

U.S. SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE  
SECURITIES AND EXCHANGE COMMISSION  
ASSET MANAGEMENT ADVISORY COMMITTEE

Via Webex Video Teleconference

Wednesday, September 16, 2020

U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, D.C.

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<p style="text-align: right;">Page 6</p> <p>1 PROCEEDINGS</p> <p>2 MR. BERNARD: Good morning. I'd like to call</p> <p>3 this meeting on September 16, 2020, of the Asset</p> <p>4 Management Advisory Committee meeting to order. Welcome</p> <p>5 to those of you joining on sec.gov. I would note that</p> <p>6 we have a quorum. This is a virtual meeting on Webex.</p> <p>7 And we've already done a sound check to ensure that all</p> <p>8 committee members and commissioners can hear. If there</p> <p>9 is any problems among those who are participating,</p> <p>10 please send a private text to Gabe Collins or Veronica</p> <p>11 Davis, and they will help us sort it out.</p> <p>12 To open the meeting, I'd like to thank</p> <p>13 Chairman Clayton and Commissioners Peirce, Roisman and</p> <p>14 Crenshaw for their attendance with a special welcome to</p> <p>15 the most recent appointee, Commissioner Crenshaw, and</p> <p>16 invite each of them to offer any opening remarks they</p> <p>17 may have. Chairman Clayton?</p> <p>18 CHAIRMAN CLAYTON: Thank you, Ed, and welcome,</p> <p>19 everyone, to today's meeting of the Commission's Asset</p> <p>20 Management Advisory Committee or, as we call it, the</p> <p>21 AMAC, including -- joining us virtually or listening to</p> <p>22 the meeting through the Commission's website. I'm very</p> <p>23 glad that the important work of the committee and, more</p> <p>24 broadly, the Commission has been able to continue</p> <p>25 virtually uninterrupted as we remain in our telework</p>	<p style="text-align: right;">Page 8</p> <p>1 panelists and others presenting during today's meeting</p> <p>2 for your time and your willingness to share your</p> <p>3 insights with the committee and with the Commission.</p> <p>4 Today's agenda is full and reflects both the</p> <p>5 breadth of the Asset Management Advisory Committee's</p> <p>6 work and the depth of analysis that your structure</p> <p>7 allows. To that end, I look forward to presentations</p> <p>8 from two subcommittees, the ESG Subcommittee and the</p> <p>9 Private Investments Subcommittee. I understand that</p> <p>10 both subcommittees continue to make progress on the</p> <p>11 respective workstreams and will be able to provide</p> <p>12 updates to help inform the AMAC.</p> <p>13 In addition, I welcome today's discussion on</p> <p>14 the impact of COVID-19 within the asset management</p> <p>15 industry, which is a follow-up to the conversation the</p> <p>16 committee began in May. Today's discussion should</p> <p>17 provide additional insight into these impacts with a</p> <p>18 particular focus on exchange-traded products and the</p> <p>19 industry's operations. The Commission and staff</p> <p>20 continue to monitor the effects of COVID-19 on our</p> <p>21 markets, including through our market monitoring group</p> <p>22 and our ongoing outreach to market participants.</p> <p>23 And I appreciate the opportunity for</p> <p>24 additional feedback that this discussion will provide.</p> <p>25 I assure you that we are listening and we are adjusting</p>
<p style="text-align: right;">Page 7</p> <p>1 posture. I'm very pleased to be joined today by several</p> <p>2 of my fellow commissioners. And Ed, as you mentioned,</p> <p>3 I'd like to welcome Commissioner Crenshaw, who is</p> <p>4 attending her first AMAC meeting as a commissioner.</p> <p>5 Many of you likely worked with Commissioner</p> <p>6 Crenshaw during her career here at the SEC.</p> <p>7 Commissioners Peirce and Roisman, as Ed noted, are also</p> <p>8 joining as well. Before I discuss today's agenda, a</p> <p>9 number of thank yous are appropriate, first, everyone</p> <p>10 who has worked hard to make today's meeting productive</p> <p>11 and insightful. Thank you to the members of the</p> <p>12 committee, including Ed, for your continued leadership.</p> <p>13 It's greatly appreciated, Ed.</p> <p>14 Thank you also to the committee members</p> <p>15 serving as today's panel moderators. And I'm proud to</p> <p>16 say I know both of them very well, Erik Sirri and</p> <p>17 Gilbert Garcia. Thank you to the Commission staff who</p> <p>18 have helped with today's meeting, including Director</p> <p>19 Dalia Blass and her staff and to all of the staff in our</p> <p>20 office of minority and women inclusion, including Robert</p> <p>21 Marchman, our senior adviser for diversity and</p> <p>22 inclusion. Robert, you're just doing a terrific job.</p> <p>23 Thanks as always to the staff in the Office of</p> <p>24 Information Technology and the Office of the Secretary</p> <p>25 for your assistance. And thank you especially to the</p>	<p style="text-align: right;">Page 9</p> <p>1 in light of your experiences. They greatly help us.</p> <p>2 Turning to today's panelists, I look forward to the</p> <p>3 panelists' presentation regarding private investment</p> <p>4 returns.</p> <p>5 I've spoken on numerous occasions about my</p> <p>6 interest in promoting access and choice for Main Street</p> <p>7 investors, including ways we might increase their access</p> <p>8 to private markets while we ensure appropriate investor</p> <p>9 protections. As part of this, we should examine whether</p> <p>10 appropriately-structured funds can facilitate greater</p> <p>11 Main Street investor access to private investments,</p> <p>12 particularly as a component of an investor portfolio</p> <p>13 that is analogous to the portfolio of a well-managed</p> <p>14 pension fund.</p> <p>15 We should make sure to focus on fees and</p> <p>16 investor protections. As I've said previously, one of</p> <p>17 the greatest things about our public markets is that</p> <p>18 they allow our Main Street investors to invest side by</p> <p>19 side with sophisticated and institutional investors in</p> <p>20 the same companies. I believe a similar result can be</p> <p>21 achieved through appropriately-structured funds.</p> <p>22 The input from today's panelists will no doubt</p> <p>23 provide useful information for our efforts. I also</p> <p>24 welcome your continued discussions on improving</p> <p>25 diversity and inclusion in the asset management</p>

<p style="text-align: right;">Page 10</p> <p>1 industry. The discussions held at your July meeting on  2 this topic provided a stark, honest and very helpful  3 analysis of the current state of diversity and inclusion  4 in the asset management industry, including  5 opportunities for diverse asset managers.  6 That meeting clarified further that there is  7 significant support for our shared goal of expanding  8 those opportunities and sustained interest in helping us  9 determine how best we can achieve it. I'm hopeful that  10 today's panelists will help to further consideration of  11 this issue with an eye towards some of the best  12 practices observed by consultants and professionally  13 managed pension funds.  14 Thank you again to all of today's participants  15 and attendees. The range of experience and perspectives  16 that the Commission receives from the AMAC and our other  17 advisory committees truly improves our regulatory  18 decisions and enables us to benefit the investors and  19 the markets that we serve. Thank you, Ed.  20 MR. BERNARD: Thank you, Commissioner Clayton  21 or Chairman Clayton. Forgive me.  22 Commissioner Peirce?  23 COMMISSIONER PEIRCE: Thank you, Ed, and  24 thanks to the members of the committee and to all of  25 today's panelists. I'm looking forward to the</p>	<p style="text-align: right;">Page 12</p> <p>1 good morning, everyone. I'm happy to attend the second  2 virtual meeting of our AMAC. Thanks as always to Ed for  3 his excellent leadership, to the Commission staff for  4 your hard work in preparing for this meeting and to all  5 of you on the committee for sharing your valuable time  6 in what I'm sure will be your thoughtful questions and  7 commentary. The committee spent its first six months  8 exploring a variety of timely topics.  9 I'm happy to see the committee now turning  10 back to focus more on some of these same topics, retail  11 access to private market investments, ESG, diversity and  12 inclusion in the asset management industry and the  13 effects of COVID-19. I look forward to the update this  14 morning from the ESG Subcommittee. I've spoken publicly  15 on the topic of ESG disclosure, noting my views that  16 investors should be provided clear information about  17 asset managers' goals and assumptions in order to  18 understand the variety of ESG investment products that  19 are available.  20 I applaud the private sector's efforts to  21 bring clarity and consistency to this area. Such  22 efforts will be helpful to the asset management industry  23 as well as to the Commission whose staff reviews  24 advisors' product disclosure and ultimately to the  25 investors who purchase those investments.</p>
<p style="text-align: right;">Page 11</p> <p>1 discussions. Just a couple comments on the diversity  2 and inclusion panel. I think one thing we should think  3 about is the role that regulation may play in excluding  4 certain people from participating in this industry. I  5 think we -- we heard about that at the Small Business  6 Capital Formation Advisory Committee, where -- where the  7 accredited investor threshold was cited as something  8 that has kept people from participating in those  9 markets.  10 And I think traditionally we've seen  11 regulation can be a way to keep people out and to keep  12 - to protect incumbents and to keep new entrants out.  13 So maybe we can think about the role that regulation  14 plays. And then second, I know you all have a very busy  15 agenda, but I'd like to add another potential item for  16 consideration which is prompted by last month's  17 withdrawal of the Boulder no-action letter.  18 It would be interesting to hear from all of  19 you what you think the implications of that will be for  20 closed-end funds. And so I would -- I would love to  21 hear that discussion at some point. Thank you. And I  22 hope that you all have a wonderful day.  23 MR. BERNARD: Thank you, Commissioner Peirce.  24 Commissioner Roisman?  25 COMMISSIONER ROISMAN: Thank you, Ed. And</p>	<p style="text-align: right;">Page 13</p> <p>1 Moving on from ESG, I also am looking forward  2 to today's panels and would like to thank each of our  3 moderators and panelists who bring extensive expertise  4 in these areas. The first panel on private investment  5 returns addresses a topic integral to the question of  6 whether and how retail investors should be able to  7 access the private market.  8 As for the second panel, I commend the  9 committee for circling back to the topic of improving  10 diversity and inclusion in the asset management  11 industry. I learned from and valued the prior meeting's  12 discussions and look forward to hearing more today,  13 particularly from our panelists.  14 Finally, thank you to this committee for  15 following up on the discussion about COVID-19. I think  16 we and many others will spend months, if not years,  17 studying the effects of this pandemic on our markets. I  18 appreciate all of you pressing forward with this  19 endeavor while our memories and data sets are fresh.  20 I will conclude by thanking you all again for  21 undertaking such complex and challenging issues. I'll  22 be actively listening to your insights and would be  23 interested in engaging with you to glean policy ideas in  24 all of these areas. Thank you again, and I hope you  25 also have a great rest of the day.</p>

<p style="text-align: right;">Page 14</p> <p>1 MR. BERNARD: Thank you very much,  2 Commissioner Roisman.  3 Commissioner Crenshaw?  4 COMMISSIONER CRENSHAW: Good morning and thank  5 you, Ed. And thank you to Chairman Clayton for the very  6 warm welcome. It's great to be at my first Asset  7 Management Advisory Committee Meeting. I met Ed briefly  8 last year when I was working for Commissioner Jackson.  9 And some of you I know from other work that I've done in  10 the past at the Commission. For the rest of you, I look  11 forward to meeting you perhaps in person one day.  12 In the meantime, thank you for your time and  13 your thoughtfulness. And I'm eager to hear your views  14 in the challenging areas that you are undertaking today  15 and moving forward. Specifically today, I look forward  16 to hearing from the ESG subcommittee. As you all know,  17 the CFTC released the management climate risk in the  18 U.S. financial system report last week.  19 Among other things, the report noted that  20 climate change poses a major risk to the stability of  21 the U.S. financial system and to its ability to sustain  22 the American economy. The report also highlights how  23 climate risk disclosures offers a variety of potential  24 benefits to issuers, investors and society. Finally, it  25 makes clear that if regulators, including the SEC, don't</p>	<p style="text-align: right;">Page 16</p> <p>1 fighting a pandemic that is perpetuating income and  2 wealth inequality. I'm interested in hearing from you  3 on how the SEC can help the industry move forward. It's  4 great to be here. I look forward to the discussions and  5 thank you again.  6 MR. BERNARD: Thank you, Commissioner Crenshaw  7 and all commissioners. We're grateful for your  8 attendance and for your remarks. And now I'll turn to  9 the director of investment management, Dalia Blass, who  10 I think would like to share a few thoughts as well.  11 MS. BLASS: Thank you, Ed. Good morning and  12 welcome to this morning's meeting of the Asset  13 Management Advisory Committee. Before we get started,  14 let me remind you that I'm speaking today only for  15 myself and not for the Commission, the commissioners or  16 my colleagues on the staff. First, I would like to  17 thank the chairman and commissioners for your  18 participation today. In particular, I would like to  19 extend a warm welcome to our new commissioner, Caroline  20 Crenshaw.  21 Commissioner Crenshaw has a wealth of  22 experience at the Commission addressing issues related  23 to asset managers. And I really look forward to hearing  24 her views on the many important issues the AMAC is  25 considering. I would also like to add my thanks to Ed</p>
<p style="text-align: right;">Page 15</p> <p>1 move swiftly, risk will proliferate while investors will  2 lack the ability to properly account for those risks in  3 their investing decisions.  4 So I'm interested in hearing from you, the  5 committee, on how the SEC should respond. I'm also  6 looking forward to the private investment subcommittee  7 panel. Many have suggested that private markets offer  8 higher returns and diversification benefits that public  9 markets do not provide. I'm interested in hearing the  10 evidence to support this perspective. And I'm also  11 interested in hearing whether we have sufficient data to  12 assess this fully.  13 I also understand there will be a panel  14 discussion on improving diversity and inclusion in the  15 securities markets. Diverse perspectives in both  16 government and the private sector are crucial. These  17 views improve our understanding of issues and ultimately  18 lead to better decision-making and outcomes.  19 To me, having diverse perspectives doesn't  20 just mean having people with different opinions. It  21 means having people with different experiences and  22 different backgrounds. While we've made progress on  23 this front, there is much more we need to do. That has  24 been made clear in recent months as our nation is  25 grappling with how to address structural racism and</p>	<p style="text-align: right;">Page 17</p> <p>1 Bernard for his leadership and all of the subcommittee  2 leaders, committee members and panelists for their  3 contributions.  4 I appreciate the tremendous amount of work and  5 engagement that each of you has provided to move the  6 committee's discussions forward, particularly during  7 these unprecedented times as we juggle professional and  8 personal commitments in telework postures. According to  9 today's agenda, the AMAC is considering discussions  10 about several important topics. The first two panels  11 will provide updates on the work of the ESG subcommittee  12 and the private investment subcommittee.  13 In the afternoon, we will hear from a panel of  14 market participants and their views on improving  15 diversity and inclusion in the asset management  16 industry. We will close with a follow-up discussion  17 about the market impact of COVID-19, particularly on  18 exchange-traded funds and operations.  19 Ed, before I turn it back to you, I would like  20 to thank Christian Broadbent, Sirimal Mukerjee, Angela  21 Mokodean and other division staff who have worked truly  22 tirelessly to support the committee and the  23 subcommittee's works. I also would like to thank the  24 division's Managing Executive Office and the  25 Commission's Office of Information Technology for yet</p>

<p style="text-align: right;">Page 18</p> <p>1 again enabling us to meet virtually today. With that,  2 Ed, I turn it back to you. And I look forward to this  3 morning's discussions.</p> <p>4 MR. BERNARD: Great. Thank you very much. So  5 one quick AMAC update before I turn to today's agenda.  6 Since our July meeting, Diversity and Inclusion in Asset  7 Management has been formally made a subcommittee. And  8 I'm delighted to note that AMAC Members Scott Draeger  9 and Paul Greff have joined in this work with Gilbert  10 Garcia, who has been leading it since the outset.</p> <p>11 Turning to today's agenda, I'll let each panel  12 leader introduce the session. And Director Blass just  13 gave us a sense of what's coming. For now, I just  14 wanted to offer a couple of observations. And I'll sort  15 of break the sessions into two groupings, if you will.</p> <p>16 Our first three sessions are going to -- are  17 part of the ongoing subcommittee work, as you just  18 heard. The ESG subcommittee will provide an update on  19 their work seeking your input. And private investments  20 and diversity and inclusion teams will each present  21 panels with outside speakers to bring more insight into  22 their work from outside voices. In all three cases, I  23 think you'll see the efforts of each group to ensure we  24 hear a range of viewpoints as part of our work. They  25 are not yet at the point of making specific</p>	<p style="text-align: right;">Page 20</p> <p>1 this fall to consider those. At the end of the day, as  2 become our practice, we'll seek initial reactions and  3 input from the committee with quick remarks around the  4 table in our now well-established lightning round.</p> <p>5 So with that, if you'll forgive me, I'm going  6 to refresh everyone on some quick housekeeping, and then  7 we'll get underway. We're actually doing great on time.  8 Please scroll around your screen and make sure you know  9 where your audio and video buttons are as well as how to  10 access the chat function. And remember to send chat  11 functions privately to the individual you intend.</p> <p>12 And speaking of that, if you run into  13 technical problems, please send a private chat to Gabe  14 Collins or Veronica Davis, who will be available for the  15 duration of today's meeting. We'll each manage our own  16 status. So when you're not speaking, please ensure  17 you're muted. And when you're ready to speak, don't  18 forget to unmute. We've all been doing this quite a bit  19 in the last few months.</p> <p>20 My hope is you'll keep your video on so we  21 have a sense of our collective presence unless you're  22 interrupted or need to step away from your screen. We  23 will identify question-and-answer breaks as we proceed.  24 In past meetings, it seems to work fine for folks to  25 simply unmute and speak to raise comments or questions</p>
<p style="text-align: right;">Page 19</p> <p>1 recommendations.</p> <p>2 And I hope you'll engage in those discussions  3 in the spirit of fully exploring each respective topic.  4 By contrast, our two shorter sessions this afternoon  5 will be more focused on getting to recommendations  6 growing out of our special focus on COVID-19-related  7 issues in our May meeting.</p> <p>8 Ryan Ludt led the exchange-traded products  9 panel at the May meeting and agreed to continue leading  10 that workstream. In that session, Ryan will provide a  11 quick introduction, incorporating input he's received  12 already from the committee and open up to any questions  13 and comments. We'll test for support to see if we're  14 ready to vote on a formal approval to submit those  15 recommendations or if we believe there are revision --  16 any revisions.</p> <p>17 After that, Mike Durbin will lead a discussion  18 of issues his panel's team recommends be prioritized for  19 possible recommendations relating to operational issues  20 that were highlighted by the impacts of the COVID  21 crisis. We don't plan to seek a vote on this material  22 today. Rather, Mike's objective is to get input from  23 the committee in order to move quickly to a draft memo  24 recommendations for consideration. And I anticipate  25 scheduling a very brief meeting for the committee later</p>	<p style="text-align: right;">Page 21</p> <p>1 or raise your hand the old-fashioned way so we -- in an  2 analog fashion so we can see it.</p> <p>3 Since an SEC tech support professional is the  4 host, others can't see if you use the raise hand flag in  5 the Webex functionality. So with that, I'll take a  6 pause to see if I see any hands raised. Let me go to  7 tile view. I don't see any evidence of questions.</p> <p>8 So Michelle, thanks again for your leadership,  9 and I'll turn it over to you for our first discussion.</p> <p>10 UPDATE FROM THE ESG SUBCOMMITTEE</p> <p>11 MS. BECK: Thank you so much, Ed. And let me  12 share this -- the materials we prepared. Hopefully  13 that's coming up on the screen. One second. Of course  14 I'm getting a little bit of freezing going on so just a  15 moment. Here we go. Are you able to see my screen?</p> <p>16 MR. BERNARD: Yes.</p> <p>17 MS. BECK: Terrific. Well, thank you,  18 everybody. So we are back to update you on our progress  19 since the last time we met. So let me take us to the  20 first page. So you may recall we had five workstreams  21 of the different folks that will be speaking today,  22 we'll be speaking to. So we have Aye So, Jane Carten,  23 Jeff Ptak. And Rich Hall had been in touch earlier this  24 morning. I'm not seeing him on the screen right now.  25 So we may not have him in attendance. Rich, if you are,</p>

<p style="text-align: right;">Page 22</p> <p>1 please do speak up. And if not, we'll just be -- we'll</p> <p>2 lightly cover his materials because he did some very</p> <p>3 thoughtful materials. So those are the five that we're</p> <p>4 going to update you on.</p> <p>5 For three of them, we're going to explore a</p> <p>6 range of potential actions. And I want to explain that</p> <p>7 a little bit more. So we'll have some things on the</p> <p>8 page that are not our recommendations. And it's a</p> <p>9 little bit of a risky thing to do to put that on a -- to</p> <p>10 put some of these items on a page that may not actually</p> <p>11 be things that we plan to recommend to this committee.</p> <p>12 We wanted it to stimulate discussion and to</p> <p>13 get more information from you as a committee because</p> <p>14 seeing those on the page, we can, you know, take the</p> <p>15 pulse of the room, and folks can give us more</p> <p>16 information. Some of the great feedback you gave us</p> <p>17 after the last committee meeting gave us some direction</p> <p>18 on some of those items. But I just want to pause and</p> <p>19 make sure that nobody listening thinks that they're on</p> <p>20 the page because we are recommending them. It's not the</p> <p>21 case. We just want to explore the pros and cons of them</p> <p>22 with this group before making our final recommendations</p> <p>23 in December.</p> <p>24 So the five work streams that we have split</p> <p>25 out in a couple ways. You know, we put up at the top</p>	<p style="text-align: right;">Page 24</p> <p>1 And finally, at the bottom, we have issuer disclosures.</p> <p>2 So disclosure by the issue is the securities</p> <p>3 that are purchased by these funds. It helps to support</p> <p>4 both pieces of the equation to give the truth in</p> <p>5 labeling piece of are the actions being taken that are</p> <p>6 consistent with whatever values the investor has in the</p> <p>7 fund and also to help measure whether or not they're</p> <p>8 contributing appropriately to performance.</p> <p>9 So that was how we saw the workstream as</p> <p>10 fitting together. So I mentioned earlier we explore a</p> <p>11 spectrum of potential recommendations, everything from</p> <p>12 do absolutely nothing to extreme intervention. And</p> <p>13 again, please don't take these as recommendations.</p> <p>14 We're just exploring the pros and cons. They are straw</p> <p>15 men to gather your feedback.</p> <p>16 And December is when we plan to come back with</p> <p>17 actual recommendations. Only three of the workstreams</p> <p>18 really required this approach because -- and they're the</p> <p>19 ones that we plan to continue to coming back -- come</p> <p>20 back to within December. So the first workstream was</p> <p>21 the one that explores values versus value. And Rich</p> <p>22 Hall has done some very thoughtful materials here. So</p> <p>23 again, I'm just going to do a callout for Rich. Have</p> <p>24 you been able to join the call yet? If not, I'll</p> <p>25 wavetop his materials. And then we'll move on to the</p>
<p style="text-align: right;">Page 23</p> <p>1 there values versus value. Is ESG -- and also, by the</p> <p>2 way, not just environmental, social and governance funds</p> <p>3 but also sustainable funds and the impact funds. We are</p> <p>4 addressing the whole cohort.</p> <p>5 Is it about values, or is it about value? In</p> <p>6 the last meeting, Commissioner Lee pointed out it</p> <p>7 doesn't have to be an either/or. And that's absolutely</p> <p>8 the case. So you'll see that we can approach them as an</p> <p>9 "and." You can -- there are investors that are going to</p> <p>10 want to make sure that these funds are delivering</p> <p>11 according to their values, and there are investors that</p> <p>12 are going to be wanting to ensure that they deliver</p> <p>13 according to value.</p> <p>14 And so I note that some of our workstreams</p> <p>15 fall under one category more than the other. So we'll</p> <p>16 be talking about ESG ratings and truth in labeling in</p> <p>17 funds. And that really can help underscore whether or</p> <p>18 not the contents of the fund deliver what the investor</p> <p>19 expects, which is a little bit more along the lines of</p> <p>20 values. We'll be exploring should there be any action</p> <p>21 taken about proxy voting in funds to ensure, again, that</p> <p>22 they are voting according to their values. On the</p> <p>23 right-hand side, we'll be exploring performance</p> <p>24 measurement as a way of truly getting at is the fund</p> <p>25 actually providing value as expected or as described.</p>	<p style="text-align: right;">Page 25</p> <p>1 next section on performance. So firstly, Rich</p> <p>2 considered how ESG should be traded within the context</p> <p>3 of the Names Rule. We know that the Commission already</p> <p>4 received commentary on this topic. So we weren't</p> <p>5 planning to do much more with it.</p> <p>6 But he -- he did some thoughtful content about</p> <p>7 the approach that he thought should be used for the</p> <p>8 Names Rule. If ESG is mostly about values, you want to</p> <p>9 make sure that disclosure is the topic of discussion,</p> <p>10 making sure disclosure features the ability to express</p> <p>11 those values. And ESG's value, it's about financial</p> <p>12 metrics and how should performance be disclosed and</p> <p>13 managed. So I'll pause there.</p> <p>14 It sounds like we have some noise on the line.</p> <p>15 Okay. So I'll move past the Names Rule content, rather</p> <p>16 than taking the time on that. We also have an appendix</p> <p>17 in which Rich put together some answers for some of the</p> <p>18 specific questions asked earlier in the year by the SEC</p> <p>19 about how the Names Rule should treat ESG funds.</p> <p>20 I'll just note that the disclosure questions</p> <p>21 that Rich raises are something that will come up a</p> <p>22 little bit later in the presentation as well. So the</p> <p>23 thought process here is how should you avoid being</p> <p>24 deceptive. If the investor is trying to make sure fund</p> <p>25 expresses its values. So the -- we'll pick up the</p>

<p style="text-align: right;">Page 26</p> <p>1 disclosure item in -- under the rating systems slides in 2 just a few more.</p> <p>3 With the financial metrics, this is the topic 4 we're going to be turning next to with Aye Soe. So if 5 ESG factors lead to superior financial returns, how 6 would you show it? And, you know, which are the 7 different styles of investment, and how easy are they to 8 elaborate on the performance of? So with -- I'm going 9 to move next to Aye Soe. So Aye, I'm going to take you 10 to the slides on performance so you can build on that 11 last slide.</p> <p>12 MS. SOE: Thank you, Michelle. And I really 13 want to thank Michelle and Ed, also the division staff 14 for really helping the discussion topics, you know, 15 helping us guide in our thinking process and providing 16 helpful material. So in terms of performance 17 measurement, you know, this subsection is to think 18 through what are the risk and returns drivers of ESG 19 funds or ESG strategies. And what is the best way to 20 measure whether the strategies, the financial outcomes 21 of the strategies are aligning with the fund's 22 objectives? So really overlaps a bit heavily with the 23 prior sections of values versus value or values and 24 value.</p> <p>25 Since the meeting in May, we got a lot of very</p>	<p style="text-align: right;">Page 28</p> <p>1 for us to understand. What is driving the performance 2 of ESG funds during COVID-19 crisis?</p> <p>3 So moving on to the next page, there is a lot 4 of -- as I mentioned earlier, there is a lot of 5 literature that's come out about ESG funds and the 6 performance. But I want to really highlight, Michelle, 7 the previous page. Yeah. But I want to highlight one 8 research because it touches upon ESG performance during 9 COVID-19 crisis. As I mentioned, COVID-19 selloff, you 10 know, the ESG funds were better than the broad market 11 index. As such, you know, there were claims that 12 companies with high ESG scores were immunized against 13 the pandemic.</p> <p>14 There is an academic paper that came out just 15 a few weeks ago by a group of academics from University 16 of Waterloo as well as NYU. So it's a consortium of 17 academics that look at the performance of ESG funds 18 specifically. And they control for variables such as 19 industry. That's very important because we saw energy 20 declining substantially but tech, you know, appreciating 21 at a rapid pace so controlling for variables such as 22 industry, liquidity, accounting managers and intangible 23 assets. What they found was that ESG is not 24 significantly associated with market returns during the 25 COVID-19 crisis.</p>
<p style="text-align: right;">Page 27</p> <p>1 good feedback. So our efforts have been, you know -- 2 and our efforts have been on understanding the research 3 that are coming out at a rapid pace on ESG strategies 4 and the performance. And in particular, we aim to 5 understand two things. Once is the performance of ESG 6 strategies during COVID-19 crisis. And the second is 7 the impact of ESG individually and also collectively on 8 portfolio returns and risk.</p> <p>9 And I remember Chairman Clayton mentioning 10 that in a previous -- in our May session, you know. 11 It's unclear as to how ESG are affecting portfolio 12 returns individually, and collectively do they make 13 sense, the combining. So we really want to dive deeper 14 into that. And I bring up the -- we bring up the 15 performance of ESG strategies during COVID-19 crisis 16 because, as we all understand, since March, the 17 performance of ESG funds have been much better than the 18 broad market. There has been a lot of, you know, 19 literature or not literature but in financial media 20 articles even calling -- as far as calling ESG a equity 21 vaccine.</p> <p>22 And needless to say, you know, because of the 23 performance, flows have followed. So ESG has been 24 possibly the one investment style that has gathered the 25 most assets in the last six months. So it's something</p>	<p style="text-align: right;">Page 29</p> <p>1 However, what ESG returns -- I'm sorry -- the 2 COVID-19 crisis returns are positively associated, 3 companies, those with intangible assets, companies with 4 heavy R&amp;D, heavy tech presence. You know, they were 5 richly rewarded in the last six months. That's not 6 surprising. I was just reading last night. When you 7 look at Apple -- and its market capitalization is larger 8 than the FTSE 100.</p> <p>9 And so, you know, companies with huge 10 intangible assets are richly rewarded in the last six 11 months of COVID-19 crisis. Innovation-related assets -- 12 so companies with innovation-related assets, rather than 13 those that are spending on social capital, they would -- 14 they perform better than, you know, companies that don't 15 during this COVID-19-related market drawdown.</p> <p>16 So what the article is drawing attention to is 17 oftentimes, you know, is it high ESG companies that are 18 doing well during COVID-19 crisis or companies that 19 happen to have high ESG scores but they -- instead -- 20 but they are also investing heavily in intangible assets 21 and R&amp;D spending and innovation-driven are the ones that 22 are doing better during the COVID-19 crisis. So I -- we 23 bring that up as something that, during the workstream, 24 we are heavily talking through this sort of correlation 25 versus causation issues.</p>



