**Bingham Presents 2013: Asset Management**
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**ARTHUR LABY:** Good afternoon and welcome to, Bingham Presents 2013: Asset Management, broadcast live from Bingham McCutchen LLP's offices in New York and online at www.sechistorical.org. I am Arthur Laby, Professor of Law at Rutgers University School of Law, and moderator for this program.

This event is the fifth in the Bingham Presents series and it is made possible through a partnership between Bingham McCutchen and the SEC Historical Society.

With close to 1,000 lawyers and offices on three continents, anchored by major commitments in the world's key financial centers, Bingham McCutchen offers market-leading practices focused on the financial services industry. Bingham lawyers provide global intelligence to help clients understand how capital markets fit together.

The SEC Historical Society through its virtual museum and archive at www.sechistorical.org, shares, preserves and advances knowledge of the history of financial regulation. I am a member of the Society's Board of Advisors and serve on the Museum Committee, advising on the growth and outreach of the virtual museum and archive.

Since the inaugural Bingham Presents broadcast in 2009, this series has examined such issues as criminal enforcement of the securities laws, harmonization of the regulation of investment advisors and broker-dealers, and enforcement after the Dodd-Frank Act. All of the previous Bingham Presents broadcasts are available in both audio and edited transcripts formats in the Bingham Presents section under Programs in the virtual museum and archive. I encourage you to check them out at the end of this broadcast.

The SEC Historical Society is grateful for the continuing generous sponsorship of Bingham for this Series.

This evening we will be examining asset management. Joining me are three distinguished panelists: Andrew "Buddy" Donohue, Managing Director at Goldman Sachs and a former Director of the SEC's Division of Investment Management; Tom Harman, a partner here at Bingham and formerly Chief Counsel and Associate Director in the SEC's Division of Investment Management; and Nancy Morris, Chief Compliance Officer at Wellington Management Company, and formerly Secretary of the SEC and Deputy Chief Counsel in the Division of Investment Management.

I wanted to start off our discussion with what is perhaps on everyone's mind, and that is the emphasis on enforcement. It seems like we are seeing more enforcement activity particularly in the asset management area. I would like to get our panelists' views on some the recent enforcement cases that have grabbed headlines. What do they represent? Is there anything new or different here? So why don't we start with Tom, and of course we will hear from the others soon.

**TOM HARMAN:** Thank you, Arthur. It's a pleasure to be here. I would say that there is something new, there is something old here in terms of maybe what's not new. I think the continued emphasis in cases like Steven Cohen on insider trading is a persistent theme and thread throughout the SEC's activities in the last 30 years. The names and perhaps some of the details will change from case to case. This shows to me there is all in the determination of the staff and the Commissioners, in particular the Enforcement division, to continue to pursue insider trading as it manifests itself. But something that's clearly new is the emphasis on what I would call structured securities' cases, whether they are CLOs, CVOs, CDOs or swaps, whether a security present. I think the other case involves a determination by the SEC to leave its mark on some of these complex securities in the ways in which they were both assembled and marketed. So that's the way I would take a first stab at it at high level.

**ARTHUR LABY:** Tom, let me ask you a follow-up question before any of the others may respond as well. You mentioned one example, which is insider trading. Do you think advisory firms should be reconsidering their approach to some of the old problems like insider trading or should they be looking at this the way they have in the past. Does this new emphasis on enforcement indicates that perhaps they need to rethink the way they address those problems?

**TOM HARMAN:** I think that they should be, and in fact they are continuing to think through what they are doing, how they do it today against the backdrop of concerns that are out there, in the area of expert networks, for example, asset management firms, whether they are mutual fund shops or whether they are hedge fund shops. The use of expert networks is something that they need to be thinking about, and thinking about the law of insider trading as those two overlap.

**ARTHUR LABY:** Nancy, do you have any views on this?

**NANCY MORRIS:** I am looking at the enforcement. There is nothing really all that new in my view about insider trading cases. It's always been the predominant case that the SEC has brought. But what is a little bit new, I think, are the aggressive techniques that are being used now to investigate insider trading. We have all heard of things like wire-tapping, deep photo shoots from afar showing cash exchanging hands, et cetera. I think there's a renewed emphasis, which makes it important when you are in-house and certainly when you are chief compliance officer. I am focusing on what should I be doing as a CCO in terms of compliance. There's a whole new area of political intelligence that we really haven't seen much of before. The expert network area, and what are the things that I can do in-house, for example SMS, that manage to make sure that my firm stays on the right side of that line. Those things can include negotiating with your third-party service providers to ensure that they understand what your position is.

