures by financial professionals.

Additionally, we need to modernize our current regulatory framework. Our capital markets are the envy of the world. But while we have a 21st century financial marketplace, we are operating under a 20th century regulatory structure. I am a big believer in looking at the rearview mirror in order to assess existing policies to determine whether or not they are still appropriate for today's markets.

For example, the I.M. Division made the right decision to withdraw the 2004 staff guidance letters, regarding investment adviser's responsibilities and voting client proxies, and retaining proxy advisory firms in preparation for the November roundtable that will more closely examine this issue.

Needless to say, I am encouraged by the work and priorities of the SEC's Division of Investment Management. And I look forward to hearing more about how its agenda is consistent with the SEC's congressionally mandated trifold mission to protect investors; maintain fair, orderly, and efficient markets; and to facilitate capital formation.

So, my time is expired. But the Chair now recognizes the Ranking Member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 5 minutes for an opening statement.

Mrs. MALONEY. Thank you so much, Mr. Chairman. SEC's Division of Investment Management is one of the agency's most important divisions, because it regulates the asset management industry, including investment advisors, mutual funds, and exchange-traded funds or ETFs.

Mutual funds and ETFs have been growing at an incredible speed. Our mutual funds have grown from $4.4 trillion in assets in 2000 to a staggering $18.7 trillion in assets presently. And ETFs have grown from just $1.5 billion in assets in 2003 to nearly $3.3 trillion today.

The Investment Management Division oversees more than 12,000 registered investment advisors, and these investment advisors collectively have over $71 trillion in assets under management.

The Division has taken some positive steps during Director Blass's tenure. In particular, I was pleased that Director Blass outlined a number of critical investor protection issues that mutual funds need to answer before they start holding significant amounts of cryptocurrencies.

There are many outstanding questions about whether cryptocurrencies are appropriate investments with mutual funds, and I want to thank you for your thoughtful investor protection focused approach on this issue.

The Division has also taken a couple of actions that I am concerned about. For example, earlier this month, the Investment Management Division, suddenly and without any explanation, withdrew two no-action letters from 2004 relating to proxy advisors. Proxy advisors provide recommendations to institutional investors, including mutual funds, on how to vote on board of director elections and shareholder resolutions.

Mutual funds typically delegate the decision on how to vote on shareholder resolutions to the investment advisor managing the fund. Because mutual funds are often shareholders at hundreds, or even thousands, of different public companies, investment advisors sometimes rely on the recommendations of proxy advisors for how to vote on these matters.

The SEC had provided detailed guidance on how and when investment advisors could rely on the recommendations of proxy firms in two no-action letters in 2004. And this system had worked well for 14 years.

But then, 2 weeks ago, the SEC's Investment Management Division suddenly withdrew these two letters. The only reasons the SEC cited were unspecific developments since 2004 and a desire to facilitate a discussion about proxy advisors at the SEC roundtable in November.

Now, this is concerning. It is unclear why the SEC needed to withdraw two no-action letters that have been extensively relied upon for years, in order to simply facilitate discussion about proxy advisors. Surely, it was possibly to have a robust discussion about this without suddenly withdrawing the guidance that the markets had been observing and relying on for years.

And I would be very interested in this hearing what developments since 2004 necessitated the abrupt withdrawal of these two letters.

In addition, in 2016, the SEC adopted a series of important rules on liquidity management for mutual funds. One of these rules would have enhanced the disclosures that mutual funds make about the liquidity, allowing investors to make more informed choices, and potentially avoiding investing in funds that are riskier than the investor wants.

Unfortunately, about 18 months after this rule was finalized, but before the new disclosure took effect, the SEC voted to roll back the rule by eliminating the public disclosure about funds' liquidity. So, I will be very interested in hearing why the SEC thinks investors are not capable of properly understanding statistics about a fund's liquidity profile.

I look forward from—hearing from Director Blass about all these issues. And I yield back the balance of my time.

Chairman HUIZENGA. The gentlelady yields back. And with that, the Chair recognizes the Vice Chairman of the committee, the gentleman from Illinois, Mr. Hultgren, for 2 minutes.

Mr. HULTGREN. Thank you, Chairman Huizenga, for convening this hearing. Throughout this Congress, the subcommittee has made an effort to review our securities' laws to identify reforms that will allow our regulators, and regulatory framework, to support capital formation and drive economic growth. This all culminated with the passage of the bipartisan JOBS 3.0 package that is awaiting consideration in the Senate and hopefully we will move forward sometime soon there.

This review of our regulatory framework is not an endeavor that can be successful without regulators who are willing to do the same. So far, I am very pleased with the efforts put forth by the Commission to review the regulatory framework, and their willingness to work with Congress, industry representatives, and Main Street investors to support structure and certainty in our capital markets.

Just 2 weeks ago, your Division withdrew staff guidance letters issued in 2004 regarding the proxy process. I applaud this step ahead of the SEC's upcoming roundtable on the U.S. proxy process. These actions represent thoughtful engagements and consideration of how to best protect shareholders and promote transparency in our capital markets.

With millions of Americans already participating in our asset management industry, the Division of Investment Management plays a critical role in protecting the average retail investor from fraud and abuse, as this Division regulates the investment funds and advisors that interact directly with these Main Street investors.

Additionally, as Congress looks for more ways to encourage people to save for retirement, it is important that this Division continuously strive to promote transparency and accessibility to allow more Main Street investors to enter the markets.

Ms. Blass, I look forward to your testimony and any recommendations that you have for protecting Main Street investors as they save for retirement, their children's education, and much more. With that, Mr. Chairman, I yield back the balance of my time.

Chairman HUIZENGA. The gentleman yields back. And with that, today, I am very pleased to welcome the testimony of Ms. Dalia Blass, Director of the Investment Management Division of the SEC. Ms. Blass has extensive private sector industry service, as well as serving at the SEC in a number of leadership roles within the Division of Investment Management prior to becoming Director.

Very pleased to see that—your team behind you. You have—we have a few familiar faces. A couple of new faces, though, to that team are your kids, Alexander and Kathleen, who are here on—I believe, on an excused absence. If it is not an excused absence, have the teacher come talk to me.

But just to—just to let you guys know, the work that your mom does is very, very important. And we want to say thank you to you because I know it might mean mom has to take some late-night phone calls sometimes, or sometimes on a Saturday, or things that are going on. But the work that she is doing is very important for our country, right now, but also for the country that you guys are going to be inheriting as well.

So, having a bunch of kids myself, I know that sometimes they are on the front end of the challenges that the jobs that mom and dad might have. But I just want to say thank you to you and let you know your mom's doing an awesome job. So, thanks for being here.

So, with that, Ms. Blass, you are going to be recognized for 5 minutes, and thank you for being here.

STATEMENT OF MS. DALIA BLASS

Ms. BLASS. Thank you. Chairman Huizenga, Ranking Member Maloney, and Members of the subcommittee, thank you for inviting me to testify before you today about the work of the Division of Investment Management.

I would also like to thank my family for their support, including my two oldest children who are seated behind me today. This is a great opportunity for them to experience government at work.

I am honored to serve as Director of the Division of Investment Management, where I work every day with talented and dedicated staff, to develop regulatory policy for the asset management industry. It is an industry that is critical to the U.S. economy and the retirement and financial needs of millions of American investors.

As you said, Mr. Chairman, by way of example is that at the end of last year, over 100 million investors, individuals, representing nearly 60 million households, that is 45 percent of U.S. households, owned funds.

In light of the importance of the asset management industry to investors and the markets, since my appointment as Director of the Division last year, we have embraced three principles that guide our efforts in developing, assessing, and implementing policy initiatives. First, improving the retail investor experience. Second, modernizing the regulatory framework and our engagement. And third, leveraging our resources efficiently.

The Division has been hard at work in 2018, so I will just touch on a few highlights from my written testimony. Improving the retail investor experience is about assessing the information needs of and our interactions with Main Street investors. Technology has presented us new opportunities for how we provide and solicit information.

With that in mind, the Division is working on several initiatives to improve the investor experience. For example, earlier this year, the Commission proposed a comprehensive rulemaking package on the standards of conduct of financial professionals. The package is designed to serve retail investors by bringing the legal requirements and mandated disclosures in line with investor expectations. The package included regulation best interest, the relationship summary disclosure, and an interpretation of the investment advisory fiduciary standard.

Our Division led the staff's efforts on the relationship summary, which is designed to educate investors about whether they are dealing with a broker-dealer, an investment advisor, or both, and why that matters when considering the services, fees, and conflicts of the financial professional.

In the proposal, the Commission sought comments and ways to optimize delivery of information to retail investors. This rulemaking has also been an opportunity to try out new ways to reach Main Street investors.

We have rolled out a new Website inviting investors to tell us about their experience, developed simpler ways for investors to provide comments, and held roundtables in seven cities. This investor feedback has been valuable to the staff as we consider the comments we have received.

Another example is our work to improve the design, delivery, and content of fund disclosures. Disclosure is the backbone of the Federal securities laws and is a critical tool for investors when making investment decisions. With that in mind, the Commission issued a request for comment to gain insight in ways to improve and modernize fund disclosures.

Moving to the second principle, modernizing our regulatory framework and engagement, the Division is working on several initiatives to help our markets grow and develop for the benefit of all market participants, including our Main Street investors. This includes work on an ETF rule and revisiting the role of fund boards.

We are also hard at work on important initiatives, like a recommendation for adopting a rule under the FAIR Act and proposing rule changes to modernize the ways BDCs and closed-end funds are offered to the market.

Finally, with respect to the third principle, we are looking at how we can employ our resources effectively and efficiently. We are a Division of around 180 people responsible for policy effecting more than 20,000 registered funds and investment advisors.

In an industry that is approximately $80 trillion in assets under management, enhanced use of technology and continuous process improvements are critical to our effectiveness and our efficiency. In that regard, one of our main focuses is enhanced use of data analysis in our disclosure, oversight, and regulatory initiatives.