<p style="text-align: right;">Page 30</p> <p>1 Moving onto the next slide, we also -- the</p> <p>2 workstream wanted to understand, you know, does bundling</p> <p>3 of ESG together make sense at all, and how do they</p> <p>4 affect securities' performance as well as on the</p> <p>5 portfolio level. How do they drive the risk and return.</p> <p>6 To that point, I bring up the research published by</p> <p>7 MSCI on how they -- on deconstructing ESG rating</p> <p>8 performance and how do they impact portfolio return over</p> <p>9 various time horizon.</p> <p>10 And we want to understand, you know, should</p> <p>11 they be combined differently. And most importantly, is</p> <p>12 the sum of the parts greater than the whole or vice</p> <p>13 versa? To that sense, you know, the research split the</p> <p>14 companies with high ESG scores and grouped them,</p> <p>15 companies with ESG scores into high ESG score and then</p> <p>16 the low ESG scores. And they find that companies with</p> <p>17 high ESG score and high ESG scores outperform those</p> <p>18 with lower ESG scores.</p> <p>19 The one thing I'd like to point out is that,</p> <p>20 you know, highest ranked ESG -- high ESG-ranked</p> <p>21 portfolio outperform more than high G-ranked portfolio,</p> <p>22 which, in turn, outperform high S-ranked portfolio,</p> <p>23 which, in turn, outperform high E-ranked portfolio.</p> <p>24 So there is an order to which, you know, these</p> <p>25 performance are taking place. So what the research</p>	<p style="text-align: right;">Page 32</p> <p>1 values to see if they are being aligned or not.</p> <p>2 And we can see those -- we can decompose the</p> <p>3 sources of return and see what kind of bets from</p> <p>4 securities selection to allocation decisions. However,</p> <p>5 ESG does not have such attribution system for investors</p> <p>6 to clearly see and provide transparency into, you know,</p> <p>7 whether the performance is really driving from ESG or</p> <p>8 not.</p> <p>9 If you -- we look at a survey by Moody's,</p> <p>10 which shows that 71 percent of portfolio managers are</p> <p>11 unable to view performance attribution of ESG factors.</p> <p>12 Only 15 percent have visibility of ESG factors. And</p> <p>13 then another additional 15 percent say they can view ESG</p> <p>14 factors but on limited basis.</p> <p>15 So in order for end investors to clearly</p> <p>16 understand investment outcomes from ESG investing, there</p> <p>17 is a need for performance attribution mechanism. You</p> <p>18 know, for example, understanding do the returns come</p> <p>19 from E if this is a climate change fund or if it's an</p> <p>20 overall ESG fund, do returns come from ESG altogether.</p> <p>21 At the moment, we don't have such system in the market.</p> <p>22 I like to point that out. So as Michelle alluded to</p> <p>23 earlier, you know, we are exploring this framework of do</p> <p>24 nothing and then to strong intervention model.</p> <p>25 But in order for this performance measurement</p>
<p style="text-align: right;">Page 31</p> <p>1 points out is that the whole can be greater than the sum</p> <p>2 of the parts. But you can see ESG is a topic in which</p> <p>3 we have conflicting research views. Even among</p> <p>4 ourselves, we can have different viewpoints because it's</p> <p>5 an emerging topic with, you know, differing point of</p> <p>6 view that provides a rich area for debate.</p> <p>7 Moving on to the next slide, I hope to -- oh,</p> <p>8 I'd like -- I'm having a bit of a background, yes, if we</p> <p>9 can mute. Thank you. So this is the topic that, you</p> <p>10 know, our sub-workstream spent quite a bit of time</p> <p>11 debating and talking and going back and forth, looking</p> <p>12 at -- we pointed out those two differing research</p> <p>13 because in a field such as ESG, you can have opposing</p> <p>14 point of view when it comes to performance of ESG.</p> <p>15 So we talk at length about should ESG funds</p> <p>16 require additional performance disclosure. When we</p> <p>17 think about traditional investment style such as growth</p> <p>18 and value, you know, or a manager or fund that is in</p> <p>19 large-cap value, to catch a style drift such as, you</p> <p>20 know, if you are in mid-cap and you are buying --</p> <p>21 securities, there are commercially-available third-party</p> <p>22 returns-based as well as holdings-based performance</p> <p>23 attribution systems that can decompose the sources of</p> <p>24 return and see what bets the fund is taking. That's</p> <p>25 mentioned earlier in a prior panel about values versus</p>	<p style="text-align: right;">Page 33</p> <p>1 sub-workstream to start at -- what that entails, we look</p> <p>2 at the existing SEC performance disclosure, our</p> <p>3 requirement for register funds as the baseline. We look</p> <p>4 at the -- what are the requirements for investment</p> <p>5 objectives and goals. We look at risk return summary,</p> <p>6 you know, the requirements on, you know, disclaimer as</p> <p>7 to how the fund intends to achieve its investment</p> <p>8 objectives, narrative risk disclosure, risk return --</p> <p>9 the requirement to benchmark against broad market index.</p> <p>10 So we use that as our starting point to form our</p> <p>11 discussion.</p> <p>12 Moving on to the next slide, so this is the --</p> <p>13 this is the framework, the overarching framework and of</p> <p>14 which we are basing our -- we will be basing our</p> <p>15 recommendations in December from. So -- and to do</p> <p>16 nothing, which is, you know, little or no change to</p> <p>17 existing disclosure, which is in line with the current</p> <p>18 requirement for SEC performance reporting. There are</p> <p>19 pros and cons, as always; right?</p> <p>20 On the pros side, it's low-cost for managers.</p> <p>21 There is no additional due burden. ESG is treated in</p> <p>22 the same vein as other investment strategies. And that</p> <p>23 could allow for innovation to take place in what is a</p> <p>24 nascent field. So those are positives.</p> <p>25 However, on the difficult side, again, it</p>

<p style="text-align: right;">Page 34</p> <p>1 comes down to providing transparency to the end  2 investor. How do they assess performance impact of ESG  3 objectives? And, you know -- and a do-nothing framework  4 at the moment, that's not a -- that's not possible.</p> <p>5 As we move away from do-nothing, we get to  6 moderate intervention. That is to provide best practice  7 guidelines -- description of ESG performance objectives  8 and how that, you know, impacts, you know, the actual  9 fund performance. This is not mandated but it's  10 providing best practice guideline that -- the benefit of  11 that is there is potential for greater transparency in  12 value versus values, aligning that framework. However,  13 there -- the disadvantage of this model is that unless  14 mandated, compliance is voluntary.</p> <p>15 So you run the risk of a lot of the funds not  16 adhering to that. And if it's -- you know, and also  17 there is a lack of comparability if you just impose it  18 only on the ESG funds. Moving a bit further on the  19 moderate intervention, the second part, is to best  20 practice guidelines as well as mandate the use of  21 secondary style adjusted benchmark. So it will be a  22 broad market index as well as a ESG-style benchmark.  23 That could -- that will provide greater transparency on  24 value versus values, provide greater accountability and  25 comparability across all the ESG funds.</p>	<p style="text-align: right;">Page 36</p> <p>1 may need to unmute.</p> <p>2 We'll give it a moment because she may be  3 having some technical difficulties there. I have seen  4 her on the line. And also, we've been joined by Rich  5 Hall, and so he'll be bringing us up at the end of the  6 presentation to take us through some of his materials.</p> <p>7 I'll move on to the next piece and then come  8 back to proxy, Jane, and see if you're able to reach out  9 to Nick Bain to see what the AV issue is. So this  10 workstream was meant to provide recommendations for how  11 or whether to use third-party ESG rating systems.</p> <p>12 What we realized as we were going through  13 this, that it was a broader question that we were  14 asking, which is really how do you address truth in  15 labeling concerns for ESG or sustainable or impact funds  16 and avoid this concept of greenwashing where people  17 might put the name on their fund but not really  18 undertake the practices that are expected by investors.  19 So one of the questions we asked was do you -- would  20 third-party ESG rating systems make a difference in  21 that. But as we looked at this broader question, some  22 of the answers might not be about ESG rating systems but  23 might be about disclosure. So we considered a few  24 alternatives, again, along the lines of a spectrum so  25 reminding you that with little or no change to the</p>
<p style="text-align: right;">Page 35</p> <p>1 Again, unless mandated, in this case,  2 compliance is voluntary. And having a secondary  3 benchmark is quite burdensome for fund managers. And,  4 you know, so that increased burden is always something  5 that we're mindful of when we're discussing through  6 this. And at the end of the extreme spectrum, of  7 course, is strong intervention, which is to mandate the  8 performance attribution of ESG as well as ESG factors  9 such -- that will provide absolute transparency in terms  10 of, you know, understanding the value versus values.</p> <p>11 However, it's a -- it's possibly a --  12 something that the market probably is not ready for at  13 the moment. There is no consistent methodology, data  14 system infrastructure to do so. And it's significant  15 burden on ESG funds and may reduce incentives to develop  16 new strategies. So with that, this is the progress that  17 this sub-stream has done so far so -- and I'll leave it  18 back to Michelle. Thank you.</p> <p>19 MS. BECK: Thank you. And I expect there will  20 be questions coming up from the committee. And we will  21 be leaving 10 minutes at the end for questions. But if  22 you really just can't help yourself and have a question  23 that you need to shoot to us right now, please go ahead.  24 If not, I was going to take us next to the proxy voting  25 question and turn it over to Jane Carten. And Jane, you</p>	<p style="text-align: right;">Page 37</p> <p>1 current disclosure requirements for ESG funds has some  2 positives. It's definitely less expensive for managers.  3 It allows this burgeoning area to continue to flourish  4 and create new developments.</p> <p>5 And other funds out in the world that are not  6 ESG funds do not always have to provide empirical proof  7 for every claim they make that they might have a more  8 seasoned or knowledgeable manager that's more  9 insightful. So there are claims out there that don't  10 need to be proven why these. And the con, however, is  11 there is potential for misrepresentation to investors,  12 that there might be ESG in the name but no ESG in the  13 game.</p> <p>14 And it's difficult to distinguish between  15 strategies of varying quality in terms of how well  16 they're executing on their mandate. It doesn't really  17 provide an incentive for folks to raise the bar either.  18 So then we looked midway through the spectrum at  19 possible moderate intervention. And so this would be  20 best practice guidelines related to disclosure. And so  21 likely we'd be asking folks to explain in their  22 disclosure as a best practice guideline how do they  23 accomplish their ESG objectives.</p> <p>24 We also thought that the newly-recommended  25 taxonomy from the ICI, the Investment Company's</p>

<p style="text-align: right;">Page 38</p> <p>1 Institute, could be very helpful here. So they --</p> <p>2 they've got a -- you know, do you include? Do you</p> <p>3 exclude? Do you do a bit of both? Are you</p> <p>4 quantitative? Are you qualitative? So if we, in best</p> <p>5 practice guidelines, gave an idea of what language</p> <p>6 people could center on so it would be comparable, that</p> <p>7 form of language, we thought, was actually a good</p> <p>8 starting point.</p> <p>9 So enhancing disclosure on a voluntary basis</p> <p>10 is definitely relatively low-cost for managers. It does</p> <p>11 allow better comparability and consistency than the</p> <p>12 current state. It allows the field to continue to</p> <p>13 develop in new ways and allows for a variety of styles</p> <p>14 and doesn't lock into one particular style.</p> <p>15 But the voluntary nature might mean that funds</p> <p>16 still represent -- misrepresent what they're doing.</p> <p>17 And, you know, you get selective disclosure. And</p> <p>18 without mandated definitions, the comparability might be</p> <p>19 misleading. So then we go all the way to the end of the</p> <p>20 spectrum, again, not a recommendation. Just exploring</p> <p>21 this topic.</p> <p>22 What if we required funds claiming ESG to have</p> <p>23 a higher ESG score than their benchmark from a third</p> <p>24 party rating agency? And I put that as NSR -- NRSRO to</p> <p>25 make it comparable to the credit ratings. So these</p>	<p style="text-align: right;">Page 40</p> <p>1 approaches used by some of the vendors in the field</p> <p>2 currently differ markedly. They are very different</p> <p>3 styles and answering very different questions. So to</p> <p>4 bless one or the other of them would be to lock into a</p> <p>5 particular style when, like other forms of research,</p> <p>6 investors might prefer something different. So a little</p> <p>7 bit of a drilldown on this ICI taxonomy that I mentioned</p> <p>8 before.</p> <p>9 You know, the -- if we had a -- in the option</p> <p>10 that we just explored where you have voluntary type of</p> <p>11 disclosure enhancement, you would -- we'd be asking the</p> <p>12 funds to say how do they achieve their ESG strategy and</p> <p>13 particularly to use language around do they exclude</p> <p>14 securities, include securities or use a combined</p> <p>15 approach and whether their method is purely qualitative,</p> <p>16 whether it's quantitative and uses some kind of a</p> <p>17 scoring system, or whether it's some combination of</p> <p>18 both.</p> <p>19 Some of our discussion was that having a fund</p> <p>20 board approve that kind of disclosure might add extra</p> <p>21 quality control and extra rigor. And the ideal is to</p> <p>22 have statements about performance in shareholder</p> <p>23 reporting that attribute, in some way, to the investment</p> <p>24 process that's been laid out in the disclosure.</p> <p>25 On the right is just a note about the</p>
<p style="text-align: right;">Page 39</p> <p>1 would be ratings of ESG content. And it would be a</p> <p>2 consistent and measurable approach. It would derive -</p> <p>3 drive the definite kind of consistency and reliability</p> <p>4 from investors.</p> <p>5 It would be quicker to put in place than some</p> <p>6 of the other ideas we've also had about a more thorough</p> <p>7 go in disclosure of all the -- for all the issuers that</p> <p>8 are securities in the portfolio. So I'll pause there</p> <p>9 for a moment. Jeff Ptak will be picking up issuer</p> <p>10 disclosure. But the greater issuer disclosure is, the</p> <p>11 better the investor in an ESG fund could make their own</p> <p>12 score. They could, themselves, figure out the content</p> <p>13 of the fund. The stronger the disclosure is for the</p> <p>14 underlying securities. But it's certainly not fast to</p> <p>15 get full issuer disclosure in place. So it's quicker to</p> <p>16 put into place than that.</p> <p>17 And the cons we have, it could drive cost for</p> <p>18 -- higher. And then if you have a very small number of</p> <p>19 these rating agencies, it's going to limit development</p> <p>20 of the field. It's going to have a very particular lens</p> <p>21 on these funds and -- but if you have too many with</p> <p>22 many, many different styles, suddenly it becomes less</p> <p>23 meaningful. And it isn't really that great of an</p> <p>24 advance over the options to the left.</p> <p>25 And finally, we note that the rating</p>	<p style="text-align: right;">Page 41</p> <p>1 comparability of ESG rating entities. And the point of</p> <p>2 the chart is two different companies might rate the same</p> <p>3 security quite differently. So you'll see there is, you</p> <p>4 know, the range of whether one's good or bad under one</p> <p>5 rating company versus another varies quite a lot. And</p> <p>6 there is not a linear relationship between them. So</p> <p>7 those were my comments on ESG rating systems and the</p> <p>8 truth in labeling or disclosure. I'm going to pass back</p> <p>9 to see if Jane's audio is working. Well, it doesn't</p> <p>10 appear to be. I hear a sound.</p> <p>11 MR. BAIN: Michelle, stand by. We're still</p> <p>12 having trouble, issues with her audio.</p> <p>13 MS. BECK: Okay. What we'll do, then, is move</p> <p>14 on to the next thing that Jeff Ptak leads. And since we</p> <p>15 started the conversation, Rich Hall has been able to</p> <p>16 join so can take us home with the value versus values</p> <p>17 topic at the end. So let me move to Jeff and talk about</p> <p>18 disclosure by issuers.</p> <p>19 MR. PTAK: Thanks, Michelle. Good morning,</p> <p>20 everybody. Thanks for the opportunity to speak on my</p> <p>21 workstream, which is opportunities to improve the</p> <p>22 quality of ESG disclosure by issuers. And we had</p> <p>23 previewed the objective of this workstream I think a</p> <p>24 meeting or two ago.</p> <p>25 But simply put, the objective is to make</p>

<p style="text-align: right;">Page 42</p> <p>1 recommendations to the Commission concerning guidance it  2 should or could give corporate issuers or regulation it  3 could act for how those issuers disclose and present ESG  4 data and related information. Implicit in this work is  5 the concept of materiality. Essentially, what we're  6 saying here is that ESG issues are material. Therefore,  7 issuers should be able to obtain the information from  8 issuers. And that information should be comprehensive,  9 meaningful and comparable.</p> <p>10 And so in the next slide, we'll explore each  11 one of those three dimensions. Thanks, Michelle. So  12 when we think about the opportunity to improve the  13 quality of ESG disclosure, there are those three  14 dimensions I mentioned before, comprehensiveness,  15 meaningfulness and comparability. So let's sort of dive  16 into each one of those and, you know, what sort of  17 standard might be enshrined to uphold best practices in  18 each one of those areas.</p> <p>19 So let's start with comprehensiveness. You  20 could require disclosures and metrics that cover all  21 material ESG issues. So again, that concept of  22 materiality is front and center here. But when we're  23 going through and assessing the comprehensiveness of ESG  24 disclosures from issuers, then we -- we have to ask  25 ourselves whether all of the material ESG issues have</p>	<p style="text-align: right;">Page 44</p> <p>1 in the absence of a standard for comprehensiveness,  2 meaningfulness and comparability. And we are giving you  3 a few examples. This is an exhaustive list.</p> <p>4 But when we think about the comprehensiveness,  5 I would say that one of the real practical issues that  6 investors are facing when they're trying to get  7 information on -- ESG issues is that not every public  8 company is disclosing ESG risk. And that's even less so  9 for private companies.</p> <p>10 With respect to fixed income, disclosure can  11 be poor. And it can be issuer or lender-focused but not  12 both. And so it may not be stakeholder-universal in the  13 way the information is being presented. Again, that has  14 a bearing on the comprehensiveness of ESG disclosure  15 that's provided by issuers of those securities. Let's  16 turn to meaningfulness.</p> <p>17 One sort of important kind of point of  18 orientation is whether the disclosure, the information  19 that's provided, is backward-looking or forward-looking.  20 I think that what we find is that, you know, there tends  21 to be a focus on backward-looking, more retrospective  22 type of disclosure versus forward-looking disclosure,  23 which can be quite valuable in its own right.</p> <p>24 There can be voluminous metrics. But that can  25 challenge analysis. It's the kitchen sink approach. Or</p>
<p style="text-align: right;">Page 43</p> <p>1 been adequately disclosed in documents that those  2 issuers are filing. Meaningfulness. So require  3 disclosures and metrics that convey an issuer's exposure  4 to each material ESG issue that's been identified in  5 standards that acknowledge the dynamic nature of  6 materiality.</p> <p>7 You know, we have to acknowledge that  8 materiality can change given the state of a business or  9 other circumstances that surround a particular issuer's  10 business. And so that should be reflected in sort of  11 the dynamic nature of the way issuers are defining  12 materiality and the information that they are conveying  13 to users of their documents, investors.</p> <p>14 Comparability. Required disclosures and  15 metrics need to balance standardization to promote  16 comparison across industries with adequate specificity  17 to enhance comparability within industry. So that's the  18 third of the three dimensions, again, to make this a bit  19 more tangible and to form some organizing principles for  20 how one might define their approach to enhancing the  21 quality of ESG disclosure.</p> <p>22 Why don't we go ahead and we'll jump another  23 slide here? And we're going to examine each one of  24 these three dimensions and then some of the issues that  25 I think investors have been confronted with, you know,</p>	<p style="text-align: right;">Page 45</p> <p>1 it can make it difficult for investors to really home in  2 on what are the most material ESG issues that could have  3 a bearing on that issuer, therefore, the investor's  4 experience with that instrument.</p> <p>5 A lack of positive impact data. You might get  6 plenty of information on what it is a firm, an issuer,  7 is doing to mitigate negative impact, negative  8 consequences, less so about forward-looking positive  9 impact data. And then there is cherry-picking. You  10 know, oftentimes what investors will get -- I don't want  11 to say oftentimes. But too often what investors will  12 get is something that's more like a marketing -- than a  13 truly meaningful document that's at the level of the  14 disclosure that we've been accustomed to receiving from  15 issuers that's more financially-oriented.</p> <p>16 Let's turn to comparability, which is the  17 third of our three dimensions. And there is no shortage  18 of standard setters and different stakeholders that are  19 part of the process, all approaching this in a very  20 circumspect, studious way and putting their best foot  21 forward. But it does create challenges for investors  22 insofar as issuers are responding to multiple frameworks  23 and trying to reconcile between them. And so that can  24 detract a bit from comparability when, say, investors  25 are trying to compare one issuer to the next. Why don't</p>

<p style="text-align: right;">Page 46</p> <p>1 we go ahead and we'll jump to the next slide?</p> <p>2 Thanks, Michelle. So now we're going to talk</p> <p>3 about gaps in disclosure and the role regulation can</p> <p>4 play. And I would preface this by saying I think it's</p> <p>5 consistent with some of the comments that you've heard</p> <p>6 from our other subcommittee members and Michelle, you</p> <p>7 know, really sort of the way to receive this. This is</p> <p>8 information about potential direction of travel, of</p> <p>9 recommendations that we might make in this particular</p> <p>10 area.</p> <p>11 And when we thought a bit about where the gaps</p> <p>12 in the disclosure are and the role regulation could</p> <p>13 play, it really coalesces in a few areas, standard</p> <p>14 setting, disclosure framework, standardization and</p> <p>15 presentation. And so we have slides for each one of</p> <p>16 these. And I won't belabor any one of them, just in the</p> <p>17 interest of time.</p> <p>18 But why don't we jump to the first one, which</p> <p>19 is standard-setting. In here, there are various choices</p> <p>20 that -- that one would have as far as how do we go out</p> <p>21 and promulgate a set of standards that guide the way</p> <p>22 issuers provide information through disclosure to</p> <p>23 investors? One of the choices that you can make is to</p> <p>24 embrace third-party standard-setting organizations, ESG</p> <p>25 reporting metrics. You could make third-party standard</p>	<p style="text-align: right;">Page 48</p> <p>1 issuers. They have a certain universality. And then</p> <p>2 you supplement that with specific disclosures that are</p> <p>3 tailored to the business or the industry concerned. It</p> <p>4 seems like that sort of balanced approach could satisfy</p> <p>5 multiple stakeholder groups and also boasts consistency</p> <p>6 insofar as the core travels from one industry to the</p> <p>7 next.</p> <p>8 And then expand reporting requirements from</p> <p>9 the largest firms to nearly all companies. Though we do</p> <p>10 acknowledge that given the burdens, you know, and the</p> <p>11 fact that some firms are better-equipped than others to</p> <p>12 respond to different disclosure requirement frameworks,</p> <p>13 it could make sense to adopt a multi-tier approach</p> <p>14 that's adapted to smaller issuers who, again, may not be</p> <p>15 resourced to provide disclosure and other metrics at the</p> <p>16 same level as larger, better-resourced firms.</p> <p>17 Let's turn to the third issue,</p> <p>18 standardization. And so when we talk about</p> <p>19 standardizing, we're talking about industry-specific</p> <p>20 disclosures and environmental impacts, starting with</p> <p>21 climate change, forward-looking disclosures, backward</p> <p>22 looking measures, discussions of risk management and</p> <p>23 climate scenario analysis and then what we're thinking</p> <p>24 of as baseline ESG disclosures.</p> <p>25 But really what you want to make sure is that,</p>
<p style="text-align: right;">Page 47</p> <p>1 setters recommendations authoritative and binding.</p> <p>2 There is precedent for this, as we well know, when it</p> <p>3 comes to financial disclosure. That's GAAP.</p> <p>4 You can also hold third-party standard setters</p> <p>5 accountable for harmonizing existing standards. Again,</p> <p>6 there is a lot of thoughtful, very dogged work that's</p> <p>7 being done in this area. The challenge can become</p> <p>8 making sure that it works in harmony and so setting up a</p> <p>9 process or a framework by which harmonization takes</p> <p>10 place. This is a valuable role that standard setters</p> <p>11 can play in helping to ensure that disclosure</p> <p>12 information is as meaningful as possible and then, of</p> <p>13 course, encouraging collaboration among standard</p> <p>14 setters, which is probably the best way of all to ensure</p> <p>15 that there is uniformity in the way the different</p> <p>16 standard setters are approaching this area.</p> <p>17 Let's move to the next area, which is the</p> <p>18 disclosure framework, again. There are different</p> <p>19 choices that -- you know, that one faces, rules-based</p> <p>20 versus principles-based. What one could do is require a</p> <p>21 principles-based disclosure framework that focuses on</p> <p>22 material issue, you know, and establish a balanced</p> <p>23 approach to required disclosure, you know, sort of think</p> <p>24 of it as core and explore. There is a focused list of</p> <p>25 mandatory disclosures that are applicable to most</p>	<p style="text-align: right;">Page 49</p> <p>1 you know, you have sort of like the more important</p> <p>2 themes and categories consistent from issuer to issuer.</p> <p>3 And there are certain baseline metrics that are</p> <p>4 contained within the disclosures that facilitate in</p> <p>5 comparison across issuers. Let's turn to the fourth</p> <p>6 area. And that's presentation. And the notion here is</p> <p>7 that you make ESG disclosures look like other financial</p> <p>8 disclosures. What are some examples of that? The</p> <p>9 notion is that the data should be temporally aligned</p> <p>10 with financial disclosures.</p> <p>11 You should encourage integrated reporting. A</p> <p>12 single encompassing report, like an annual report, and</p> <p>13 it is machine-readable in a standard format with</p> <p>14 standard taxonomy. So in many ways, it becomes</p> <p>15 interchangeable with a financial disclosure that is</p> <p>16 well-established and that all of us are very familiar</p> <p>17 with.</p> <p>18 Let's go ahead, and we will jump to the next</p> <p>19 slide. And so this slide is probably familiar to you by</p> <p>20 now. You know, do nothing and strong intervention, they</p> <p>21 really bookend the potential recommendations that we</p> <p>22 could make for this workstream in our review, each of</p> <p>23 these. One reference point that I would remind</p> <p>24 everybody of and this is something that I might have</p> <p>25 mentioned when I reported out previously the Investor</p>

