

WILLIAMS & JENSEN, PLLC

CONGRESSIONAL HEARING REPORT

DATE OF HEARING: October 23, 2015

SUBJECT: “Oversight of the SEC’s Division of Investment Management”

COMMITTEE: House Financial Services

SUBCOMMITTEE: Capital Markets and Government Sponsored Enterprises

STAFF MEMBER COVERING HEARING: Rebecca L. Konst and Alex Barcham

Members Present

Republicans: Chairman Scott Garrett (NJ), Representative Robert Hurt (VA), Representative Ed Royce (CA), Representative Randy Neugebauer (TX), Representative Bill Huizenga (MI), Representative Sean Duffy (WI), Representative Steve Stivers (OH), Representative Randy Hultgren (IL), Representative Dennis Ross (FL), Representative David Schweikert (AZ), Representative Bruce Poliquin (ME), Representative French Hill (AR)

Democrats: Ranking Member Carolyn Maloney (NY), Representative Bred Sherman (CA), Representative Stephen Lynch (MA), Representative Ed Perlmutter (CO), Representative David Scott (GA), Representative James Himes (CT), Representative John Carney (DE), Representative Nydia Velazquez (NY)*

* Full Committee Members who are not part of the Subcommittee were granted permission to participate in the hearing.

Witnesses

[Mr. David Grim](#), Director, Division of Investment Management, U.S. Securities and Exchange Commission

Overview

On October 23, the House Financial Services Committee’s Subcommittee on Capital Markets and Government Sponsored Enterprises held a [hearing](#) on “Oversight of the SEC’s Division of Investment Management.” The hearing focused on the Department of Labor (DOL) fiduciary duty rule, the designation of asset managers as systemically important financial institutions (SIFI), the use of proxy advisers, and regulation of private funds.

Topics discussed included: (1) Asset Management and FSOC; (2) Proxy Advisors; (3) Liquidity Risk Management Rules; (4) Business Development Companies; (5) Private Funds; (6) Money market

Fund Reforms; (7) Fund Examinations; (8) Fiduciary Duty; (9) Transition Plans for Investment Advisers; (10) Research; (11) Investor Disclosure; (12) Puerto Rico; and (13) Liquidity.

Members Statements

Chairman Scott Garrett (R-NJ) said the hearing would focus on the SEC Division of Investment Management (IM). He noted that David Grim had recently been appointed as Director of the Division of Investment Management. He said there is bipartisan agreement that the SEC should remain the primary regulator of investment funds and capital markets. He suggested that the SEC's independence has been under attack by the Financial Stability Oversight Council (FSOC), which has attempted to place bank-like regulations on asset managers. He said authority for asset managers rests with the SEC, not the prudential regulators. **Garrett** suggested that the SEC is "finally" asserting its jurisdiction over the capital markets. He expressed concern that the SEC's agenda is still unduly influenced by the prudential regulators. He expressed interest in the SEC's work on Section 913 of the Dodd-Frank Act (DFA) and Department of Labor's fiduciary rule.

Ranking Member Carolyn Maloney (D-NY) emphasized the importance of IM, noting that it oversees the asset management industry. She pointed to the rapid growth of exchange traded funds (ETFs) over the past few years. She said there are 12,000 registered investment advisers under the IM's oversight. She questioned whether ETFs pose excessive risks. She said IM is working on critical liquidity management rules for mutual funds, and the FSOC has raised concerns that without liquidity management rules there is a risk of fire sales. She praised the SEC for moving forward with mutual fund liquidity rules. She noted that the rule also proposed allowing mutual funds to make use of swing pricing. She suggested that swing pricing can eliminate the first user advantage associated with mutual funds.

Representative Robert Hurt (R-VA) stressed the need for vigorous oversight of the SEC. He said small businesses and startups rely on the capital markets for access to capital. He expressed concern that regulations are slowing down the flow of capital. He said the DFA placed inappropriate registration requirements on private equity fund advisers. He emphasized that private equity funds and their advisers did not cause the financial crisis and do not pose a systemic risk. He suggested that the registration regime should be revised.