Thank you, again, for inviting me to discuss the Division's effort and the work of its dedicated and talented staff. I look forward to answering your questions.

[The prepared statement of Ms. Blass can be found on page 26 of the Appendix.]

Chairman HUIZENGA. Thank you for your testimony. At this time, I recognize myself for 5 minutes of questioning.

As the Ranking Member had brought up as well, there were the no-action letters, the two letters that were issued in 2014 to Institutional Shareholder Services and the Egan-Jones Proxy Services. Can you please elaborate on how rescinding these letters will actually help investment advisors vote in their clients' best interests and manage conflicts of interest?

Ms. BLASS. Thank you for the question. So, the investor advisors, the law has not changed. The Commission adopted a rule back in 2003 with respect to proxy voting and that is the basis. That is the foundation, if you will.

Since that time, there have been the two no-action letters that were—interpretive letters that were issued, as well as staff guidance thereafter. We have been undertaking a full review of all guidance issued by the Division. This is part of modernizing our regulatory framework to see which guidance should be amended, rescinded, supplemented as we look at market developments.

We have been doing extensive outreach to issuers, to proxy advisors, to investors in this space. Our outreach resulted in our determination to hold a roundtable to make sure that we have a forum to discuss these issues, where all participants, all interested parties can come together and have a good discussion about the issues in this space, because it is extremely important to investors. This is how they exercise their voice in the market.

Chairman HUIZENGA. And that roundtable is scheduled for when?

Ms. BLASS. November 15th.

Chairman HUIZENGA. OK.

Ms. BLASS. So, looking at the—our engagement led to we needed this roundtable. It is a good path forward. And looking at the roundtable, we also looked back at a roundtable that we hosted back in 2013. And in that roundtable, those two letters got a lot of air time.

There are significant issues that should be discussed in the coming roundtable. So, with that in mind, and also in mind the market developments since 2004 when they were issued, we determined the best course of action would be to withdraw these two letters and discuss the important issues with respect to proxy advice.

Chairman HUIZENGA. OK. In light of that, do you believe that the SEC should provide further guidance, what it means to be a, quote, "independent third party," or how an investment advisor can satisfy the fiduciary duty as required by the 2003 rule?

Ms. BLASS. That is one of the very questions that we are hoping to get information about, during this roundtable, so that we can make appropriate recommendations to the Commission.

Chairman HUIZENGA. OK. Well, it is interesting that the two largest proxy advisory firms combined control is at least 97 percent of the proxy advisory industry. And, obviously, they also sell services while they are then doing some of these reviews. And I am very concerned about the potential conflicts of interest on behalf of these firms and the folks that they are trying to serve.

Let me quickly move on to exchange-traded funds, ETFs. According to recent data by the ICI, Investment Company Institute, ETFs contain $3.61 trillion in assets with 1,923 different ETFs. One of the reasons ETFs have grown so rapidly is because they offer a lower cost alternative to mutual funds.

Can you please elaborate on why ETFs are less costly than mutual funds and highlight other reasons that may prove to be better—they may be a better alternative for investors?

Ms. BLASS. ETFs are an investment company, and they are different than mutual funds. They are open-end investment companies, but they are different than mutual funds. An investor can go in and out of an ETF intraday. At any point in the day, they can buy and sell. Versus a mutual fund, you are bound by end of day.

The structure of the ETF provides certain tax efficiencies and that provides lower cost. A lot of that is due to the in-kind nature of how they transact with the primary market, the authorized participants.

They also have less fees and other respects as well. For example, they usually don't have a load. The transfer agency fees are less. A lot fewer fees in ETFs.

Chairman HUIZENGA. And there was a June 28, 2017, the SEC voted to propose a new rule to modernize regulatory framework of ETFs. And I am curious if you can explain how the proposed rule leveled the playing field?

And then, finally, really quickly, last month, the SEC rejected nine proposed Bitcoin ETF proposals and decided to delay the decision allowing for CBOE Bitcoin ETF. Do you believe that some version of Bitcoin ETF will be approved in the near future? And can you speak to the pros and cons of approving or not approving those product?

Ms. BLASS. So, in June of this year, the Commission proposed an ETF that would cover the ETFs that we usually see in the exemptive application program. We have issued over 300 individual exemptive orders to ETF sponsors for them to launch and operate to date.

So, a rule would create a transparent, consistent, and efficient regulatory framework for these ETFs that increasingly, investors have shown interest in holding these products.

With respect to your question with respect to Bitcoin ETFs, those were actually exchange-traded products, not exchange-traded funds. And this is something that I do think is important, because there is market confusion when the term ETF is used, regardless of what the product is about.

An ETF is an investment company. It comes under the 1940 Act and has to comply with the mandates of the 1940 Act. An ETP (exchange-traded product) is usually a commodity pool, and it is a— it comes to market in the same way an operating company would come to market. These are different products and so it is important to understand the differences.

Chairman HUIZENGA. My time is well expired so we will have a generous gavel with Ranking Member as well, who is recognized for 5 minutes.

Mrs. MALONEY. Thank you so much, Mr. Chairman. And thank you, Director Blass, for your testimony.

I would like to ask you about the SEC's 2014 rule on money market funds. As you know, the SEC's rule made certain money market funds that invest in corporate and municipal debt, more transparent, requiring them to tell investors the fund's true market-based value every day, known as a floating Net Asset Value, or NAV.

This is designed to take away the first mover advantage, that gives the investor an incentive to be the first one to withdraw their money, which is what leads to devastating investor runs that can destabilize the entire market. So, I think that this was one of the most important post-crisis reforms that we made.

The rule has now been in effect for about 2 years. So, my question to you is, have you seen any major problems in money market funds since the rule came into effect that would necessitate major changes to the SEC's 2014 rule?

Ms. BLASS. The rule was adopted back in 2014. The Commission, at the time, adopted that—the reform package for money funds—to address certain structural risks presented by money funds since their inception.

Ultimately, to answer your question about whether any changes are necessary, that would be a decision of the Commission. We, the staff, monitor money market funds daily. We monitor them pretty closely.

During the implementation, we did see a significant shift in assets from prime funds into government funds. A shift to the tune of over $1 trillion. We have and we will continue monitoring money funds, as well as our short-term funding markets, to see how they evolve within our regulatory framework.

Now, we do know that certain—people believe that further changes may be necessary or are necessary with respect to money funds. I will note that our doors are always open. We are happy to engage and hear their perspectives.

Mrs. MALONEY. OK. On the no-action letters, the SEC simply said that it had decided to withdraw the letters, because, quote, "developments since 2004." So, I just would like to know exactly what were the developments since 2004 that made it necessary to just withdraw these two letters?

Ms. BLASS. So, the Commission adopted the rule for proxy voting toward the end of 2003. Since that time, investment advisors have had experience with how to develop policies and procedures to address conflicts. They have a better sense of what those conflicts are.

The market has also changed significantly. Back then, the assets of the asset management industry were just about $7.5 trillion. At this point, it is well over $20 trillion. That is just the registered fund assets.

The passive investing has also grown tremendously since that time. The regulatory landscape for those proxy advisors has also changed. Technological changes in data analysis and gathering has also been very significant in that time. There have been a lot of market developments in that time.

What hasn't changed, this is—and you mentioned it in your opening statement is this is about—fundamentally about how shareholders exercise their rights. This is about shareholder rights.

And the proxy firms are a very important part of this ecosystem, if you will. We wanted to focus on discussing these issues, which are really important to shareholders in the upcoming roundtable, to see what changes, if any, should be made since the adoption by the Commission of the rule in 2003.

Given how much airtime, whether rightly or wrongly, these two letters have received, we determined the best course of action, to make sure that we get robust discussion in the roundtable, would be to withdraw these two letters.

Mrs. MALONEY. Well, I would like to follow up by asking—you mentioned that the 2014 legal bulletin on proxy advisors remains in effect, right? So, do you believe that the guidance in this bulletin is effectively identical to the two 2004 letters that you withdrew, meaning that nothing of SEC's substantive guidance on proxy advisors has actually changed?

Ms. BLASS. I don't—I wouldn't say those—the letters are identical to the staff legal bulletin. And the staff legal bulletin is closer to what the Commission said, with respect to the investment advisors' fiduciary duty and duty to monitor—fiduciary duty. It is a fiduciary with respect to its duty to monitor the use of proxy advisory firms.

And I will note that the staff legal bulletin and the staff statement we put out, with respect to the withdrawal, we did note that we expect to discuss the staff legal bulletin in the roundtable.

Mrs. MALONEY. My time has expired. Thank you.

Ms. BLASS. Thank you.

Chairman HUIZENGA. The gentlelady's time has expired. With that, the gentleman from Illinois is recognized for 5 minutes.

Mr. HULTGREN. Thank you again, Mr. Chairman. Ms. Blass, thank you. Welcome. Glad you are here.

In my opening statement, I mentioned my appreciation for the SEC's willingness to review current regulations and engage with Congress, investors, and industry regarding reforms to fit today's capital markets.

Just recently, the SEC reinforced this idea with the announcement of a staff roundtable on the proxy process in November. Additionally, just 2 weeks ago, your Division withdrew two no-action letters from 2004 that were issued to proxy advisory firms.

Your testimony states that these were revoked as part of the preparation for the roundtable. I wondered, is this intended to allow for a more complete consideration of the proxy process as it stands today, compared to 2004 when the letters were issued?

Ms. BLASS. That is what we hope to have in the roundtable, a wholesome discussion of all aspects of the proxy process.

Mr. HULTGREN. OK. Understanding that this roundtable is still to come, do you believe that rescinding these letters will bring more transparency and accountability to the proxy voting process? And is there further guidance that you already anticipate will be needed?