<p style="text-align: right;">Page 50</p> <p>1 as Owner Subcommittee of the SEC Investor Advisory  2 Committee presented a set of recommendations to the SEC  3 in May of this year. And so I would say that some of  4 the choices, the options that we are presenting here are  5 congruent with what you would have seen from the  6 Investor as Owner Subcommittee in that May 14, 2020  7 document. But I will go through each one of these  8 briefly so that you get a sense of what the potential  9 directions of travel could be depending on whether you  10 chose to do nothing, to moderately intervene, or to  11 intervene more heavily.</p> <p>12 So let's start with do nothing. And that is  13 largely status quo. You make minimal changes to the  14 current issue or disclosure requirements. The pros, the  15 benefits of that are there is obviously a low cost and  16 burden for issuers. It does facilitate a market-driven  17 response, where investors come to reward issuers who  18 uphold best-disclosure practices, and it encourages  19 others to follow those practices in the belief that  20 they, too, will be rewarded in the future.</p> <p>21 What are the tradeoffs, the cons? It doesn't  22 uphold best practices for comprehensive meaningful  23 comparable disclosure in the various ways we have  24 described. And it can impede development of a common  25 disclosure standard and framework, which results in</p>	<p style="text-align: right;">Page 52</p> <p>1 haven't coalesced around a third-party framework yet.  2 And it is a gradual patchwork approach, which might not  3 approach standardization and comparability in ways that  4 benefits users of disclosure.</p> <p>5 Finally, I will talk about strong  6 intervention, which is the right-most column. Under  7 this approach, you are codifying a comprehensive set of  8 disclosure rules through regulations and really  9 irrespective of materiality and issuer size. So,  10 basically, what you are saying is that there is one  11 standard. It is rules-driven. And it applies to every  12 issuer.</p> <p>13 What are the benefits of this? It certainly  14 doesn't suffer from ambiguity. It entrenches a clear,  15 comprehensive standard for disclosing ESG matters. It  16 also boasts authoritativeness, consistency, and obviates  17 the need for a patchwork approach that could take time  18 to implement and, arguably, courts the risk of  19 confusion.</p> <p>20 What are the cons, the tradeoffs? It fails to  21 acknowledge differences, any ESG issue materiality,  22 issuer size, and readiness. It puts a potentially heavy  23 burden on issuers to implement disclosure, and a rules-  24 based approach could detract from disclosure  25 meaningfulness insofar as it devolves into a set of</p>
<p style="text-align: right;">Page 51</p> <p>1 continued inefficiency. We are kind of just all over  2 the place. And you have issuers that are responding to  3 multiple frameworks and standards, and it is difficult  4 for them to be as efficient as they would want to be.</p> <p>5 Let's move over a column to "Moderate  6 Intervention." Under this approach and there is a  7 lot of different sort of do-nothing, moderate, strong  8 intervention approaches that one can take. In this, you  9 are encouraging and then you are mandating disclosure  10 per principles developed by third party standard  11 setters. And you are curing by materiality and issuer  12 size.</p> <p>13 What are the benefits of this approach? It  14 gives issuers some time to prepare for and adapt to  15 emerging disclosure frameworks. It taps a successful  16 model, Generally Accepted Accounting Principles,  17 promotes a common disclosure standard without being  18 overly prescriptive, and differentiates per materiality  19 and issuer size. So there is a certain amount of  20 tailoring and customization that you can do,  21 acknowledging that there is not the same state of  22 writing this across issuers as perhaps there would be  23 when it comes to financial disclosure that we are  24 accustomed to.</p> <p>25 What are the cons? Industry and regulators</p>	<p style="text-align: right;">Page 53</p> <p>1 boilerplate disclosures that may or may not be pertinent  2 to the issuer concerned or simply not be useful to an  3 investor that is trying to get a sense of what the  4 future could look like in terms of risks that would be  5 bearing down in that particular issue from an ESG  6 standpoint.</p> <p>7 So, hopefully, that gives you a picture of  8 what the different directions of travel could look like  9 under a do-nothing, moderate intervention, and strong  10 intervention approach. And, with that, I will go ahead  11 and turn things back to Michelle.</p> <p>12 MS. BECK: Terrific. So we apparently solved  13 all of our technical issues, and we are going to be  14 hearing first from Jane on the proxy-building issue. So  15 let me take us back to that slide. And then we will  16 finish it off with Rich, who won't appear on video but  17 will be here on audio.</p> <p>18 So, Jane, are you able to address the proxy  19 voting?</p> <p>20 MS. CARTEN: Good morning. Can you hear me?</p> <p>21 MS. BECK: Yes.</p> <p>22 MS. CARTEN: Great. Awesome. So that was a  23 lot of traumatic buildup with technical issues to not  24 much of a slide because when we were considering what  25 requirements should given ESG planned proxy-voting</p>

<p style="text-align: right;">Page 54</p> <p>1 practices, one of the things that became quite clear is</p> <p>2 that the SEC had just voted to amend rules concerning</p> <p>3 proxy solicitations and had provided supplemental</p> <p>4 guidance just recently. And we definitely took</p> <p>5 seriously the idea that it is okay sometimes to say</p> <p>6 doing nothing is, in fact, what should be done at the</p> <p>7 moment. And in the end, because of the recent amended</p> <p>8 rules, we decided that additional conditions don't need</p> <p>9 to be placed on proxy voting at the moment, that some of</p> <p>10 the benefits to the amended rules that the SEC put</p> <p>11 forward included additional conditions to the</p> <p>12 availability of certain existing exemptions for the</p> <p>13 information and filing requirements of the Federal proxy</p> <p>14 rules that are commonly used by proxy-voting advice</p> <p>15 businesses and disclosure of conflicts of interest</p> <p>16 between proxy adviser and affiliates, clarity that</p> <p>17 proxy-voting advice generally constitutes a</p> <p>18 solicitation, and failure to disclose certain</p> <p>19 information may be subject to any provisions of the</p> <p>20 proxy rules.</p> <p>21 So we believe that these actions effectively</p> <p>22 improved investors' ethical outcomes and in combination</p> <p>23 with Rule 13(f) do provide an adequate level of</p> <p>24 transparency with respect to proxy voting, whether a</p> <p>25 fund is designed to include ESG considerations or not.</p>	<p style="text-align: right;">Page 56</p> <p>1 haven't studied it. The names rule has been in place</p> <p>2 for a significant period of time. They put it in, the</p> <p>3 SEC put it in, place because they wanted to make sure</p> <p>4 that investors may rely on a name, in part, in terms of</p> <p>5 deciding on whether or not to make an investment in a</p> <p>6 fund. And they wanted to make sure that the fund names</p> <p>7 were not misleading and that there was consistency</p> <p>8 between what the fund name asserted it would do or the</p> <p>9 assets that it would invest in and what actually we</p> <p>10 found under the hood when we looked inside the</p> <p>11 investment holdings.</p> <p>12 And so the percentage has varied over time,</p> <p>13 but presently if you fall within certain names category</p> <p>14 requirements, 80 percent of your assets by value need to</p> <p>15 line up with what you are asserting in your name. And</p> <p>16 so what are those things that require that alignment?</p> <p>17 It is an interesting mix because on the surface level,</p> <p>18 it is pretty obvious things like the type of investment</p> <p>19 are you investing, it is a stock fund, it is a bond or</p> <p>20 the industry of investment, and then also some regional</p> <p>21 categories, so either by a broader geographic region or</p> <p>22 country.</p> <p>23 But what is not included are things that would</p> <p>24 seem to be something that investors would consider in a</p> <p>25 name. That could be the investment objective, things</p>
<p style="text-align: right;">Page 55</p> <p>1 MS. BECK: Excellent. Thank you so much,</p> <p>2 Jane.</p> <p>3 So we don't plan to move forward with any</p> <p>4 recommendations in December on this. I am now going to</p> <p>5 take us to the value of risk slides. So Rich hopefully</p> <p>6 will be able to address these items now. Rich, are you</p> <p>7 on the line?</p> <p>8 MR. HALL: Yes, I am. Can you hear me?</p> <p>9 MS. BECK: Yes, we can. Thank you.</p> <p>10 MR. HALL: So we were asked to consider three</p> <p>11 questions as part of this workstream. One is, how</p> <p>12 should ESG be treated within the context of the name</p> <p>13 rule? And that really changes upon an issuer</p> <p>14 determination of whether you are using it as a strategy</p> <p>15 or whether you think it is a fundamental issue.</p> <p>16 And then to go into a dissection of, well,</p> <p>17 values are about investor choice. And is there any</p> <p>18 difference? If it is about a choice, how should that</p> <p>19 possibly impact disclosure versus value? And that is</p> <p>20 maybe a manager or a company is claiming that their ESG</p> <p>21 performance enhances their opportunity to create value</p> <p>22 for the investors. And if that is the case or that is</p> <p>23 the assertion, how should that change disclosure?</p> <p>24 So maybe we can go to the next slide, please.</p> <p>25 So just a quick recap of the names rule for those who</p>	<p style="text-align: right;">Page 57</p> <p>1 like low volatility or capital appreciation. And then</p> <p>2 you get to the point where it probably intersects, this</p> <p>3 conversation intersects, most is strategy, ESG strategy,</p> <p>4 or should strategy by the name. And strategies today</p> <p>5 are excluded, their growth, value, ESG, low-carbon.</p> <p>6 These are all things that would not require any fund</p> <p>7 manager to have alignment between the name and the</p> <p>8 underlying assets.</p> <p>9 The protections about not having materially</p> <p>10 deceptive or misleading names still do apply. So if we</p> <p>11 can go to the next page, now we will kind of get into</p> <p>12 the consideration of the first question. So how should</p> <p>13 ESG be treated under the names rule? So right now, as I</p> <p>14 just mentioned, ESG is considered a strategy. So it</p> <p>15 does have the basic protections that there can't be</p> <p>16 blatant greenwashing, throwing the ESG in the name, when</p> <p>17 there is no intention whatsoever to incorporate that in</p> <p>18 strategies. But it is important to really think about</p> <p>19 what are the attributes that are being used in the</p> <p>20 selection process. And then that dictates whether ESG</p> <p>21 is really still a strategy or does it at some point</p> <p>22 possibly become fundamental?</p> <p>23 And I would say that it seems like on the</p> <p>24 strategy side, that that is an easier thing to assert</p> <p>25 than there is a lot more latitude about it. At some</p>

<p style="text-align: right;">Page 58</p> <p>1 point, though, it may become fundamental. And, then,  2 there is a determination that needs to be made about  3 whether or not we shift it to be so fundamental that it  4 may qualify under the other elements of the names-rule  5 license? The easiest example I could come up with on  6 that is that you were looking to apply either inclusion  7 or exclusion requirements in your asset selection. And  8 based on your criteria, maybe the inclusion is so select  9 that you drift to the point where you are basically an  10 industry bump. And, then, if that is the case, should  11 there be some sort of line because you have zeroed in on  12 such a tight definition that that comes to task?</p> <p>13 So I think there is work to be done here to  14 think about like where is that line and how do you  15 tighten this up so that investors really do get what  16 they are asking for or what is being marketed to them?  17 And I would say, note, that I know that the SEC is  18 seeking commentary from the market about whether  19 strategies and ESG, in particular, should become  20 something eventually.</p> <p>21 So we go to the next page. I think we should  22 be on that one. If ESG is about values, then how should  23 that affect disclosure? So, again, you know, we  24 continue to have basic protections under the names rule.  25 But when you go into the zone of values, that is an</p>	<p style="text-align: right;">Page 60</p> <p>1 the investor probably should bear a significant portion  2 of the burden in the decision-making process.</p> <p>3 And, then, lastly, if we go to if it is  4 about value. And so we talked a little bit about this  5 already. Right? Some practitioners believe that ESG  6 factors will lead to superior returns in the long run.  7 And there are two primary drivers that I have heard are  8 the most common. One is that ESG risk can be material.  9 And they may not be properly priced today. And so if  10 you can investigate those from a fundamental perspective  11 and have a better means of assessing them, then you may  12 make better investment selections and drive further  13 value for your investors. And the second is more  14 centered around venture capital flows and that there is  15 a significant movement in the flow of capital that is  16 expected to happen in support of various businesses that  17 may be social impact-related or may be more  18 environmentally friendly and that those flows alone have  19 the potential to drive market value. So we should try  20 and be in position ahead of flows and, therefore,  21 benefit by the added demand. So those are the two  22 fundamental reasons that I have heard explain it.</p> <p>23 We talked a little bit about inclusion and  24 exclusion. Those two can be very strong in terms of  25 limiting an investment universe and creating potential</p>
<p style="text-align: right;">Page 59</p> <p>1 investor making a choice. Investors do have a right to  2 make choices about how they want to invest. Especially  3 individual investors have the opportunity to say, "I am  4 willing to either hopefully enhance but possibly forego  5 return by taking certain risks" that go along or are  6 intended with a particular strategy here.</p> <p>7 And so when you get to that point, it seems  8 like the investor should bear some burden of diligence  9 to confirm that they are actually getting what they  10 want. And at the same time, you have to be able to have  11 some means for verifying that, so a trust-but-verify  12 type of mentality so that the disclosure is sufficient  13 for the investor to really make an informed choice about  14 what they are buying and if it is actually going to  15 hopefully accomplish the choices they are making in  16 trying to express their individual values.</p> <p>17 And, ultimately, it seems like based on that,  18 that the investors should shoulder that burden. And if  19 they can't come to satisfactory resolutions in their  20 investigations and diligence, then this is actually  21 going to happen that they should be the ones who should  22 say, "Well, I am just going to need to walk away because  23 I don't have the information or the disclosure to  24 support it." So I would encourage robust disclosure,  25 but if in the end, if it is a value-based decision, then</p>	<p style="text-align: right;">Page 61</p> <p>1 risks in terms of the end holdings that a fund needs to  2 have or will have. And so that seems like pretty strong  3 disclosure should be required there so that investors  4 can adequately understand the risks that they are taking  5 relative to a broad market risk, which you well-know.  6 Once you start taking it down that field, you begin to  7 track and introduce different factors in investment. So  8 an investor needs to be able to understand that so that  9 they are making informed risk decisions.</p> <p>10 The third part of ESG is also pretty common.  11 And that is we use it as part of the overall investment  12 decision-making mosaic. Right? So we have all of our  13 basic fundamental financial metrics and other things  14 that we use to limit the investment managers who can  15 select the assets. And one of the things that we  16 include in that is ESG. So that would seem not to argue  17 for any asymmetric disclosure. Right? If ESG is a  18 significant portion of your investment-selection  19 strategy, then you should just be describing that to the  20 same degree that you describe everything else that flows  21 into your investment strategy.</p> <p>22 And I think that all of that, really, goes to  23 the question of managers are out there generally to make  24 a profit. And they are seeking competitive advantage  25 through the ways that they employ information to select</p>



<p style="text-align: right;">Page 62</p> <p>1 assets, which hopefully generate attractive returns or  2 more attractive returns relative to benchmarks or  3 competitors. And, therefore, they should enjoy the  4 opportunity to protect them sort of as part of their  5 process.  6 So I think that is going to be a fine line,  7 not to make a manager kind of talk about the secret  8 sauce in such detail that they give away their  9 intellectual properties. At the same time, how do you  10 make them disclose enough of what they are doing so that  11 investors understand the risks that they are taking when  12 they go into it. The biggest is finding that balance  13 when it comes to, is it about value.  14 I think those were the three questions that we  15 had. There was another set of questions that the SEC  16 did ask in its solicitation for commentary on the names  17 rule. I will put a slide up, and we will talk about  18 that.  19 MS. BECK: And, Rich, if there are more  20 questions on that topic, we need to hear the questions.  21  22 So it is just breaking up. It sounds like  23 somebody needs to go on mute. Okay.  24 I am going to wrap up on next steps. So  25 during the question period or afterward or in some of</p>	<p style="text-align: right;">Page 64</p> <p>1 lot of what retail investors see, though, they don't  2 look at the prospectus. They don't look at the annual  3 report. They just look at either an ad, whether it may  4 be a print ad, a television ad, a website, and the  5 communication tends to be you know, they try to grab  6 the readers' attention. So it may be fairly short. You  7 know, examples might be the Morningstar rating of a fund  8 or if it is a fixed-income fund, the percentage of  9 assets that are in AAA bonds.  10 Have you guys thought about not just how your  11 recommendations will impact the documents that are filed  12 with the SEC but also should there be recommendations in  13 terms of marketing material, in terms of whether there  14 should be some kind of standardization for the rules  15 governing advertising? I mean, just to sort of give you  16 an example, today if a FINRA analyst looks at fund  17 material, they are basically going to see if it is  18 consistent with the prospectus. So if we see an ESG  19 fund ad, we are going to make sure that that is  20 consistent with the prospectus for the fund, but we are  21 not going to question whether the investments in the  22 fund truly are meeting ESG criteria because that is just  23 not our role.  24 So I just want to throw that out and see if  25 that is something you have given thought to and whether</p>
<p style="text-align: right;">Page 63</p> <p>1 the notes we sent around after, we are looking for the  2 feedback of the committee members and the reaction to  3 the range of actions. You know, are there people who  4 are strong components of do nothing? Do you think we  5 missed something in the various forms of interventions  6 of the three that we explored? And during the next  7 quarter, we are going to be meeting with investors and  8 issuers to drill in more on these disclosure questions  9 of what would the burden be, what is most useful to  10 investors, what is most difficult for issuers to provide  11 so that as we work toward our final recommendations, we  12 get a bit more of that external perspective when we  13 finally come back in December.  14 So I am going to pause now to see if folks  15 have questions. We have about 10 minutes for questions.  16 Oh. Joe Savage?  17 MR. SAVAGE: Thank you.  18 First of all, that was a great presentation,  19 really well-done and really good, Michelle, in terms of  20 dealing with the technical difficulties. So kudos for  21 that.  22 When I was watching this, you know, I think  23 there are a lot of focus on what disclosures need to be  24 in the prospectus or the annual report and whether it  25 needs to be standardization of ESG factors. You know, a</p>	<p style="text-align: right;">Page 65</p> <p>1 you have any recommendations. Thank you.  2 MS. BECK: Well, I will pop up first. You  3 know, it hasn't come up much in our discussion yet. So  4 it sounds like something we need to add to our final  5 work to figure out where the once we decide what we  6 are going to recommend around the official forms of  7 disclosure, then perhaps connecting the dots to what it  8 means for advertising would be a piece we should add as  9 well.  10 It looks like a question from Russ.  11 MR. WERMERS: Hi, Michelle, and thanks for a  12 great panel discussion. I just had a quick thought.  13 I'm sorry. Can you hear me? Okay. I just had a quick  14 thought. It looked like you had two screens where you  15 had several frames of thought in your panel, which were  16 great. You had two streams that kind of caught my  17 attention, though. One was how funds should or might be  18 compelled to have more truth in advertising I would  19 guess as the SP funds. And the second screen Jeffrey  20 I think discussed this was issuers, issuer-level  21 disclosure.  22 I think this is I am just wondering if the  23 panel has thought about tradeoffs between the two  24 because the fund manager can be thought of as a monitor.  25 Right? He monitors or policies his underlying issuers.</p>

<p style="text-align: right;">Page 66</p> <p>1 And so I guess maybe the SEC needs to think about, do  2 we monitor the monitor or do we monitor the underlying  3 agents here?  4 And as an example, as an example, stocks,  5 firms, issuers can brainwash and get great MSCI scores.  6 And the fund may look just fantastic. And, really, it  7 has had no effect. I mean, the fund has done the best  8 they can, but the fund investors are not getting what  9 they think they are getting in the underlying assets.  10 MS. BECK: I will start. And, then, Jeff, I  11 will probably pass it over to you. One of the  12 discussions we had in the subcommittee is if you had a  13 very thorough, very extreme form of issuer disclosure  14 that covered all of the bases and had great reliability,  15 you wouldn't need as much of the fund disclosure that we  16 are talking about because investors could or third-party  17 agencies could use publicly available data to rate and  18 score and everyone could rely on it. So that is the  19 more fundamental change that would actually address most  20 of these other issues, but it is much harder to put in  21 place, much harder. You know, it is the length of time,  22 of cost, and how do you get to that level of certainty  23 that that issuer disclosure is good. But it was the  24 more fundamental thing to do in order to solve these  25 other problems that we are talking about in this area.</p>	<p style="text-align: right;">Page 68</p> <p>1 meaningful, and comparable just because it is going to  2 be that much more difficult for a fund to, let's say, go  3 through and fake it to greenwash because we are going to  4 have a rich set of disclosures. They are going to  5 evidence whether or not the firms they are investing in  6 are, in fact, upholding best practices from an  7 environmental, social, or governance standpoint;  8 whereas, today, I don't know that we could necessarily  9 say that. And I know that there have been different  10 solutions that have come in and tried to compensate for  11 some of that ambiguity, including ratings. Those can  12 suffer from some of their own issues. So I do tend to  13 think of issuer disclosure as something that could help  14 to address not just some of the issues that we are  15 seeing at the issuer disclosure level but also at the  16 fund level with greenwashing.  17 MS. BECK: Thanks, Jeff.  18 We have got a question from Commissioner  19 Roisman, then after that Scot Draeger. So Commissioner  20 Roisman?  21 COMMISSIONER ROISMAN: I can certainly wait  22 until Scot. I want to give the committee ample time.  23 So I will defer to him and come back at the end if that  24 works.  25 MS. BECK: Okay. All right. Scott, go ahead.</p>
<p style="text-align: right;">Page 67</p> <p>1 So it was about, you know, not letting the perfect be  2 the enemy of the good because to get to that level of  3 perfection is pretty difficult, but it is the more  4 powerful intervention. That was something that I think  5 we thought as a subcommittee.  6 Jeff, did you have any other thoughts?  7 MR. PTAK: Yes. I think you sum it up well.  8 And, Russ, you make good points there. I guess sort of  9 the frame that I was coming at this from from my  10 workstream, which was on issuer disclosure, is, as we  11 know right now, the SEC plays a role, both in  12 monitoring, if you will, investment companies and the  13 issuers into securities they invest. And so I think  14 that we were thinking about potential approaches to ESG  15 disclosure in a similar way that you would need to have  16 frameworks that are pertinent to both of those areas,  17 recognizing their importance to investors, whether they  18 are investing directly in an issuer securities or they  19 are doing so with the help of a professional investor in  20 the form of an investment company.  21 As far as greenwashing goes, I recognize that  22 there is a diversity of very thoughtful views on this.  23 As I have reflected more on it, I do tend to think that  24 that problem begins to recede a bit as you have a set of  25 disclosure requirements that are more comprehensive,</p>	<p style="text-align: right;">Page 69</p> <p>1 MR. DRAEGER: Hi. Out of respect for the  2 commissioner, I will sit back and follow the  3 commissioner. I want to make sure you indeed have the  4 time to ask the questions.  5 COMMISSIONER ROISMAN: I really appreciate  6 that, Scot.  7 And thank you, Michelle. I think that was a  8 phenomenal presentation. I really commend you and the  9 subcommittee for great work. I actually really  10 appreciate the fact that you guys put our more than you  11 are actually necessarily going to do, but it is a great  12 point for getting input, not only from fellow members of  13 the committee but also from hopefully the public will  14 engage. And it is great that you guys are meeting with  15 both issuers and asset managers. I just think that was  16 really an exceptional presentation.  17 I just want to have a question relating to the  18 issuer disclosure and materiality. I think I just want  19 to give you my perspective. And I think this is where  20 it would be helpful just as something to think about. I  21 think we all agree that there is definitely ESG  22 information that is material to investors. And  23 companies have different you know, companies are just  24 differently affected by it, but to the extent that they  25 have ESG risks or things like that, they are required to</p>

<p style="text-align: right;">Page 70</p> <p>1 disclose that. And so there have been portfolio 2 management strategies such as growth and value 3 strategies for a long, long time. And certain 4 information might be useful for an asset manager or for 5 each one of those, but we haven't necessarily based our 6 issuer disclosure requirement on what is useful for a 7 particular investing strategy. So the question I have 8 is like, should ESG strategies necessarily be treated 9 the same way?</p> <p>10 To the extent that you guys are talking about 11 ESG as a material piece of information that all asset 12 managers need to do for all of their investment 13 decisions, I would think that makes sense. I have heard 14 that from many asset managers. But in terms of I think 15 when I am approaching whether we need to have a new 16 disclosure requirement for issuers, it is to whether 17 that is a material piece of information for investors to 18 make an investing decision.</p> <p>19 And so I just want to point that out. And, 20 you know, to the extent you are willing, I would love to 21 follow up with the subcommittee and have a greater 22 discussion about this and other pieces.</p> <p>23 MS. BECK: Excellent. That would be very 24 helpful. I know that Jeff has done a lot of thought 25 about that materiality question. And the point is a</p>	<p style="text-align: right;">Page 72</p> <p>1 MS. BECK: So great. One for us to think 2 about. So thanks for raising it. And we will bring it 3 in.</p> <p>4 So, Ed, if that needed to be our last 5 question, there were still a few hands raised. And so 6 either in the around-the-room period or afterward in 7 email, we would love to hear your questions or your 8 comments because it will help make the final 9 presentation that much better.</p> <p>10 MR. BERNARD: Yes. If I could? 11 Unfortunately, I am the guy in charge of keeping us on 12 time. So, first of all, that was a phenomenal panel. 13 Thank you to all. For those who had technical 14 difficulties, we feel your pain. We have all been 15 there.</p> <p>16 And, Michelle, you did an extremely deft job 17 in navigating it. I think you have now shot to the top 18 of my list of people I want on my team in a crisis. So 19 congratulations to all.</p> <p>20 And I would encourage everyone, particularly 21 if you still have questions but there is a lot of rich 22 material there. Go away. Read it. If you have 23 additional thoughts, please reach out to Michelle or 24 subcommittee members. And I suspect they will be 25 reaching back out to the committee as well for further</p>
<p style="text-align: right;">Page 71</p> <p>1 good one that it is not just about for the convenience 2 of certain kinds of investors, but it needs to represent 3 real risk or real factor driving performance.</p> <p>4 MR. BERNARD: Michelle, this is Ed. I am 5 going to suggest that maybe the next question be the 6 last one.</p> <p>7 MS. BECK: Okay. I saw that Gilbert Garcia 8 had his hand up. So, Gilbert, go ahead.</p> <p>9 MR. GARCIA: Thank you very much. Michelle 10 and to all of the subcommittee members, should there be 11 a requirement that managers that are doing these ESG 12 funds and so forth have to have a minimum requirement of 13 following ESG best practices of some sort themselves?</p> <p>14 MS. BECK: In terms of their own hiring 15 practices, their own staffing, their own</p> <p>16 MR. GARCIA: That's right. In other words, 17 before you can even I am just speaking out loud 18 before you can even manage an ESG fund, if you are not 19 ESG yourself, whether it is your board, whether it is 20 your partners, whether it is staff or something like 21 that, I mean, should you start there?</p> <p>22 MS. BECK: We can take that under 23 consideration. I don't know if any of the committee 24 members have a response on that.</p> <p>25 (No response.)</p>	<p style="text-align: right;">Page 73</p> <p>1 input.</p> <p>2 Before we go to break and I am going to 3 suggest since we are a couple of minutes over, we will 4 come back at 10:45 sharp Eastern Time, but Dalia Blass 5 wanted to make a quick comment about a technical problem 6 that most on the committee probably aren't even aware 7 of. So Dalia?</p> <p>8 MS. BLASS: Thanks. This was extremely 9 informative and a very thoughtful presentation. I know 10 I have a ton of questions, but I will save them.</p> <p>11 Just for our external viewers, apologies. I 12 know the broadcast cut off for a few minutes. One slide 13 I think was not being covered. We apologize for that. 14 Committee members, you probably were not aware because 15 the WebEx was on a different platform. We are going to 16 see an archived version of this webcast, whether we can 17 fill that gap. So, again, apologies. And we will do 18 our best to see if we can fill that gap.</p> <p>19 And apologies to the subcommittee members. It 20 was an extraordinary presentation. So sorry that one 21 little piece of it was not out there. It truly was 22 about like a minute and half, so not an extended period 23 of time. And we will see if we can get a fix going. So 24 thank you for that.</p> <p>25 MR. BERNARD: And I would just say to those</p>