Witness Testimony

Mr. David Grim, Director, Division of Investment Management, U.S. Securities and Exchange Commission said the mission of the Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. He stated that the Division promotes this mission through regulating the asset management industry. He noted that a primary function of the Division is to administer the Investment Company Act and the Investment Advisers Act and to develop regulatory policy for both investment companies and investment advisers. **Grim** said the four core activities of the Division are: (1) crafting rulemaking recommendations to the Commission on matters within the Division's expertise; (2) reviewing fund filings; (3) providing interpretive and other guidance to the asset management industry and the public about the securities laws and corresponding regulations; and (4) monitoring risks in the asset management industry.

Grim noted that in July 2014, the Commission adopted significant reforms to the rules governing money market mutual funds. He said the amendments were intended to reduce the risk of runs on money market funds, provide important tools to help further protect investors and the financial

system in a crisis, and enhance the transparency and fairness of these products for America's investors. He also noted that in September 2015, the Commission adopted amendments related to the removal of credit ratings references in rule 2a-7, the primary rule that governs money market funds under the Investment Company Act, and in Form N-MFP, the money market fund portfolio disclosure form. He said these amendments give effect to section 939A of the DFA. **Grim** stated that on May 20, 2015, the Commission proposed new rules and forms, as well as amendments to its rules and forms, to modernize the reporting and disclosure of information by registered investment companies. He stated that if adopted the proposed rules would require registered funds, other than money market funds, to provide portfolio-wide and position-level holdings data to the Commission on a monthly basis. **Grim** said on September 22, 2015, the Commission proposed a new rule that if adopted would require open-end funds to adopt and implement liquidity management programs. He noted that the proposed amendments also, if adopted, would permit mutual funds to use "swing pricing," and would enhance disclosure regarding fund liquidity and redemption practices.

Grim explained that at the direction of the Chair, the Division also is working on initiatives aimed at helping to ensure the Commission's regulatory program is fully addressing the increasingly complex portfolio composition and operations of the asset management industry. He stated that these initiatives include potential new rules concerning: (1) the use of derivatives by investment companies; (2) transition plans for investment advisers; (3) stress testing for large investment advisers and large investment companies; and (4) third-party compliance reviews. **Grim** said pursuant to Section 965 of the Dodd-Frank Act, the Division established a new risk and examinations office. He stated that Division staff assigned to this office monitors trends in the asset management industry and carries out the Division's limited inspection and examination program.

Question and Answer

Asset Management and FSOC

Chairman Scott Garrett (R-NJ) asked if the SEC is a prudential regulator, to which **Grim** responded in the negative. **Garrett** said earlier this year Federal Reserve Board Governor Daniel Tarullo stated that short term wholesale funding and asset management should be a part of "prudential market regulation." He asked if **Grim** is familiar with the term prudential market regulation, to which **Grim** said the FSOC has been looking at the asset management industry for systemic risk. He said the FSOC is looking at how to address any potential systemic risks. **Garrett** asked if the rules proposed by the SEC are prudential regulations. **Grim** said the SEC's rules are part of their three part mission.

Chairman Scott Garrett (R-NJ) asked about IM's work with the FSOC on the review of asset management products and activities. **Grim** stated that the Chair of the SEC, not the Commission itself, is the member of FSOC. He said IM assists the Chair on issues under IM's jurisdiction. **Garrett** asked if IM staff meets with FSOC staff. **Grim** said IM meets with all of the FSOC agencies. **Grim** asked if the FSOC is soliciting input from IM on asset management issues. **Grim** said the IM provides its expertise in this area. **Garrett** suggested that many of the members of FSOC lack expertise on the asset management industry. **Grim** said the FSOC members have solicited IM's input.