I sit back and look at the Steve Cohen and SAC Capital case and so I wrote some notes down on this. I think for me in-house and talking with the people that I work with and others in the industry, I have two main lessons out of this already and the case has just been brought. A firm's success or survival really depends on the integrity of its personnel, in that the gains associated with insider trading are quite fleeting, but the damage done to a firm's reputation is permanent. Clients will not take a chance on an investment manager whose ethical integrity is called into question. The other thing is that there is no room in the business for a 'see no evil, hear no evil, speak no evil' approach. Investment advisers are fiduciaries and as such their case tells me we have to speak up if we see something going on.

**BUDDY DONOHUE:** How about a nuance to some of the cases. Others on the panel may have greater insight to this but the case against Cohen is a supervisory case, a failure to supervise. For the firm, their responsibility under the Advisers Act is to have policy and procedures specifically to address insider trading, to help prevent it and detect it. It should be a wake-up call to everyone, I think which is, this isn't just the guy who did it is going to get hit, and that the firm might have some responsibility relative to the gains that might have come from that. But individuals may have responsibility because they failed to carry out their duties in terms of supervising the people that actually engaged in the insider trading. I thought that was some of the significance that came out of the Cohen case. You also could say, I guess that's all they could get him on, even though there seems to have been several significant insider trading cases within the same firm. That was one of the takeaways that I had which was that they are looking at the structure that's there, and whose responsible for overseeing to make sure these things don't happen. Did they ignore red flags? Did they do the things that one would expect they should do or that they had to do really under their policies?

**NANCY MORRIS:** I would agree with you on that, Buddy. In the context of supervision this is going to be a very powerful case you will really drive home to managers in the industry that they have to know what their people are doing and that they have to supervise them properly. Are they complying with your code of ethics? Are they complying with your insider trading policies, let alone doing their job that they are supposed to be doing? So I agree with you there.

**TOM HARMAN:** The supervisor became the all-purpose tool in a toolkit in the last 20 or 30 years. I would say large number of the SEC enforcement actions over the last 25 or 30 years included failure to supervise. There are a variety of reasons for it. I think, because as a former SEC person, it just sounds good that you are able to say, this is what we are sanctioning them for. From a standpoint of flexibility, I think there are a number of reasons why the offer of the tool and toolkit but it's something that everyone should keep in mind because it is sometimes the only charge that may be left at the end of the day when the settlement is signed.

**BUDDY DONOHUE:** Tom, it has been less frequent in the advisor space then obviously in the broker-dealer space that has more structured rule-based responsibility of supervisors supervising those directly under them. Many asset managers are not set up in a way that you could immediately identify who is the supervisor, particularly in the portfolio management area where they are collaborative. It doesn't mean that it doesn't apply. I think it's been less on top of mind on the asset management side of the business, certainly than it is on the broker-dealer side.

**TOM HARMAN:** I agree with you that the whole duty to supervise is in the Advisers Act because it's literally carved out of the '34 Act and dropped into the Advisers Act. But if you look at a lot of pricing cases, in particular of 22(c)1 cases where portfolio managers corrupted or came at the system by which securities were valued every day, there's oftentimes failure to supervise in the litany of things that the settlement is eventually wrapped around.

**ARTHUR LABY:** Let me ask one follow-up question about supervisory responsibility. It's a very important topic and I am glad that we are focusing on it. Regulators have always relied on a firm's own in-house supervisory system, as we said it's a critical part of the regulatory system. I was wondering if each of you could just reflect for a moment on whether you think that system is really working, whereby firms are the first level supervisors of their own conduct. Is that a system that is working well, and of course I am asking that just on the heels of our prior discussion about enforcement. I would like to get each of your perspectives on whether this system more generally is working well.

**NANCY MORRIS:** Your suggestion would be that perhaps some sort of external supervision would be appropriate. I think it can totally work in-house at a firm. I think it just depends on the size of the firm; it has to be structured appropriately. I think it's important for people to understand if they are a supervisor, it's important for them to understand what it is they are supervising. It's important for them to document what their supervisory role is and to document what it is that they have to do in order to meet that. But that's a first line function. I think firms have multiple layers of supervision including committees that oversee activities. Those committees are oftentimes independent from the area that they are looking at or certainly cross departmental sort of committees that can I think recognize and appropriately curb behavior that they think is perhaps moving in the wrong direction. So if the inference is that we have to go to an external source to oversee it, I am not sure I agree with that. The other alternative would be some sort of a self regulatory organization to oversee the industry and that's also something that I am not entirely keen about. I think it would create enormous additional cost without necessarily having great benefit. I would argue the SEC could do more in this area to provide greater guidance on what they expect.