<p style="text-align: right;">Page 74</p> <p>1 viewers if you are interested in the topic, just keep an</p> <p>2 eye on our webpage, on the sec.gov. And I am sure as</p> <p>3 and when we can fill the record, it will be there for</p> <p>4 you.</p> <p>5 So, with that, everyone, let's take a 10-</p> <p>6 minute break. And I will start the proceedings again at</p> <p>7 10:45 promptly. Thanks so much.</p> <p>8 (A brief recess was taken.)</p> <p>9 MR. BERNARD: Let's get started again. Next</p> <p>10 up is our Private Investment Subcommittee, chaired by</p> <p>11 Rama Subramaniam. After a brief update on the</p> <p>12 committee's ongoing work, this session will be devoted</p> <p>13 to a panel discussion with four distinguished speakers:</p> <p>14 two from industry and two from academia.</p> <p>15 As I noted in my opening remarks, I think we</p> <p>16 will hear a range of views today and at times</p> <p>17 disagreements on some basic concepts, such as returns</p> <p>18 and how to measure them. As our purpose today is to</p> <p>19 focus on the issues and not any particular market</p> <p>20 participants, our speakers have generally refrained from</p> <p>21 associating with specific firms, even when that</p> <p>22 information is in the public domain. For those in the</p> <p>23 audience who are interested in more detailed</p> <p>24 information, I think you will find the footnotes and</p> <p>25 references on their slides to be helpful.</p>	<p style="text-align: right;">Page 76</p> <p>1 I hope to cover my slides in around 50</p> <p>2 minutes, allowing 75 to 80 minutes for the panel. And,</p> <p>3 as such, I plan to briefly cover the following:</p> <p>4 firstly, a quick recap on why we are focused on</p> <p>5 potential expansion of access to private investments.</p> <p>6 This really is a recap on the supply and demand dynamics</p> <p>7 in U.S. asset management; secondly, an update on the two</p> <p>8 main workstreams, the analysis of whether private</p> <p>9 investments provide better and/or diversifying returns</p> <p>10 will be the focus of the panel. And I don't plan to say</p> <p>11 much more on that today. I will briefly touch on our</p> <p>12 analysis of the regulatory landscape as we start to</p> <p>13 think about recommendations and how they can be</p> <p>14 incorporated within the current regulatory landscape.</p> <p>15 Next, I want to briefly touch on design</p> <p>16 principles. This is really an attempt to solicit</p> <p>17 feedback and comments from the AMAC Committee members</p> <p>18 after the meeting. So for now, we will just briefly</p> <p>19 discuss some of the design principles we are thinking</p> <p>20 about.</p> <p>21 And, lastly, I will spend just a couple of</p> <p>22 minutes defining and discussing a couple of key terms</p> <p>23 that will be used on the panels just to make sure that</p> <p>24 everyone is on the same page. I apologize if people are</p> <p>25 very familiar with these terms, but given the wide</p>
<p style="text-align: right;">Page 75</p> <p>1 So, with that, I will turn it over to Rama to</p> <p>2 open the session.</p> <p>3 MR. SUBRAMANIAM: Thank you.</p> <p>4 I hope everyone can hear me. I am going to</p> <p>5 show you my screen. Wrong screen. Right. Can people</p> <p>6 see my slides?</p> <p>7 MR. BAIN: It looks good, Rama.</p> <p>8 MR. SUBRAMANIAM: Yes? Thank you, Ed. I want</p> <p>9 to thank the SEC commissioners and staff for the</p> <p>10 opportunity to present an update on the Private</p> <p>11 Investment Subcommittee and our work to analyze whether</p> <p>12 wider access to private investment should be</p> <p>13 recommended. I particularly want to thank Christian</p> <p>14 Broadbent, Emily Rowland, Sirimal Mukerjee, and Angela</p> <p>15 Mokodean for their help in pulling together our</p> <p>16 presentation and to Erik for moderating.</p> <p>17 Our agenda today will be taken up by a panel</p> <p>18 discussion moderated by Erik Sirri with four eminently</p> <p>19 qualified individuals spanning academia and the</p> <p>20 industry. I want to thank Noel, Bryan, Josh, and</p> <p>21 Ludovic for sharing their valuable insights. They will</p> <p>22 focus on the first workstream the committee set</p> <p>23 themselves. That is whether private investments provide</p> <p>24 additive and/or diversifying returns to a typical public</p> <p>25 markets portfolio.</p>	<p style="text-align: right;">Page 77</p> <p>1 diversity and range of people on the panel, I thought it</p> <p>2 would be worth spending five minutes on that.</p> <p>3 With that, let me start with the supply and</p> <p>4 demand dynamics in U.S. asset management. And, really,</p> <p>5 this is a recap from previous slides in discussions from</p> <p>6 other people that have presented to the committee.</p> <p>7 First of all, on the demand side, we see the</p> <p>8 pool of investment assets continuing to grow due to</p> <p>9 demographics and macroeconomic factors. Within the</p> <p>10 asset management industry, we see retirement savings</p> <p>11 representing more than half of the AUM. And within</p> <p>12 retirement savings, we see a dynamic where IRAs and</p> <p>13 self-directed and defined-contribution plans; i.e.,</p> <p>14 401(k)'s, continue to increase in size and relative</p> <p>15 share of retirement assets. In contrast, defined-</p> <p>16 benefit plans continue to reduce. And many of these</p> <p>17 plans are transitioning to the payout phase of their</p> <p>18 cycle.</p> <p>19 This is a slide I have used a couple of times.</p> <p>20 And I thank Michael Goldstein again from January</p> <p>21 showing the growth in the U.S. money-management</p> <p>22 industry, both in absolute terms as well as a share of</p> <p>23 GDP. The U.S. money-management industry at the end of</p> <p>24 2019 stands at about 45 trillion in size.</p> <p>25 Another Michael Goldstein slide from January</p>

<p style="text-align: right;">Page 78</p> <p>1 breaks down by percentage terms the composition of those</p> <p>2 assets. Retirement assets, the bottom three bars, have</p> <p>3 grown in relative proportion, but within retirement</p> <p>4 assets, we see a growth in IRA accounts and a decline in</p> <p>5 defined-benefit pension plans.</p> <p>6 Drilling into the retirement side just a bit</p> <p>7 more, this is a slide from the investment company Fact</p> <p>8 Book, which they graciously allowed me to use, which</p> <p>9 shows a breakdown in trillion-dollar terms of different</p> <p>10 retirement assets. The message here is that IRAs and</p> <p>11 401(k) plans have grown from approximately \$2.2 trillion</p> <p>12 in 1995 to \$17.2 trillion in 2019 and have grown from 33</p> <p>13 percent to over 53 percent of total retirement assets.</p> <p>14 In contrast, in the same period, defined-</p> <p>15 benefit plans, whilst they have grown in absolute terms</p> <p>16 from 3.4 trillion to 10.1 trillion, as a percentage,</p> <p>17 they have fallen from 49 to 31 percent. So the clear</p> <p>18 message is that we have an increasing amount of</p> <p>19 retirement assets and within those retirement assets an</p> <p>20 increasing amount of assets that are largely self-</p> <p>21 directed and limited to public markets; whereas, the</p> <p>22 private market participants over time and plans are</p> <p>23 getting smaller in proportion and size.</p> <p>24 What about the supply side? Here is an even</p> <p>25 clearer picture. We are seeing public equity markets</p>	<p style="text-align: right;">Page 80</p> <p>1 General Electric, AT&amp;T, Exxon, and Cola-Cola dominated</p> <p>2 the S&amp;P 500 top 5, the top 5 companies now are all over</p> <p>3 a trillion dollars and in the case of Apple over \$2</p> <p>4 trillion. They comprise Apple, Amazon, Microsoft,</p> <p>5 Google, with Facebook coming up to the \$1 trillion</p> <p>6 market. So we are seeing a far greater concentration of</p> <p>7 public companies and in some ways less choice in public</p> <p>8 markets.</p> <p>9 Turning to private offerings versus public</p> <p>10 offerings, this is a slide from a paper from the</p> <p>11 Committee on Capital Markets Regulation. I would say</p> <p>12 that all of this material is, by the way, available at</p> <p>13 S-links at the back of this presentation.</p> <p>14 We see that for the full years of data, 2015,</p> <p>15 '16, and '17, equity raised via IPOs is more than double</p> <p>16 the equity raised by private Reg D offerings. Similar</p> <p>17 SEC data but on a wider universe pulled from a white</p> <p>18 paper referred to at the bottom there shows Reg D</p> <p>19 offerings of over \$1.8 trillion in 2017 versus</p> <p>20 registered equity.</p> <p>21 Now, the Reg D offerings here cover both</p> <p>22 initial offerings and follow-on offerings and cover both</p> <p>23 corporate and noncorporate issuers, so a much wider</p> <p>24 range of offerings compared to the previous slide. But</p> <p>25 the trend is clearly there in that private offerings are</p>
<p style="text-align: right;">Page 79</p> <p>1 whilst larger in absolute dollar terms getting farm more</p> <p>2 concentrated with fewer listed companies and dominated</p> <p>3 by large companies. We are seeing companies staying</p> <p>4 private for longer and getting larger whilst they are</p> <p>5 private.</p> <p>6 We are also seeing private fundraising easily</p> <p>7 surpassing public fundraising. Again some slides to</p> <p>8 highlight this. This was a slide I had in my last</p> <p>9 presentation, the yellow line showing the market cap of</p> <p>10 listed companies growing; however, the number of listed</p> <p>11 companies dropping from the peak of about 8,000 in the</p> <p>12 mid '90s to around 4,000 currently. Meanwhile, we see</p> <p>13 private companies staying private for longer. Whilst</p> <p>14 not quite at the peak of 14 years, which was around the</p> <p>15 dot-com and the financial crisis, we are seeing median</p> <p>16 age of around 10 years, as opposed to 6 years for</p> <p>17 private companies that are staying private longer.</p> <p>18 And, lastly, we see the concentration of</p> <p>19 public companies in the S&amp;P 500. The 2 lines show the</p> <p>20 percentage of the top 5 in 10 companies, the makeup of</p> <p>21 the S&amp;P 500 with the top 10 companies now accounting for</p> <p>22 around one-third of the total market capitalization of</p> <p>23 the S&amp;P 500. The bottom part of the slide shows the</p> <p>24 absolute market capitalization of the largest companies.</p> <p>25 Not only has the composition changed since 1995, when</p>	<p style="text-align: right;">Page 81</p> <p>1 much larger than public offerings and within private</p> <p>2 offerings, Reg D is still by far the most widely used</p> <p>3 exemption for private offerings.</p> <p>4 We wanted to briefly touch on the regulatory</p> <p>5 landscape. I would say our analysis on the regulatory</p> <p>6 landscape has been to date an initial survey of what are</p> <p>7 the main areas we would need to think about and either</p> <p>8 fit within or recommend changes to in order to promote</p> <p>9 wider access to private investments.</p> <p>10 Where we have landed is there are really three</p> <p>11 areas that we need to focus on. The first is the</p> <p>12 Securities Act, which provides for various exemptions</p> <p>13 from registration for issuers of securities. Reg D is</p> <p>14 still the widest used exemption, but there has been a</p> <p>15 substantial growth in the number of exemptions</p> <p>16 available, including things like the Reg Crowdfunding</p> <p>17 for around a million dollars and the Reg A and Reg A</p> <p>18 plus offerings for higher amounts that were introduced</p> <p>19 or updates with the JOBS Act.</p> <p>20 However, as one of the speakers said at the</p> <p>21 start of today it was Commissioner Clayton, actually</p> <p>22 we are likely to be looking at people accessing</p> <p>23 private investments through a fund structure. And,</p> <p>24 therefore, the Investment Company Act needs to be</p> <p>25 considered and, in particular, either fitting within the</p>

<p style="text-align: right;">Page 82</p> <p>1 registered Investment Company Act framework or 2 discussing the much higher requirements of being a 3 qualified purchaser. 4 And, lastly, we briefly want to touch on the 5 additional requirements for 401(k) under ERISA. I don't 6 intend to spend too much time on these slides in the 7 interest of getting through the material, but the first 8 thing is the Securities Act, which applies to issuers. 9 As mentioned before, there are very safe harbors in 10 exempt offerings, but by far, the largest used exemption 11 is the Rule 506(b) of Reg D, the so-called accredited 12 investor and non-generally solicited offers. The 13 accredited investor definition has two main prongs: the 14 income, or net worth, prong requiring income in excess 15 of 200,000 or 300,000 in the case of joint income in 16 each of the last 2 years or a net worth in excess of 1 17 million. We have seen recent extensions that the SEC 18 has promulgated to the extent accredited investors 19 should specify people based on professional 20 certifications, designations, or credentials. 21 As mentioned, the Investment Company Act 22 becomes important where we are talking about investments 23 in funds which themselves invest in private companies. 24 Most PE funds or most private funds use two exemptions: 25 the so-called Section 3(c)(1) or 3(c)(7) exemptions.</p>	<p style="text-align: right;">Page 84</p> <p>1 seeking liquidity. However, some people might be 2 surprised to learn that closed-end funds have 3 historically required -- they have a 15 percent limit on 4 illiquid investments unless all investors are accredited 5 investors. This has been the approach of the SEC's 6 Division of Investment Management. And recently staff 7 have indicated that they are reexamining the staff 8 position, which is something we definitely should 9 encourage. 10 There is an additional requirement under the 11 Investment Advisers Act which I don't plan to cover but 12 where a fund is charging a performance fee, you also 13 need to have a qualified client which has an additional 14 financial requirement that falls somewhere between the 15 accredited-investor financial requirement and the 16 qualified-purchaser financial requirement. 17 Lastly, the 401(k) plan as an additional level 18 of ERISA requirements need to be taken into account, 19 including to prudently select and monitor any (break in 20 audio) information letter setting out a framework and 21 opening the door for target-date funds to have a portion 22 of their investments in illiquid investments. That is a 23 welcome improvement. 24 Just to give an idea of who qualifies an 25 accredited investor on financial thresholds or a</p>
<p style="text-align: right;">Page 83</p> <p>1 Both are nonpublic offerings. Section 3(c)(1) limits 2 the number of investors to 100, and Section 3(c)(7) 3 requires qualified purchasers. Qualified purchaser 4 requirements are primarily financial and much higher 5 than accredited-investor requirements, generally 6 requiring more than 5 million of investments for 7 individuals. 8 The alternative is to be a registered 9 investment company. Registered investment companies 10 come in various flavors; are open-end, like mutual 11 funds; closed-end; for example, interval funds; and 12 ETFs, which can be either open-end or unit investment 13 trusts. 14 There are substantial requirements and 15 restrictions of registered investment companies which 16 are beyond the scope we are covering today. That 17 includes investment advisory contracts, corporate 18 governance requirements, limitation on affiliated 19 transactions, use of leverage, and other things. 20 Focusing, however, on private investments, it 21 is important to note that open-end funds are subject to 22 a general 15 percent threshold on acquiring illiquid 23 investments, which makes sense given that open-ended 24 funds have to be able to redeem on fairly short notice, 25 normally daily, in order to provide liquidity to people</p>	<p style="text-align: right;">Page 85</p> <p>1 qualified purchaser, it is estimated around 13 percent 2 of households meet the accredited-investor definition 3 and less than 2 percent meet the qualified-purchaser 4 threshold. On 401(k) account balances, looking at the 5 Fidelity data at the end of 2019, the average balance of 6 a 401(k) account is \$112,000. With about \$233,000 out 7 of 17.3 million accounts, around 1.35 percent having 8 balances in excess of 1 million, let alone 5 million. 9 As such, access to accredited-investor investments and 10 qualified-purchaser investments is very restrictive. 11 Briefly, on design principles, as I said, we 12 will be reaching out separately to get the feedback from 13 AMAC members. We don't want to preempt the conclusion 14 from the analysis of private investment returns, but we 15 thought it would be good to get some guiding principles 16 in place to help us come up with potential 17 recommendations. 18 I won't cover all of these in the interest of 19 time, but some of the design principles we have come up 20 with include should access be only via a diversified 21 pool. Here we mean a diversified pool of private 22 investments, rather than a diverse-wide pool where there 23 is some private investment. Should access be chaperoned 24 by an intermediary? And should they act in a fiduciary 25 capacity? Disclosure was a point that was earlier</p>

<p style="text-align: right;">Page 86</p> <p>1 raised by Chairman Clayton. That is something else that  2 we have picked up on. What kind of disclosure? Fee  3 disclosure? What other disclosures? What restriction  4 should there be on underlying investments? Should there  5 be different shaded access, retail versus super retail?  6 And should there be an incentive for funds that can  7 show true market pricing in secondary trading? And,  8 lastly, we talk about main street and retail investors,  9 but who are we talking about exactly? Individual  10 investors? We have seen the growth of IRA and 401(k)'s.  11 It seems like they are a valid universe to also  12 consider as many households' wealth are in the IRAs and  13 401(k) plans.  14 Lastly, I wanted to cover a couple of key  15 terms that would be used in the panel: firstly, IRR. I  16 wanted to cover this because IRR sometimes garners some  17 controversy and some strong comments. Mathematically,  18 IRR is relatively simple to explain. It is a discount  19 rate that makes the net present value of cash flows  20 equal to zero. It favors early cash flows. The example  21 below of three investments with the same initial cash  22 outlay but with different cash flows over time, they all  23 have the same net present value and discount it at 8  24 percent and substantially similar multiples on  25 investment capital between 2.25 and 2.8. The first</p>	<p style="text-align: right;">Page 88</p> <p>1 20. In the meantime, the index has grown from 100 to  2 115 to 130.  3 Future value in those cash flows gives us the  4 column marked in red. And the K-S PME is simply the  5 future value of cash flows plus NAV. So the 20 and the  6 37 divided by 33, so 1.14.  7 The IRR we have discussed. The L-N PME  8 effectively looks at the public market equivalent of  9 that investment. So it says if you put 25 into the  10 public market and then get 15 back at the end of year  11 one, your NAV should be 16 in the public market at the  12 end of year two and you do an IRR of that. And so your  13 IRR from your private investment is 24 percent. Your  14 IRR, effectively, from the L-N PME is 14 percent,  15 indicating that the private market outperforms by 10  16 percent. A Direct Alpha is a similar approach but  17 simply takes the IRR of the future value cash flows, so  18 just the IRR of these red numbers.  19 I know that is a lot to take in, but I think  20 the main message here is there might be a ratio or there  21 might be a percentage number. When it is a percentage  22 number, you have to decide whether you need to compare  23 it to the private market to the public market, where  24 there is a direct stand-alone number like Direct Alpha.  25 I have used up my 15 minutes. And, with that,</p>
<p style="text-align: right;">Page 87</p> <p>1 investment is equal cash flows over five years. The  2 second investment back-ended cash flows in years four  3 and five. And the first investment front-ended cash  4 flows in years one and two. You can see a substantial  5 difference in the IRR, ranging from 26 percent to 76  6 percent. So when using an IRR, one should always be  7 conscious of its sensitivity to cash flow and its  8 assumption of a reinvestment rate that might not be  9 achievable.  10 Lastly, I want to touch on public market  11 equivalent. You will hear the term "public market  12 equivalent" being mentioned I am sure on the panel  13 several times. At its core, public market equivalent is  14 a relative simple concept of comparing returns for  15 private investment to a public market benchmark. There  16 are, however, several variants that are beyond the scope  17 of today's discussion to fully cover.  18 I would quickly say, though, that the two  19 types of public market equivalents you will hear is a  20 ratio, such as the K-S PME ratio, where a ratio greater  21 than one generally indicates a private investment that  22 outperforms a public investment. The K-S PME ratio can  23 be most easily described with a simple example of an  24 investment with an initial capital call of 25, a year  25 one cash flow of 15 and a year two net asset value of</p>	<p style="text-align: right;">Page 89</p> <p>1 I want to spend the rest of the time on the panel. And  2 so I will hand over to Erik Sirri and unshare my screen.  3 Give me one sec to unshare. If a tech can help me  4 unshare on their side? I have lost my WebEx screen.  5 Thank you. Erik?  6 MR. SIRRI: Thank you, Rama.  7 And good morning. My name is Erik Sirri. I  8 will be the moderator of the panel on private investment  9 returns.  10 For investments in public securities like  11 stocks, bonds, and mutual funds, returns are relatively  12 straightforward to calculate. Methods for calculating  13 these returns are sufficiently standard and customary  14 that they can appear in mutual fund prospectuses,  15 shareholder reports, and they can be used by investors  16 for comparison purposes; for instance, either to other  17 funds or to standardized benchmarks, like the S&amp;P 500 or  18 the Barclays Agg.  19 As Rama illustrated, returns to private  20 investments can be difficult to calculate. And, unlike  21 public returns, there is no universally accepted  22 standard method for their calculation. Not only are  23 accurate returns important for investors to judge  24 relative fund performance, but reliable returns are  25 required for investors to make portfolio risk and</p>

<p style="text-align: right;">Page 90</p> <p>1 hedging decisions.</p> <p>2 We are fortunate today to have with us four</p> <p>3 experts to help us on these issues. Two of our</p> <p>4 panelists are from the industry, where they specialize</p> <p>5 in private markets and the data that describe them. Our</p> <p>6 other two panelists are academic scholars whose research</p> <p>7 and expertise are in the private markets. We hope this</p> <p>8 panel will give you the audience a sense of both the</p> <p>9 complexity of the issues inherent in the private markets</p> <p>10 as well as a range of views held by sophisticated</p> <p>11 participants in these markets.</p> <p>12 So let's jump right into the panel. I know I</p> <p>13 speak for Ed and the rest of the subcommittee when I say</p> <p>14 that we are very grateful for the time and energy these</p> <p>15 distinguished panelists have put into their</p> <p>16 presentations. Rather than give a full introduction to</p> <p>17 each of the panelists, let me refer you to their bios</p> <p>18 that appear on the SEC's AMAC website.</p> <p>19 We have asked each of the panelists to speak</p> <p>20 for 7 to 10 minutes. We will then have some discussion</p> <p>21 among the panel members, after which we will open the</p> <p>22 floor up to discussions and questions from the entire</p> <p>23 AMAC.</p> <p>24 With us today are Bryan Jenkins of Hamilton</p> <p>25 Lane, where he heads Private Market Analytics Group;</p>	<p style="text-align: right;">Page 92</p> <p>1 investment firm. We have been investing in private</p> <p>2 markets for over 30 years. Private markets is all we</p> <p>3 do. Now, private markets is more than just private</p> <p>4 equity. It also encompasses private credit as well as</p> <p>5 private real estate and private real assets, so</p> <p>6 infrastructure and natural resources.</p> <p>7 Across those strategies, we manage or advise</p> <p>8 on over half a trillion dollars worth of assets as of</p> <p>9 June 30th, 2020. And those assets are across primary</p> <p>10 fund commitments to new private equity funds; secondary</p> <p>11 transactions, so purchases of seasoned or mature</p> <p>12 interests in private equity funds; as well as direct</p> <p>13 investments into public companies.</p> <p>14 Last year, we deployed over \$33 billion worth</p> <p>15 of capital into private investments on behalf of our</p> <p>16 clients, which we think makes us one of the largest</p> <p>17 allocators of private capital in the world. So we serve</p> <p>18 over 600 clients, mostly sophisticated, thoughtful</p> <p>19 institutional investors. And it is really a broad</p> <p>20 cross-section of investor types. So we serve pension</p> <p>21 plans, both private and public, large and small; Taft-</p> <p>22 Hartley plans; financial institution; sovereign wealth</p> <p>23 funds; endowments and charitable foundations; family</p> <p>24 offices of high-net-worth individuals. And those</p> <p>25 clients have varying degrees of familiarity with private</p>
<p style="text-align: right;">Page 91</p> <p>1 Noel O'Neil from Cambridge Associates, where he is the</p> <p>2 head of global investment research; Josh Lerner, the</p> <p>3 Jacob H. Schiff professor at Harvard Business School;</p> <p>4 and Ludovic Phalippou, professor of financial economics</p> <p>5 at the Said School of Oxford University.</p> <p>6 With that, let me turn things over to our</p> <p>7 first panelist: Bryan Jenkins from Hamilton Lane. It</p> <p>8 is your floor, Bryan.</p> <p>9 MR. JENKINS: Thank you, Erik. Just give me</p> <p>10 one second to share my screen here. Can everyone see my</p> <p>11 screen?</p> <p>12 MR. SIRRI: Not yet. There it comes. Here we</p> <p>13 go. You are good.</p> <p>14 MR. JENKINS: All right. So thank you, Erik.</p> <p>15 And I also want to thank the committee for inviting me</p> <p>16 here to speak on this panel today.</p> <p>17 As Erik mentioned, my name is Bryan Jenkins.</p> <p>18 And I head up the research and analytics function at</p> <p>19 Hamilton Lane, where I specialize in the assessment of</p> <p>20 private markets data, portfolio strategy performance</p> <p>21 assessment, and the development of the firm's novel</p> <p>22 private markets industry dataset.</p> <p>23 So I do want to spend just a quick minute on</p> <p>24 Hamilton Lane for any of the committee members who are</p> <p>25 not familiar with our firm. We are a private markets</p>	<p style="text-align: right;">Page 93</p> <p>1 assets when they first engage Hamilton Lane. Some have</p> <p>2 been investing in private markets for decades and have</p> <p>3 an experienced staff. Others may have dabbled in</p> <p>4 venture capital during the rebellious stage in their</p> <p>5 early aughts and have leading familiarity with private</p> <p>6 assets. And others are de novo investors in private</p> <p>7 markets and really seeking answers to some of the same</p> <p>8 questions that this committee is looking to get answered</p> <p>9 here today. So we think we are in a unique position to</p> <p>10 assist those investors by providing data and analysis to</p> <p>11 support their decisions to invest in private markets.</p> <p>12 So because of our platform, because of our position in</p> <p>13 the industry, we have one of the most unique and</p> <p>14 comprehensive and, most importantly, one of the highest-</p> <p>15 quality datasets in the industry. And this is in an</p> <p>16 asset class where quality data has historically been</p> <p>17 very difficult to come by. Actually, between the</p> <p>18 Hamilton Lane dataset and the Cambridge Associates</p> <p>19 dataset, which will be represented by one of my co-</p> <p>20 panelists, you have two of the finest highest-quality</p> <p>21 datasets in the industry in front of you on the panel</p> <p>22 today. We are tracking trillions of assets, thousands</p> <p>23 of funds, tens of thousands of companies. I think,</p> <p>24 importantly, all of this information comes from</p> <p>25 financial statements that LPs are receiving, so from the</p>