Ranking Member Carolyn Maloney (D-NY) said Chair White previously outlined steps for modernizing the oversight of the asset management industry. She noted that the SEC has issued some rules in this area, but has not yet proposed rules regarding stress testing and transition plans

for winding down asset managers. She asked when these rule will be issued. **Grim** said the financial crisis showed the need for stress testing and transition plans. He said the DFA mandated stress testing rules for large non-bank entities. He stated that the SEC has made good progress on stress testing rules for large investment companies, but did not offer a timeline for moving forward. He said he expects the rule in the “near term.”

Representative Sean Duffy (R-WI) noted the focus of the FSOC and the SEC on asset managers. He stated it has been speculated that FSOC will designate an asset manager as systemically important (SIFI) in the future. He asked whether FSOC members adequately understand the market. **Grim** stated it is important that Congress set up FSOC since it has all of the financial regulators together and the SEC is a member. He stated it is critical for Chair White to be there to offer expertise on the SEC’s responsibilities. He reiterated that the SEC is at the table but acknowledged the other FSOC members would not have the same expertise.

Representative Duffy (R-WI) asked whether the FSOC actually takes the SEC’s advice on asset management. **Grim** stated the SEC has provided expertise. He stated sometimes they agree and sometimes they do not.

Representative Duffy (R-WI) asked whether asset management industry poses a systemic risk. **Grim** stated that is a determination which is up to FSOC ultimately. **Duffy** asked whether FSOC is the best to determine this issue. **Grim** stated the crisis showed the importance of the financial regulators having a mechanism to share views which is what the DFA set up. He stated the SEC is the technical expert on market issues generally. **Duffy** noted concerns with “mission creep.” He asked whether there is concern over the Office of Financial Research (OFR) report and how “bad” it was. **Grim** stated the recent approach by FSOC where they have shifted to a focus on activities and issued a request for comment is a shift consistent with the SEC focus.

Representative Dennis Ross (R-FL) asked about the FSOC review of asset managers. He asked whether they are systemically important. **Grim** stated the ultimate determination of systemic is up to FSOC. **Ross** asked whether FSOC has reached out to the SEC on what the right criteria is. **Grim** stated Chair White has been very involved. **Ross** asked for Grim’s criteria to classify an asset manager as a SIFI. **Grim** stated it is too early to say. He stated if that determination is made it would be important to have criteria set but the FSOC is right now focusing on activities. **Ross** stated these criteria need to be transparent so asset managers can get out of the classification. **Grim** stated right now the focus has been on activities not on designation. He stated this has been a healthy change in focus.

Representative Duffy (R-WI) asked whether Federal Reserve Governor Daniel Tarullo fully understands asset managers and is working towards what is in the best interest of the industry. **Grim** stated any FSOC member has the ability to share in the SEC’s expertise.

Representative Brad Sherman (D-CA) asked whether the SEC has enough tools to determine whether an asset manager is systemic. **Grim** stated FSOC has the tools under the DFA.

Representative Ed Royce (R-CA) stated the OFR asset management report included a number of factual errors, including misnaming Fidelity’s highest level asset management entity and misrepresenting the amount of their assets under management; improperly describing Vanguard’s

structure; and misrepresenting the amount of assets under management for PIMCO. He stated the SEC allowed stakeholders to point out these mistakes. He asked whether some of the mistakes could have been avoided if the OFR worked closely with the financial regulators or opened their work for public comment. **Grim** stated SEC staff provided comments on the OFR report. He stated the OFR chose not to take some of those comments into account. **Royce** noted his bill ([the Office of Financial Research Accountability Act of 2015](#)) introduced with Representative Patrick Murphy (D-FL), would address these issues and requires the OFR to submit an annual report for the upcoming year and require input from other regulators.

Representative Himes (D-CT) stated Grim noted that FSOC released an RFQ on systemic risk associated with asset managers. He asked about preliminary conclusions from these comments. **Grim** stated the comments focused on specified activities in the industry. He stated the comments were received from a wide range of commenters. He stated the FSOC is assessing those and figuring out what is the appropriate next step in light of those comments.