Ms. BLASS. I think it is important for us to use the roundtable to get better information about the state of play, the market developments, how proxy advisors are being used. I can go on down the list. That is what the roundtable is about. So we can get this information. Can have folks, in a transparent fashion, talk together about where the state of play is. And then, we can make appropriate recommendations to the Commission.

Mr. HULTGREN. Great. In July, I sent a letter to the financial regulators, with responsibility for the Volcker Rule, requesting that they reconsider the definition of covered funds so that it excludes venture capital.

As my letter stated, the congressional record clearly demonstrates through a—colloquy between Senator Boxer and then Chairman Franks that investing in investor capital was never intended to be prohibited by the Volcker Rule when Section 619 was drafted by Congress.

Additionally, in July when Chairman Powell came before this Committee, I asked him about this issue. And he stated that these activities are not a threat to safety and soundness.

I understand that the comment period is still open on this issue. However, I would like to pose a hypothetical to you. Say that a bank-controlled cover funds—excuse me, a bank-controlled covered fund at a venture capital firm has an agreement on a $200 million investment into a startup company owned by the venture capital fund. However, the venture capital fund says they would prefer to have the fund make an investment into a credit or a debit instrument instead of an equity instrument.

Based around the current construct, the bank fund would not be allowed to invest, unless the company was willing to sell an equity piece of the company. Why should it be that the Volcker Rule—why should it be that the Volcker Rule should differentiate between credit investments and equity investments? And why should a bank be allowed to lend through its own balance sheet but not through a fund?

Ms. BLASS. We do appreciate that the definition of covered funds is both overinclusive and underinclusive, in some circumstances, and that there had been implementation challenges with the definition of covered funds. That is why we have the request for comment out.

I believe the comment period closes mid-October, and we did ask a lot of questions in that regard. And we look forward to seeing commentaries, thoughts, and opinions about this.

Mr. HULTGREN. Great. We are looking forward to some clarity as well on it. So, looking forward to resolution there.

Finally, as you know, the standard of care that governs personalized investment has been a widely debated issue before this committee and across the asset management industry. I am pleased that the SEC has stepped in, following the rule by the Fifth Circuit Court of Appeals that nullified the DOL (Department of Labor) fiduciary rule.

I believe that the SEC is better suited to regulate this standard. I have been following the regulation of the best-interest rulemaking process. During this process, some commenters expressed concern about the proposed form CRS. How do you plan to incorporate the feedback you receive through the comment process on that?

Ms. BLASS. Thank you for the question. We have received thousands of comment letters. I think there are north of 6,000, at this point. We have also had investor roundtables. We have had the "Tell Us" campaign, so investors can submit comments directly into the comment file through our—the feedback form that we have on the "Tell Us" page. And they have been doing so.

So, we have received a—and we have also had third parties perform investor testing and submit these results into the comment file. We have a lot of great comments, and the staff is going through it to see what changes—what recommendations should be made to the—to the form—changes to be made to the form, so we can make recommendations to the Commission.

Mr. HULTGREN. Thank you, Director Blass. I will yield back the last 30 seconds to the Chairman if he has any other questions, or I just yield back my time.

Chairman HUIZENGA. It is an efficient day at the committee. Well, thank you. The—with that, Mr. Sherman from California is recognized for 5 minutes.

Mr. SHERMAN. First, I have a comment about cryptocurrencies, then I will go into three questions. Cryptocurrencies are either an investment or a medium of exchange. To the extent they are a medium of exchange, they undermine the power of the Federal Government.

We get seigniorage which is a huge profit center for the U.S. Government. If the dollar wasn't used around the world, we wouldn't get it. Second, we have lower borrowing costs. And third, our sanctions policy around the world can bite because the U.S. dollar is the medium of exchange.

There is a libertarian, almost anarchist, philosophy out there that says disempower the U.S. Federal Government. As part of the U.S. Federal Government, I disagree.

But you deal with investments. And if there was an investment vehicle that wanted to register, that invested in nothing but illegally issued securities—publicly traded securities that had never been registered, violations of every State and Federal law, I don't think you would say, well, you can register a security whose assets consist exclusively of illegally issued securities.

Cryptocurrencies are, if they are investment vehicles, illegally issued securities. They are an investment vehicle with none of the investment protection. So, I hope that you would do everything possible to stop cryptocurrencies and investments based on them, not to mention the billions that had been lost by various investors.

Now, for questions. I want to congratulate the SEC on advancing Rule 30e-3 which modernized the default method for shareholder reports. You are saving $2 billion over the next 10 years and 2 million trees. What more can the SEC do to reduce the clutter that builds up on my desk as I get these on paper and to save the trees?

Ms. BLASS. Thank you for the question. We have actually launched the investor experience initiative to broadly look at all fund disclosures and what we can do to improve the design, delivery, and content. So, not just how we deliver the documents—

Mr. SHERMAN. Yes.

Ms. BLASS. Or a disclosure, but what we can do to make the disclosure move into the 21st century. To make use of modern technology. To provide it to investors in a way that they could assimilate the disclosure—

Mr. SHERMAN. Yes.

Ms. BLASS. So that they can make the informed investment decisions. Disclosure—

Mr. SHERMAN. And an advantage there, if it is delivered electronically, you could require to have a link in there. So, I click here, and I see some other document.

Ms. BLASS. You can use layered disclosure. Whether you use paper or you use electronic delivery, you can use layered disclosure to provide better information to investors.

Mr. SHERMAN. Yes. It works better electronically. I hope you will save as many trees as possible. And I think it is actually better for investors. Because when I get it on paper, I lose it. When I get it electronically, six—two—I get some extra time. Two weeks later, I can look it up and see it on my iPad. Not that I would fail to pay attention to what is going on in these hearings.

I have opposed legislation that would undo the SEC's 2014 money market reforms. These reforms were put in place to increase transparency. Do you share the concerns of Chairman Clayton, that making major changes to these reforms would be disruptive of the—in particular, the insta—the money market funds that invest in corporate debt and are held by institutional investors?

Ms. BLASS. So, I will let the Chairman speak for himself. I do believe that he was acknowledging the shift in assets that I mentioned, the one trillion dollars—over one trillion dollars—that shifted from the prime funds into the government funds. And that putting aside the merits of the rule or that outcome, we should always carefully consider the impacts of such shifts on investors and the markets.

Mr. SHERMAN. I hope we—well, I am going to move on to the third question and final one. In 2014, the S&P and Russell removed business development companies from their various stock indexes. I spend a lot of time in this room. We are all dedicated to providing capital to small business. But the reason they did is over concerns the disclosure rule of the index fund's overall expense ratio.

Given that the cost incorporated into an index fund's expense ratio, under this disclosure rule, when it makes an investment in a business development company are not additional expenses of the index fund, what steps is the SEC staff taking to look at the negative impacts of this, in effect, double counting of expenses and the negative effect it has on capital for small business?

Ms. BLASS. I believe you are referring to the acquired fund fees and expenses, which the Commission adopted back in 2006 to provide transparency to investors with respect to fund-to-fund investments.

We are aware of the—of the issue, with respect to business development companies. There has been extensive engagement. And I believe there is an application, exemptive application, now on file, which the staff is working on.

Mr. SHERMAN. I hope you move forward with that and I yield back.

Chairman HUIZENGA. The gentleman's time has expired. With that, the gentleman from Ohio, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you. And I want to follow up on a question that Mr. Sherman just asked, just to make sure I understand. So, obviously, the SEC's acquired fund fee rule—fund fee and expense rule has had a negative impact on a lot of business development companies that have faced potential delisting from some indices and other things.

And, as you probably know, BDCs are not a passive investment. They are much more like a REIT (real estate investment trust). And they deserve the same kind of consideration, like a REIT, with regard to the AFFE (acquired fund fees and expenses). Do you think that that is something you guys would be willing to look at? And do you see those as similar investment tools with the same kind of operating costs and expenses that could drive an artificial number on the AFFE that could cause problems for the BDCs that want to be listed? And would you be willing to look at some type of exemption from the AFFE, similar to what REITs have?

Ms. BLASS. So, as I mentioned, this was a rule that was adopted by the Commission back in 2006. And, actually, I happen to have been the staff attorney that worked on that rule.

Mr. STIVERS. Great.

Ms. BLASS. At the time, when the rule was adopted, BDC assets were significantly—

Mr. STIVERS. They were nothing almost.

Ms. BLASS. Smaller.

Mr. STIVERS. Rounded to zero, yes.

Ms. BLASS. Maybe not zero, but pretty—

Mr. STIVERS. Rounded to zero.

Ms. BLASS. —close.

Mr. STIVERS. Yes.

Ms. BLASS. And we actually did not receive any input from BDCs, at the time, no highlight of this issue that you are raising. Since then, there has been outreach. They have raised this particular issue. And they have filed a request for an exemption from the—from this provision with the—with the Division. And that is being actively reviewed by the staff.

Mr. STIVERS. Great. I appreciate your review on it. I think it is having a negative impact on an investment that allows a lot of Main Street folks to be able to participate in middle-market companies and investments that they haven't had access to. Only accredited investors have, normally, had access to those type of investment vehicles where they can share in the upside of the growth of businesses. And it is a very big deal. And it also funds Main Street jobs. So, I think it is a big deal for our economy. It is a great opportunity for Main Street investors. And it is just a different type of investment than a passive investment. So, I appreciate your willingness to consider that.

And that is all I had. I will yield back.

Chairman HUIZENGA. The gentleman yields back. With that, the Chair recognizes the gentleman from Massachusetts for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman, and welcome, Director. In a letter this summer to the SEC commissioners, our Secretary of State, Bill Galvin in Massachusetts, asserted, in its best-interest proposal, the SEC was simply offering a weak and somewhat vague standard that, unless modified, would force Massachusetts to adopt its own rules to protect investors and require broker-dealers to provide non-conflicted advice that puts the investors' interests ahead of the brokers' interests and compensation.