<p style="text-align: right;">Page 94</p> <p>1 valuation statements, audited reports, cash flow  2 notices. That information is checked. It is audited.  3 It is rigorously QCed. And, most importantly, it is  4 representative of what institutional LPs have been  5 investing in.</p> <p>6 So I included page 5 here for reference for  7 the committee. Rama touched on some of this in his  8 introduction. We will probably come back to some of  9 this during the open discussion. So I don't want to  10 spend too much time here but a couple of quick points.  11 First, as Rama and Erik alluded to in their  12 introduction, comparisons between private market returns  13 and public market returns can be challenging because the  14 way returns are measured is different in each of those  15 asset classes, IRR for private markets, usually a time-  16 weighted return for public markets.</p> <p>17 Number two, the way that we get around some of  18 those challenges is by using a public market equivalent.  19 So Rama went over some of the different flavors of  20 public market equivalent in his introduction. That is  21 generally the method that we prefer to make comparisons  22 between private asset performance and public markets.</p> <p>23 And, third, while PME, public market  24 equivalents, are our preferred comparison methodology,  25 there are other metrics that investors are using to</p>	<p style="text-align: right;">Page 96</p> <p>1 If they were not deploying capital in the private  2 equity, they would likely otherwise be deploying it into  3 traded assets, likely their traded equity book, which  4 nowadays tends to be very global and often mirrors the  5 geographic allocation of the MSCI world.</p> <p>6 Second, we have the S&amp;P 500 historically used  7 for comparisons, still favored by some North America  8 focused investors who are primarily investing in U.S.-  9 focused funds.</p> <p>10 And, then, third, we have a Small Cap Value  11 Index here. So there have been some arguments that  12 small cap value stocks are closer to the types of  13 companies that are targeted by private investment funds  14 in terms of enterprise value as well as having the value  15 tilt.</p> <p>16 We have those three indices here for  17 performance comparisons. The general themes are  18 consistent, regardless of the index you look at. In the  19 19 vintage years that we are seeing here, performance of  20 private equity has been pretty good relative to public  21 markets, so outperforming the global equity benchmark by  22 about 500 basis points on average across these vintage  23 years.</p> <p>24 The S&amp;P 500 Small Cap Value Index, there are  25 some vintages where performance has been about the same</p>
<p style="text-align: right;">Page 95</p> <p>1 assess performance in private markets. So I wanted to  2 make the committee aware that there are other techniques  3 besides public market equivalents that some investors  4 use.</p> <p>5 On page 6, I am showing one of the most  6 standard ways to look at performance data in private  7 markets. So what we are looking at are the vintage year  8 returns of private equity. So private equity here is  9 buyout funds, venture capital funds, and growth equity  10 funds. And so private equity funds are typically  11 grouped by vintage year or the year that they began  12 investing. So each of those blue bars is representative  13 of the performance of funds that began investing in that  14 year through Q4 2019, which is the as-of date of this  15 performance. So these are not calendar-year returns.  16 And also, for avoidance of doubt, all of the private  17 equity performance shown on this slide as well as  18 subsequent slides are net of fees charged by general  19 partners, so management fees as well as performance  20 fees.</p> <p>21 So each of the dots on this page represents a  22 public market equivalent, PME. And we have selected  23 three indices here for comparison. The first is the  24 MSCI World Global Equity Index. A lot of institutional  25 investors look at this as an opportunity cost benchmark.</p>	<p style="text-align: right;">Page 97</p> <p>1 as those two indices, mostly concentrated around the  2 global financial crisis, but in most of the vintage  3 years through this time period, including more recent  4 vintage years, private equity is posted attracted  5 performance. If you had begun investing in private  6 equity in 2011, you would have achieved a 300 basis  7 point premium to the S&amp;P 500.</p> <p>8 And, then, last, I would point out the  9 comparison to value, small cap value, stocks. This is  10 something that in the '90s and early 2000s, small cap  11 value performance looked pretty favorable against  12 private equity, but in more recent years, the  13 performance gap between private equity and the small cap  14 value stocks has widened, so potentially some additional  15 factors to explain private equity performance.</p> <p>16 Page 7 here, a slightly different view of  17 performance. Some investors like to look at performance  18 over various time horizons, grouping all vintage years  19 together, looking at performance over one, three, five,  20 10, sometimes 20 or 25 years.</p> <p>21 So what we are showing here is performance on  22 a rolling 10-year basis, 15 years shown on the chart,  23 really 25 years worth of data. And I think some of the  24 themes are similar to what you see on the previous page.  25 Consistent outperformance of global equities, the</p>

<p style="text-align: right;">Page 98</p> <p>1 performance gap against U.S. equities, as well as small  2 cap equities is narrower. And I think, different from  3 the previous page, there is a period more recently where  4 some traded equity performance has approached private  5 equity performance and even briefly eclipsed it. I  6 think it is interesting to reflect on the conditions  7 under which that occurred. So if you think about the  8 time period, it is a 10-year period starting at the  9 trough of the financial crisis and culminating at the  10 peak of a 10-year bull market that has been really  11 booming by loose monetary policy that it has pushed up  12 valuations in both traded assets as well as private  13 assets.</p> <p>14 And then also consider that for the 10-year  15 returns in 2018 and 2019, for private equity, that is  16 right about average, around 13 percent. Those returns  17 for traded assets would be towards the higher end of  18 their distributions. Certainly a 15 percent return for  19 U.S. equities would be at the higher end of the  20 distribution for 10-year returns.</p> <p>21 So I am coming up close to my time. So I will  22 just flip quickly through these last few slides, and we  23 can come back to these if people have questions in the  24 Q&amp;A session.</p> <p>25 Page 8, I just wanted to quickly highlight</p>	<p style="text-align: right;">Page 100</p> <p>1 And, last before I cede my time to the next  2 panelist on private credit, that asset class is the  3 private equity strategy that has the smallest difference  4 and the worst-case return from its long-term average  5 return. So the difference in average return to worst  6 case is narrowest there. And so I think that says  7 something about the consistency of the return in private  8 credit, even though that is a relatively younger asset  9 class.</p> <p>10 So I think I am pushing up against my 10  11 minutes. So I will cede the virtual podium to the next  12 presenter.</p> <p>13 MR. SIRRI: Bryan, thank you very much. So if  14 you will unshare your screen? And Noel, our next  15 speaker is Noel O'Neil from Cambridge Associates.</p> <p>16 MS. O'NEIL: All right. I needed to unmute  17 myself there. Let me share so can you all see my  18 sorry about that little technical challenge there.</p> <p>19 Thank you for the time to speak with you  20 today, very much appreciate the opportunity. I am Noel  21 O'Neil. I am president of the Cambridge Associates. I  22 lead all of our global investment activity, both private  23 equity and non-private equity.</p> <p>24 Cambridge Associates, just a brief background.  25 We have been in existence since the mid 1970s. We</p>
<p style="text-align: right;">Page 99</p> <p>1 that private markets is more than just private equity.  2 About 60 to 70 percent of the market is venture capital  3 and buyout funds. The other 30 to 40 percent are things  4 like private credit. Some of these funds have stepped  5 in to lend to middle market companies, where banks have  6 been treated, as well as private real estate and  7 infrastructure and natural resources. And they are a  8 significant portion of the nearly \$6 trillion of AUM in  9 this asset class.</p> <p>10 And then I will just skip to the last slide  11 here. What are showing on page 10, we looked at 5-year  12 returns over the last 25 years and picked the lowest 5  13 year return for each of these assets, so both private  14 assets as well as traded assets. So it gives you a  15 sense of some of the potential downside in a worst-case  16 scenario over a five-year hold period.</p> <p>17 So for developed market buyouts, that worst-  18 case scenario, is about 2.4 percent, so nothing to write  19 home about, certainly well below what we would generally  20 target for buyout returns but on a leg-for-leg  21 comparison basis to the MSCI world, a bit out of that.</p> <p>22 Now, venture capital, the downside there is  23 certainly a lot higher. I think most would expect that  24 given the risk profile of that asset class. And that  25 downside return was around the dot-com bubble.</p>	<p style="text-align: right;">Page 101</p> <p>1 manage or advise on our \$400 billion of investment  2 portfolios for about 900 institutional clients across  3 endowments and foundations, pension funds, and large  4 family offices.</p> <p>5 We have been involved in on behalf of our  6 clients investing in private equity, venture capital,  7 and other private investment areas, as Bryan described,  8 since roughly 1980, starting in venture capital first in  9 U.S., then in private equity or the buyout area in the  10 mid 1980s, and subsequently outside of the U.S. in  11 Europe, Asia, et cetera.</p> <p>12 In other to be more effective investors, we  13 started a process early on of collecting the data from  14 venture capital and private equity funds. That is the  15 dataset that I am going to use today to share some of  16 the insights we have on the questions of both investment  17 return from private investments as well as risk  18 indicators.</p> <p>19 Similar to Bryan, though, the dataset that we  20 have is actually very, very similar to the dataset that  21 Hamilton Lane has, goes back to, as I said, early 1980s,  22 covers about 8,000 separate funds, a little over 8,000  23 funds that we have collected data on, many of which have  24 completed their lifecycle. So the full investment  25 period of money going in, money coming out is long, long</p>

<p style="text-align: right;">Page 102</p> <p>1 finished. And, then, aggregate, the aggregate  2 commitments in those funds was close to \$6 trillion. So  3 it is a fairly substantial history of viewing private  4 investments across a variety of asset classes, both  5 venture capital and leveraged buyouts, as well as  6 private credit, et cetera.</p> <p>7 I wanted to with these first couple of  8 exhibits address something similar to what Bryan  9 addressed, which is the return from private investments  10 relative to public equity markets. This first chart has  11 what we call private equity, which is primarily  12 leveraged buyouts, does not include venture capital, for  13 example; does not include private credit; et cetera.</p> <p>14 And this just shows the annualized returns  15 over long periods of time. So the private equity is in  16 the blue. This goes back 30 years. And we have two  17 public equity market reference points in here: the S&amp;P  18 500 and the Russell 3000. And the cap as here is using  19 MPME, as Rama described earlier, essentially a  20 methodology to take the same cash flows that were  21 invested in private equity and put them into the public  22 equity markets.</p> <p>23 As you will see, the longer-term returns  24 premium from investing in private equity is quite  25 significant over the public equity markets, but this</p>	<p style="text-align: right;">Page 104</p> <p>1 The next point I wanted to address is a way of  2 thinking about risk. In public equities and in public  3 investments that are listed and priced every day,  4 investors, we included, use standard deviation return,  5 for example, as an indication of risk. In private  6 equity and private investments broadly, standard  7 deviation isn't that useful a tool because of the lack  8 of real mark-to-market. So one of the ways we look at  9 risk is dispersion of returns. So this chart shows  10 in this case, I am just using private equity as an  11 example that the dispersion is similar in venture  12 actually wider in venture capital, and dispersion is  13 much less, as Bryan mentioned, in areas like private  14 credit. But what this data illustrates is that the  15 difference between the top-performing funds in any given  16 size range so the bars here go from small, less than  17 \$200 million, sized private equity funds to on the right  18 the very largest and most commonly known mega private  19 equity funds that are over \$10 billion in size. Two key  20 points on this. One is that there is a wide level of  21 dispersion between the top-performing funds and the  22 bottom. Second is the bottom you actually can lose in  23 the smaller bond sizes. And to one of the points Robyn  24 made earlier, I think it does emphasize the need for  25 diversification in making private equity investments,</p>
<p style="text-align: right;">Page 103</p> <p>1 also shows them you know, one of Bryan's chart shows  2 that premium spread versus public equity markets has  3 been much less in recent periods, in part, because, as  4 Bryan mentioned, the public equity market returns have  5 been very strong post-financial crisis. But I would say  6 also because the amount of capital being invested in  7 private markets has grown steadily over these periods.  8 And the industry has become more competitive.</p> <p>9 The next chart basically highlights the same  10 information for venture capital. In this case, we are  11 comparing the venture capital returns against both the  12 S&amp;P 500 as well as NASDAQ. It is very debatable what is  13 an appropriate public equity benchmark for venture  14 capital. And we have often looked at much smaller cap  15 benchmarks, like Russell 2000 growth, for example, or  16 even sector benchmarks that are more focused on  17 technology. But, anyway, a key observation from this  18 data is that long-term venture capital returns were  19 very, very strong events, public equity markets,  20 particularly in the late '90s. In the recent decades,  21 while they have been very strong compared, for example,  22 to the NASDAQ Index, which is, you know, heavily  23 influenced by some big tech companies, as you know, the  24 private venture capital investments have actually lagged  25 over shorter periods.</p>	<p style="text-align: right;">Page 105</p> <p>1 particularly if that is going to be available to smaller  2 investors.</p> <p>3 A related point on this next chart, but I  4 wanted to contrast what that dispersion looks like for  5 private equity areas, which is the right three columns  6 here. So the first to the right in green is "Global  7 Venture Capital." The next one from the right is  8 "Global Private Equity," and we included private real  9 estate as a reference point in here as well. A key  10 point on this chart is dispersion, meaning the  11 difference between return earned by the median or  12 average fund versus the return earned by the top  13 quartile or 50 percentile in this case, is much, much  14 wider than it is for the asset classes on the left. So  15 the asset classes on the left, you know, there are  16 various types of public equities and fixed income.</p> <p>17 And this dispersion is for active manager  18 strategies in those areas. For example, in U.S. large  19 cap core, you know, the dispersion between a top  20 quartile or 50th percentile fund versus the median is  21 quite narrow.</p> <p>22 The other very significant difference between  23 the left and the right side of this chart is that the  24 left-side investors and this is a very important  25 point for retail investors is you have a passive</p>

<p style="text-align: right;">Page 106</p> <p>1 investment option. You can elect to invest in the  2 market and not pay active fees. In the private  3 investment markets, there is no passive option. You  4 have to invest actively. You have to pick someone to  5 make the investments for you. And so our point is the  6 dispersion on how well people do is a very important  7 thing, which means selecting who it is you are private  8 equity investing on your behalf is very important.</p> <p>9 I also wanted to briefly address one of the  10 questions Rama raised, which is around the degree to  11 which private investments provide diversification value.  12 This chart gives a summary of some statistical  13 correlation data between various categories of private  14 equity funds so that Mega Cap those are the really  15 big funds, all the way down to sort of small, or PE,  16 funds, which can be as small as \$200 million in fund  17 size and compares that to some public equity indices,  18 the S&amp;P, Russell 2000, ACWI, et cetera.</p> <p>19 Now, I would be the first to say that using  20 correlation data with private equity is limited, at  21 best, in that private equity valuations are not done  22 anything like sort of the frequency or effectiveness of  23 the public equity markets. So any look at correlation  24 data necessarily needs a caveat. The broad point that  25 this makes is that there is more diversification value</p>	<p style="text-align: right;">Page 108</p> <p>1 example, on the right side of this chart, where we talk  2 about venture capital, early-stage venture investments  3 in, for example, technology and biotechnology,  4 information technology, biotechnology, you know, are  5 subject to sort of economic influences that make their  6 performance quite different from the broader economy  7 and, therefore, different to some significant extent  8 from global public equity markets.</p> <p>9 So from a diversification point of view, think  10 those areas have more diversification value. I would  11 say I think mainstream buyouts provides very limited  12 diversification value to a typical public equity  13 portfolio.</p> <p>14 Those were the main points I wanted to raise.  15 You know, I would just say, in summary, we think  16 private equity has provided extra return over public  17 equities and public equity markets in the past. That  18 spread or benefit clearly is getting eroded to some  19 degree as private equity has become a larger and larger  20 area, more competition. You know, we still think for  21 investors who have the capacity to invest with the best  22 private equity firms and know how to find those, it is  23 still an attractive area but not something to get  24 involved in unless you feel like you have the capability  25 to do the appropriate due diligence, et cetera.</p>
<p style="text-align: right;">Page 107</p> <p>1 as you get away from the largest types of (audio  2 distorted) funds and get to smaller, more focused funds  3 and particularly I don't have the data here, but I  4 will address it separately as well later that in  5 subsets of private investments, like, for example, let's  6 say, particularly venture capital, where the cycle of  7 investments and the (audio distorted) those investments  8 are very different from the broad economy, but those  9 areas of private investing can provide meaningful  10 diversification to a typical public equity portfolio.</p> <p>11 And, just to expand on that point a little bit  12 I think Bryan had a somewhat similar chart that when  13 people know about private investments or even loosely  14 the term "private equity," sometimes we get that there  15 is a very broad swath of different types of private  16 investments out there.</p> <p>17 We use this chart just to sort of illustrate  18 that what we think is a lengthy (audio distorted)  19 between the types of private investments and the sort of  20 overall performance of the economy. So in the center of  21 this chart and by far the biggest category of private  22 investment, which is leveraged buyouts for private  23 equity that are we would say largely (audio distorted)  24 linked to GDP in broader economic cycles; whereas, the  25 further you can get away from that, particularly, for</p>	<p style="text-align: right;">Page 109</p> <p>1 Let me stop there and hand it back to you,  2 Erik, and the next speaker.</p> <p>3 MR. SIRRI: Noel, thank you very much. This  4 is very helpful. So if you will unshare? Great.</p> <p>5 Our next speaker is Josh Lerner from Harvard  6 Business School.</p> <p>7 MR. LERNER: Thank you, Erik. And thank you  8 to the committee for the chance to talk here.</p> <p>9 I was looking over my slides last night, and I  10 must admit I felt a little bit resonance with the old  11 story of Harry Truman and his search for a one-armed  12 member of a Council of Economic Advisers because he  13 never wanted to hear economists saying, "On the one  14 hand," "On the other hand." I am afraid I am somewhat  15 guilty of that in this talk. But, hopefully, at least  16 some of the considerations I raise here will be helpful  17 for the committee in their thoughts around these issues.</p> <p>18 So, anyway, I have been doing this for a long  19 time and certainly written a lot of cases on a lot of  20 private equity groups, worked with limited partners,  21 general partners, as well as government bodies around  22 this. I don't consider myself to have a dog in this  23 fight but just for full disclosure.</p> <p>24 And, as I mentioned, these are some big  25 questions, but I thought that sort of taking some fact-</p>

<p style="text-align: right;">Page 110</p> <p>1 based approach here and highlighting a few key things  2 that might be germane for the subcommittee in terms of  3 weighing these issues might be helpful.</p> <p>4 The first is that I do think that, as was sort  5 of alluded to before, there are some you know, you  6 can certainly make a case that there are some potential  7 diversification benefits from private equity and that  8 certainly to the extent that it made sense in a  9 portfolio of a pension plan, defined-benefit pension  10 plan, it might make sense for an individual investor as  11 well.</p> <p>12 Perhaps the most powerful case, at least in my  13 view, for this is a paper that my fellow panelist Ludo  14 wrote in our top journal, Journal of Finance, 18 months  15 ago or so with Andrew Ang and Will Geotzmann, where they  16 basically argued that private equity did have a set of  17 characteristics, a set of factors, to use the finance  18 lingo, that was different from that seen in the public  19 market in that one could get substantial diversification  20 from it, not just simply private equity versus the other  21 stuff but also even within the different classes of  22 private equity.</p> <p>23 So that is really the one hand, but, on the  24 other hand, there is a set of things that have already  25 been hinted at. You know, certainly one of them is the</p>	<p style="text-align: right;">Page 112</p> <p>1 2-and-20-type arrangement. But we know that, at least  2 historically, the retail products that have been offered  3 have had another layer of fee on top of that, which in  4 some cases has been sales loads or management fees,  5 backend charges, and so forth. I just threw a few  6 examples up here garnered from media accounts, but, in  7 general, I do think that that I mean, we might  8 plausibly worry that in these cases, adding another  9 layer of fees on top of it for retail investors would  10 take whatever limited juice was there and basically take  11 away all of the alpha.</p> <p>12 Another consideration which has been raised,  13 at least that I have heard raised, in some of these  14 discussions has been about the fact that, you know, not  15 all investments are done through funds. And, in  16 particular, we know that there has been a lot of  17 interest in doing co-investments. Co-investments are  18 reasonably attractive at many levels, not the least of  19 which is that in many cases, they are being done on a  20 no-fee/no-carry, or low-fee/low-carry basis. And, as a  21 result, they avoid some of the fee drag, which occurs  22 otherwise, because I think that, certainly, we would all  23 agree that private equity on a gross basis looks very  24 attractive. It is just that simply the overlay of the 2  25 and 20, which sort of brought those numbers back down to</p>
<p style="text-align: right;">Page 111</p> <p>1 relatively little outperformance that private equity has  2 generated. As you look at recent vintage years relative  3 to the public markets, essentially this is Preqin's  4 data, but I think it looks very similar to the data we  5 saw from my prior panelists, that, essentially, there  6 has not been much. There are some PMEs. They have been  7 above one in general but not by much and that,  8 certainly, it doesn't seem like that there is a huge  9 amount of juice in the lemon in terms of outperformance  10 that is there.</p> <p>11 Another fairly stark way to look at it is to  12 look at just the absolute performance. So this  13 essentially is TVPI by vintage year. And we could take  14 this back a couple of more decades and make the point  15 even more dramatically that while there have been ups  16 and downs, the general trend has been downward, which  17 presumably reflects to a certain extent, as Noel alluded  18 to, the increased intensification of competition in this  19 sector. So this is concerning enough, but there is a  20 sort of added issue out there which has to do with fees,  21 particularly fees in the context of retail products.</p> <p>22 The kind of analyses we saw over here from  23 Preqin or in this case from Cambridge are essentially  24 looking at the returns garnered by an institutional  25 investor, who is presumably paying the sort of standard</p>	<p style="text-align: right;">Page 113</p> <p>1 Earth.</p> <p>2 So, essentially, here in this chart on the  3 right, we illustrate our working with another data  4 source, that of State Street, which in their custodial  5 role would essentially see all of the cash flows that  6 they institutions, the limited partners they have  7 relationships with make. And, as a result, it sort of  8 illustrates that for State Street's institutions, their  9 private equity commitments have gone from the share  10 that is in the form of co-investments or other non-fund-  11 type investments has gone from on the order of 2 or 3  12 percent that characterized it during the 1980s or the  13 first half of the '90s to a much more dramatic level.  14 And, in fact, in the last year of our analysis, 2017, it  15 represented almost 40 percent of the money going on, not  16 in the form of funds but through these alternative  17 vehicles.</p> <p>18 You might say this really helps address some  19 of these concerns. The challenge is that when you look  20 in the long term, what one sees is that the co  21 investments in other kinds of alternative vehicles  22 haven't really done that well. And here we are  23 essentially comparing apples to apples. So we are  24 saying, if you invested in a deal, what would have been  25 the returns you have gotten from that co-investment,</p>

<p style="text-align: right;">Page 114</p> <p>1 again, any kind of modest fees that might be charged</p> <p>2 relative to the net returns you have gotten from</p> <p>3 investing in the corresponding fund?</p> <p>4 And you might think that it is a no-brainer</p> <p>5 that you are going to outperform from the co-investment</p> <p>6 simply because you are not paying fees, but, as one sees</p> <p>7 in the top line at least, over the long haul, in</p> <p>8 actuality, people have underperformed in those</p> <p>9 investment. And you might say, "How can this be?"</p> <p>10 Well, a lot of it seems to really stem from what one</p> <p>11 might term "adverse selection issues," that many of the</p> <p>12 co-investments get concentrated around market peaks in</p> <p>13 many of the biggest deals. There are any number of</p> <p>14 logical reasons why that might be, but the end game is</p> <p>15 that it doesn't seem that one has that this seems to</p> <p>16 be a very clear route for outperformance.</p> <p>17 Now, again, on the other hand, when you look</p> <p>18 at the most recent period, particularly the years after</p> <p>19 the global financial crisis, one does have a</p> <p>20 significantly better performance here. But, in general,</p> <p>21 the co-investments have been tough and challenging, a</p> <p>22 challenging area.</p> <p>23 So I guess in some sense, I feel taking stock</p> <p>24 of research and trying to assess it, it is a little bit</p> <p>25 like some of the research that we talked about last year</p>	<p style="text-align: right;">Page 116</p> <p>1 of Cambridge Associates, and the conclusions that I</p> <p>2 reach using the same data, it would take me quite a</p> <p>3 while. So we could do such an exercise, but separately.</p> <p>4 Here in my seven minutes, instead, I wanted to focus on</p> <p>5 how private equity firms present their track records.</p> <p>6 In this presentation, I'm not going to make any</p> <p>7 assumptions, no calculations. I'm just going to show</p> <p>8 you things that we see in practice and I'm going to</p> <p>9 comment on them.</p> <p>10 In fact, my career in private equity started</p> <p>11 20 years ago when I was a PhD student and I knew</p> <p>12 nothing. And somebody, well a fellow PhD student called</p> <p>13 Oliver Gottschalg, showed me what he thought was a bit</p> <p>14 of trickery. He said look, I have here a bunch of</p> <p>15 fundraising prospectuses from private equity firms.</p> <p>16 It's a track record about -- of -- about any private</p> <p>17 equity firm in the world.</p> <p>18 And you can see here all that data about their</p> <p>19 past returns, et cetera. And he was basically the only</p> <p>20 one to have collected such data there in the early</p> <p>21 2000s. And when I started reading these documents, I</p> <p>22 was in a state of shock. The documents said it was</p> <p>23 confidential everywhere. And I couldn't take my eyes</p> <p>24 off the footnotes that were basically saying that the</p> <p>25 track records were selected, for example, over there</p>
<p style="text-align: right;">Page 115</p> <p>1 on the employment and economic impact of private equity.</p> <p>2 It really seemed to satisfy no one in the sense that I</p> <p>3 think there are some considerations, on the one hand,</p> <p>4 that perhaps make a logical case for why this may make</p> <p>5 sense, but there also a number of important</p> <p>6 considerations here.</p> <p>7 So, in any case, hopefully laying out some of</p> <p>8 this data will be helpful to the subcommittee as it</p> <p>9 undergoes its deliberations around this process. And,</p> <p>10 with that, I will unshare myself and turn it over to</p> <p>11 Erik.</p> <p>12 MR. SIRRI: Perfect, Josh. Thank you so much.</p> <p>13 Our final panelist will be Ludovic Phalippou</p> <p>14 from Oxford University.</p> <p>15 MR. PHALIPPOU: Thank you for having me. I am</p> <p>16 going to share my presentation.</p> <p>17 Do you see it? I think you are all right?</p> <p>18 MR. BERNARD: Yeah, we got it.</p> <p>19 MR. SIRRI: Yes, we see it.</p> <p>20 MR. PHALIPPOU: All right. I am not going to</p> <p>21 talk about performance, per se, performance evidence.</p> <p>22 I've written about it in a book, in a paper recently.</p> <p>23 And wouldn't want to repeat largely what Josh just said.</p> <p>24 And for me to explain why, what you hear from</p> <p>25 petitioner presentations -- so the one of Hamilton Lane,</p>	<p style="text-align: right;">Page 117</p> <p>1 were some gross of fees, over there were some weird</p> <p>2 performance measures, like Time Zero IRR. And there</p> <p>3 were some Since Inception IRRs that were not making any</p> <p>4 sense. It was just shocking.</p> <p>5 And I tried to describe a bit what I was</p> <p>6 seeing in some early papers. But my colleagues didn't</p> <p>7 really know this data. They hadn't seen them, except</p> <p>8 probably for Josh. It was hard to get traction and</p> <p>9 nobody basically believed me. People said, "Look, it's</p> <p>10 all sophisticated investors. They can get all the data</p> <p>11 they want. We do all the calculations. So there's no</p> <p>12 point in you whining that like fundraising prospectuses</p> <p>13 are misleading or things like that. This is -- you're</p> <p>14 just impossible." Okay?</p> <p>15 And it just turns out that a few weeks ago,</p> <p>16 and I think for the first time, one such presentation of</p> <p>17 private equity fund track records, ended up -- a</p> <p>18 fundraising presentation ended up in the public domain.</p> <p>19 And so I thought, you know, I'm going to share that</p> <p>20 with you, because it looks very much like the ones I've</p> <p>21 been seeing for 20 years. And it is one of these</p> <p>22 presentations that does shock me.</p> <p>23 And so I'm going to show you a bit the sort of</p> <p>24 information that people investing in private equity are</p> <p>25 presented with. And I think this is very relevant for</p>