Representative Bruce Poliquin (R-ME) stated he spends 25 percent of his time talking to constituents desiring money from the federal government. He stated there are \$25 trillion in retirement savings in the U.S. and most is in mutual funds. He stated asset managers are attempting to help retirees. He noted a study of Douglas Holtz-Eakin (American Action Forum) which stated that if asset managers are designated as systemic, rates of returns on retirement savings will be 25 percent less. He asked whether asset managers helping small investors should not be penalized if they do not hold assets on their balance sheets. **Grim** stated there are over \$18 trillion in registered investment companies. He stated it will ultimately be the FSOC who determines SIFI status of asset managers.

Proxy Advisors

Chairman Scott Garrett (R-NJ) said the SEC issued a staff legal bulletin regarding proxy advisors. He asked about the results from the most recent proxy season. **Grim** said the Commission held a roundtable on proxy advisor firms. He said the SEC Staff is still examining the impacts of the bulletin. He said there is anecdotal evidence that the bulletin is having a positive effect.

Representative Bill Huizenga (R-MI) asked whether the SEC rule in 2003 permitting reliance on independent third parties related to proxy advisors is still consistent. **Grim** noted the focus of the SEC on this issue. He stated the SEC staff put together a staff bulletin around proxy advisory firms. He stated the focus is on disclosure of conflicts and how investment advisers oversee those proxy firms. He noted there have been concerns expressed about investment advisers outsourcing their proxy responsibilities and the bulletin provides advice on what investment advisers should be focused on.

Representative Bill Huizenga (R-MI) asked whether the independence of the proxy advisors is an important factor when determining to use a proxy firm. **Grim** stated proxy advisory firms need to provide conflicts disclosures. He stated the SEC is still studying the impact of the guidance. **Huizenga** asked for the timeframe for additional guidance. **Grim** stated the SEC is focused on this but he is not certain when it can be expected.

Representative Royce (R-CA) asked whether proxy advisory firms should not be held to the same standards of accountability and transparency as the public companies they advise on. **Grim** stated

the SEC guidance was focused on encouraging disclosure of material conflicts of interest and on how investment advisers use proxy advisory firms. **Royce** asked whether the SEC should have a formal rulemaking on this issue. He suggested this needs to be more than a staff legal bulletin. **Grim** stated after issuing the guidance they have had a proxy season run and the examination unit is conducting exams. He stated they will decide whether further actions are necessary.

Liquidity Risk Management Rules

Ranking Member Carolyn Maloney (D-NY) noted that while European nations already use swing pricing, concerns have been raised that there could be impediments to swing pricing in the U.S. She asked why the SEC would not make swing pricing mandatory, as it is in Europe. **Grim** said swing pricing is intended to make the market fairer for all investors. He said there are some operational challenges with swing pricing, which the SEC included questions on in its release on liquidity management rules for mutual funds and ETFs. **Maloney** asked if there are situations where swing pricing could harm certain investors. **Grim** said he hopes this is not the case and emphasized that the SEC is still reviewing public comments. **Maloney** asked how swing pricing would have affected the runs on mutual funds and equity products during the financial crisis. **Grim** said money market fund rules have already been adopted by the Commission. He said it is unclear how swing pricing would have affected the market.

Representative Sherman (D-CA) asked about the liquidity rules. He asked whether there will be a requirement that 50 percent of funds be in bucket one or two. **Grim** stated one element of the rule is to propose six buckets which are disclosed and transparent. He noted another part of the rule codifies some guidance which caps the amount of illiquid assets a fund could hold. He noted the buckets are a separate requirement.