**ARTHUR LABY:** Any other views on that topic?

**BUDDY DONOHUE:** I echo that point. I think it has to be in-house. Compliance is owned by the firm, and the sense that somehow you could take the regulatory requirements and outsource them really says that that function is owned by someone else. I think that the more systems you use in order to try and ensure compliance and more people think of it as being compliance's responsibility for making sure bad things don't happen, when the reality is, it's the business' responsibility to make sure bad things don't happen and compliance has some tools to help the business do that. So I think it has to be part of the business and it would anyway even you said you have to outsource it. You don't want someone else finding that you are having problems and internally that's the only way you can identify conflict. It's the only way you can deal with the issues that you need to deal with. The solutions to those are not easy and are different for different firms based on the structure of the firm.

**TOM HARMAN:** I would agree emphatically with that, Buddy and Nancy. I think that in fact with some clients we have seen the key compliance personnel imbedded in each of the different segments of the business as opposed to being a separate office of compliance. I think that's really taken the notion who owns it to its logical conclusion, which is every different business segment within an advisor firm or a broker-dealer firm should have its own compliance experts with their boots on the ground handling the questions in real time. Otherwise, everyone else is coming in after the fact, sweeping it up and trying to fix it, and that's oftentimes far more expensive than catching it more or less in real time.

**ARTHUR LABY:** Thanks, Tom. We have been talking about this emphasis on enforcement and I would like to ask about the other side of the coin of that emphasis on enforcement. It seems that the emphasis on enforcement might mean a de-emphasis on the Division of Investment Management and other operating divisions at the SEC. I wanted to see if I could get your comments on whether you think that's right. Is the role of the Division changing as a result of the emphasis on enforcement? What do you envision in the next several years, two, three, five years or longer for the Division in light of recent events in the enforcement area? Buddy, do you want to start on this one?

**BUDDY DONOHUE:** I would like to start. My sense was that there's a significant increase in the relative resource of the Commission that was devoted to enforcement and to OCIE relative to other divisions. I said okay, that's an interesting thesis. What are the facts? So I went back and looked and in 2004, 54% of the people that worked in the SEC worked in either OCIE or in Enforcement. And in the budget for 2014, ten years later, resources for the people inside the SEC: 54% are in OCIE and Enforcement. Now I would have lost a lot of money on a bet. What you don't see coming through is actually the amount of resources that would then split between OCIE and Enforcement. Enforcement went down from in 2004 to 2014; they originally had 32% and are now down to 29% of the staff. OCIE went from 22% of the staff up to 25%. So my instinct was wrong. Now maybe if I picked different periods, but I figured ten years is a fair period to pick in. I didn't feel like doing a lot of research on it but I liked to test what my instincts are and I really like it when I get borne out. I am not so happy if I am not borne out. But I think what we are feeling is what's happening in the asset management area, in terms of the devotion of the resources, particularly in Enforcement to the asset management industry. And therefore our perception is driven by that, not by actually the head count that exists inside the Commission. We could talk later if you want of that and what some of the drivers might be and what some of the facts might be. But it actually is an allocation of resources by the SEC. In fact they decreased relatively the human part of the allocation of resources from Enforcement and OCIE, which is one way to look at it.

**ARTHUR LABY:** Nancy, Tom, can you see that in your practices?

**NANCY MORRIS:** I guess that's interesting. I think the number game is interesting although I don't know if that necessarily translates into an emphasis or de-emphasis, one way or the other. I think those priorities ultimately are set by the Chairman.

**BUDDY DONOHUE:** Well, it is true Enforcement guys only do enforcement.

**NANCY MORRIS:** Correct. But I think where I see sort of an emphasis or de-emphasis; Dodd-Frank regulation has really required the Division of Investment Management to devote the vast majority of its resources to trying to get those rules and regulation out the door. It's going to be that way for a few years. I think other areas might feel or suffer from some neglect, absent some other kind of scandal coming to the forefront which would then re-prioritize division resources.

**TOM HARMAN:** By the way, on the metrics that I had just given, the Investment Management division went from 4.6% of the number of people down to 3.9%. So there was a relative decrease in terms of the number of the amount of resources from the SEC devoted to investment management.

**ARTHUR LABY:** But you mentioned Chair White…

**TOM HARMAN:** And by the way that's probably the end of my stance.

**ARTHUR LABY:** We won't call on you for more stance. You mentioned that Chair White, and as you know she was confirmed for a second term -- to 2019. I wanted to ask each of you if you have seen changes at the Commission since April 2013 that reflects her arrival. I'm wondering if you could just comment briefly on how her background might influence her tenure in what you have seen so far. Tom, have you seen anything yet that you could point out to us?

**TOM HARMAN:** It's not clear to me, six months in, what her Chairmanship is going to be remembered for, but my guess is that, given her incredibly strong experience, she already feels very comfortable with, and probably continue to feel very comfortable in the enforcement realm, and one could reasonably presume that she will leave a strong footprint there.