<p style="text-align: right;">Page 118</p> <p>1 the SEC, and that's why I'm doing it. Because the SEC,  2 I think, has always been very interested in  3 understanding how track records were presented to the  4 public. And the SEC has a long history of trying to  5 make track records presentable in a way that was fair  6 and meaningful in all the fields.</p> <p>7 So I was asked to anonymize this company, so  8 they are called "TBN", okay? And this is their first  9 slide, okay? They say, look, "This is us at a glance.  10 Strong performance. Experienced Organization. An  11 expanding market in which we invest. A different  12 strategy and a reputable process. We have invested  13 zillions under management" and blah, blah, blah. Okay?  14 That's their first slide.</p> <p>15 Here are a few remarks about this first slide,  16 about this firm at a glance. So it's a presentation  17 that's publicly available. It was made to public  18 pension funds. The one of Rhode Island here, just in  19 June this year.</p> <p>20 First remark is that the returns are presented  21 gross of fees, which can be a bit surprising. I think  22 it's important for people to have orders of magnitudes  23 of what fees are in private equity, because 220 sounds a  24 bit abstract; it doesn't sound that much. But what it  25 means when you convert into an annual rate, that would</p>	<p style="text-align: right;">Page 120</p> <p>1 have become 24 trillion, okay? So if a private equity  2 firm like this one would have transformed 7 billion into  3 24 trillion, I think you would have noticed. If people  4 don't know what 24 trillion means, it's basically like  5 the GDP of the U.S., and you would need to add Japan to  6 it, because you wouldn't get quite there yet, okay?</p> <p>7 So the multiple of money is quite high. So a  8 bit of a better measure -- but we, knowing the effective  9 duration of cash flow is pretty empty as well. But  10 what's most amazing to me is that the track record is  11 selective, you know. Like if you have a mutual fund, or  12 like any investment manager, you're not allowed to show  13 a selected track record. We completely know that it's  14 too easy to just select your investments and just like  15 present this as your track record.</p> <p>16 And the way it's done in private equity is as  17 follows: the first thing is to say -- written here is a  18 footnote, number one, of the realized returns. You say,  19 oh, that's, you know, sense enough. But except, if you  20 can realize your winner, and you hold onto your losers,  21 then your realized returns will always look amazing. So  22 that's very, very selective. That's very, very biased.</p> <p>23 Then you say in software -- so then, you know,  24 imagine you invested in different industries. You  25 picked the industry that looked the best, and you say</p>
<p style="text-align: right;">Page 119</p> <p>1 be similar to an expense ratio that you would see in the  2 mutual fund space, the average private equity fund  3 charges six to seven percent a year, okay? So we are  4 talking about fees that are three to four times the  5 magnitude of mutual fund fees. I think that's very  6 important to have these numbers well in mind. Okay?</p> <p>7 At first here -- a 50 percent gross IRR net  8 would probably be at 25 or 30, but an IRR is not a rate  9 of return, so that's not useful. But anyway, but the  10 first thing is to note is that we are presented numbers  11 as gross of fees in a very high fee asset class, so to  12 me it's surprising.</p> <p>13 The second thing is this IRR. We heard  14 earlier that you need to be careful with IRR and so on.  15 It's not that you need to be careful, it's that this  16 number makes absolutely no sense. It's not about being  17 careful, it's about banning it. When a firm like this  18 tells you, I have 50 percent return, most people think  19 like oh, wow, it's like 50 percent like rate of return  20 on money. Like, this is just amazing. Yeah, it would  21 be amazing.</p> <p>22 Because somebody -- this track record is 20  23 years long. If somebody had earned 20 years 50 percent  24 a year, they would have multiplied money by 3,300. And  25 they have "zillions", which is about 7 billion, would</p>	<p style="text-align: right;">Page 121</p> <p>1 that's what you recall in that industry on mine.  2 Imagine a mutual fund manager allowed to do the same  3 thing. A mutual fund manager having losing positions.  4 Hold on to these positions. Winning positions they  5 sell. They just show you their realized investments.  6 And they show you only the ones in the industry of your  7 choice.</p> <p>8 On top of that, there is this other thing that  9 is there in many, many track records. This is the track  10 record of people that are still in our staff. So  11 imagine that Josh and I are working for TBN. Josh does  12 only amazing investments. I do only bad investments.  13 They fire me. They keep Josh. The track record looks  14 amazing. And again, it sounds pretty innocent. It's  15 like, you know, if Josh was better, so they kept him,  16 because his track record looked so good. Except, if  17 exposed, you can say, well this investment didn't do  18 quite well. We're going to put this one on Ludo. And  19 this one did pretty well. We're going to put that one  20 on Josh. And we are firing Ludo and oh, all the bad  21 investments are gone. All right?</p> <p>22 This is pretty extraordinary. It's also  23 pretty extraordinary that you are allowed very often --  24 and you see that in many track records -- to take  25 investments that you've done in your previous job and</p>

<p style="text-align: right;">Page 122</p> <p>1 say, well, actually I was responsible for that great</p> <p>2 investment in my previous job, but this one that didn't</p> <p>3 go well I wasn't really responsible, so that's not going</p> <p>4 to count on my track record. So you just cherry pick.</p> <p>5 I mean, if these are the rules of the game,</p> <p>6 you can just like, manufacture the most amazing track</p> <p>7 records out of thin air, okay? To have a bad track</p> <p>8 record, you should really like work very hard, okay.</p> <p>9 And again, it's like, if you would tell mutual funds you</p> <p>10 can play with these rules, they -- you know, it would be</p> <p>11 jaw-dropping for them, okay? Like, they would think</p> <p>12 like it's Christmas, okay.</p> <p>13 So this -- this is a presentation shown to so-</p> <p>14 called sophisticated investors. But people have been</p> <p>15 saying, look, they know what they are doing, people are</p> <p>16 smart, blah, blah, blah. You're just, you know, talking</p> <p>17 nonsense. My question is, if people are that smart and</p> <p>18 that sophisticated, why are they treated like idiots?</p> <p>19 Because if such a presentation would be shown in my</p> <p>20 college endowment, the person would pretty quickly be</p> <p>21 put on the spot and feel ashamed show something like</p> <p>22 this. If they are not feeling ashamed, they are feeling</p> <p>23 free to show that to public pension funds, it means that</p> <p>24 some people are influenced by these kind of misleading</p> <p>25 numbers.</p>	<p style="text-align: right;">Page 124</p> <p>1 fees. And that happens to be what publicly traded</p> <p>2 software have done in the U.S. I could only go back 10</p> <p>3 years, because there was no indices before in software.</p> <p>4 But again, to show you that benchmark is not trivial.</p> <p>5 And if you do it properly, very often you find that, you</p> <p>6 know, reality is very different from what is shown in</p> <p>7 these fundraising prospectuses.</p> <p>8 And so that's a bit tricky, because as the SEC</p> <p>9 has been concerned for nearly a hundred years now, you</p> <p>10 want to be sure that when people are presented any</p> <p>11 investment opportunity, they are presented things that</p> <p>12 are kind of adding up and making sense.</p> <p>13 Now, I'm going to continue with showing you an</p> <p>14 example that is in SEC filings, by the way these firms</p> <p>15 present themselves. In fact, a firm here that I call</p> <p>16 B4-A is one of the big four firms, okay, and it's going</p> <p>17 to be A. So A says this in their SEC filings. They</p> <p>18 say, they were founded in the 1990s, early 1990s -- they</p> <p>19 say, "We generated 39 percent gross IRR and 25 percent</p> <p>20 net as of end of 2019." So basically over 30 years'</p> <p>21 period, that's our return. In fact there was a board</p> <p>22 member of this company that came to our academy</p> <p>23 conference once, and very, you know, proudly, announced</p> <p>24 that, "You know, we just raised the largest fund ever in</p> <p>25 private equity. But no wonder we did. We generated 39</p>
<p style="text-align: right;">Page 123</p> <p>1 Now, this one very quickly, that's like slide</p> <p>2 number two or three. If I show you this, I bet you that</p> <p>3 what you thought is that what this means is that what</p> <p>4 this TBN form does is they take money with EBITDA</p> <p>5 margins of minus three percent, and they grow it, hence</p> <p>6 the rising arrow, to 38 percent average margin in their</p> <p>7 portfolio. You would think that. You would think they</p> <p>8 have companies that have zero to 10 percent margin and</p> <p>9 bring them to 38.</p> <p>10 You read the footnotes. It just happens that</p> <p>11 the minus three and 10 percent is the margin of some</p> <p>12 public firms in the software industry. And 38 percent</p> <p>13 is the margin in their portfolio. These numbers have</p> <p>14 nothing to do with one another. They're just put there</p> <p>15 on the graph, a rising arrow, and bingo. That's our</p> <p>16 value creation advantage.</p> <p>17 Again, go back to the sophistication argument.</p> <p>18 If you are talking to somebody sophisticated, why do</p> <p>19 you show things like this, that makes absolutely zero</p> <p>20 sense?</p> <p>21 That's where a correct track record -- I</p> <p>22 probably don't have much time to go over this -- would</p> <p>23 just highlight that basically, depending on their</p> <p>24 holding period, we could think that their actual true</p> <p>25 return is probably something like 23 percent net of</p>	<p style="text-align: right;">Page 125</p> <p>1 percent return over 30 years' period." I mean, who</p> <p>2 would believe that, right?</p> <p>3 So this guy was saying we raised so much money</p> <p>4 because we generated 39 percent return over 30 years.</p> <p>5 Who would believe this? And of course, you know, my</p> <p>6 grandma hearing something like this would be very</p> <p>7 excited. The problem is that my grandma doesn't know</p> <p>8 that IRR is a completely fictitious number. She doesn't</p> <p>9 know that, okay?</p> <p>10 So same thing for another one that I called</p> <p>11 Big4-B. These guys, they started even earlier. They're</p> <p>12 actually exactly my age. So I know that they are</p> <p>13 exactly 44. And they have a 26 percent return over 44</p> <p>14 years. Which, they don't mind comparing to a geometric</p> <p>15 average of a public market return. These two things</p> <p>16 have nothing to do with one another, an IRR and</p> <p>17 geometric average of the public index. But they don't</p> <p>18 mind. And they show these numbers.</p> <p>19 So just to note for one's selves, if these</p> <p>20 guys, Big4-A, okay, had earned 39 percent -- which on</p> <p>21 just one billion dollars -- they have much more under</p> <p>22 management, okay. But just one billion dollars, 39</p> <p>23 percent over 30 years, they would have returned 20</p> <p>24 trillion. Remember, that's the GDP of the U.S. So my</p> <p>25 grandmother would get very excited with 39 percent</p>



<p style="text-align: right;">Page 126</p> <p>1 return. No wonder she's excited. Somebody's basically  2 telling her that they transformed 1 billion into the GPD  3 of the U.S. over 30 years' period.  4 The problem is that it's obviously not true.  5 This firm actually, for every one dollar invested, they  6 revert -- they report only gross returns -- they revert  7 1.8 times gross. So net is like 1.5, which happens to  8 be like public market returns, okay?  9 For the other one, same thing. 26 percent  10 over 45 years, actually there it's even more than the  11 GDP of the U.S. Actually half of the planet Earth's  12 GDP. So somebody is writing on SEC forms, "Look, I've  13 been, over the last 45 years, I've returned 26 percent  14 gross." And that person is basically telling you that  15 the one billion would have been converted into half of  16 the Earth's GDP. And you know, that's cool. You know,  17 it just -- put these numbers like that, people get very  18 impressed, and that's all allowed.  19 MR. SIRRI: Ludovic, I cut you off. But I  20 wanted -- can you wrap up? I want to be sure we have  21 time for discussion.  22 MR. PHALIPPOU: Yeah. It's my -- it's kind of  23 my last slide. And this number really is like super  24 high and super meaningless. Not only that, but on top  25 of that, never changes. So I put together this thing.</p>	<p style="text-align: right;">Page 128</p> <p>1 the world not to present to you fair and balanced  2 evidence.  3 So my focus would be the most relevant for the  4 SEC to know, especially given the track record of the  5 SEC of tracing, particularly in the mutual fund space,  6 all the deceiving way that people have found to present  7 track records to their investors. Thank you very much.  8 MR. SIRRI: Ludo, thank you very much. That  9 was very insightful. So maybe to start things off, let  10 me loop back to Josh. Josh, you used a PME measure in  11 your work; other reports have presented rates using IRR.  12 Josh, in your view, how should the SEC approach the  13 question of what information private investment managers  14 should give to retail investors, when it comes to  15 performance and risk?  16 MR. LERNER: Well, first of all I want to say  17 that I do share Ludo's unhappiness with the IRR as a  18 measure. And we can, you know, sort of talk about any  19 number of examples. But you know, just one of a number  20 of odious aspects of the IRR he didn't mention is that  21 you can actually end up with multiple routes. I  22 remember an instance a few years ago where there was a  23 venture fund that he had the LP started, he had an IRR  24 measure of 10 percent. The GPs had it, thought it was  25 30 percent. And the answer was that they were both</p>
<p style="text-align: right;">Page 127</p> <p>1 The one on the left hand side is every form filed with  2 the SEC by my Big4-B. And you can see that there are 76  3 to 96 funds that had a 26 percent net IR. And this  4 number, number never changes, ever since 1996. So every  5 year they tell you they have the return. Okay? That  6 would make some people very, very jealous, okay? And a  7 number of people would question how on Earth is this  8 allowed, okay?  9 And the second one is my Big4-A firm. Same  10 thing, number never changes. And there is year end  11 amount; also the number never changes. I pointed this  12 out in a paper in 2014. Since then they changed their  13 format. But they still report same IR, but that's very  14 misleading to people. So again, if the sophisticated  15 investor argument held true, I don't quite understand  16 why people would be presented with these sorts of  17 information. This information is always kept  18 confidential. Nobody's allowed to look at it, not even  19 for research, and so on. And you really wonder whether  20 it's confidential because it contains a Coca Cola  21 recipe, or whether it's just very embarrassing when put  22 in daylight.  23 Again, remember that these fees are very high,  24 and many people make a very good living out of these  25 very, very, very high fees, and have all the reasons in</p>	<p style="text-align: right;">Page 129</p> <p>1 right. Because basically when you get inflows and  2 outflows you can actually get multiple IRRs for the  3 same, same funds. So this is a very tricky kind of  4 measure which, while it's widely used, is not without  5 its problematic aspects.  6 That being said, you know, I tend to be a fan  7 of the Big 10's approach, which is to say, you know,  8 what you'd really like to do is to say let's convey,  9 look at as many different metrics as one can, including  10 PMEs, including, you know, multiples and so forth to try  11 to get a sense of, you know, grounding in reality. That  12 any one measure may be problematic for a variety of  13 reasons, but taken together one should get a -- or  14 potentially a clearer view of what it looks like.  15 MR. SIRRI: Noel or Bryan, do you want to jump  16 in on this?  17 MR. JENKINS: Yeah, sure. I'm happy to jump  18 in. I think we're in agreement with Josh's, I think he  19 called it the Big 10 approach, of looking at a number of  20 different metrics. And I -- you know, I think I agree  21 with Ludo in that the transparency in this industry  22 could be much improved, yeah, for when we are evaluating  23 funds. In addition to, you know, the marketing  24 documents, we're also getting full attribution on the  25 deals or on the full cash flows, cash flows for each</p>

<p style="text-align: right;">Page 130</p> <p>1 deal. And so we're able to do a type of analysis that</p> <p>2 is difficult to do off of just what's provided in a</p> <p>3 marketing document.</p> <p>4 So I think having some of that information</p> <p>5 available will make some of the performance comparisons</p> <p>6 a little more transparent.</p> <p>7 MR. O'NEIL: I'd agree with Josh as well, on</p> <p>8 that you have to look at more than just one measure.</p> <p>9 And two quick comments on Ludo's points. One is I</p> <p>10 totally agree with him that marketing of track records</p> <p>11 by private equity GPs can be incredibly misleading and</p> <p>12 misrepresentative, and very commonly, for the reasons he</p> <p>13 cited, by using both gross numbers and selectively</p> <p>14 including or excluding. And so you know, that's</p> <p>15 something we always look very carefully at. And the</p> <p>16 second point he made, which is one I meant to make at</p> <p>17 the end of my presentation -- I have a chart in my deck</p> <p>18 that you could refer to later. And that, just</p> <p>19 reinforcing his observation that fees in private equity</p> <p>20 are very high. We would measure that over time, and</p> <p>21 it's very supportive of the 600 to 700 basis points that</p> <p>22 Ludo referred to. And it's you know, private equity</p> <p>23 returns at a gross level would have to be very high to</p> <p>24 support that level of fees and still be attractive to</p> <p>25 investors.</p>	<p style="text-align: right;">Page 132</p> <p>1 don't necessarily have short-term liabilities. They're</p> <p>2 a -- we're taking a longer-term view. And they tend to</p> <p>3 think about their liquidity premium as being smaller</p> <p>4 than say a retail investor. You know, 55 years old and</p> <p>5 a few years away from retirement, you might want to</p> <p>6 demand a higher liquidity premium for your time in</p> <p>7 assets that they may need to access in the short term.</p> <p>8 MR. SIRRI: Does anyone else want to comment</p> <p>9 on liquidity?</p> <p>10 MR. LERNER: Ludo -- I mean, I don't.</p> <p>11 MR. SIRRI: Go ahead, Josh.</p> <p>12 MR. LERNER: No, I was just saying Ludo wrote</p> <p>13 an article on this exact subject, so he should say</p> <p>14 something.</p> <p>15 MR. SIRRI: All right, Ludo. You're on.</p> <p>16 MR. PHALIPPOU: Yeah. I think when it's a</p> <p>17 small part are above 40, it shouldn't command that big</p> <p>18 of a premium. But we need to be careful with the</p> <p>19 withdrawals that retail investors may need. But when we</p> <p>20 look at the retails like I did in my paper, they look</p> <p>21 pretty close to many public market indices. Of course</p> <p>22 you can choose indices where it looks better. So we've</p> <p>23 seen that in some presentations. If you choose MSCI</p> <p>24 World indices, or it is particularly is mainly U.S. and</p> <p>25 the U.S. Dollar also appreciated, you would get a</p>
<p style="text-align: right;">Page 131</p> <p>1 And you know, one of the things that we've</p> <p>2 been waiting to see over time, which we haven't seen</p> <p>3 enough of yet, is pressure on GPs to reduce fees. And</p> <p>4 we certainly try very hard to apply that pressure</p> <p>5 ourselves, but it's -- you know, we're limited by the</p> <p>6 sort of supply and demand of the industry.</p> <p>7 MR. SIRRI: Okay, thank you. Let me turn to</p> <p>8 something we -- I don't think anyone mentioned, and</p> <p>9 that's liquidity. You know, the comparisons were made</p> <p>10 to these public benchmarks like the S&amp;P 500 or Wilshire</p> <p>11 or something like that. But those are fairly liquid</p> <p>12 securities that underlie those benchmarks. Not so for</p> <p>13 private investments. Are investors going to be fairly</p> <p>14 compensated for bearing this liquidity risk in your</p> <p>15 view? I'll throw that open to the group.</p> <p>16 MR. JENKINS: Sure. I'm happy to kick off</p> <p>17 with this one. They were thinking on the liquidity</p> <p>18 premium that investors should demand, and they should</p> <p>19 demand a liquidity premium for holding these assets</p> <p>20 that, you know, on average are held for six years. And</p> <p>21 the life of the fund often expands, 10, 12, 15 years.</p> <p>22 Sometimes beyond that. The liquidity premium that</p> <p>23 investors should demand should partially depend on the</p> <p>24 duration of their liabilities. And so there's certainly</p> <p>25 some institutional LPs that take the approach that they</p>	<p style="text-align: right;">Page 133</p> <p>1 different picture than if you choose like small cap, mid</p> <p>2 cap U.S. stocks as benchmarks, et cetera. So when you</p> <p>3 look at indices that are closer to what private equity</p> <p>4 does that doesn't look like there is much out-</p> <p>5 performance to begin with. Going forward as well, given</p> <p>6 that the expected returns are generally lower, the fee</p> <p>7 structure in private equity is such that it's pretty</p> <p>8 hard to see how there could be any premium anyway.</p> <p>9 MR. SIRRI: All right. Josh mentioned the</p> <p>10 term Adverse Selection. And you know, one of the things</p> <p>11 that it seems to me is true about these kinds of assets</p> <p>12 is that a small fraction of investments could provide a</p> <p>13 lion's share of returns in a pool. That's not true of</p> <p>14 something like the S&amp;P 500. Do you think that poses a</p> <p>15 challenge in any way for the Commission as they value</p> <p>16 how to structure or regulate these investments? The</p> <p>17 effective cross-sectional skew in where their returns</p> <p>18 are?</p> <p>19 MR. NEIL: Maybe a brief comment, Erik. That</p> <p>20 skew, as you described, is particular noticeable in</p> <p>21 venture capital, in technology, where the -- you know,</p> <p>22 I'm unsure -- average venture capital returns, but the</p> <p>23 skew is very extreme, and a small percent of the venture</p> <p>24 capital deals and venture capital funds generate a very</p> <p>25 large amount of aggregate profit. I think that is</p>

<p style="text-align: right;">Page 134</p> <p>1 particularly relevant in that it makes it very difficult</p> <p>2 to be able to broadly invest in that asset class if you</p> <p>3 don't think you can access that subset of investments</p> <p>4 that would generate those returns. The skew in our</p> <p>5 experience is much less so in mainstream private equity</p> <p>6 or buyouts, and not that different from public equity</p> <p>7 markets.</p> <p>8 MR. JENKINS: Yeah, I would agree with Noel's</p> <p>9 comments. I think someone else's that we've done have</p> <p>10 supported that. And it -- you know, I would observe</p> <p>11 that there are a small handful of large companies that</p> <p>12 are driving the returns in the S&amp;P 500 and private</p> <p>13 equity looking at the fund universe, there's a larger</p> <p>14 percentage of funds that are driving that turn. I do</p> <p>15 think it is an argument for having a more diversified</p> <p>16 portfolio. So taking more of a scattershot approach,</p> <p>17 where you're investing in one or two funds per year,</p> <p>18 that is going to increase the potential that you're</p> <p>19 going to underperform public markets.</p> <p>20 MR. SIRRI: Well, let me ask you a bit of an</p> <p>21 integrated question then, before we throw it open to the</p> <p>22 panel. And I think Ed said we can go a few minutes over</p> <p>23 but not much. You all are experts in this area. You've</p> <p>24 thought about all the issues, the good, the bad, the</p> <p>25 ugly. Net, net, do you think this is a world where</p>	<p style="text-align: right;">Page 136</p> <p>1 fee structures, so they weren't stacked against the</p> <p>2 retail investors, would be really important.</p> <p>3 MR. PHALIPPOU: So the way I would say it is</p> <p>4 it took 90 years or nearly 100 years for the SEC to get</p> <p>5 a comprehensive set of regulations for the mutual fund</p> <p>6 industry in order to close all or most of the loopholes.</p> <p>7 As we went, people demonstrated that, you know, there</p> <p>8 was people who were doing fund incubation in order to</p> <p>9 address strategy calls. They showed that people do some</p> <p>10 late trading to play with 3:30 p.m. close, et cetera.</p> <p>11 And there was limited ways to do tricks with public</p> <p>12 markets. And some mutual funds went out of their way, a</p> <p>13 number of them, to find tricks, okay? And it took 100</p> <p>14 years for the SEC to close most of them, okay?</p> <p>15 Here the SEC hasn't even started. So if you</p> <p>16 are to do that, to allow this investment to be there</p> <p>17 alongside mutual funds and the like, then it has to be a</p> <p>18 level playing field. You need to have the same rules.</p> <p>19 You need to catch up, in a universe that is much more</p> <p>20 complicated than mutual funds to get the same rules in.</p> <p>21 The equivalent of late trading, the equivalent of</p> <p>22 incubation, et cetera, all that needs to go through. If</p> <p>23 you have all of these rules in place, there is no reason</p> <p>24 why private equity should be excluded. But holding a</p> <p>25 private asset versus public should make no difference.</p>
<p style="text-align: right;">Page 135</p> <p>1 retail investors would be better off if they had some</p> <p>2 form of access to these private markets, taking into</p> <p>3 account all these imperfections that you all have been</p> <p>4 talking about?</p> <p>5 MR. JENKINS: I guess I'll start off again.</p> <p>6 So I think from a choice perspective, I think certainly</p> <p>7 having a choice. Although the challenges a lot of the</p> <p>8 panelist have alluded to, I think first is the</p> <p>9 appropriate structure. And then second, having the</p> <p>10 appropriate transparency so that retail investors can</p> <p>11 make an informed choice. So that I think those are the</p> <p>12 two limiting factors potentially for whether retail</p> <p>13 investors should have access to these investment</p> <p>14 opportunities.</p> <p>15 MR. SIRRI: Josh? Ludovic? No?</p> <p>16 MR. PHALIPPOU: Josh, go ahead. And I can go</p> <p>17 after.</p> <p>18 MR. LERNER: Well, I feel there's no return to</p> <p>19 being a centrist. Otherwise I guess our governor</p> <p>20 Charlie Baker would be running away with the Presidency,</p> <p>21 the Presidential election on the Republi-crat ticket.</p> <p>22 But I do think that you know, the points that were</p> <p>23 raised of saying that -- I would think that before this</p> <p>24 could be done, you know, really addressing some of those</p> <p>25 issues about both the clarity of presentation and the</p>	<p style="text-align: right;">Page 137</p> <p>1 It's not a problem. The problem is that you have a huge</p> <p>2 set of very advanced regulation on the one, for one</p> <p>3 type, rightly so, and the other type would require even</p> <p>4 more regulation because it has even more -- you have</p> <p>5 even more room for trickery. Then you have zero. And</p> <p>6 so that's the gap that you have to close. If that is</p> <p>7 closed, there's absolutely no problem for people having</p> <p>8 private versus public assets.</p> <p>9 And notice that even pension funds do not even</p> <p>10 report the right fees that they are paying,</p> <p>11 particularly. So all these efforts you did on mutual</p> <p>12 funds to try to get an expense ratio, it took years to</p> <p>13 the SEC to try to say what would be a total expense</p> <p>14 ratio; what would be a fair way to present expenses of</p> <p>15 mutual funds. Here you are in a universe where it's a</p> <p>16 hundred times more complicated to come up with a total</p> <p>17 expense ratio equivalent. And pension funds are really</p> <p>18 not there. So you have a lot to do in order to let</p> <p>19 people in on a level playing field. And you will have to</p> <p>20 do it, because they should be able to invest in private</p> <p>21 assets. But right now you don't have a level playing</p> <p>22 field. It would be really weird to me that mutual funds</p> <p>23 are allowed to just be on the side of private equity and</p> <p>24 nobody plays by the same rules.</p> <p>25 MR. SIRRI: All right. We have time maybe for</p>

<p style="text-align: right;">Page 138</p> <p>1 a question, at most two. Russ, do you want to ask?</p> <p>2 MR. WERMERS: Thanks, Erik. Great panel of</p> <p>3 top experts, obviously. So I think this question</p> <p>4 relates to the last question, Erik, that you posed, for</p> <p>5 the comments that your panel made, in response. If I</p> <p>6 may, given the dangers that have been pointed out in</p> <p>7 this panel, which are very useful, I think: high fees,</p> <p>8 misrepresenting returns, things like that, using</p> <p>9 inappropriate statistics, I think I'd be very reluctant</p> <p>10 at this point to myself invest in a private equity fund.</p> <p>11 But I may very well be -- I may very well be interested</p> <p>12 in investing in a Fidelity fund that invests in private</p> <p>13 equity. It's held shares in a private equity fund, or</p> <p>14 through a price mutual fund that it's attained. So what</p> <p>15 -- I guess my question is, to what degree would these</p> <p>16 concerns about private equity valuation be over in</p> <p>17 private equity as a potential asset class within the</p> <p>18 mutual fund industry?</p> <p>19 MR. SIRRI: Any of you want to handle that?</p> <p>20 MR. LERNER: I'll take a first shot, I guess.</p> <p>21 Which is that, you know, there has been a history of</p> <p>22 publicly traded private equity. Not so much -- you know,</p> <p>23 clearly more recently we've seen cases of management</p> <p>24 companies going public. But earlier we saw a number of</p> <p>25 examples of you know, funds of various types, you know,</p>	<p style="text-align: right;">Page 140</p> <p>1 context, there is also, in certain jurisdictions, semi-</p> <p>2 liquid vehicles that allow monthly or quarterly</p> <p>3 subscriptions and redemptions. I think primarily</p> <p>4 Australia and Europe. In addition to some of those</p> <p>5 traded structures which are primarily listed on European</p> <p>6 exchanges, there are also what I would think of as more</p> <p>7 of a hedge fund type structure for some of these private</p> <p>8 investments.</p> <p>9 MR. PHALIPPOU: Yeah, I think it's inevitable.</p> <p>10 One way or the other way would be more and more private</p> <p>11 assets. Like mutual funds would push to have more of</p> <p>12 them. Private equity funds would push. You have to face</p> <p>13 the situation. I think it's inevitable that then</p> <p>14 probably the balance would be struck to add, you give</p> <p>15 quote liquidity and assessment, and so every quarter,</p> <p>16 auction days or something like that. But we are -- we</p> <p>17 are relatively sure about this NAV, that this market</p> <p>18 NAV, that we do like an auction. And then we have then</p> <p>19 a fair redemption and trade point for people. And maybe</p> <p>20 public markets will go this way. You know, I don't</p> <p>21 think people really need to trade every millisecond, so,</p> <p>22 you know, to have like these windows where we run many</p> <p>23 auctions and then we are done.</p> <p>24 MR. SIRRI: Well, look, you've certainly given</p> <p>25 us a lot to think about. Ed was kind enough to give us</p>
<p style="text-align: right;">Page 139</p> <p>1 doing that. In fact you can go back to the, you know,</p> <p>2 the very earliest days of the venture industry with</p> <p>3 American Research and Development and the other early</p> <p>4 venture funds, which essentially raised money from the</p> <p>5 public, not because they wanted to but simply because</p> <p>6 the endowments and others just wouldn't invest in them,</p> <p>7 because they didn't understand or appreciate what they</p> <p>8 were -- what they were doing.</p> <p>9 I think it is fair to say that, you know, the</p> <p>10 experience of the publicly traded funds has been</p> <p>11 somewhat mixed. But how much of that is due to the fact</p> <p>12 that you know, being in a public environment when one's</p> <p>13 doing long-run private investments is hard. But there's</p> <p>14 a disconnect there. And how much of it is just due to</p> <p>15 the fact that in some sense there was a little bit of</p> <p>16 adverse selection, where maybe some of the, you know,</p> <p>17 some of the things that went public over the years were</p> <p>18 not perhaps the -- you know, not talking about the</p> <p>19 management companies, but raised funds from the public</p> <p>20 were perhaps not some of the best people who just</p> <p>21 couldn't raise money in other -- in other avenues. So I</p> <p>22 think it's a fair, fair question.</p> <p>23 MR. SIRRI: Any other panelists want to</p> <p>24 remark?</p> <p>25 MR. JENKINS: Yeah, I would add to Josh's</p>	<p style="text-align: right;">Page 141</p> <p>1 five extra minutes, but I think we've taken our time. On</p> <p>2 behalf of the subcommittee and in fact the entire AMAC,</p> <p>3 we thank all four of the panelists. I thought it was</p> <p>4 excellent. You raised a lot of ideas. You've given us</p> <p>5 a lot to think about. So thank you for your time. And</p> <p>6 Ed, I'll turn it back to you.</p> <p>7 MR. BERNARD: Great. Let me add my thanks.</p> <p>8 And actually quickly, before I close up this session,</p> <p>9 Rama, did you want to say anything else, or should I</p> <p>10 close us out?</p> <p>11 MR. SUBRAMANIAM: No, go ahead Ed. Go ahead.</p> <p>12 MR. BERNARD: Okay. Let me just echo Erik's</p> <p>13 thanks. That was a spectacular panel. We're grateful</p> <p>14 to all of you for taking the time to be with us. And</p> <p>15 you have given us a great deal to think about. As we</p> <p>16 break for lunch, I would comment that both the ESG and</p> <p>17 the private investment panel now gives us a clear sense</p> <p>18 of just how not only important but how complex the</p> <p>19 issues we as a committee have taken on. And I commend</p> <p>20 the subcommittees for providing the attention that's</p> <p>21 required to tackle complex issues. So with that, we</p> <p>22 will break for lunch. Give everybody a chance to get</p> <p>23 away from their screens. We will start again at 1:00</p> <p>24 promptly. For those of you watching the public</p> <p>25 broadcast, you'll see a holding screen in place until</p>