Business Development Companies

Representative Ed Perlmutter (D-CO) asked about Grim's views on proposals to modify the rules regarding the eligible "acquisitions" of business development companies (BDCs). **Grim** said the SEC is very focused on BDCs because their shares are predominantly held by retail investors and BDCs have grown significantly in the last ten years. He said Congress has discussed bills to change the treatment of BDCs. He noted that SEC Chair Mary Jo White wrote a letter to Congress regarding one of these bills in the last Congress. He stated that the letter indicated that while BDCs can already take on more leverage than other types of funds, the bill would increase this leverage even further, which could raise investor protection concerns.

Private Funds

Representative Robert Hurt (R-VA) stated two of the three components of the SEC's mission are to protect investors and to promote fair markets. He asked whether private equity funds caused the 2008 crisis to which **Grim** responded they did not. **Hurt** asked whether those funds present systemic risk. **Grim** stated the SEC's focus on private equity funds in the Dodd-Frank Act (DFA) is the requirement for them to be registered. He stated the SEC believes that is a "good thing" and the protections which come from being registered are important. **Grim** stated FSOC will ultimately determine systemic risk. He stated the SEC's focus has been on investor protection. **Hurt** stated the private fund framework would prevent cascading failures. **Grim** stated the SEC has been focused on potential investor protection issues. He noted examinations have raised concerns related to fees in terms of investor protections.

Representative Hurt (R-VA) noted the registration provision came from the DFA. He asked whether the SEC can tailor enforcement and rulemaking to reflect that these funds are different. **Grim** stated they do and they have. He explained the industry had questions surrounding certain instruments they invest in and custody. He noted the SEC staff provided some technical advice on how the custody rule applies. **Hurt** asked whether there are opportunities to continue that in the future to which **Grim** replied in the affirmative.

Representative Hurt (R-VA) asked how the information the SEC is gathering on private funds is helpful. **Grim** stated that this information allows the SEC to look at industry wide trends and risks, and leads the SEC to be better informed regulators. **Hurt** asked whether this information has been useful. **Grim** stated Form PF is the form filed and the SEC published for the first time some global industry data about the private fund industry. He suggested this is good for the SEC and the public and they “are happy about it.”

Representative James Himes (D-CT) noted concerns over registration requirements for small funds. He stated those funds are held by institutional investors and expressed concerns over the amount of data the SEC would collect. He expressed concern over fees and transparency of fees. He asked whether the issues in the private fund arena are prevalent or only a “few bad actors.” **Grim** stated DFA had the SEC develop some rules to implement the registration of a number of private fund advisers. He stated as the exam staff has been doing examinations, they have found a range of concerning practices and have been focused on the transparency of fees. He stated some cases have been referred to the Division of Enforcement. **Himes** asked how concerned Congress should be that this is a structural problem. **Grim** stated the SEC generally sees the benefits of registration under the Advisers Act.

Money Market Fund Reforms

Representative Stephen Lynch (D-MA) noted the money market rules adopted in July 2014 allow the NAV to float. He stated with that type of rule they are testing its “sea worthiness” which is hard to do when things are calm. He asked for an update on that rule. **Grim** stated one part of the money market rule was the floating NAV provision which applies to institutional prime funds. **Lynch** noted concerns have been raised regarding this change. **Grim** stated after the rule was adopted, the SEC staff put together a team to monitor issues. He stated a number of fund complexes have announced changes to their lineup in response to the change in the rules. He stated there is a lot of work on implementation of the rule, but he noted the deadline is still in the future. He stated the SEC is monitoring things and it is too early to determine.

Fund Examinations

Representative Stephen Lynch (D-MA) asked about the increase in the number of funds. He stated ETFs and mutual funds can be a real blessing if run properly. He stated while the number of funds have “exploded” the number of examiners to monitor those funds has shrunk. He asked about the SEC’s ability to do their job. **Grim** stated just about all the examiners that monitor funds are in the examination office. He noted the Chair has been clear that having the correct number of examiners is a critical issue. He stated only 10 percent of advisers get examined each year. He stated the bottom line is it is a challenge. He stated this is an issue that has been on their minds for a long time. **Grim** noted the Chair has asked for more examiners in the most recent budget request. He noted the SEC released a study with three options to address the shortage of examinations, including assessing user fees on investment advisers, using an SRO for examinations, or authorizing

FINRA to examine investment advisers. He noted Chair White has also discussed the idea of private third party adviser examinations.