**ARTHUR LABY:** Nancy, Buddy?

**NANCY MORRIS:** I would agree. I don't think I have much more to offer there. I think it is just too early in the term other than as Tom said she has a very strong enforcement background. I would expect to see that manifest itself certainly. There is no question she's extraordinarily energetic and a real quick learner and really focused on the business of the Commission. So it will be interesting to see.

**BUDDY DONOHUE:** I think early signs are good, if you look at some of the things that she's already gotten down, things that had been difficult prior to her arrival. Whether you like it or not the money market front also did get out and it got out with pretty strong support. Now she has two new Commissioners. I think that's a big challenge that she has. It is too early to tell except that I think early signs are that and from what little I have heard, it seems like there is some pretty good cooperation among the Commissioners which really is a key to whether or not she will be successful.

**ARTHUR LABY:** Nancy, you mentioned Dodd-Frank just a few moments ago. This week marks the anniversary of the collapse of Lehman. Dodd-Frank is just over three years old. The focus was not primarily on asset managers in Dodd-Frank, but there are plenty of issues relevant to funds and advisors. I would ask each of you, if you could comment on your view of the law and what effect you think it's having on the operating divisions at the SEC as far as you know. Nancy, you alluded to this earlier. Could we start with you and then invite the others to comment as well?

**NANCY MORRIS:** Sure. One, it's not only the SEC, it's the CFTC, it's the other agencies in government that are still quite mired down in trying to get Dodd-Frank implemented. On balance, I hope we will be better off when everything is said and done, but to be honest there's still just so much that has yet to be done that it's hard to say. It is what it is whether it's going to be good or bad; we certainly have to live with it. I think it is creating huge operational issues for in-house investment managers. These rules and regulations are coming fast and furious, and they keep coming and coming and coming. It's not only in the US, it's in Europe and in Asia as well, and so synthesizing everything, getting it right, making sure you understand the nuances of these new regulations coming out will require a lot of in-house resources for the next several years. One of the concerns I would have is that all these new regulations will obviously be a source for potential enforcement action, and I would hope that's not the case. But given the volume of regulations, you can certainly see it happening.

**BUDDY DONOHUE:** A couple of observations from my perspective. At a macro level, I think that Dodd-Frank, in its emphasis on making changes in the derivatives and swaps and futures markets, may bring certain greater transparency and safety to that world. Insofar as money managers and their pooled funds of varying source are in those markets, that might be a better thing, although there will certainly be a cost to all those improvements at a more granular level. I think that the staff of the Division of Investment Management has spent a lot of time drafting and the SEC Commissioners spent a lot of time adopting various rules for investment advisors, drawing lines here, drawing lines there, new disclosure forms. It creates all of these new regulations for investment managers. It has soaked up a huge chunk of Investment Management staff time.

I felt really proud of the division. They pretty much got all the work done on time. Short time frames for some of those studies they had to complete, which were not easy. They had certain rule-making they had to do and pretty much they got it done very quickly. I don't think that's a drag on them anymore. I think there's some residual from that. But there's a drag in the whole Commission. If you think about, in your own experience, if you have a board of directors, you only have so much time. And you have something important that needs to get done but they have stuff that's urgent. In the SEC's case that might be certain actions that they have to take that are mandated by law. You have to have something really important and urgent in order to get time on the agenda. So no matter how much the division works on something that's really important, maybe it won't be important long term; unless it's on that agenda, it's not going to get done. When you talk about taking up staff time, I think that is one of the impacts that's going to be felt for a long time, which is the backlog of important things that the divisions have been working on, that would improve the situation but they are not going to be acted on because they don't have the priority, however important they might be. I think that really is a shame.

These are my personal views on Dodd-Frank. I worry about the amount of power that's been given to the Fed. The fact that you are going to wind up with potentially all the big banks moving in the same direction at the same time. I do worry about their increased involvement in many areas that they had not been before. I do worry that there is a view of many, I don't know that they are necessarily stated this way, but it's about reducing risk and I fear that actually just moved it.

**TOM HARMAN:** I don't have the statistics, Buddy, but I think that statistics ought to have been generated to date to make sure that they are too big to fail so, even greater fear because there are fewer and larger banks today. So if that was one of the chief goals of Dodd-Frank, it's not exactly been achieved.

**BUDDY DONOHUE:** The idea that somehow you take risk out of marketplaces. I mean that's where you get your returns. The questions of people taking the risks -- do they have the wherewithal to deal with that? I worry about whether what liquidity is going to be really about the marketplaces, whether or not there's only big dealers out there that have the capability of making markets in the markets that are necessary and will they have the capital and will they be permitted to use the capital at the time that the financial markets really need it.