<p style="text-align: right;">Page 142</p> <p>1 about 1:00. So with that, everyone, please enjoy a  2 little time away from the screen. And committee  3 members, please be back a couple of minutes before 1:00,  4 and we'll get going promptly at 1:00. Thanks very much.  5 (Whereupon, at luncheon recess was held from  6 12:21 p.m. to 1:00 p.m.)  7 AFTERNOON SESSION  8 MR. BERNARD: Okay, welcome back, everyone,  9 from lunch.  10 Just as in our July meeting, Gilbert Garcia  11 and team have assembled a distinguished group of  12 speakers. And I'll turn it over to Gilbert now to  13 refresh us on the arc of the team's overall work and  14 introduce the panel.  15 Gilbert?  16 MR. GARCIA: Thank you, Ed.  17 And let me just first say my own couple of  18 thanks, if I could, which is I want to say thank you to  19 Chairman Clayton, to all the SEC commissioners, to Dalia  20 Blass and, again, to Mr. Ed Bernard for making this  21 topic a priority, and for it to evolving into a  22 subcommittee [sic].  23 And I want to thank my new members that are  24 going to start working with me on this, Mr. Paul Greff  25 and Scot Draeger, who join me.</p>	<p style="text-align: right;">Page 144</p> <p>1 on asset flows.  2 But sadly, we heard from our speakers last  3 time, we learned about the total disregard for  4 transparency by many of these largest consultants. We  5 learned how they blatantly ignore requests for such  6 basic information, best practice information like  7 employee demographic disclosure, like information on  8 manager recommendations, and even conflicts of interest.  9 We even heard that the SEC, when sending out their  10 diversity assessment to the 1,300 regulated entities,  11 the responses they received cover just 69 -- 69 out of  12 1,300. If that was my daughter's math exam, 69 out of  13 1,300, my wife and I would be alarmed, and we would  14 immediately conclude that there's something very wrong.  15  16 But today is going to be much more uplifting,  17 because today we're going to celebrate some of the best  18 practices by some of the industry leaders. And I am  19 hopeful that there are people in the universe watching  20 and listening who will listen to some of the things that  21 they have done, and will learn from some of the things  22 that they have done, whether it's what they did to avoid  23 issues, whether the issues that -- they learned bumps  24 along the way, but, at the end of the day, to learn from  25 them some of the best practices that they have taken</p>
<p style="text-align: right;">Page 143</p> <p>1 And I want to say thank you to Robert  2 Marchman, who in many ways has been the Obi Wan Kenobi  3 supporting behind the scenes. He often is -- you know,  4 doesn't get the recognition he deserves. But you know  5 what? He's been phenomenal.  6 Now we have a chance to do something really  7 profound here with AMAC, something that can address and  8 at least move the needle some to address this alarming  9 wealth inequality that exists in our country today. And  10 this wealth inequality is really the root of so many of  11 the things that we're facing today, because it really  12 leads to unequal access to health care, to justice, to  13 education, and to women and people of color, unequal  14 access to really achieving the pinnacle of the American  15 Dream.  16 So I'm going to review our journey here with  17 this committee, and I'm going to talk about where we've  18 been and where we're going. And along the way I'll give  19 some of the formalities of what we're going to do today  20 on the panel.  21 So we started last AMAC meeting with data. We  22 heard about the role the consultant community plays in  23 the asset management ecosystem. But we also learned  24 about the incredible concentration of assets among the  25 largest consultants, and their extraordinary influence</p>	<p style="text-align: right;">Page 145</p> <p>1 upon themselves to write a good playbook.  2 So we're going to have two panels. The first  3 will consist of three consultants or consultant-like  4 entities. They're going to each speak for 10 minutes.  5 And then after the 10 minutes we will have 15 minutes of  6 Q&amp;A. After that first group we will then hear from  7 three more speakers, some of the largest allocators,  8 some of the leaders, again, in this area. They will all  9 speak for 10 minutes, and then there would be 15 minutes  10 of Q&amp;A after those 3 speakers.  11 In December we hope to bring forward to the  12 AMAC some suggestions, and we hope to bring forward some  13 other industry leaders like John Rogers, like Martin  14 Cabrera, people who have been working on diversity for  15 30 years in the financial services industry. And then  16 somewhere in early 2021 we hope to bring concrete  17 suggestions before the AMAC Committee for consideration.  18 That -- ultimately, we hope many of those good ideas  19 will go forward to the SEC themselves.  20 So having said that, our first panel is going  21 to consist of Mr. Mike Manning, who is the managing  22 partner of NEPC Consulting, one of the largest 10 in the  23 country, and one of the leaders. The other will be Mr.  24 Mike Miller, who is a chief investment officer of  25 Colonial Consulting, one of the leaders in the</p>

<p style="text-align: right;">Page 146</p> <p>1 foundation space, and he has an interesting story of how</p> <p>2 they got involved with diversity. And the last will be</p> <p>3 Mr. Clayton Jue, who's been one of the leaders in the</p> <p>4 manager of manager diversity space for over 30 years.</p> <p>5 So, Mr. Manning, please take it away.</p> <p>6 (Pause.)</p> <p>7 MR. GARCIA: Mike, I think you're muted.</p> <p>8 MR. MANNING: I'm back. You missed a great</p> <p>9 start. I'll start all over again, though.</p> <p>10 So I want to say thank you, Gilbert, and for,</p> <p>11 you know, the entire membership of the AMAC for tackling</p> <p>12 this really important issue and helping the industry</p> <p>13 move forward on this. I'm excited to be here today, and</p> <p>14 to play my part in that conversation.</p> <p>15 You know, NEPC is one of the largest</p> <p>16 investment consultants in the industry. And I think,</p> <p>17 because of that, we owe a responsibility to show</p> <p>18 leadership across a variety of ways, but certainly as it</p> <p>19 relates to promoting diversity. I'm proud of the work</p> <p>20 that we've done to date, but I also recognize that</p> <p>21 there's a lot of work to do in the industry broadly, but</p> <p>22 certainly also in NEPC.</p> <p>23 So my conversation today is to talk about the</p> <p>24 three ways -- the three areas in which we're taking</p> <p>25 steps to improve diversity here at NEPC: the first of</p>	<p style="text-align: right;">Page 148</p> <p>1 I mean, one, obviously, is to look to people</p> <p>2 who may not be consultants, but are adjacent within the</p> <p>3 investment management industry, and trying to attract</p> <p>4 them into the consulting marketplace.</p> <p>5 The second way is to build a groundspring of</p> <p>6 talent. And, you know, that is through our MBA program,</p> <p>7 through our internship program, try and identify diverse</p> <p>8 talent, bring them in, expose them to, you know, the</p> <p>9 exciting work that we get to do at NEPC, where you get</p> <p>10 to use your intellectual mind, you're engaging with</p> <p>11 clients, and doing really important work as a trusted</p> <p>12 adviser.</p> <p>13 You know, we think we have a lot to offer to</p> <p>14 folks who want to join our industry. And so developing</p> <p>15 specific programs to target increase in the diversity --</p> <p>16 and every one of our hiring managers has a goal that 50</p> <p>17 percent of their team has to be diverse. And if it's</p> <p>18 not, they need to make progress towards that throughout</p> <p>19 the year. So that's one of the things that all of our</p> <p>20 managers are measured on.</p> <p>21 Once we've got a more diverse workforce -- and</p> <p>22 we understand it's going to take a while to get there --</p> <p>23 we want to have a place that's inclusive. And the steps</p> <p>24 that we're doing to do that are multifaceted. A few</p> <p>25 recent things are we've had unconscious bias training</p>
<p style="text-align: right;">Page 147</p> <p>1 those is dealing with our own internal workforce; the</p> <p>2 second is how we're working to develop a more inclusive</p> <p>3 culture at NEPC; and then, finally, what we're doing to</p> <p>4 engage with the diverse manager community.</p> <p>5 So starting back on our workforce, you know,</p> <p>6 the focus here for a consulting -- in a consulting firm</p> <p>7 that preaches the benefits of diversification for our</p> <p>8 clients, in terms of their asset allocation, we think</p> <p>9 it's critical to have diversity of thought in our</p> <p>10 workplace and in the decision-making bodies at NEPC.</p> <p>11 And so we're working hard to identify people, to bring</p> <p>12 them into NEPC, and to incorporate those voices and</p> <p>13 those perspectives that are, frankly, different from a</p> <p>14 lot of those that are already here at NEPC.</p> <p>15 I'm proud to say that we have -- 50 percent of</p> <p>16 our new hires in 2020 have been minorities. So we're</p> <p>17 really excited about the steps that we're taking there.</p> <p>18 But we also recognize that we have to do more in terms</p> <p>19 of lifting up the diverse candidates we have at NEPC, in</p> <p>20 terms of getting them to more senior positions.</p> <p>21 One of the steps that we're taking -- and I</p> <p>22 think, if you look at the industry as a whole, there's</p> <p>23 not a lot of diverse representation in the consulting</p> <p>24 industry. And so what are the steps that we at NEPC can</p> <p>25 take to build a more diverse workforce ourselves?</p>	<p style="text-align: right;">Page 149</p> <p>1 for the senior leaders at the firm, and are going to</p> <p>2 cascade that down further. It's leading into the</p> <p>3 conversations, you know, from the events this summer</p> <p>4 with George Floyd, and just talking about social and</p> <p>5 racial injustice more broadly across the firm, and then</p> <p>6 also creating some affinity groups within some of our</p> <p>7 diverse communities so that they can work together to</p> <p>8 help us understand what we need to do to be a better</p> <p>9 environment, in terms of are there programs that we can</p> <p>10 put forward, are there ways that we can do a better job</p> <p>11 of mentoring or developing that level of talent.</p> <p>12 You know, our ultimate goal is for the people</p> <p>13 that we're able to bring in to NEPC, to allow them to be</p> <p>14 their full and best self at work. And to the extent</p> <p>15 that we can do that across our entire workforce, you</p> <p>16 know, we think we'll be better off as an organization,</p> <p>17 and from that our clients will benefit from that, as</p> <p>18 well.</p> <p>19 So those are the two internal aspects:</p> <p>20 building a more diverse workforce, and then making it</p> <p>21 more inclusive. The third area I want to talk about is</p> <p>22 what we're doing in terms of engaging with the</p> <p>23 investment manager community. And here it's really a</p> <p>24 three-step process.</p> <p>25 The first step in that process is making sure</p>

<p style="text-align: right;">Page 150</p> <p>1 that we're canvassing the full landscape and engaging  2 with diverse managers. And it's not -- it is easy  3 sometimes for diverse managers, particularly those that  4 are smaller, to have the same level of marketing team or  5 marketing staff to go out and reach out to all the  6 consultants. And so, for us, one of the things that  7 we're doing is we have a goal that our number of manager  8 meetings will go up 10 percent by year over year, in  9 terms of the meetings that we're having with diverse  10 managers.</p> <p>11 So by expecting and demanding all of our  12 researchers increase their level of exposure to the  13 managers, we hope to get to our second goal, which is  14 that we want 10 percent of our focused placement list,  15 or one-rated strategies, to be diverse managers by the  16 end of 2021.</p> <p>17 So when we started this, we were at six  18 percent. We have moved up to seven. We clearly have  19 work to go. But what we want to do is not just canvass  20 the landscape, but we also want to make sure, from that  21 canvassing, we're identifying and profiling the best  22 managers that can then be brought out to our clients to  23 make sure that they are getting exposure to them through  24 the manager search and identification process.</p> <p>25 The final one of those, where we're holding</p>	<p style="text-align: right;">Page 152</p> <p>1 important to share that and be a leader in that  2 transparency, and would actually love to see more of  3 that coming back from the manager community, because it  4 allows us to understand who is doing a great job on that  5 front.</p> <p>6 So with that, I'll stop my comments and look  7 forward to your questions.</p> <p>8 MR. GARCIA: Mr. Manning, we salute you.  9 Mr. Miller?</p> <p>10 MR. MILLER: Good afternoon, everyone, and  11 thank you. I want to thank Chairman Clayton, the  12 commissioners, SEC staff, Ed Bernard, Gilbert, of  13 course, and the AMAC for focusing on this critical  14 topic. My name is Michael Miller, and I'm the chief  15 investment officer of Colonial Consulting.</p> <p>16 We are a New York City-based investment  17 adviser whose predecessor found -- firm was founded in  18 1980. I joined the firm in 1986, so I have spent many,  19 many years in this industry. We count approximately 120  20 endowments and foundations as clients today, and they  21 have capital of approximately \$35 billion.</p> <p>22 So, as this section of today's meeting is  23 focused on advisors and allocators such as our firm, I  24 want to briefly share our story with the hope that it  25 will provide the Commission, staff, and this committee</p>
<p style="text-align: right;">Page 151</p> <p>1 ourselves accountable, is for our internal profit  2 sharing plan, and for those assets that we control in  3 discretionary mandates. We're measuring the percentage  4 of assets that are actually hired by diverse managers.</p> <p>5 So we want to make sure -- and that we have looked at  6 it -- our exposure is we've got about twice as much in  7 assets as our broad -- advisory client base that are  8 held by or managed by diverse managers.</p> <p>9 So, again, really, a three-pronged approach  10 there: one, making sure we're canvassing the landscape;  11 two, that we are identifying managers and rating them  12 highly, so we're giving them to clients as recommended  13 managers; and then finally, where we control the assets,  14 that we're putting our money where our mouth is, and  15 building a portfolio that contains assets managed by  16 diverse managers.</p> <p>17 And then, Gilbert, to your point about  18 transparency, you know, I think that's where we've tried  19 to lead in being transparent. And sometimes the numbers  20 -- I know the numbers aren't always where we want to be.</p> <p>21 But in -- you know, when clients ask, or when industry  22 experts ask, we give them full transparency in terms of  23 who works at NEPC, you know, what levels they are, you  24 know, in terms of ownership or senior professionals, you  25 know, all the way down to entry level. We think it's</p>	<p style="text-align: right;">Page 153</p> <p>1 with ideas regarding how the SEC might use its authority  2 to inspire meaningful change.</p> <p>3 I want to begin by emphasizing two points.  4 First, as you heard at the committee's last meeting, a  5 meaningful and lasting shift towards an equitable,  6 merit-based distribution of capital across the  7 institutional investment industry is a very long road.  8 We've been at this for nearly eight years now. And  9 while there is much we can point to -- and I'll describe  10 momentarily -- regarding the positive impact this has  11 had on our client portfolios, it's very clear to me that  12 there is very, very much to be done. And we seek to  13 ensure that our process and team are objectively and  14 aggressively pursuing exceptional managers that are  15 majority-owned by women and people of color.</p> <p>16 Second, until the value of having diversity  17 across the portfolio of decision-makers is as natural  18 and widely accepted as concepts such as asset class,  19 diversification, style diversification, et cetera, we  20 will never get past conversations around social  21 engineering or the idea, misguided as it may be, that  22 allocating capital to diverse managers is somehow at  23 odds with investment success. I cannot overemphasize  24 the fact that, in reality, the opposite is the case.</p> <p>25 Back to our story for a moment. About eight</p>

<p style="text-align: right;">Page 154</p> <p>1 years ago, one client came to us and asked us about the  2 diversity of their portfolio, the degree to which our  3 research process was providing them with a level playing  4 field, or providing a level playing field for the  5 investment manager community. That began a journey  6 which started off very slowly, as we assumed our work  7 was actually far better than it actually was.</p> <p>8 Lesson one for us in this was the power of  9 impression over facts. And until we actually sat down  10 and measured our work, we were truly unaware of how  11 poorly we were doing. Even after realizing there was a  12 real issue, this was still just one client's request.  13 Change can be difficult and costly, and absent  14 significant pressure, our efforts, no matter how well-  15 intentioned, were gradual.</p> <p>16 We also had very little appreciation for the  17 fact that there was much more going on here than just  18 the perpetuation of a system that definitively excludes  19 women and people of color.</p> <p>20 Fortunately, we have a talented and diverse  21 leadership team and staff that caused us to get more  22 serious about manager diversity somewhat internally.  23 Our effort began to accelerate almost four years ago,  24 and has produced the following results.</p> <p>25 Colonial's advisory and discretionary client base</p>	<p style="text-align: right;">Page 156</p> <p>1 One is a sustained commitment on the part of  2 the firm's leadership to this work. That involves  3 several items that were all done simultaneously: first  4 we hired an exceptionally talented individual to be 100  5 percent dedicated to ensuring that diverse managers were  6 an integral part of our research effort; second, we have  7 been multi-year sponsors of a significant number of  8 trade organizations that promote and support diverse  9 managers, and seek to improve the future of the talent  10 pipeline; third, we made it very clear to our team that  11 finding world-class, diverse managers was mission  12 critical in terms of our ability to most wisely advise  13 our clients.</p> <p>14 The next major issue was to recognize that  15 hierarchical or centralized decision-making in our  16 research process could introduce a lot of issues that  17 would slow or stop the approval of talented, diverse  18 managers during a period where individuals on our team  19 were each on their own journey towards becoming less  20 biased in their work. By changing the way we decided on  21 managers and the way we structured the vetting process,  22 we were able to overcome some of those hurdles more  23 rapidly.</p> <p>24 Third, we've long been big believers in  25 recommending newer firms, younger investment</p>
<p style="text-align: right;">Page 155</p> <p>1 has 8.4 percent of its assets today allocated to diverse  2 managers, and 12.6 percent of it allocated to managers  3 that are diverse around the world.</p> <p>4 Our discretionary or outsourced CIO client  5 portfolios have just under 22 percent of their assets  6 allocated to diverse managers globally, on average.  7 This difference between advisory and discretionary is  8 due to the fact that our discretionary work is  9 relatively new. So we built portfolios more recently  10 from a much more robust and diverse research effort.  11 Ninety-two percent of our clients use at least one  12 diverse manager, and there are currently forty-seven  13 such firms across client portfolios, with forty of those  14 forty-seven being domiciled in the United States.</p> <p>15 That line-up I just referred to -- refers to  16 is, essentially, across all asset classes.</p> <p>17 I also want to categorically state that we're  18 still missing out on a great deal of talent, and are  19 roughly, in my view, in the third inning of this effort,  20 both in terms of the number of firms we recommend, and,  21 even more significantly, the capital that has been  22 invested.</p> <p>23 With that said, we're not unhappy with where  24 we are, and I would point to three major items that  25 helped us get here.</p>	<p style="text-align: right;">Page 157</p> <p>1 professionals, and this naturally allowed us to avoid  2 the very real problem of trying to find a significant  3 number of well-established and large diverse firms, as  4 there are very few such choices. And that's, obviously,  5 one of the reasons this committee and Commission is  6 focused on this issue currently.</p> <p>7 So in thinking about how the industry moves  8 forward, I have just a few comments.</p> <p>9 First, particularly in the early days of our  10 effort, we struggled with the question of whether and  11 how we should raise this issue with clients. At the end  12 of the day, we simply allowed the quality of the  13 managers to do the talking. This was convenient, but --  14 and allowed differentiated excellence to do the talking  15 for us, but it also avoided the bigger picture issue  16 that was at work.</p> <p>17 One place where a lot of progress can be made  18 is to make this into a business issue for the advisory  19 community. The more firms like ours hear from clients,  20 hear from the Commission, then the more quickly we will  21 all act. Remember that we were able to move very slowly  22 in the beginning because we felt no pressure to make  23 change, other than the fact that we just wanted to. And  24 that's not good enough.</p> <p>25 Our suggestion for the Commissions [sic] are</p>



<p style="text-align: right;">Page 158</p> <p>1 to begin by continuing to hold hearings such as this</p> <p>2 one, and to raise the profile of the industry's lack of</p> <p>3 diversity. The second is to somehow mandate disclosure</p> <p>4 of each adviser's client assets in the hands of diverse</p> <p>5 managers. This should not be optional, and it will not</p> <p>6 come as a surprise to hear that, when we were asked to</p> <p>7 commit to annual reporting to our clients, who are</p> <p>8 interested, we did not want to embarrass ourselves, and</p> <p>9 it was quite motivating.</p> <p>10 The reporting we developed includes the number</p> <p>11 of diverse managers we meet each year, the percentage</p> <p>12 that represents of all manager meetings. We also report</p> <p>13 on the number of diverse managers that we are currently</p> <p>14 recommending, the number that our clients currently</p> <p>15 employ, and the dollars that our clients have allocated</p> <p>16 to diverse managers. These are not complex items to</p> <p>17 track, and the SEC and asset owners demanding ongoing</p> <p>18 disclosure would have a very significant impact.</p> <p>19 The other major item to consider is the</p> <p>20 definition of diversity. Ours is more than 50 percent</p> <p>21 ownership, and this represents a clear and important</p> <p>22 line in the sand. That is not to diminish the efforts</p> <p>23 of firms that have strong diversity amongst their ranks,</p> <p>24 and are clearly making meaningful contributions to this</p> <p>25 issue. However, reporting must be based on consistent,</p>	<p style="text-align: right;">Page 160</p> <p>1 giving you a high five over the screen. I hope that you</p> <p>2 saw that.</p> <p>3 Mr. Clayton Jue, you're up, sir.</p> <p>4 MR. JUE: All right, thank you for having me</p> <p>5 here today, Gilbert and committee members. I'm Clayton</p> <p>6 Jue. I am founder and CEO of Leading Edge Investment</p> <p>7 Advisors. Now, we are manager managers founded in 2005,</p> <p>8 and we focus on creating and designing emerging manager</p> <p>9 programs for institutional investors.</p> <p>10 I've been in the manager of managers business,</p> <p>11 specifically focused on emerging firms, since 1990.</p> <p>12 Prior to that I was with a major consulting firm. So I</p> <p>13 have quite a bit of experience looking at the challenges</p> <p>14 and finding solutions, different solutions on how to</p> <p>15 address those challenges.</p> <p>16 I want to highlight that we are -- I am</p> <p>17 similar, as a manager of managers, to some of my co-</p> <p>18 panelists here who are consultants, but I'm also</p> <p>19 different. I'm similar in the respect that we act as a</p> <p>20 fiduciary for our clients. I'm different in the respect</p> <p>21 that I am a comprehensive provider for an emerging</p> <p>22 manager program.</p> <p>23 What does that mean? That means I go out and</p> <p>24 I actively source and identify managers that -- similar</p> <p>25 to your consultants. So we do go out, and we do</p>
<p style="text-align: right;">Page 159</p> <p>1 objective standards, and majority ownership is a very,</p> <p>2 very good place to start.</p> <p>3 Finally, the urgency to take meaningful steps</p> <p>4 forward involves an important duality. For many it</p> <p>5 begins with a desire to improve equity in our society.</p> <p>6 At the same time we must also expand the appreciation</p> <p>7 for the fact that manager diversity is about producing</p> <p>8 superior outcomes.</p> <p>9 This was the aha moment for us, as we started</p> <p>10 to meet with more diverse managers, and realized that</p> <p>11 this was a huge win-win situation. We were finding</p> <p>12 differentiated talent, and unique talent that was being</p> <p>13 overlooked or ignored, and this is where we became</p> <p>14 extremely enthusiastic. Not only would our clients be</p> <p>15 able to leverage their capital to take on an equity, but</p> <p>16 their portfolios would be more wisely invested due to</p> <p>17 the clear and obvious benefits of differentiated</p> <p>18 thinking.</p> <p>19 As you look forward to your efforts, I'm</p> <p>20 excited to see and looking forward to seeing the</p> <p>21 continual and well-documented progress towards a more</p> <p>22 equitable and superior investment community.</p> <p>23 I thank you again for listening to me, and I</p> <p>24 appreciate the invitation to be here today.</p> <p>25 MR. GARCIA: Mr. Miller, thank you. I'm</p>	<p style="text-align: right;">Page 161</p> <p>1 evaluate the product offerings that they have. We look</p> <p>2 at their competitive strengths. We look at their</p> <p>3 capabilities. And, basically, we try to determine what</p> <p>4 they're good at.</p> <p>5 Secondly, I -- after finding out what they're</p> <p>6 good at, I design and construct an investment program</p> <p>7 that utilizes the individual strengths and capabilities</p> <p>8 of the managers. We also determine who the managers</p> <p>9 are, the allocations, and the role they play in the</p> <p>10 investment program.</p> <p>11 And then thirdly, we evaluate and provide</p> <p>12 ongoing oversight of the program, making changes as</p> <p>13 necessary, as well as providing support and guidance to</p> <p>14 the underlying managers as they grow their businesses.</p> <p>15 So in my capacity as a manager of managers, I</p> <p>16 am a talent scout, I am a casting director, and I am</p> <p>17 also a team coach. So that's a little bit different</p> <p>18 than most general consultants.</p> <p>19 Our clients typically give us full discretion</p> <p>20 to implement the program. However, I like to point out</p> <p>21 that it is a collaborative effort, and we work closely</p> <p>22 with all of our clients on all the decisions.</p> <p>23 My comments today are based on my 30 years of</p> <p>24 experience, observations, and reflections as a manager</p> <p>25 of managers.</p>