Secretary Galvin also contends that the proposal merely presents a veneer of a fiduciary standard and that would allow existing weaknesses in FINRA's suitability standard to persist. What are your—what are your responses to the concerns that—and, by the way, I agree with Secretary Galvin. He has been very vigilant on behalf of consumers, especially financial consumers.

What are your responses to his concerns?

Ms. BLASS. Thank you for the question. If I may, I just want to start by recognizing my colleagues in the Division of Trading and Markets who led our—the staff's efforts with respect to developing recommendation and regulation best interest. So, without stepping onto their turf too much, I will offer you my perspective.

What the proposal does is it took the principles from the investment advisor fiduciary standard, the duty of care and the duty of loyalty. It looked at the principles in the DOL fiduciary rule, the impartial conduct standards.

Taking these principles, it tailored the principles to the broker-dealer relationship, a model to preserve that model. This was important to provide—continue providing choice to investment advisors—to the—to the—choice to investors in the market with respect to commission accounts.

What we did notice, after the DOL fiduciary rule went into effect, is that we did see a reduction in these commission-based accounts. That was—that impacted the choice of investors. So, while we were looking at these principles and wanted to make sure these principles moved over were applied to the broker-dealer model, we did it in a way we tailored it to preserve that choice for the retail investor.

Mr. LYNCH. You suggested there is some harmony there. But we passed the Dodd-Frank Act, and I think it was Section 913. It says that the investment—regarding the standard of conduct for brokers.

In that—we put language in there that said that the standard must be no less stringent that the fiduciary standard under the Advisors Act. And, clearly, it is not—I understand that the court overruled us in that effort. But there is still statutory language that insists that the standard be no less stringent.

And I think having a best-interest standard, which is clearly less exacting than the fiduciary standard, we fail to meet that obligation that is set forward in the Dodd-Frank Act. Do you concede that that is a gap now? That there is a delta between what we were hoping for in Dodd-Frank and what we are—what we are receiving now under the SEC's rule?

Ms. BLASS. As part of the Commission's proposed rulemaking package, the Commission also put out a proposed interpretation of the investment advisor fiduciary standard. I believe when you look at the standard, as outlined, the Federal fiduciary standard, and you look at Regulation Best Interest, you will see core principles that are the same.

For example, neither—an investment advisor and a broker-dealer must act in the best interest in the customer, the retail customer. So, the principles, the core principles, are the same. They were tailored in Regulation Best Interest to apply to the broker-dealer model.

All that—I think it is also important to keep in mind, this is a proposal. We have received north of 6,000 letters, comment letters to this proposal. And we are in the process of going through these comments to see what changes, if any, we should be recommending up to the Commission.

Mr. LYNCH. That is great. Thank you very much. I appreciate your answer. And I hope that you do take those comments seriously and try to hew to the stricter standard to protect investors.

Thank you. I yield back.

Chairman HUIZENGA. The gentleman's time has expired. With that, the gentleman from Minnesota, Mr. Emmer, is recognized for 5 minutes.

Mr. EMMER. I thank the Chair and I thank Ms. Blass for being here today. Appreciate your testimony.

I have a couple of areas that I am going to try and focus on. First, last month, Chair Clayton announced that the SEC is working on a concept release to explore, quote, "broader access to investing in privately held companies, among other things." Can you walk me through the role that the Division of Investment Management has in developing this concept release?

Ms. BLASS. In my Division, we have private funds and we have registered funds. And that is a statutory distinction, if you will. We have had some requests to see how we can expand some of these opportunities, for example, by way of registered funds investing more in private funds.

We work with folks who are interested in this. Our doors are always open to hear their perspectives. Ultimately, we balance investor protection with making sure that we are also looking to see in what ways we can provide more opportunities for investors, for retail investors.

Mr. EMMER. Are—but are you—is your Division working on this concept release?

Ms. BLASS. This would impact our Division, so we would be working closely with other divisions who are also at the center of this, if you will.

Mr. EMMER. OK. And I think you have already covered, with the Chair's questions, the issue about—well, I guess I would ask it this way because he was asking about ETFs earlier. As the Director, would you be willing to spend time and resources to consider ways for Main Street investors to benefit from private equity investments via ETFs or other investment vehicles? Particularly, if this helps provide capital to smaller and innovative companies?

Ms. BLASS. So, as I mentioned, the—it is a statutory delineation between private and public that said we do have requests to see how that could be expanded. And we always welcome people's thoughts. Our doors are open. And we are happy to work with them, as long as we balance the investor protection with the opportunities, if you will.

Mr. EMMER. Got it. Shifting gears to proxy advisors. In the SEC's view, why is there so little competition in the proxy advisor industry?

Ms. BLASS. So, the proxy advisory industry is really high volume, low margin. And with that, economies of scale kick in and that is how you get the few numbers at hand. There are about five proxy advisory firms, with two being the majority in the market. And I do believe it is just economies of scale.

Mr. EMMER. Well, do you believe that the SEC needs to step in to correct what is a distortion? Because clearly you don't want it concentrated in just a few. I would imagine it would be much better, despite the low margin, high volume. Much better if you had many different choices out in the marketplace. Is this something that you think the SEC should step in and examine and try to—try to cure?

Ms. BLASS. If I may, I will offer a couple of points on this and this would be from the perspective of investment management. Because I do know that proxy plumbing, in general, is a bigger issue or a broader issue.

First, with respect to proxy voting, the investment advisor is the fiduciary. The investment advisor is the one that is tasked with voting in the best interest of its client. So, that is one thing to keep in mind.

The other is these are issues, the ones you raised, had been raised over time, and that is one of the reasons why we are having the roundtable. We want to have this discussion. We want to understand the market better. And we want this to be done in a transparent, public forum so that we can get the views of as many interested parties as possible. Including, I should mention, that there is a comment file that is already open for people to submit their viewpoints. Any point, at this point, from today onward.

Mr. EMMER. And maybe I am beating it too much. But just very quickly in the couple seconds I have left. Beyond the roundtable, how is the SEC and your Division reviewing, in any way, the state of competition transparency policies in conflicts of interest among proxy advisory firms?

Ms. BLASS. So, we actually have done—with colleagues from the Division of Corporation Finance and other—and colleagues from the Office of the Chief Accountant for the Commission, we have been doing extensive outreach. We have reached out to investors, to registered funds, VTO advisors, to the proxy advisory firms.

So, we have done outreach in this area and it actually was this outreach that led us down the path to a roundtable, so we can have this broad, public forum to discuss all these issues.

Mr. EMMER. Thank you. My time has expired.

Chairman HUIZENGA. The gentleman's time has expired. With that, the gentleman from Arkansas, Mr.—oh, I am sorry. Mr. Davidson is here. Sorry. With that, gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Hi. Thank you so much for being here. Thanks for you prior comments on ETFs involving cryptocurrencies. I take it, from the fact that the SEC's deemed Bitcoin to be a commodity, not a security. That is why you are calling it a product. Is that accurate?

Ms. BLASS. Well, it depends on how the fund—what the fund holds. There is a test under the Investment Company Act. And 40—at least 40 percent of the fund's portfolio should be investment securities. And then, they would come under the Investment Company Act.

Mr. DAVIDSON. OK. So, is that—what other criteria would lead you to call it product instead of a fund? So, an ETF versus an ETP?

Ms. BLASS. So, when I look at ETFs, I think of them as investment companies that meet the definition of investment company under the Investment Company Act.

Mr. DAVIDSON. OK.

Ms. BLASS. So, it is the portfolio. It is the composition of the portfolio.

Mr. DAVIDSON. OK. So, I guess in the sense that there has been an ongoing effort to create these, that an ETF that involves cryptocurrencies or some form of token, has the SEC come up with guidance or—I think the concern for the industry is that we are getting regulation by enforcement, or regulation by rejection in this case.

But it is hard to discern what actually would meet the criteria. Do you have something like that in the works?

Ms. BLASS. We do. So, the Investment Company Act, since its inception in 1940, it is a—it is a very innovative act. It is very flexible. It has allowed a lot of innovation, including ETFs in general.

Several sponsors are interested in offering exchange-traded funds that would hold crypto-related assets. We are engaging with these sponsors to make sure that our engagement is as broad and as transparent as possible.

Back in January, we issued a letter to the ICI and SIFMA AMG, and that letter is—no, we have a Website now—

Mr. DAVIDSON. Right.

Ms. BLASS. —that has the letter. And we are interested in any comments. We encourage the comments to come in on this public Website, so that we can have a transparent dialog and bring different viewpoints in.

That letter highlighted the issues that these sponsors should consider before they are able to offer these funds to the market. At this point in time, believe it or not even though we issued it in January, they are just starting now to come back to us with responses.

Mr. DAVIDSON. OK. So, thanks for that. We will certainly, by all means, look at the—if you are concerned about this issue, look at the January 2018 letter and provide comment to the SEC.

And then, I think the other part is one of the biggest challenges that has been highlighted, with cryptocurrencies or digital tokens of a broader range, is custody. What custody issues do you see—do you—ways to resolve that or concerns that it may not be able to be addressed? Where are you—where is the SEC thinking about with respect to custody?

Ms. BLASS. Yes. So, we did raise, in the letter of the custody issues whether, for example, there would be a qualified custodian. And, at this stage, we have had some good outreach, folks who are considering how to structure and in a manner that would be compliant with our rules.

Mr. DAVIDSON. And so, I get that. But the whole premise of a distributed ledger is there is a record. And, frankly, it is not just a record in one place. It is a record all over the planet. And it is not just available to the SEC. It is available to the consumer. And, frankly, anyone can look and say this is the—this is the address.

So, I think the concern so far, particularly with respect to things that aren't really securities that the SEC is looking at as part of a bundle. The underlying asset may not be a security, but it is in a fund, so the SEC has oversight there.