**NANCY MORRIS:** It's already affecting the markets right now. And it's very tough.

**BUDDY DONOHUE:** Some of that may be a reflection of Dodd-Frank. Some of it may have occurred in any event as others who might not have some of the regulatory requirements jumping in and taking the easy trades, even the more difficult trades. I look at the impact on investments. Many of the advisers that had previously been eligible for an exclusion now came within the purview of registering with the SEC. I think that having had the job I had and I am sure the jobs you had, there was always a gap that we thought when we were there.

**ARTHUR LABY:** Let me ask the panel about that; I think that's an important point.

**BUDDY DONOHUE:** I'll take over asking the questions so that you can answer them for me.

**ARTHUR LABY:** That's not the way it works today but good try. So as you know the SEC now oversees private fund advisors that register with the SEC as a result of Dodd-Frank. As you say, it is a major change and I wonder if you could each reflect for a second on what you think of that. Will registration really make a difference? And how is it going? Is the industry to the extent that you know transitioning well to a regulated industry? This is a major change as a result of the Dodd-Frank.

**NANCY MORRIS:** I have some numbers, Buddy.

**BUDDY DONOHUE:** You each did your homework.

**NANCY MORRIS:** I did a little homework. More than 1350 new registrants have come in and have registered with the SEC as an investment advisor. There are more than 30,000 private funds with total assets in excess of 8 trillion dollars. So has it made a difference? What we obviously have a whole lot more investment advisors that are registered with the SEC. Do I think it will make a difference? I do.

**BUDDY DONOHUE:** We have a lot more, just different based on practice.

**NANCY MORRIS:** There's a whole group that went to the states, but in terms of private funds, under the SEC's purview, certainly under their ability to gain access to information about those funds and how they manage and what their risk profile are. They obviously have the information that they have never had before. I think it will be interesting to see how they slice and dice that information. It's a lot of information, if you look at the ADV Part I, in particular, they have ballooned for private fund managers. They are thousands of pages long now. Assuming you can even pull it up because they are so big it's hard to actually even pull them up. But will it make a difference? I think so. I think there is a discipline associated with registration. I think the requirement to have a chief compliance officer and a code of ethics begins to introduce advisors to that culture, that you certainly hope they will have a fiduciary. I just think it's a more disciplined approach to how you look at your business from a fiduciary and compliance point of view. So in the long run, yes. I also think enforcement will make a big difference as well.

**TOM HARMAN:** I'll agree with all that but personally I am still scratching my head. We are talking about a credited investor, a qualified purchaser or whatever the institutional type of investor is that typically predominates these funds and you can scratch your head and say, well, I thought the SEC should be spending the vast majority of its budget reviewing, inspecting, enforcing against more retail products whose investors can't protect themselves.

**NANCY MORRIS:** There are a lot of sophisticated…

**TOM HARMAN:** Were you there for Madoff?

**NANCY MORRIS:** Yes.

**TOM HARMAN:** I was.

**ARTHUR LABY:** Tom, that's actually a great point. If you are willing to do it, I might ask the panelists if they might reflect on that for a second. You raised a very fundamental question of the role of regulation and the role of the SEC; there are many who take that view that, with respect to the qualified purchasers or accredited investors, perhaps the SEC ought to forbear and not be as involved, and spend much more of their resources protecting individual investors, smaller investors. That's certainly a reasonable approach to take.

**BUDDY DONOHUE:** It's not protecting dentists or doctors.

**ARTHUR LABY:** Tom, is your point that if you are an advisor to rich people, you shouldn't have to register? Because that was never the rule. So it's not the advisor registration that's the driving point. Is it the collection of the data?

**TOM HARMAN:** Let me through for a little finer point on that. To the extent that we are worried about unregulated and opaque pools of capital such as hedge funds swinging around into the markets, and disrupting things, Form PF gives the SEC some information about what those hitherto unregistered advisors are doing. So that's probably a good thing from a macro level. But the whole notion of the SEC spending lots of taxpayer dollars to make certain that, for all of the rich doctors and dentists, that the advisor of their funds will do exactly what he or she said they were going to do in the offering memorandum and that sort of stuff just leaves me thinking … somewhere along the line I miss something because I am not sure this makes a whole lot of sense. When Nancy and I were Chief Counsel and Deputy Chief Counsel, back when dinosaurs roamed the earth, people came in asking about the 100% fund exemption. I was, let's just get this letter out because this isn't where America is investing. So there were interesting letters but I am not sure that was the essential mission of the SEC. These private funds are premised in part on private offerings under the '33 Act, for sophisticated investors who can fend for themselves and don't need the protection of the SEC. It just seems to me somewhere along the line, the message has gotten a little mixed up. If it's these professional money managers who have a huge impact on the capital markets, I get that part.