Representative Sherman (D-CA) expressed concern over using third parties for examinations. He stated bond rating agencies are selected by the issuer. He stated if these outside firms come in will they be selected by the fund or by a panel. **Grim** stated with respect to third party compliance reviews Chair White has directed staff to come up with a recommendation. **Sherman** asked the SEC to review the Frank-Sherman proposal in the original DFA. He stated the SEC ignored this when writing the proposal. **Sherman** stated the idea of an outside “grader” chosen by the company did not work in the past.

Fiduciary Duty

Representative Randy Neugebauer (R-TX) noted Department of Labor Secretary Perez has stated the DOL has coordinated with the SEC on the fiduciary rule. He asked what coordination has been undertaken. **Grim** stated the SEC has provided expertise about the potential impact of their rule proposal. **Neugebauer** asked what analysis has been done on the impact on SEC registered advisers. **Grim** stated Chair White has directed staff to develop a recommendation at the SEC on a uniform fiduciary duty and as part of that staff has done extensive analysis around a number of impact questions. He noted they conducted a study after the DFA and also have a request for comments (RFQ). **Neugebauer** asked whether the SEC is prepared to release a recommendation. **Grim** stated they are in the process of doing the analysis and will then make a recommendation. **Neugebauer** stated Congress would like to see the analysis once completed.

Representative Neugebauer (R-TX) asked whether it is concerning that investment advisers would be subject to two standards. **Grim** stated the way the law works right now is that certain investment advisers that have ERISA clients are subject to both standards if they have clients which operate under both jurisdictions. He stated the SEC has been providing expertise on the impacts of the DOL proposal but it is a DOL standard.

Representative David Scott (D-GA) stated in the DFA it is the domain of the SEC to come up with a uniform definition of fiduciary. He stated section 913 clearly states this. **Grim** stated section 913 gives the SEC the authority to issue a uniform fiduciary duty standard. **Scott** stated the DOL is getting into the SEC’s “bailiwick.” He asked why the DOL is “dabbling” in this issue, creating confusion, and threatening the ability of low income investors to get the advice they need. **Grim** stated the question of “why” is better directed to the DOL. He stated pursuant to the section 913 requirements Chair White has required staff to develop a recommendation. **Scott** stated the public is getting “fed up” because of these types of “invasions” into other agencies’ responsibilities. He suggested the DOL proposal will have “immense” unintended consequences. He encouraged the SEC to move forward on their proposal and to “fight the DOL” to preserve the SEC’s responsibility.

Representative Ross (R-FL) stated the DOL rule is creating a whole new right of action. He asked whether the DOL has reached out to the SEC. **Grim** stated the SEC has provided subject matter expertise. He stated the SEC is talking to the DOL on potential impacts. **Ross** asked whether there will be a conflict if the SEC has a different definition for reasonable compensation. **Grim** stated an important issue is the compensation and fee structure. He stated as the SEC studies potential

impacts they have been focused on those compensation issues. **Ross** stated reasonable compensation is important.

Representative John Carney (D-DE) stated he was a part of the push to make the DOL and SEC work together on a uniform fiduciary rule. He asked for a timetable on the SEC study and proposal. **Grim** stated the timetable will be up to the Commission. He stated they are working on the recommendation and are studying some of the impact questions. **Carney** asked how long it will be until a recommendation is ready. **Grim** stated he is not certain.