If you look at the custody of it, you are going through a path to create a duplication of effort to say, we have to find a way to tag something that already has a ledger to say who owns this account. It would be like saying, "no, really, really, who owns this Fidelity account?" Well, Fidelity already shows you this is the owner. And we are going to pay a third party to tell you that this was the person that owns the Fidelity account. But on a massive number of levels, because it would be every token, or every coin in the case.

So, is there a way to address that without adding a third party and just using the ledger?

Ms. BLASS. I appreciate your concerns and the question. So—and the promise of blockchain and distributed ledger technology and what it could mean, not just in the custody space, but broadly in the asset management space. What it could do and that, ultimately, it would go to the benefit of Main Street investors.

Mr. DAVIDSON. Right, it would eliminate a lot of intermediaries. And it would benefit the investor and the consumer.

Ms. BLASS. Yes. There is the promise of that technology. Where we are, at this stage, is having that conversation of, here is our law and this is the product you want to offer. What are the issues, and how can we marry the two together?

So, that is the conversation we are having. I—the Federal securities laws, the Investment Company Act, as I mentioned, adopted back in 1940. Look at the innovation in the asset management space since 1940. Amazing products have come to markets. Different products have come to markets that provides opportunities for retail investors. That has always happened since 1940.

So, with that, this is a new flavor.

Mr. DAVIDSON. Yes, still a 1940 act that needs updating. My time is expired. I could talk for much longer. Thank you, Chairman. And I yield.

Chairman HUIZENGA. The gentleman's time has expired. With that, the gentleman from Arkansas is recognized for 5 minutes.

Mr. HILL. I thank the Chairman. I appreciate you holding this hearing. And it is always terrific to have Director Blass back before the committee. She brings all of her knowledge and intellectual power to this committee. And we need it. We need it desperately. So, thanks for representing the Commission.

Last Congress, it was—it was a pleasure to work with Dr. Foster and complete the work on our ETF research bill, H.R. 910. It was a bipartisan, bicameral effort to improve research available to individual investors who are using exchange-traded funds which have proliferated since 2000.

And I would echo your comments about the 1940 Act. That product is an example of a product that was innovated under the act without really amending the 1940 Act itself. And think of all the people benefited by that. So, thank you for your leadership in this area.

On May 23rd, you issued the notice for the rulemaking under H.R. 910, and comments were due in early July. So, when do you expect the final rulemaking to be completed on research for exchange-traded funds?

Ms. BLASS. So, the comment period is now closed at the beginning of July, July 7th I believe. The staff has looked through the comments and has worked through our recommendations. And we hope to get that to the Commission in the near future.

Mr. HILL. Thank you. And you also—this summer, you have been busy on ETFs. So, you also have participated in a roundtable that we had under our Chairman's direction. And talked about how to both make sure consumers have information, but also have markets readily accept new ideas for ETFs. And you have proposed to innovate that space. How do you think your rule, that you proposed in June, will aid the Commission in time-to-market for new exchanged-traded fund ideas?

Ms. BLASS. So, for a sponsor to—a new sponsor to launch an exchange-traded fund, at this point, they still have to go through the exemptive application process. Even with a plain vanilla ETF, as we call it, it still takes even a few weeks. The notice period, alone, is about a month. That is time to market.

Even if you put aside the process, the operating under the exemptive rubric, if you will, we are, to date, over 300 exemptive orders. That creates inconsistencies, an unlevel playing field. And an investor investing in an ETF, they would not know that their ETF may have differences in their exemptions from another ETF. They just think of it as an ETF.

So, the—what the proposal is seeking to do, is designed to do, is create a transparent, effective, and efficient regulatory framework for a segment of the asset management industry that is now $3.6 trillion and growing, significantly.

Mr. HILL. And on that subject of ETF, as a term. You gave a speech, recently, where you were—expressed some concern over the nomenclature of an ETF, what is one and what isn't one. Would that be contained in the same rule? And what is your general intent there?

Ms. BLASS. We did request comment on this issue.

Mr. HILL. Yes.

Ms. BLASS. When you look at products outside and the ETF is used, and it could be a commodity pool, it is not an ETF. In some cases, I have seen the Financial Press refer to an exchange-traded note as an ETF.

Mr. HILL. Yes.

Ms. BLASS. And this creates market confusion. And investors do not understand—would not understand what it is, exactly, they are buying. So, we did request comment on this issue, and we are looking forward to seeing what folks give us.

Mr. HILL. Good. I think that is important because they are not all the same. And I think some creating a design where consumers can easily put them in the proper bucket, when they are considering their investment suitability, would be helpful.

In the time I have remaining, I was looking back at the investment management decision to implement Volcker. And I was—it seemed to me that it was—your interpretation has treated it differently, whether it is an equity investment, or a debt or a note investment. And didn't that—interposing the SEC between the corporate finance, between a company owner and a prospective investor. Shouldn't those be equally treated, whether it is an equity investment or a debt investment?

Ms. BLASS. I appreciate the concerns and the question. And I appreciate all the implementation challenges—

Mr. HILL. Yes.

Ms. BLASS. —that have been raised. The agent—the agencies—the Volcker agencies, if you will, did put out a rule proposal. On the covered-fund definition, we have a significant amount of questions there in our request for comment.

And, ultimately, the—our goal with this is, hopefully, to streamline the obstacle—the implementation challenges. And we do have questions that—in the proposal that go to your—

Mr. HILL. I appreciate that. My time is expired. It speaks to why we need a bicameral solution for this Volcker Rule. It is complex. We need to have harmonization between the regulatory agencies. I yield back. Thank you, Chairman.

Chairman HUIZENGA. All right. The gentleman makes an excellent point. With that, the gentleman from North Carolina, Mr. Budd, is recognized for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman. And, Director Blass, it is great to have you here. And it is great to have your family, your children, with you. And I think it may have been mentioned earlier, but we will provide notes for school teachers if needed, absolutely.

So, we really appreciate your service. I want to start with some concerns I have with the covered funds section in the recent Volcker NPR. And I think my friend from Michigan, Mr. Hultgren, touched on this earlier, but I want to echo those concerns.

In my view, the current definition of covered funds, under the rule, is too broad, and includes funds that engage in long-term investing and lending which are already activities that banks can do directly. However, they aren't able to do so indirectly through a fund which are far less risky than on-balance sheet lending. It doesn't seem to make sense to capture these types of activities under a rule that was designed to prohibit short-term speculative trading activity.

So, I asked Chairman Powell, when he was here, and I wanted to get your view as well this morning. So, how will you revise the fund's portion of the notice of proposed rulemaking, so that these types of activities are no longer swept into the rule? So that startups and small businesses can receive the much-needed capital in lender banks to grow their businesses?

Ms. BLASS. Thank you for the question. So, the request for comment is out there, and the agencies look forward to receiving information about this, and other aspects of the current fund definition that have raised questions.

With respect to the long-term versus short-term investments, if I may offer. I do appreciate the concerns raised by banks that they can do this directly under the merchant banking authority. And they cannot under the—through a fund under the Volcker Rule.

Two things about—we do want to ease compliance. But there are two things, if I—if I may, for your consideration. One is the Volcker Rule includes private equity funds. Just the term, private equity fund. And private funds invest in both short-term and long-term investments.

And then, when you look at the—in the Volcker Rule, this is statutory. Not the rule. The statute. The—there—it covers the illiquid funds. And when you look at that one, that also includes long-term investments which could be read as an intent of Congress to cover long-term investments and not just short-term.

That said, we do appreciate the concerns raised in this area. And we do have the request for comment out.

Mr. BUDD. Very good. Thank you so much. So, I also want to ask some follow up questions on proxy advisors, but I think that has been covered already.

So, I want to switch over to crypto for a moment. I am leading a letter this week with—to Chairman Clayton, asking the SEC to clarify the criteria used to determine when offers and sales of digital tokens should be properly considered investment contracts and, therefore, offerings of securities, and properly clarify what makes an offer a non-security or a commodity. So, the reason I am doing this is that not all tokens are securities, and treating all tokens as securities harms American innovation and leadership in the cryptocurrency space.

So, I want to ask you, Director Blass, in your view, are there any benefits to investing in cryptocurrencies?

Ms. BLASS. So, in my role as a member of the staff and Director of this Division, what I look at is the product that a sponsor wants to offer, the law. And work with that sponsor to see what issues are under the law. And work with them to see—provide guidance, listen to their perspectives.

That is what we do and keeping in mind our mission which is investor protection, capital formation, and fair and orderly markets. So, that is our—the umbrella we work under. And what we do is work with the sponsor, keeping in mind our regulatory infrastructure.

Mr. BUDD. Thank you for your engagement there. It is so critical that we, in this country, are on the forefront of this. So, it means a lot.

I want to ask you, also, do you think that cryptocurrencies have the potential to help foster greater innovation and provide more investment choices for investors?

Ms. BLASS. When I look at the cryptocurrency space, I actually look at the blockchain, the technology, the blockchain technology, the distributed-ledger technology. And I do understand that asset managers, and others in the financial services industry, are looking at that technology to see how they can bring it in-house. And, ultimately, that could really be to the benefit of Main Street investors.

We would—we are—our doors are always open. We would love to hear about what they are doing, how they are doing, and what obstacles there are out there. But that is technology that we are definitely very interested in.

Mr. BUDD. I appreciate you drawing the distinction between the currencies and the numerous currencies out there and the technology that underlies it. So, thank you so much.

I want to appreciate you and thank you for joining us today. And I yield back to the Chairman.

Chairman HUIZENGA. The gentleman yields back. With that, seeing no other further questions, we would like to say thank you to the—to our witness today, Ms. Blass and her special guests. It might not have been the most exciting day for you. There were a lot of acronyms. We call that the alphabet soup of government. Lots of—lots of letters all attached to it. But, again, I just want to say thank you for your—for what you do and your family. And this is—this is important stuff. And we really appreciate your time.