**BUDDY DONOHUE:** There was a disconnect there in terms of potential use of resources. The Advisors Act then doesn't apply here in a private fund or is your point more which I think is probably obvious that if you have limited resources then you got to be devoted to protecting those people that can't afford…

**TOM HARMAN:** That's my point and to the extent that you got 1300 new registered advisors who are coming in because they are managing an accredited investor's money or more robust, and the SEC OCIE is going to be examining a certain number of them. They can't just ignore them because they are on their rolls. So at the end of the day those hedge funds are going to be occupying a certain percentage of the SEC's brain space. Those aren't the mutual funds and the ETF's and the other things that the retailers and Americans are investing either their pension assets or their discretionary assets.

**BUDDY DONOHUE:** Tom, to your point, OCIE is going to spend a disproportion of its resources because of their risk based approach.

**TOM HARMAN:** Right. Because they are interesting and because the OCIE people will be concerned that they will be called for to produce a letter to Congressman so and so or report to so and so on this new segment of the industry that they now have responsibility over. It is inevitable that these advisors and their hedge funds will take up more space where previously they occupied a very little space.

**ARTHUR LABY:** And of course the proud traditions continue to apply whether somebody is or not. Nancy, I am sorry.

**NANCY MORRIS:** I was just going to say they have certainly accounted for, potentially I could be wrong this, but disproportionate number of cases involving insider trading fraud on the market.

**BUDDY DONOHUE:** The other fear may be inside is that if you have data then don't use it.

**NANCY MORRIS:** Yes.

**BUDDY DONOHUE:** You may not have known but you could have known because the data was there.

**ARTHUR LABY:** So I wanted to change gear slightly and drill down a little bit deeper on a couple of other issues. One question that I wanted to ask you about is innovation. Any time new rules are passed, one worries about the effects of those rules on Innovation. You three are very experienced; somebody earlier on this panel mentioned ETFs. I am wondering if you could reflect for a second on that idea. What does it take to launch a new product?  Do new rules in some cases -- do they act as an impediment in some respects to launching new products? Tom, do you want to start us on this one?

**TOM HARMAN:** I think ETFs are an interesting example because I was at the Commission when some of the first ETF's passed through the portals and that was some 20 years ago. You still need a series of start-up exemptions to get up and running as an ETF. So there has been innovation and there has been more ETF's over these last 20 years and they have gone from being fairly an equity product to fixed income as well. We are poised on the cusp of potential rules in the next couple of years that will do away with the need for all these start up exemptions. But it just feels like it takes a long time.

**NANCY MORRIS:** Interesting. I agree with you, Tom, I do think that innovation continues regardless. People adapt to whatever it is that ultimately comes out in the form of rules and regulations. I have seen people pull back from product developments.  And the perfect area is the CFTC mutual funds CPO registration. A lot of funds are pulling back and don't even want to get close. Because they don't want to trigger the CFTC registration and so they are specifically making products that are going to fit within a strict mold; they will not in anyway, shape or form sort of go over into that CFTC space. We are probably not going to see some innovative products that we might have otherwise have seen from some of those entities. I am sure about the uncertainties of how the regulatory frameworks are going to interact with each other although that is becoming a bit clearer now but I thought that was interesting to see a lot of people just pull back and say, don't even go close.

**BUDDY DONOHUE:** And probably I would have a different perspective, the biggest impediment that I see in innovation is uncertainty.

**NANCY MORRIS:** Yes.

**BUDDY DONOHUE:** It's not even where you know what it says, you know how it applies, it's rather the uncertainty about how something is going to be viewed, particularly where you have grave concerns about how OCIE might be viewed or how the Enforcement asset management unit might view it. It's not that you don't think that what you are proposing is grounded in the law. You may never get to make the argument. That may be irrelevant by the time that it comes up, unless you are willing to add on something. What I see is in coming up with new product development, that the uncertainties that are out there have been impediments to developing many new products. The uncertainties of derivatives, when you put them into new products, and exactly how it's going to be viewed going on. It is an impediment to many of the newer products that where people have been trying to move over some good products that exist in private funds and put them in the registered fund arena so that they can make them more readily available to other investors or also to the same investors but built with protections That's where I have seen many of the biggest challenges which is how do we make sure that in fact what OCIE when viewed with hindsight 10 years from now, we are going to say, that was okay, as opposed to, you should have known that on a principal basis that somehow that is not appropriate. That's the way a lot is being viewed in terms of what happened.

**ARTHUR LABY:** How do we address that? It is apparent that innovation can lead to uncertainty. What are some possible ways that we can address that uncertainty or is it just inherent in innovating new products, and there's no way around it?

**BUDDY DONOHUE:** I think the way that in the past many have addressed that is that they would have come to Investment Management, gone to Tom and Nancy, and said listen, here's the issue I am facing, what is the guidance you have and to the extent that you requested some no action, relief, that might be provided, and provide clarity, not just to you but to your competitors also in terms of what the rules of the road are at least in terms of how Investment Management thinks about the issue. I don't know do you see it that much and I think many have a reluctance to go in and ask the questions, even when you are pretty sure you are right and for fear not just that they might have a different view, but now they have put it up as item of interest or whatever they are calling that, so that without a full hearing it's up with some of the analysis done without anybody really abdicating.