Representative Carney (D-DE) asked whether Grim is aware of the DOL proposal to which Grim stated he is aware. **Carney** asked about the provisions in the proposal. **Grim** noted the DOL has received many comments on the proposal. He stated the SEC provided input on potential impacts of what they are proposing. **Carney** asked whether the DOL is heading in the same direction as the SEC. **Grim** stated he is not certain. **Carney** stated the whole point was to achieve uniformity. **Grim** pointed out that ERISA and the Investment Advisers Act already have differing requirements.

Representative Carney (D-DE) noted concerns that small balance accounts will be orphaned. He asked whether the SEC is looking at this. **Grim** stated this is very important. He stated the SEC has asked for data on that issue among others. He stated the staffs of the Division of Investment Management and Division of Economic Risk Analysis (DERA) have been looking at that data.

Representative Huizenga (R-MI) asked whether the DOL asked for SEC help on the fiduciary rule. **Grim** stated DOL did ask for input. **Huizenga** asked who this advice went to at the DOL. **Grim** stated he is unsure of the details. **Huizenga** stated he will follow up on this in writing.

Representative David Schweikert (R-AZ) asked about the harmonization of who regulates who. He suggested there is a crisis in the retirement sector. **Schweikert** stated when the SEC provides information to the DOL is there at least a discussion of accessibility. He asked whether the regulators take in to account the barriers the proposals will create. **Grim** stated investor access to investment advice is a cornerstone of what the SEC is attempting to accomplish. He explained the SEC has been fortunate to have received a lot of comments on the access issue.

Representative Schweikert (R-AZ) asked how small investors receive advice. He asked whether there is a discussion of how to make the advice egalitarian and not a legal “sink.” **Grim** stated some of the feedback which is relevant in the fiduciary recommendation is for investor testing. He stated the SEC conducted a study prior to the DFA which looked at investor’s preference for who provides them advice. **Schweikert** asked whether the policy makers should require a harmonization of these rules. **Grim** stated as they develop their recommendation the SEC will take this into consideration.

Representative French Hill (R-AR) asked whether the SEC has written its fiduciary proposal. **Grim** stated they are in the process of developing a recommendation. **Hill** asked whether they are in the first or ninth “inning.” **Grim** stated the recommendation is on the “front burner.” He stated they are developing the recommendation for Commission consideration. **Hill** asked when the process was started. **Grim** stated this discussion pre-dates the DFA. He stated since the DFA, SEC staff provided a study to Congress within six months. **Hill** stated this is “ridiculous” that this takes

this long and that the DOL pre-empts the SEC work. **Grim** stated it is an important topic but it is complicated. He stated DOL and the SEC have different mandates and statutes. **Hill** asked whether the competing standards will be confusing. **Grim** stated the SEC is considering that confusion issue. **Hill** asked whether the SEC should have the lead on this. **Grim** stated the SEC is focused on the possible confusion.

Representative Randy Hultgren (R-IL) noted the DOL fiduciary proposal and stated it is evident that the DOL has little understanding of the market and little concern for the consequences. He noted he has sent two letters to Secretary Perez and he has yet to respond. **Hultgren** asked whether the exclusive sale of proprietary products would violate the regulations. **Grim** stated under section 913 one provision deals with the sale of proprietary products and the SEC received a lot of comment on this issue during the study conducted.

Representative Hultgren (R-IL) noted section 913 provides the SEC the authority to create a fiduciary duty standard. He asked where the SEC is in the process. **Grim** noted Chair White directed the SEC to create a recommendation. He stated Investment Management, Trading and Markets and DERA have all been working on a recommendation.

Representative Hultgren (R-IL) stated a politically biased DOL should not be putting in place flawed rules and the SEC could do a better job. He noted on March 6, Secretary Perez stated he has met with Chair White. **Hultgren** asked what advice the DOL has used from the SEC. **Grim** stated the SEC has shared expertise with the DOL. He stated a lot of what discussed has been on the impacts of the choices the DOL is making.

Representative Hultgren (R-IL) asked whether the DOL should suspend its rulemaking effort until the SEC provides a rule. **Grim** stated what the DOL does is up to the DOL.