So, with that, I would like to allow—sorry, I have to get back on script here. The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

So, again, Ms. Blass, thank you for your—for your time and your expertise. And we look forward to working with you more in the future.

With that, our hearing is adjourned.

[Whereupon, at 11:24 a.m., the subcommittee was adjourned.]

A P P E N D I X

September 26, 2018

Testimony on "Oversight of the SEC's Division of Investment Management"
Dalia Blass

Director, Division of Investment Management

Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment

September 26, 2018

Chairman Huizenga, Ranking Member Maloney, and Members of the Subcommittee, thank you for inviting me to testify before you today about the work of the Division of Investment Management (the "Division"). I would also like to thank you for your interest in asset management and the efforts of our Division in this space.

The asset management industry is critical to the U.S. economy and for the retirement and financial needs of millions of American investors, particularly our Main Street investors. Over the last two decades, assets in mutual funds have grown from around $4.5 trillion to over $19 trillion, a growth of over 330 percent.[1] During this same time period, exchange-traded funds ("ETFs") have grown from around $6.7 billion in assets[2] to be an over $3.6 trillion market.[3] Money market funds have grown from around $1.35 trillion in assets in 1998[4] to over $3.14 trillion today.[5] Investment advisers employ over half a million people,[6] and the staff has seen the number of investment advisers registered with the Commission grow to over 13,000, with total reported assets under management rising to nearly $84 trillion.[7] These assets represent the earnings and investments of millions of Americans who are saving for retirement, college tuition, and other goals.

Investment funds and investment advisers depend on the Division to review and respond to thousands of registration statements, requests for exemptions, requests for assistance, and other inquiries each year. As the division with primary responsibility for providing policy recommendations to the Commission concerning asset management, a dedicated team within the

[1] *See* 2018 Investment Company Fact Book (ICI, 58th ed. 2018), *available at* https://www.ici.org/pdf/2018_factbook.pdf; Investment Company Institute, Trends in Mutual Fund Investing (July 2018), *available at* https://www.ici.org/research/stats/trends/trends_07_18.
[2] *See id.*
[3] *See* ICI ETF Assets and Net Issuance, *available at* https://www.ici.org/research/stats/etf/etfs_07_18; *see also* Investment Company Act Notices and Orders, Category Listing, *available at* https://www.sec.gov/rules/icreleases.shtml.
[4] *See* 2018 Investment Company Fact Book, *supra* note 1.
[5] Based on analysis of data filed on Form N-MFP as of August 31, 2018.
[6] Based on analysis of data filed on Form ADV, Form BD, FOCUS Reports, and Form U4 filings as of December 31, 2017.
[7] Based on analysis of data reported on Form ADV through the Investment Adviser Registration Depository (IARD) system as of August 31, 2018. It consists of assets that are reported by both advisers and sub-advisers, including mutual fund and ETF assets.

Division also focuses on rulemaking and rule reviews.[8] In light of the importance of the asset management industry to investors and the markets, since my appointment as Director in September 2017, the Division has embraced three principles that guide our efforts in developing, assessing, and implementing policy initiatives: (1) improving the retail investor experience; (2) modernizing our regulatory framework and engagement; and (3) leveraging our resources efficiently.

I. Improving the Retail Investor Experience

Main Street investors should have the tools they need to make informed investment decisions. Americans increasingly depend on investments in mutual funds and ETFs and advice from investment advisers to help them save for retirement and other financial goals. As of the end of 2017, over 100 million individuals representing nearly 60 million households—45 percent of U.S. households—owned funds.[9] Of the over 13,000 investment advisers registered with the Commission, approximately 7,600 serve 34 million retail investor clients with over $12 trillion in retail client assets under management.[10] As a result, the experience of individual investors when they seek out information to help them choose a fund or an adviser is more relevant now than at any time since 1940. At the same time, technology has presented new opportunities to provide that information in ways that may be more effective. For these reasons, the Division is working on several initiatives that seek to improve the investment experience for Main Street investors.

Financial Professional Relationships

Earlier this year, the Commission proposed for public comment a comprehensive rulemaking package designed to serve retail investors by bringing the legal requirements and mandated disclosures of financial professionals in line with investor expectations.[11] The proposals were the result of collaboration among several divisions and offices across the Commission. The Division of Investment Management led the development of two of the recommendations included in the proposals.

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[8] The Division administers the Investment Company Act of 1940 (the "Investment Company Act") and Investment Advisers Act of 1940 (the "Investment Advisers Act"), which includes developing regulatory policy for investment companies (*e.g.*, mutual funds, including money market mutual funds, closed-end funds, business development companies, unit investment trusts, and exchange-traded funds) and for investment advisers.

[9] *See* 2018 Investment Company Fact Book, *supra* note 1.

[10] *See Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles,* Exchange Act Release No. 83063 (Apr. 18, 2018) [83 FR 21416 (May 23, 2018)].

[11] *See SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Investment Professionals* (Apr. 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-68; *see also Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles,* Exchange Act Release No. 83063 (Apr. 18, 2018) [83 FR 21416 (May 23, 2018)]; *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation*, Investment Adviser Act Release No. 4889 (Apr. 18, 2018); *Regulation Best Interest*, Exchange Act Release No. 83062 (Apr. 18, 2018) [83 FR 21203 (May 9, 2018)].

First, the Division developed a recommendation for a proposal that is designed to help educate investors about whether they are dealing with a broker-dealer, an investment adviser, or both, and importantly, why that matters when considering the services of a financial professional. Under this proposal, firms would be required to provide investors with a new, succinct disclosure that the Commission refers to as a "Relationship Summary." As proposed, the Relationship Summary would highlight key differences between broker-dealers and investment advisers, including: (1) the principal types of services offered; (2) the legal standards of conduct that apply to each; (3) the fees the customer would pay; and (4) certain conflicts of interest that may exist.[12] It also would include key questions for investors to ask their financial professional.

Because the proposed Relationship Summary is designed to benefit Main Street investors, the Commission has been seeking input from retail investors, investor groups, and others on this proposal. To help foster feedback from investors, the Commission has made available a website, www.sec.gov/tell-us, where investors can view examples of what the Relationship Summaries might look like and submit feedback on key questions from the proposal. The Chairman and SEC staff also have held roundtables across the country—in Denver, Houston, Miami, Washington, DC, Philadelphia, Atlanta, and Baltimore—where Main Street investors have had the opportunity to speak directly with Chairman Clayton, SEC Commissioners, and senior staff about the Commission's efforts to enhance retail investor protection and promote choice and access to a variety of investment services and products.[13] This feedback has been very valuable. Investors want to better understand their relationship with their investment professional—that is clear. A short, accessible summary of these matters can help improve that understanding. I believe the comments we have received will substantially improve the Division's development of a recommendation of the final product.

Second, the Division developed a recommendation for a proposed interpretation that would reaffirm and, in some cases, clarify the Commission's views on the investment adviser fiduciary duty standards. This proposed interpretation would draw together a range of statements from different sources about investment advisers' fiduciary duty and provide advisers with a reference point for understanding their obligations to clients.

The Division of Trading and Markets has led the developments of other aspects of the proposals, including Regulation Best Interest, which is designed to enhance the standard of conduct for broker-dealers when making recommendations to their retail customers. The Division also collaborated with the Division of Trading and Markets on a recommendation for a proposal to require a financial professional firm be direct and clear about whether it is a

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[12] *See Form CRS Relationship Summary Mock-ups, Appendices A, B, C, D, E, F* of *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles,* Exchange Act Release No. 83063 (Apr. 18, 2018) [83 FR 21416 (May 23, 2018)].

[13] *See SEC Chairman Clayton Invites Main Street Investors to 'Tell Us' About Their Investor Experience* (June 29, 2018), *available at* https://www.sec.gov/news/press-release/2018-125; *see also SEC Chairman Clayton Announces Additional Investor Roundtable in Baltimore for Main Street Investors to 'Tell Us' About Their Investor Experience* (Aug. 22, 2018), *available at* https://www.sec.gov/news/press-release/2018-162; Jay Clayton, *Statement on Public Engagement Regarding Standards of Conduct for Investment Professionals Rulemaking* (Apr. 24, 2018), *available at* https://www.sec.gov/news/public-statement/public-engagement-standards-conduct-investment-professionals-rulemaking.

registered investment adviser, a registered broker-dealer, or both in its communications with investors and prospective investors. The proposed rules also would restrict standalone broker-dealers and their financial professionals from using the terms "adviser" and "advisor." The proposal discusses whether these terms are so similar to the statutory term "investment adviser" that their use may mislead the broker-dealer's prospective customers.

Regulatory consistency is important in this effort given that financial professionals may be subject to oversight by more than one agency. We in the Division, along with the Division of Trading and Markets, have sought to engage with fellow regulators, including the Department of Labor, state insurance and securities regulators, state attorneys general, and others on this important initiative. We invite further engagement from our regulatory colleagues.

The comment period on these rulemakings closed in August, and in addition to the feedback gathered through outreach efforts, the Commission has received many letters with thoughtful and varying perspectives. The Office of the Investor Advocate is also in the process of performing investor testing on aspects of the rulemaking package, and I anticipate that the results of that testing will be made available in the comment file. SEC staff are carefully reviewing this information and will continue to consider public comments as we develop a recommendation for the Commission on next steps.

Modernizing Fund Disclosure

Disclosure is the backbone of the federal securities laws and is a critical tool for investors making investment decisions. While mandated fund disclosure is now available online, its design, delivery, and content have seen few fundamental changes over the decades. To begin the process of modernizing fund disclosure, the Commission recently issued three releases based on the recommendations of the Division that, together, seek to improve the experience of Main Street investors considering fund investments.