**TOM HARMAN:** I am struck by your point, Buddy, about uncertainty and I think it's a terrific one and in fact it seems like over the last five years, there have been so many moving regulations, not just the SEC is changing its rulebook and the CFTC is changing its rulebook, but the Europeans are changing their rulebooks and the accounting boards and panels are changing the way they look at certain derivatives and other certain issues. I think it's a very good point because instead of here's what a single issue I go in and I see the Chief Counsel in the Investment Management division and I persuade him or her. That's only the start of the whole thing because now you got to figure out all these other regulatory bodies, legal and accounting, domestic and global.

**ARTHUR LABY:** I said I wanted to drill down a little deeper on a couple of issues. I have to ask you about valuation, and fund boards' oversight of valuation of portfolio securities. What do you think the impact is of the Morgan Keegan case? What has changed if anything regarding valuation? I imagine one or more of you might have views on this one.

**TOM HARMAN:** I advise a number of boards, so I am happy to take the first shot at this, and that is I think the first thing that I have personally seen and talked to other board counsel about is that, every board is going back and looking at their mutual funds existing valuation policies and then they are comparing what they think the Morgan Keegan case is about their own policies to see whether there is any gaps. Everyone's doing that, from as far as I can tell, but after that I think a lot of people are then sort of taking a stop, wait, let's look around and I don't know of any firms offhand that are rushing to tweak their evaluation policies. I think the securities in question were the hardest of the hard to price part of the market. They were mortgage backed securities within the fixed income space. It was sort of the perfect storm in terms of a regime that counts on mark to market daily current valuation.

**BUDDY DONOHUE:** If you have the view that those facts were compelling to bring a case. Why would you ever sell for essentially causing a violation of Rule 38(a)1? That was the violation. The violation was policies and procedures. You could read the lines and say, okay fine. What's the most they can do? I'm going to not do this again. There is a lot of dicta in there about all the bad things that you did, but none of them led to anything other than, you got to follow the procedures, you got to have good procedures. Is that a fair reading of it? I was embarrassed that that was the final outcome of that case.

**TOM HARMAN:** When you look at all the briefs that were filed and just weigh them, all the different excerpts that were used, and then you look at the final settlement, which as you said was a finding that the compliance policies around valuation were not up to the snuff. It's a message case, you know. Beware directors, you can't fall asleep when facts really jump out at you that don't make sense.

**BUDDY DONOHUE:** Now let's talk about message case. I find them difficult, in the sense that, yes, they are a wake-up call to everyone, and to the extent that behavior might have been way beyond the line. It doesn't help to know where the line is. It doesn't give clarity.

For books and records, in policies and procedures case, that certainly doesn't give clarity other than go back and look at your policies and procedures and we all should do that. I would have found more compelling where there could have been just a reminder of things you needed to do as opposed to an enforcement case. Now, enforcement cases do get everybody's attention. But then you have to do with all the dicta that's in the enforcement case.

**ARTHUR LABY:** What do you all think of that? We talked earlier about supervisory responsibility; I would like to see if we can marry this discussion with that one from earlier today. Is that really the point of some of these cases, to encourage firms, much the way a speech would, but in a more robust manner, to encourage firms to go back and look at their procedures in a given area? Is that the point of the matter?

**NANCY MORRIS:** It certainly has that effect. And certainly in the evaluation in the Morgan Keegan case, everyone did go back and look at their procedures. Everybody did go back and start questioning, who's making the final decision? What are the triggers that they are pressing? How often are stale prices reviewed? I am also a sub advisor to a lot of mutual funds saying, even though we don't price the funds, we oftentimes can provide input on a fair value securities. So we may get a call saying what are you doing for your accounts? A lot of due diligence focused on what we are doing, how we are doing it and I think it ties in some respects, just the whole supervisory control, the theme that seems to be emanating from a lot of these cases that you have to have oversight and supervision and you have to have due diligence and you have to make sure you know what it is that you are doing on an ongoing basis and be involved.

**TOM HARMAN:** I would say firms supervise their employees and their officers, boards oversight the firms and this is an oversight case where the SEC said this oversight in our view is not enough.

**BUDDY DONOHUE:** Was the CCO…?

**TOM HARMAN:** CCO was not.

**BUDDY DONOHUE:** So you skip a level?

**ARTHUR LABY:** Yet another interesting aspect.

**NANCY MORRIS:** I am in the favor of not bringing cases against CCOs.

**BUDDY DONOHUE:** I probably am too.

**NANCY MORRIS:** Thank you, Buddy.

**BUDDY DONOHUE:** Most of them are in favor of skipping a level but there's a control that the board should be able to rely on in terms of someone else doing.