Representative Steve Stivers (R-OH) asked about harmonization efforts. He asked whether the SEC has asked the DOL to suspend their proposal until the SEC has released its proposal. **Grim** stated they provided subject matter expertise. **Stivers** asked whether they have been coordinating release dates to which **Grim** stated he is not certain.

Representative Steve Stivers (R-OH) asked what imposing a fiduciary standard means for investor choice because of the due diligence requirements. **Grim** stated this is an important issue to study. **Stivers** asked whether the SEC has studied what happened in the UK. He suggested the SEC needs to harmonize these rules with the DOL because they will harm investors.

Representative Sherman (D-CA) stated it is “absurd” to have one set of rules for IRAs and another set of rules for the rest of the market. He stated there will be greater protections for those with money in IRAs. He suggested there needs to be the same rule for non-IRA accounts.

Transition Plans for Investment Advisers

Representative Scott (D-GA) noted the SEC is proposing a rule requiring investment advisers to maintain transition plans. He asked for the overall impact on smaller investment companies. **Grim** stated the impact on smaller advisers is something the SEC is studying carefully as they develop a recommendation. He stated there are rules on the books already about certain transition issues. He

stated they are trying to evaluate whether the rules should be expanded to cover other transition events.

Research

Representative Hill (R-AR) asked whether securities received safe harbors for research purposes to which **Grim** replied in the affirmative. **Hill** asked whether those safe harbors should be extended to ETFs. **Grim** stated the SEC supports good research. He stated the SEC would encourage research to be good subject to certain protections. He stated he is uncertain how to apply the Securities Act of 1933 or the Securities Exchange Act of 1934 Act to this.

Investor Disclosure

Representative Poliquin (R-ME) stated Maine is highly rural and the population is elderly. He noted the SEC proposed new rule 30e-3 which would allow investment advisers to no longer send out paper annual reports to investors. He stated 71 percent of investors want to receive paper reports. He explained many seniors do not have access to the internet yet own the majority of these assets. **Poliquin** stated easy access to financial information in paper form is important. **Grim** stated this is part of a unanimous proposal by the SEC. He explained the proposal was intended to allow investors to receive disclosures in the form they desire. **Poliquin** stated forcing seniors to “opt in” is not the right choice.

Representative Sherman (D-CA) noted **Grim** mentioned the proposed rule to provide asset managers to provide statements electronically rather on paper. **Sherman** stated this will be better for investors.

Puerto Rico

Representative Nydia Velazquez (D-NY) raised the issue of exemption of companies located in Puerto Rico and U.S. territories from the Investment Company Act of 1940. She noted the recent reports surrounding UBS interactions with Puerto Ricans. **Grim** stated the way the Investment Company Act works means that Puerto Rico is exempted from many protections in the Act. He stated he does not know the facts of the UBS case. He suggested the affiliated transactions provisions in the U.S. relate to purchases and sales between affiliates and funds and purchasing of bonds from affiliated underwriters.

Representative Velazquez (D-NY) asked whether investors in Puerto Rico are at a disadvantage. **Grim** stated funds in Puerto Rico are subject to some protections. **Velazquez** asked whether this loophole should be closed. **Grim** stated the Investment Company Act protections are critical to investors. He stated he does not have an opinion. **Velazquez** noted her legislation (H.R. 2610) to close this loophole.

Market Liquidity

Representative Stivers (R-OH) asked about the potential liquidity crisis. He stated it appears that there are multiple forces moving a lot of market makers out of the markets which could result in larger price swings. He asked how many discussions the SEC has had surrounding this issue. **Grim** stated the SEC has had a lot of discussions about this. **Stivers** explained he has written to the OFR requesting them to study this issue. He suggested this is the next coming crisis. **Grim** stated liquidity is a very important issue. **Stivers** stated the SEC has not taken enough action to prevent market makers from leaving the markets.