The Commission issued a request for public comment to gain insight from the public on ways to improve and modernize fund disclosures. This is an opportunity to examine, in light of advances in technology and design techniques, whether fund disclosures are working as well as they can for the more than 100 million individuals that invest in funds. The request for comment invites Main Street investors, experts, and others to inform the Division's policy recommendations on these disclosures. In order to facilitate retail investor engagement and comment, the Commission has provided a short "Feedback Flier," which highlights key questions from the request for comment and can be viewed and submitted at www.sec.gov/tell-us. The comment period ends October 31.

The Commission also adopted a new rule that creates an optional "notice and access" method for delivering fund shareholder reports.[14] Currently, fund shareholders can receive a shareholder report in two ways: in paper through the mail or electronically. New rule 30e-3 permits a third option. Under the rule, a fund may deliver its shareholder reports by posting

[14] *See Optional Internet Availability of Investment Company Shareholder Reports*, Securities Act Release No. 10506 (June 5, 2018) [83 FR 29158 (June 22, 2018)].

them on a website that is free of charge and sending investors multiple notices in paper through the mail letting them know that the report is available either on the website or in paper. The rule includes protections for those without internet access or who simply prefer paper. For example, the rule preserves an investor's ability to easily continue to receive reports in paper, either by making a one-time request to receive all future reports in paper, or by requesting individual reports in paper whenever they desire. To inform investors in advance of this new delivery method, the rule includes an extended transition period so that the earliest a fund could begin to rely on the rule would be January 1, 2021. In the two years prior to that date, funds that want to implement the new delivery method must provide prominent disclosures in prospectuses and other shareholder documents that will notify investors of the upcoming change in delivery method, ensuring investors will have multiple opportunities to receive these reports in the form that they prefer.

Finally, the Commission issued a request for public comment on the current framework for fees that intermediaries, including, for example, broker-dealers, charge funds to deliver disclosure documents such as fund shareholder reports. These fees currently are set by rules of the New York Stock Exchange ("NYSE") and other self-regulatory organizations like the Financial Industry Regulatory Authority ("FINRA"). Among other questions, the release asks for public input on the transparency of these fees and whether the fees should be overseen by FINRA.[15] The comment period ends October 31.

Variable Insurance Product Summary Prospectus

Investors in variable annuities and other variable insurance products often have to navigate a complex set of disclosures about the variable contract and underlying investment options when deciding whether to invest. The Division is considering a recommendation that the Commission propose rules designed to provide investors with more user-friendly, layered disclosure about variable insurance products. Variable insurance products are generally more complex than other retail investment products, like mutual funds, because they combine both investment and insurance features. In addition, the products typically offer a number of underlying fund investment options that have their own fees, and often include a variety of optional features, like living benefit riders that have additional charges. The Division is considering whether to recommend a new summary prospectus that would help investors better understand these products' costs and risks, and also produce cost savings that could be passed on to investors.

II. **Modernizing Our Regulatory Framework and Engagement**

Our capital markets are the envy of the world. I believe that when the Division is dynamic and responsive, it can help our markets continue to grow and develop for the benefit of all market participants, including Main Street investors. Modernizing our regulatory framework and engagement with market participants begins with looking back at existing policies and approaches and assessing whether they are (or remain) efficient, effective, and appropriate. Current policies may not be doing what they were originally intended to do, may not take into

[15] FINRA regulates the broker-dealers who deliver the disclosure documents.

account advancements in technology, business, and investor relationships, or may have unintended consequences and costs. In order to be as dynamic and responsive as the markets we regulate, the Division is undertaking several initiatives to modernize our regulatory approach under the Investment Company Act and Investment Advisers Act in light of significant developments in the asset management industry.

Exchange-Traded Funds

ETFs are a type of exchange-traded product organized as an investment company under the Investment Company Act. ETFs possess characteristics of both mutual funds, which issue redeemable securities, and stocks or closed-end funds, which generally issue shares that trade at market-determined prices on a national securities exchange and are not redeemable. Because ETFs have characteristics that distinguish them from the types of funds contemplated by the Investment Company Act, they require exemptions from certain provisions of the Act in order to operate. Today, before a fund sponsor may begin offering ETFs, it must obtain an order from the Commission providing several exemptions from the Investment Company Act. This may result in delay and cost for new sponsors.

Modernizing the current regulatory regime for ETFs is important because the $3.6 trillion ETF market is currently operating under more than 300 individually issued exemptive orders, which have varied over time in wording and terms.[16] Such an important segment of the asset management market would benefit from a clear regulatory framework. To address this, the Commission proposed a new rule to replace the process of individually-issued orders for exemptive relief.[17] The proposal is designed to create a consistent, transparent, and efficient regulatory framework for the types of ETFs that routinely receive exemptions today and to facilitate greater competition and innovation among ETFs. Our exemptive review process is a key part of how innovation takes place under the Investment Company Act. A final rule for routine ETF relief would enable Division staff to focus more of its resources on requests for exemptions that represent the next generation of potential developments under the Act.

Covered Investment Fund Research Reports

The Commission recently proposed rules and amendments that are intended to reduce obstacles to providing research on investment funds in furtherance of the congressional mandate of the Fair Access to Investment Research (FAIR) Act of 2017.[18] The proposed rules would harmonize the treatment of investment fund research with research on other public entities by establishing a safe harbor for a broker or dealer to publish or distribute research reports on

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[16] *See* January 2018 ETF Data; *see also* Investment Company Act Notices and Orders, Category Listing, *available at* https://www.sec.gov/rules/icreleases.shtml.

[17] *See SEC Proposes New Approval Process for Certain Exchange-Traded Funds* (June 28, 2018), *available at* https://www.sec.gov/news/press-release/2018-118; *see also Exchange-Traded Funds*, Investment Company Act Release No. IC-33140 (June 28, 2018), [83 FR 37332 (July 31, 2018)].

[18] *See SEC Proposes FAIR Act Rules to Promote Research Reports on Investment Funds* (May 23, 2018), *available at* https://www.sec.gov/news/press-release/2018-92; *see also Covered Investment Fund Research Reports*, Investment Company Act Release No. 33106 (May 23, 2018) [83 FR 26788 (June 8, 2018)], *available at* https://www.sec.gov/rules/proposed/2018/33-10498.pdf.

investment funds under certain conditions. This proposed safe harbor is similar to a regulatory safe harbor that currently exists for research reports about other public entities. Overall, these proposed rules would promote research on mutual funds, ETFs, registered closed-end funds, business development companies ("BDCs"), and similar covered investment funds and provide investors with greater access to research to aid them in making investment decisions. The Division is reviewing comments from the public on the proposal as we move forward with providing a recommendation to the Commission for adoption.

Offering Modernization for Business Development Companies and Closed-end Funds

The Division is working to develop rule recommendations consistent with congressional mandates to modernize the way BDCs and closed-end funds are offered to the market. The Small Business Credit Availability Act directs the Commission to revise almost 20 securities offering and proxy rules and related form requirements in order to harmonize registration and reporting requirements for BDCs with those for public corporate issuers. Similarly, the Economic Growth, Regulatory Relief, and Consumer Protection Act directs the Commission to issue rules to allow certain registered closed-end funds to use securities offering and proxy rules similar to those available to public corporate issuers. Division staff is preparing recommendations for the Commission to propose these rules.

Use of Derivatives by Registered Funds and BDCs

Funds use derivatives for a variety of purposes, including, for example, to seek higher returns through increased investment exposures; hedge interest rate, credit, and other risks in their investment portfolios; gain access to certain markets; and achieve greater transaction efficiency. The current regulatory framework for funds' use of derivatives has developed on an instrument-by-instrument basis over many years, starting with a Commission general statement of policy in 1979,[19] and over 30 staff no-action letters and other guidance that followed. In 2015, the Commission proposed a new exemptive rule to address the use of derivatives and financial commitment transactions by registered funds and BDCs and received a significant number of comment letters on the proposal's regulatory approach. Based on these comments, the Division is considering a recommendation that the Commission re-propose a new rule designed to enhance and modernize the regulatory framework for registered investment companies' use of derivatives.

Amendments to the Marketing Rules under the Investment Advisers Act

Registered investment advisers are subject to a rule governing marketing that has not changed significantly since its adoption in 1961. Since that time, the asset management market, technology and the types of investors that investment advisers serve has evolved. For example, in 1961, investors did not have resources like the internet to research and select investment advisers, and social media in its current form did not exist. As this landscape has evolved, the Division is considering recommendations for the Commission to modernize this rule, for

[19] *See Securities Trading Practices of Registered Investment Companies*, Investment Company Act Release No. 10666 (Apr. 10, 1979).

example, by revisiting the prohibition on use of testimonials given that a growing number of today's consumers and businesses look to the experiences and recommendations of others in making informed investment decisions. The Division also is considering recommendations for changes to the rule governing payments for soliciting business on behalf of registered investment advisers. This rule was adopted in 1979, and also may need to be updated to address current market practices.

Fund Board Outreach Initiative

Since 1940, shareholders have relied on fund boards to help represent their interests. While the importance of boards has not changed, directors' responsibilities have grown significantly over the years and their areas of focus have expanded. Last fall, the Division established a new initiative to holistically revisit the responsibilities of fund boards. This initiative seeks to identify the areas where board oversight is most valuable and to assess whether changes, such as those in technology or the securities markets, warrant reconsideration of board responsibilities in certain areas. This initiative also seeks to inform future policy decisions about the appropriate role of the board in fund governance.

In connection with this initiative, the Division, in coordination with the Commission's Office of the Chief Accountant, is considering recommendations for updates to Commission guidance on the valuation of portfolio securities and other assets held by registered funds and BDCs to reflect evolution in the markets and the standards for accounting, auditing, and reporting. This effort, in part, seeks to modernize guidance to fund boards on performing their responsibilities concerning valuation in a way that recognizes that evolution.