**NANCY MORRIS:** They were trolling for a case to bring against directors and this seems to be the one they brought first and foremost.

**ARTHUR LABY:** Buddy, earlier in the evening, you mentioned money market fund regulations. Without delving deeply into the substance, do you think the proposal establishes the SEC as the primary regulator of money market funds? And do you think the adoption is likely? I would ask each of the panelists to give a view.

**BUDDY DONOHUE:** I am very concerned about the unintended consequences of the proposal. The view is that the next problem we have is going to be exactly like the problem we had before, and therefore this solution would have worked without maybe anticipating that once you set out certain rules out there people would change them based on what the rule is, and you may now have created another issue. My own sense is that some of the other regulators would have preferred some form of capital in one way or another to have them involved. But I think certainly if the SEC had not acted they would have prompted the regulators to have to consider what they could do. Remember FSOC had identified this as one of the major systemic risks they had to deal with. And so if the SEC didn't have that capability of dealing with it then I think FSOC, whether or not it wanted to, would have been compelled to do something. So, yes, in that regard I think they re-established it. This is not an easy question and is one that people who I highly respect have very different views about what the problem is, and then if there is that problem what solution should be and then what other problems have been created by that solution. I think if you take time and go and read many of the comment letters, you will see that there is a wide range of views people have about the industry, about what the issues were, what they could be and then about what the solution should be. So a long way of saying that I think it does re-establish the SEC's primary role overseeing money market funds.

**ARTHUR LABY:** Tom, your views?

**TOM HARMAN:** It's interesting because it's an industry that worked very, very well for a long period of time and now you see that it's changed tremendously in the last five years because of not necessarily regulatory issues but because the business just didn't make any sense any more with all the subsidization it yields and what not is going on. In response to your question, I do think that the SEC proposal keeps the SEC as the primary regulator of money funds. I think that's an important thing for the SEC to do. I also agree that it's a tremendously complicated issue because you have different types of money funds within different sub-species of money funds. They are very different from other ones and they are used in different ways. Some are used in trust departments where principal has to be inviolate. So for a variety of reasons it's a very complicated product but one that for years was an essential component of a successful money management firm, so it's an important product to get right.

**ARTHUR LABY:** Thanks, Tom. Our time's getting short. Let me ask one quick question that I think is a big theme. We can't spend a lot of time on it because we have to close soon. Could you comment briefly on technology and on the dimensions of technology? Nancy, I think you have thought about this a bit. You don't have much time left but if you are willing to give us a quick view on technology, that could be very interesting.

**NANCY MORRIS:** I am sure everyone agrees technology is a big issue in the sense of somewhat of a lack of guidance coming out from the regulators, SEC, let's put it that way in terms of what they are expecting of investment advisors in connection with investment models they use that are proprietary models that they lease and are using, what kind of due diligence should they be doing with respect to those models when they are dealing with brokers, what algorithms are they using, and what kind of oversight should they have of those algorithms. I think there is guidance out there from other regulators and I think if you look at the Rosenburg case, it was really a disclosure case with a lot of dicta on what people should be doing or thinking about in connection with their models. So I think it's an area that investment advisors are trying to grapple with because technology is everywhere and you have to step back and think about what you have to prioritize and what you have to focus on. But I think it's a huge resource right now in terms of managers that use any of these kinds of models. The other thing that just if I look even across the ocean at the SFC in Asia just has a proposal out that's requiring investment managers who utilize algorithms or brokers that they deal with to actually implement an appropriate due diligence oversight with respect to those algorithms and interestingly enough they didn't put that burden on the broker-dealers, they put it on the advisors. But we know it's here, we know it's going to actually focus and garner a lot of attention mostly because the failure that occurred on a number of the exchanges faced with being one of the big issues but just stale data, accepted that just shut down the exchanges. So I think there's a lot more to come in this area, there's a lot more that's going to develop from a SEC perspective.

**ARTHUR LABY:** Nancy, thank you very much. I think that has to be the final word. Nancy, Buddy and Tom, thank you very much for sharing your insights and experiences. I hope everyone found this to be an informative discussion on current issues in asset management. Today's program will be a valuable addition to the body of knowledge in the Bingham Presents series. An audio of the broadcast will be available soon in the virtual museum and archive at www.sechistorical.org, and an edited transcript will be added later. Bingham's website will also have a transcript of today's discussion. On behalf of the SEC Historical Society I would like to thank Bingham for their sponsorship and hospitality in making today's program possible. Thanks also to our audiences who have gathered here in Bingham's offices in New York and have joined us online. Good evening and goodbye for now.