Investment Company Liquidity Disclosure

Investors in mutual funds and ETFs expect to be able to exit these funds promptly, and the Investment Company Act requires redemption requests to be fulfilled within seven days. As a result, managing the liquidity of a fund's portfolio is a fundamental aspect of a fund adviser's responsibilities. In 2016, the Commission adopted an important rule designed to promote effective liquidity risk management practices among open-end funds.[20] After adoption, the staff and fund sponsors turned to the work of implementation. The staff responded to a significant number of frequently asked questions to address important implementation questions raised by fund sponsors and others as they sought to establish programs responsive to the rule's requirements.[21] After carefully gathering input from interested parties about the implementation of this requirement, in February, the Commission extended the compliance date for the classification elements of the rule.[22] In addition, the Commission recently adopted targeted

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[20] *See* rule 22e-4 under the 1940 Act [17 CFR 270.22e-4]; *see also Investment Company Liquidity Risk Management Programs*, Investment Company Act Release No. IC-32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)].
[21] *See Investment Company Liquidity Risk Management Programs Frequently Asked Questions, available at* https://www.sec.gov/investment/investment-company-liquidity-risk-management-programs-faq.
[22] *See Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs*, Investment Company Act Release No. 33010 (Feb. 22, 2018) [83 FR 8342 (Feb. 27, 2018)].

amendments to the public reporting requirements of the rule.[23] These amendments are designed to enhance the disclosure funds provide to investors about liquidity risks and reduce the risk that investors may be misled about the comparability of certain fund liquidity metrics.

Fund Innovation and Cryptocurrency-related Holdings

The success of the U.S. investment fund market can be attributed, in significant part, to the commitment of fund sponsors to innovation and continuous improvement of the products they offer for investors. This commitment is especially important because many Main Street investors rely on registered funds to help them build toward their financial goals. The Division has a long history of supporting fund innovation, with exemptive authority serving as a key feature of the Investment Company Act. For example, dialogue between fund sponsors and the Division over the years has facilitated the development of new types of investment products, like ETFs and money market funds.

There has been interest among some fund sponsors to offer registered funds that would hold cryptocurrencies and cryptocurrency-related instruments. As we have in the past, the Division has sought to engage in a dialogue on this potential product innovation. To help facilitate a transparent and productive dialogue, the Division published a letter identifying some questions that we believe need to be examined for funds to invest in crypto-related holdings in a manner consistent with the substantive requirements of the Investment Company Act and its rules.[24] Areas of inquiry in the letter are valuation, liquidity, custody, arbitrage for ETFs, and potential manipulation of cryptocurrency markets. We have included a copy of the letter and public responses received on our Division website[25] and continue to engage with fund sponsors on this dynamic product development and the evolution of the cryptocurrency markets.

Review of the Proxy Process

Shareholder engagement is a hallmark of our public capital markets, and the proxy process is a fundamental component of that engagement. Recently, the Chairman announced a staff roundtable on the proxy process to provide the staff an opportunity to engage with investors, issuers, and other market participants on topics including the voting process, retail shareholder participation, and the role of proxy advisory firms.[26] In developing the agenda for the roundtable, the Division staff has been considering, among other topics, whether prior staff guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms should be modified, rescinded, or supplemented.[27] With this pending roundtable

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[23] *See Investment Company Liquidity Disclosure*, Investment Company Act Release No. 33046 (Mar. 14, 2018) [83 FR 11905 (Mar. 19, 2018)].
[24] *See* Staff Letter to ICI and SIFMA AMG: Engaging on Fund Innovation and Cryptocurrency-related Holdings (Jan. 18, 2018), *available at* https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm.
[25] *See* https://www.sec.gov/investment/fund-innovation-cryptocurrency-related-holdings.
[26] *See Statement Announcing SEC Staff Roundtable on the Proxy Process* (July 30, 2018), *available at* https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.
[27] *See Statement Regarding Staff Proxy Advisory Letters* (Sept. 13, 2018), *available at* https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters. Staff guidance is nonbinding and does not create enforceable legal rights or obligations. *Id.*

and other policy considerations in mind, the Division staff has recently reexamined the letters that the staff issued in 2004 to Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (Sept. 15, 2004) and has determined to withdraw these letters.[28] We look forward to a robust discussion from stakeholders with multiple perspectives at the roundtable about the SEC's proxy rules.

III. Leveraging Our Resources Effectively

In the Division, I have the privilege to work with a staff of lawyers, accountants, quantitative analysts, industry experts, and other employees who are dedicated to the agency's mission. We are a Division of around 180 people responsible for policy affecting more than 20,000 registered funds and investment advisers.[29] Employing our resources efficiently is critical to our ability to serve American investors and develop informed policy in today's dynamic asset management space.

Use of Data and Analytics

The Division is committed to increasing the efficiency and effectiveness of our regulatory programs through the enhanced use of technology and data analysis. We also work closely with the Office of Information Technology, particularly with regard to protecting market sensitive data, as part of the Commission's broader efforts to assess and improve the agency's cybersecurity risk profile. We appreciate how technology has changed the markets and are seeking ways to harness technology and data for our regulatory purposes. The staff in the Division's Analytics Office has advanced our ability to interpret data, to focus our resources, and to respond with rigor to questions about asset management.

One example of their work is an internal tool we in the Division call "MAGIC"—an acronym for Monitoring and Analytics Graphical User Interface ("GUI") for Investment Companies. MAGIC allows us to pull together a number of data sets and analyze funds in a variety of ways, allowing the staff to ask questions about specific funds to determine, for example, how a fund's portfolio compares to its strategy or how a fund's holdings are aligned with its investment restrictions. Staff can also use this tool to run custom queries across thousands of open-end and closed-end funds. For example, we are able to quickly identify which funds may have exposure to certain assets, like cryptocurrencies. MAGIC also has been powerful in helping to improve our disclosure review process. Ultimately, we expect this tool to help us to implement a risk-based approach to reviewing disclosure that will improve the effectiveness and efficiency of our work. As new data and technological advancements become available, the Division has the ability to extend MAGIC's capabilities.

[28] https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.

[29] *See* Investment Company Institute, Trends in Mutual Fund Investing (Jan. 2018), *available at* https://www.ici.org/research/stats/trends/trends_01_18; Investment Company Institute: ETF Assets and Net Issuance (Jan. 2018), *available at* https://www.ici.org/etf_resources/research/etfs_01_18; U.S. Securities and Exchange Commission, Information About Registered Investment Advisers and Exempt Reporting Advisers, *available at* https://www.sec.gov/help/foiadocsinvafoiahtm.html.

The Division also is exploring the use of technology-based tools to improve the efficiency of our internal processes. One example of these efforts is the staff's development of a tracking tool to conduct Sarbanes-Oxley Act reviews. The Division is required to periodically review fund annual reports, including financial statements as required by section 408 of the Sarbanes-Oxley Act and other disclosures by management investment companies ("SOX reviews"). Division staff developed an internal tool that automates information that the staff previously tracked and compiled manually for these SOX reviews. This tool saves hundreds of hours of manual tracking each year and informs risk-based reviews of fund annual reports. The tool also facilitates consistency in staff comments and areas of focus in fund annual reports, thereby increasing the efficiency and effectiveness of our regulatory oversight.

Process Improvements

In addition to the increased use of analytical tools in our regulatory oversight, the Division continues to make efforts to improve the efficiency and effectiveness of our internal processes. This pertains to some of the core work of the Division, including the review of disclosures of over 12,000 investment companies by our Disclosure Review and Accounting Office.[30] Funds make many filings and their complexity varies. To better focus our resources, the staff generally takes a risk-based approach to reviewing disclosure filings, devoting particular focus to (1) filings by novel and complex funds; (2) new disclosures; and (3) disclosures that most directly influence investment decisions, such as disclosures on investment strategies, risks, fees, and performance.

In addition, the Division is working to improve the transparency of our fund disclosure review process. We recently launched a new webpage that is designed, in part, to provide more clarity and practical guidance on the preparation of fund disclosures.[31] For example, the webpage has accounting and disclosure information for practitioners that covers various practical topics like how to request selective review of a disclosure filing or request relief to avoid making multiple filings when a fund complex makes substantially identical disclosure changes to multiple funds. The website allows us to share with the public accounting and disclosure topics that are frequently raised with the staff. The goal of this effort is to help funds and practitioners navigate our disclosure review process.

Human Capital Planning

As the asset management market continues to evolve, the Division's staffing also must adapt. In recent years the Division has seen growth in types of investment companies that require expertise in specialized areas of finance, law, and operations, such as BDCs and ETFs, as well as funds with more complex investment strategies or investments, such as funds that use derivatives in more complex ways than in the past. In addition, the Dodd-Frank Act resulted in the Commission having greater responsibility for advisers to hedge funds and other private

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[30] The Division is responsible for reviewing filings such as prospectuses, proxy statements, and shareholder reports for mutual funds, ETFs, closed-end funds, variable insurance products, UITs, and similar investment funds.
[31] *See* U.S. Securities and Exchange Commission, Fund Disclosure at a Glance, *available at* https://www.sec.gov/investment/fund-disclosure-at-a-glance.

funds. In light of these developments, we have placed a priority on hiring and retaining talented professionals with experience in these growing areas. Further, it is vital to our mission that the Division recruits not just lawyers, but individuals with background as financial analysts, accountants, traders, and even salespeople who want to use their real-world experience in the investment management business to help protect investors. Accordingly, human capital planning is one of my highest priorities as Director, and the SEC's fiscal year 2019 budget request would allow the Division to hire additional staff to advance our mission.

Conclusion

Thank you again for inviting me to discuss the Division's efforts. The information I have shared with you today highlights the tremendous work and commitment of the staff of the Division to inform and protect investors, facilitate capital formation, and effectively regulate the securities markets. I look forward to working with all of you and am happy to answer your questions.