<p style="text-align: right;">Page 162</p> <p>1           The first principle I think that is important</p> <p>2   for maximizing program success is to make diversity and</p> <p>3   inclusion a full-time effort, as opposed to a part-time</p> <p>4   activity. Many institutions assign this responsibility</p> <p>5   or this activity to an existing staff member who also</p> <p>6   has many other responsibilities. And that's really not</p> <p>7   sufficient, because the emerging manager universe is</p> <p>8   quite broad, and it requires a wide bandwidth to cover</p> <p>9   that universe.</p> <p>10          Just as an example, the SEC has -- or had, at</p> <p>11   least in 2019 -- approximately 12,900 RIAs. That's a</p> <p>12   lot of firms. Most consultants will only focus on the</p> <p>13   largest firms, and they have all the assets, or most of</p> <p>14   -- the majority of the assets, as we all know. So to</p> <p>15   actually cover the universe adequately, you've got to</p> <p>16   have bandwidth.</p> <p>17          Secondly, you've got to have expertise at</p> <p>18   looking at smaller firms. So this is a little bit of a</p> <p>19   specialized capability. You're looking at smaller</p> <p>20   firms, they have a limited history and limited track</p> <p>21   records. And you have to have the expertise to be able</p> <p>22   to look at that closely and to make judgments and</p> <p>23   interpretations and decisions based on that. This</p> <p>24   requires resources.</p> <p>25          So how does -- how do institutions do this?</p>	<p style="text-align: right;">Page 164</p> <p>1   very challenging for active management, I think everyone</p> <p>2   is aware of that, that is changing back the other way</p> <p>3   more recently, but many of our programs did migrate to</p> <p>4   the international equity markets, and managers have been</p> <p>5   very successful in that area. So being able to adapt,</p> <p>6   being flexible, that's also very important.</p> <p>7          The third point I want to point out is -- for</p> <p>8   success is long-term commitment. There is a couple of</p> <p>9   do-nots here.</p> <p>10          Do not become discouraged if the initial</p> <p>11   results are not -- are disappointing. You really just</p> <p>12   have to be persistent, you have to be committed.</p> <p>13          Another do not is you do not allow the program</p> <p>14   to be viewed as a static, set-aside allocation. This is</p> <p>15   sometimes viewed as a compromise in standard and/or</p> <p>16   performance. That really doesn't help. The program</p> <p>17   should be able to grow. A static program sometimes</p> <p>18   creates tension between different diverse groups who are</p> <p>19   pitted against each other for those allocations. So to</p> <p>20   be able to solve that, the program should grow and</p> <p>21   expand, and provide more opportunity for everyone.</p> <p>22          Lastly, I would like to reiterate the twin</p> <p>23   requirements of transparency and accountability. It's</p> <p>24   really important. The latter, accountability, should be</p> <p>25   very granular.</p>
<p style="text-align: right;">Page 163</p> <p>1   Well, they can assign a staff member to be dedicated</p> <p>2   full-time to doing this, and give that staff member</p> <p>3   adequate resources. Or they could hire firms such as</p> <p>4   ours, a manager of managers who specializes in this</p> <p>5   area. Many of our clients do both, so there is not one</p> <p>6   only right approach.</p> <p>7          The second principle I'd like to focus on is</p> <p>8   that the emerging manager program should be fairly</p> <p>9   flexible, so a cookie-cutter approach does not work for</p> <p>10   everybody. It must be flexible. A customized approach</p> <p>11   allows the program to utilize the separate strengths of</p> <p>12   each of the individual firms. It is able to adapt and</p> <p>13   change as the market and conditions dictate. Manager</p> <p>14   selection and allocation should not be constrained by</p> <p>15   arbitrary AUM or track record requirements; it should</p> <p>16   focus on a manager's true operating capability and</p> <p>17   capacity.</p> <p>18          The biggest challenge for emerging firms today</p> <p>19   is getting that first account, and there are just many</p> <p>20   policies against being the first account for a firm. So</p> <p>21   our programs try to overcome that.</p> <p>22          And being able to adapt, the program should be</p> <p>23   able to move to areas to where managers are successful.</p> <p>24   So, for example, in the last few years many of our</p> <p>25   programs migrate from domestic equities, which has been</p>	<p style="text-align: right;">Page 165</p> <p>1          So in closing, my comments are not new. My</p> <p>2   concepts are not new. But, like in anything else that</p> <p>3   is done well, the devil is in the details.</p> <p>4          Thank you.</p> <p>5          MR. GARCIA: Thank you, Clayton. Thank you</p> <p>6   very much.</p> <p>7          We are on time. Why don't we see if we have</p> <p>8   any questions out there. Any questions for any of the</p> <p>9   speakers?</p> <p>10          And I'll certainly lead off with one, which</p> <p>11   is, Mike Miller and Mike Manning, do you all have</p> <p>12   someone dedicated, as Clayton said, full-time to sort of</p> <p>13   working with emerging firms and minority-owned firms and</p> <p>14   women-owned firms?</p> <p>15          I'll start with you, Mr. Miller.</p> <p>16          MR. MILLER: Yes, we do, Gilbert. We have</p> <p>17   someone who has become a bit of a legend in this</p> <p>18   industry, Angela Matheny, who is head of diverse manager</p> <p>19   equity at Colonial, and she was actually recently</p> <p>20   promoted to be the chief of the investment staff,</p> <p>21   working with me to run the entire team.</p> <p>22          But I want to be clear, she's a point of</p> <p>23   contact for diverse managers, but every member of our</p> <p>24   team has engaged a diverse manager, and Angela is the</p> <p>25   source here, in some degree, although that's moved</p>

<p style="text-align: right;">Page 166</p> <p>1 almost beyond her at this point. And she's the  2 cheerleader. She's actually the one who, I will tell  3 you, is the enforcer in the firm to ensure that we all  4 stay on track, and that we don't lose any of these  5 managers, or our diverse managers, in particular, in the  6 flood of ideas that come our way. So that's an  7 incredibly important part of what we're doing.</p> <p>8 MR. GARCIA: Mr. Manning?</p> <p>9 MR. MANNING: Sure. So we do not have a  10 dedicated person. Our approach has been that each  11 person who is managing a particular coverage area, you  12 know, whether that is international equity, corporate  13 income, anything along those lines, they need to know  14 their space exceptionally well.</p> <p>15 You know, we've seen other models where it is  16 one person off to the side meeting diverse managers --  17 and it doesn't sound like that's what's going on at  18 Colonial, so I'm not -- no aspersions there. But, you  19 know, if that person is doing -- to me, that's not -- it  20 is not fully involved in the research process, and it is  21 seen as something separate. And from my perspective, I  22 think we should look at these managers -- and I think  23 Mike Miller's comments were great about, you know, one  24 of -- the rationale on this is you're going to get great  25 managers out of it. So we want our dedicated</p>	<p style="text-align: right;">Page 168</p> <p>1 important point. And I will tell you this. So we are -  2 - when I said before that we are defining diversity this  3 very specific way, we're -- that's important to us,  4 because there's a lot of ways that you can massage the  5 numbers -- which is not what you're suggesting, I  6 realize -- if you don't have a definitive area of focus  7 that way.</p> <p>8 But with that said, and when we -- when I  9 referred to differentiated thinking, now we're talking  10 about some of the things that Mike Manning brought up  11 before, too, which is, you know, what is the leadership  12 structure, the diversity, and who are the decision-  13 makers, specifically within large organizations and the  14 large, publicly-traded asset managers.</p> <p>15 So we don't include them in our statistics,  16 but we very-much include them in our portfolios, because  17 that's how we press this advantage even further.</p> <p>18</p> <p>19 MR. GARCIA: Thank you. Mr. Manning, did you  20 have a comment there?</p> <p>21 MR. MANNING: Absolutely. So, you know, I  22 guess one of the things -- and the corollary here might  23 be the way that NEPC approaches ESG. And so, you know,  24 there, when we evaluate managers, we evaluate them on  25 their commitment to getting better. You don't have the</p>
<p style="text-align: right;">Page 167</p> <p>1 researchers to look at that. And so that's the approach  2 that we've taken.</p> <p>3 MR. GARCIA: Thank you. Michelle, I know you  4 had your hand up.</p> <p>5 MS. BECK: Yeah, I -- you know, I heard some  6 comments about, you know, focusing on where ownership  7 structures are minority and female. And I do wonder  8 where it leaves all of the companies where -- that are  9 publicly owned, or that have significant diversity in  10 their management structure, but not necessarily the  11 ownership structure.</p> <p>12 So I did want to understand how do you  13 incorporate them, particularly in the world where so  14 many assets have gone to passive, which tends to favor  15 large-scale, very big companies. So does that not  16 matter, should we not be looking at that?</p> <p>17 What would it do to the statistics that we  18 heard about in the first meeting if we actually expanded  19 the envelope a little, and looked at larger asset  20 managers and their diverse populations?</p> <p>21 So I am curious about your thoughts.</p> <p>22 MR. MILLER: Well, I would be happy to start.  23 Is that okay?</p> <p>24 MR. GARCIA: Yes, thank you, Mr. Miller.</p> <p>25 MR. MILLER: Yeah, so that's a really</p>	<p style="text-align: right;">Page 169</p> <p>1 same objective metrics that you do that Mike Miller  2 talked -- sorry, we have two Mike Ms, it's a little  3 harder -- that Mike Miller talked about on the clear  4 demarcation point of 50 percent ownership or not.</p> <p>5 I can see us at some point evolving to a  6 rating on diversity which includes not just the  7 ownership, but the leadership, and then also the steps  8 that they're taking as an organization to promote  9 diversity.</p> <p>10 So, you know, I think it's, you know,  11 admirable for an organization that is still majority  12 owned, but taking meaningful steps to promote that  13 diversity. It's just that it's not an objective measure  14 in today's environment, and I think we're still working  15 to -- at a minimum, we would like to get the objective  16 measures and the transparency to start there. But, you  17 know, we're continuing to ask about what they're doing  18 to promote a more diverse population, not for the sake  19 of diversity, but for the sake of you get better  20 decision-making if you've got greater thoughts around  21 the table.</p> <p>22 MR. GARCIA: Clayton, did you want to weigh in  23 real quick, before we turn it over to Mr. Bernard for a  24 question?</p> <p>25 MR. JUE: Well, diversity in larger public</p>

<p style="text-align: right;">Page 170</p> <p>1 organizations, actually, is very important. One of the</p> <p>2 reasons why many minorities and women went out on their</p> <p>3 own earlier -- in earlier years was because they were</p> <p>4 frustrated with their advancement within these larger</p> <p>5 corporations. So definitely, they should be recognized</p> <p>6 for their contributions. They should be rewarded for</p> <p>7 that. They should be able to advance based on that.</p> <p>8 I'll tell you that many of the large</p> <p>9 organizations are very proactive about their diversity</p> <p>10 efforts. We really appreciate that. And we have a good</p> <p>11 network through them, as well. We are able to find</p> <p>12 managers of -- minority individuals or women individuals</p> <p>13 who want to go out on their own very early on from these</p> <p>14 organizations, and that is part of our active sourcing.</p> <p>15 MR. GARCIA: Thank you.</p> <p>16 Mr. Bernard?</p> <p>17 MR. BERNARD: Yeah, a question, if I could. I</p> <p>18 know in our next group we've got three asset owners, and</p> <p>19 we're delighted to have them to talk about this, but you</p> <p>20 all serve a wide array of clients who are asset owners,</p> <p>21 and I'm curious to hear your thoughts on the state of</p> <p>22 play, and the extent to which asset owners are asking</p> <p>23 you to find diverse managers, or you're telling them</p> <p>24 they need to ask you.</p> <p>25 You know, to what extent are you having to</p>	<p style="text-align: right;">Page 172</p> <p>1 -- or clients excuse me -- where it may not be that</p> <p>2 important.</p> <p>3 I think one of the areas, interestingly, with</p> <p>4 the DOL recently, you know, in their conversation about</p> <p>5 ESG, you know, is this a factor that an ERISA fiduciary</p> <p>6 can take into consideration when they're building a</p> <p>7 portfolio? You know, and some of the recent discussions</p> <p>8 about where ESG is not something that should be factored</p> <p>9 in for some portfolios, you know, I think is a little</p> <p>10 bit concerning.</p> <p>11 But that is -- I would say we're all over the</p> <p>12 board, in terms of where clients are. There are some</p> <p>13 that are very forward-looking, and are pressing, and</p> <p>14 want to have a dedicated mandate, and there are some who</p> <p>15 either, frankly, don't care, and their focus is on just,</p> <p>16 "Give me the best managers," or worry that having that</p> <p>17 as a mandate might not allow them to meet their ERISA</p> <p>18 duty. So --</p> <p>19 MR. GARCIA: Mr. Miller, do you want to</p> <p>20 comment on state of play?</p> <p>21 MR. MILLER: Yes, sure. I'd be happy to. So</p> <p>22 it's interesting. Up until this year, I'd say the state</p> <p>23 of play was there were two things. One is very few</p> <p>24 people asked us about it.</p> <p>25 But what was interesting is, when we started</p>
<p style="text-align: right;">Page 171</p> <p>1 persuade them, and to what extent are you seeing</p> <p>2 increasing receptivity and/or demand for that?</p> <p>3 MR. MANNING: I'm happy to start. Mike</p> <p>4 Manning again.</p> <p>5 So we work across a whole array of clients.</p> <p>6 We are probably the most diverse institutional</p> <p>7 consulting firm, by the type of clients that we service,</p> <p>8 and it really is across the board. You know, I think if</p> <p>9 you look at -- particularly in -- at a lot of the large</p> <p>10 public funds, they may have specific mandates, whether</p> <p>11 it be to hire someone like Clayton's firm, or they have</p> <p>12 their own internal team, where they're directing -- or,</p> <p>13 you know, an objective for them is to have a certain</p> <p>14 percentage of the assets or the fees -- and I think we</p> <p>15 should -- it's important, is not just about the assets,</p> <p>16 it's about the total fee dollars that are being spent to</p> <p>17 managers -- there are some that have those specific</p> <p>18 carve-out programs, you know, like Mike Miller and his</p> <p>19 firm.</p> <p>20 We have endowments and foundations that are</p> <p>21 more socially minded, and that's an important aspect to</p> <p>22 what -- and families, actually, that -- that's a really</p> <p>23 important goal for them, and they want to -- they are</p> <p>24 asking us and pushing us, I guess, in the same way that</p> <p>25 Mike talked about, whereas there's a subset of managers</p>	<p style="text-align: right;">Page 173</p> <p>1 to raise the issue not in general terms, but with</p> <p>2 specific manager ideas, I was actually quite, I must</p> <p>3 admit, surprised at how receptive clients were. It was</p> <p>4 almost like they were waiting for us to come and say,</p> <p>5 "This is how you should do this," and they embraced it</p> <p>6 quite broadly. It was really, really interesting to me,</p> <p>7 and kind of made me wonder what took us so long.</p> <p>8 This year things have changed. A lot more</p> <p>9 clients are asking about diversity in their portfolios.</p> <p>10 They see it as another tool they could use, in terms of</p> <p>11 some of society's ills that Gilbert described earlier.</p> <p>12 And we're seeing a much larger level of interest in the</p> <p>13 subject in general, which is heartening.</p> <p>14 I just want to clarify one thing. We don't</p> <p>15 have separate sleeves, and I don't think anyone implied</p> <p>16 we do, but I want to make it clear. Diverse managers</p> <p>17 are part of our portfolios. And when they get to 30 to</p> <p>18 50 percent of the portfolios, we'll feel like we might</p> <p>19 have achieved something worth achieving. But there is</p> <p>20 no sleeve for diverse managers. There's no carve-out</p> <p>21 for them. They are managers in our portfolio,</p> <p>22 generating excellence for our clients alongside our</p> <p>23 other managers. That's the idea.</p> <p>24 But yeah, that -- so the state of play is</p> <p>25 improving it. But I will say it's not -- I wouldn't</p>

<p style="text-align: right;">Page 174</p> <p>1 call it a tsunami, by any means. It's just slowly but 2 surely getting better.</p> <p>3 MR. GARCIA: And Mr. Clayton Jue, I'm going to 4 phrase a question just a little bit different. Given 5 some of the things that have recently happened that 6 we've read about in the manager of managers space, what 7 is the state of play for you now? Are things changing? 8 Are you seeing more activity?</p> <p>9 MR. JUE: Certainly seeing a lot more inquiry 10 on the topic. We've had a number of clients that have 11 been committed to this area for a number of years, and 12 we're really proud to have those clients.</p> <p>13 A lot of the inquiry -- there are new 14 inquiries, really, from organizations or institutions 15 that -- they either haven't tried a -- you know, a 16 focused effort in diversity and inclusion, or they have 17 tried it before, but the people who were in charge of 18 that have moved on, and there is no institutional memory 19 in place to what has been done. So then we get 20 organizations come back to us, and they start all over 21 again from scratch.</p> <p>22 Now, this is a problem with a lot of public 23 funds. Staff turns over and people leave. But you've 24 got to have a record of what's been done, what's been 25 tried. And we're getting a lot of questions on, you</p>	<p style="text-align: right;">Page 176</p> <p>1 recently joined and is now a part of our internal board, 2 when we did a search for someone on the West Coast, we 3 specifically were trying to look for diversity. And so, 4 you know, we made that a big part of -- more recently, 5 in the last four or five years, we made that a big part 6 of all of our searches, is trying to make sure we're 7 interviewing a diverse slate of candidates, as opposed 8 to just the candidates who might apply. So we're really 9 going out and trying to canvass the world, looking for 10 people of diversity.</p> <p>11 MR. GARCIA: Thank you.</p> <p>12 Mr. Bernard, I think we're ready to move to 13 the next group. Very good.</p> <p>14 And for our first panelists, you're welcome to 15 please stay and be part of the conversation. But if 16 you're busy, we understand.</p> <p>17 So our next grouping is now going to be asset 18 allocators. And we, again, have three leaders in this 19 area.</p> <p>20 We're going to start with Cheryl Alston, who 21 is the executive director and CIO of the Dallas 22 Employees. But she also is on many other boards. And I 23 think you could say, wherever she goes, she touches the 24 finger, or the hand of diversity comes. And I think 25 that's phenomenal.</p>
<p style="text-align: right;">Page 175</p> <p>1 know, what's been done in the past, what's tried, what's 2 been successful, what's not been successful. So that's 3 a lot of the inquiry.</p> <p>4 And, you know, I think that, you know, if we 5 can have a more consistent, persistent effort, you make 6 more progress.</p> <p>7 MR. GARCIA: Thank you. We have about another 8 minute or two. Are there any other questions from any 9 of the committee members?</p> <p>10 Well, then, I'm just going to do one more, if 11 I could.</p> <p>12 Mike Manning, NEPC tends to have a reputation 13 for having one of the highest number of people of color 14 in consultants, and research, and even a member of your 15 board. How did you get there? And was there a decision 16 that said, "We just need to do this," or did it just 17 happen naturally?</p> <p>18 MR. MANNING: You know, I can't go back and 19 point to a specific decision, but I do know, where we 20 have identified talent, we've said -- you know, a few 21 people, you know, were coming into the organization and, 22 you know, didn't have a spot, you know, came up and 23 said, "Hey, she's incredibly talented. Let's bring her 24 in, and we can find a place for her," you know.</p> <p>25 And then, you know, with Sam Austin, who</p>	<p style="text-align: right;">Page 177</p> <p>1 And then we're going to have Mr. A.J. 2 Hernandez, who is the director of emerging managers at 3 the New York State Common Fund. And A.J. is interesting 4 because he was there, he kind of left, and he's come 5 back. And I think he's come back, you'll see, with 6 renewed enthusiasm for progress.</p> <p>7 And then we're going to close with Mr. Michael 8 Frerichs, the Illinois State treasurer. And I think 9 you'll see why, when you hear his comments, because not 10 only has he done extraordinary things for the State of 11 Illinois, but he's also done extraordinary things in the 12 area of diversity, which I think is a good example that 13 they're not mutually exclusive, to do an excellent job 14 and to achieve a lot of progress with diversity.</p> <p>15 So having said that, Cheryl Alston, welcome. 16 (Pause.)</p> <p>17 MR. GARCIA: I think you're muted there, 18 Cheryl.</p> <p>19 (Pause.)</p> <p>20 MR. GARCIA: You want to try again, Cheryl?</p> <p>21 MS. ALSTON: I do.</p> <p>22 MR. GARCIA: Okay, there we go. We got you.</p> <p>23 MS. ALSTON: Can you hear me? Yes?</p> <p>24 VOICE: Yep, go for it.</p> <p>25 MR. GARCIA: Yes, we got you.</p>

<p style="text-align: right;">Page 178</p> <p>1 MS. ALSTON: All right. Good afternoon, and I</p> <p>2 would like to express my thanks to the SEC team, Dalia</p> <p>3 Blass, Ed Bernard, committee chairman, Gilbert Garcia,</p> <p>4 and the members of AMAC for inviting me to participate</p> <p>5 on this panel. My name is Cheryl D. Alston, and I am</p> <p>6 the executive director and chief investment officer of</p> <p>7 an employees retirement fund of the City of Dallas.</p> <p>8 The Dallas Employees' Retirement Fund is a</p> <p>9 \$3.6 billion defined benefit plan for the civilian</p> <p>10 employees of the City of Dallas.</p> <p>11 The Asset Management Advisory Committee has</p> <p>12 asked for the following, you know, very strategic -- key</p> <p>13 strategic questions: What can we do to improve DEI in</p> <p>14 the industry itself, and have all segments of society</p> <p>15 have access to opportunities to succeed?</p> <p>16 There is a saying that a journey begins with a</p> <p>17 plan, developing a roadmap, and the courage to get to</p> <p>18 the destination. I was appointed to this position in</p> <p>19 2004, and I have served in the role of an asset</p> <p>20 allocator for 16 years. My discussion will focus on our</p> <p>21 journey with both large and small asset management firms</p> <p>22 on the way to improve diversity, equity, and inclusion.</p> <p>23 I want to talk about why we started on the journey, the</p> <p>24 best practices, and the lessons we learned along the</p> <p>25 way, and the results. And I will wrap up with my list</p>	<p style="text-align: right;">Page 180</p> <p>1 the market; and do you think small firms should have an</p> <p>2 opportunity to compete for business, most answers are</p> <p>3 overwhelmingly yes. Many of the inspirational American</p> <p>4 stories were built on the little guy or gal, or small,</p> <p>5 hardworking, talented firms winning against the large</p> <p>6 ones.</p> <p>7 But if you ask someone, "Do you support</p> <p>8 minority women-owned firms having an opportunity to</p> <p>9 compete for business," the tone often changes. Why?</p> <p>10 At Dallas ERF, our answer was yes to both</p> <p>11 questions. We support minority and women-owned</p> <p>12 businesses, entrepreneurship, and job creation. If you</p> <p>13 allocate \$100 million to a large firm, it barely creates</p> <p>14 a ripple, and is absorbed by their current operations.</p> <p>15 But if you give \$100 million to a diverse firm, it</p> <p>16 creates jobs.</p> <p>17 So what did we do? We have a two-pronged</p> <p>18 approach. First, we actively engaged with majority-</p> <p>19 owned firms about the discussion on DEI. We asked for</p> <p>20 diversity statistics in our RFPs, so it should be</p> <p>21 encouraging for you to know that asset managers are</p> <p>22 completing these diversity scorecards. We wanted data</p> <p>23 on the diversity of the entire firm, and the diversity</p> <p>24 of the investment management team. And we are not the</p> <p>25 first investor to ask for this information, because we</p>
<p style="text-align: right;">Page 179</p> <p>1 of recommendations.</p> <p>2 So first, why do we lean into diversity,</p> <p>3 equity, and inclusion? I know the committee has heard</p> <p>4 about all the statistics about diversity from the</p> <p>5 studies, but I will just focus on one statistic from the</p> <p>6 Knight Foundation report: the fact that across all four</p> <p>7 asset classes, mutual funds, hedge funds, private equity</p> <p>8 and real estate, diverse funds only represent 1.3</p> <p>9 percent of the total assets under management for those</p> <p>10 asset classes.</p> <p>11 After the great recession in 2008, my opinion</p> <p>12 is that progress stalled and took a step back in</p> <p>13 diversity. Institutional investors were hiring</p> <p>14 primarily very large firms. I became very concerned</p> <p>15 about the future of competition in the asset management</p> <p>16 industry if all investment services became consolidated</p> <p>17 in the hands of a few trillion-dollar companies.</p> <p>18 Diverse firms who had similar or higher investment</p> <p>19 performance for the same time period were not even given</p> <p>20 the opportunity to compete for the business, due to</p> <p>21 minimum qualifications that excluded them.</p> <p>22 So if you asked someone the following</p> <p>23 questions: do you support small businesses; do you</p> <p>24 support innovation and entrepreneurship; do you support</p> <p>25 the creation of more jobs; do you support competition in</p>	<p style="text-align: right;">Page 181</p> <p>1 revised the template that we received from the State of</p> <p>2 Connecticut.</p> <p>3 When we conduct our due diligence meetings, we</p> <p>4 talk about the diversity inclusion with the CEO and</p> <p>5 president of the firm, because we do believe the tone</p> <p>6 begins at the top. Over the past 16 years the</p> <p>7 conversations have moved from awkward and uncomfortable</p> <p>8 to discussion on policies and metrics. The most</p> <p>9 sophisticated asset managers are ready for the</p> <p>10 discussion.</p> <p>11 One highlight story was a woman approached me</p> <p>12 after a conference. She works for a hedge fund, and she</p> <p>13 told me that in my -- in the client notes associated</p> <p>14 with me they had put that I will ask about diversity,</p> <p>15 equity, and inclusion, and then about the discussion</p> <p>16 with the founder. And it was so very heartwarming to</p> <p>17 me. She told me that she felt that the reason why she</p> <p>18 had the opportunity to have this position was because I</p> <p>19 simply asked the question about what was their data, and</p> <p>20 what was their plan to improve it.</p> <p>21 Second, for minority and women-owned firms, we</p> <p>22 started the Next Generation manager program almost 10</p> <p>23 years ago. The goal of the program is the</p> <p>24 identification and selection of high-performing diverse</p> <p>25 firms. We were very intentional about the name of the</p>

<p style="text-align: right;">Page 182</p> <p>1 firm being "Next Generation," and not "Emerging 2 Managers," because we wanted to find the next set of 3 firms that could grow into industry. 4 So what are the key points of the program? 5 First, governance. Everything starts with 6 governance and the tone from the top. I report to a 7 board that is 57 percent diverse. My staff is over 60 8 percent diverse. The board believes in their fiduciary 9 duty, and they believe in a fair and equitable market. 10 The board included the program in their 11 governing documents, specifically in our investment 12 policy statement, so it lives on past the current board 13 and past the current executive director. It should also 14 be included in the strategic plan and the compensation 15 plan that flows down to the entire investment team. The 16 monitoring objectives, it needs to be done and completed 17 by the full board, just as in any strategic plan review. 18 Now, there are two approaches to staff 19 implementation. Some organizations have a single 20 champion who is responsible for the diversity effort, 21 and they give them a portion of the portfolio to 22 allocate. Another approach, which we use, is to weave 23 diversity into the DNA of all the investment team. As 24 the companies have stated, that risk management is the 25 responsibility of all employees, DEI is the</p>	<p style="text-align: right;">Page 184</p> <p>1 follow this process, but rely on a preferred vendor list 2 from consultants which often may not include diverse 3 firms. 4 Another component is we do not cap on asset 5 size. We look at the size of the manager relative to 6 the peers in the asset class. A \$10 billion company in 7 small cap would be huge, but a \$10 billion company in 8 fixed income is tiny. So you need to look at the 9 minimum qualifications that are appropriate for that 10 asset class. 11 Another key component is are there any other 12 barriers that are not related to investment factors that 13 prevent women and minority firms to compete? For 14 example, one organization had an insurance requirement 15 buried in the RFP that was so high only a very large 16 firm could meet the requirement. 17 And the final component is incorporation into 18 the portfolio. Once the firm is hired, we incorporate 19 the firm into the overall portfolio. There is a reason 20 we do not have a smaller pool, or graduation process 21 into the larger pool, because we want to avoid 22 associating diverse firms together. 23 I had one CFO tell me that she hired 2 24 minority firms over 10 years ago, and it did not work 25 out. I asked her, "How many firms, majority-owned</p>
<p style="text-align: right;">Page 183</p> <p>1 responsibility of the entire staff, so that they develop 2 the muscle and gain the expertise to make decisions 3 long-term, and it becomes part of the DNA of the 4 organization. 5 In terms of another point is a definition of 6 diversity. We believe in the Knight Foundation 7 definition, which is 25 to 49 percent of -- or more 8 ownership that's represented in their study is more 9 realistic than 51 percent, because -- and simply because 10 of the amount of capital it takes to form a new asset 11 management firm today. It's hard for one -- a few 12 people to put up that additional money. So we believe 13 25 to 45 percent, in that range, is appropriate. 14 Another key point is transparency. In order 15 to improve transparency, we started having an open 16 house. In our office we would host an open house to 17 talk about the fund, our asset allocation, the general 18 RFP process, and selection process at no cost. It gives 19 asset management firms an opportunity to ask questions. 20 And in this COVID environment we will have to host 21 these open houses virtually. 22 The next component is access. We are a public 23 entity, so we follow the RFP process published on our 24 website, and all firms are eligible to apply. I know 25 there are some institutional investors that may not</p>	<p style="text-align: right;">Page 185</p> <p>1 firms, have you hired in the same time period that you 2 have terminated?" And it was five times the number. 3 But it did not stop her from hiring another majority- 4 owned firm. 5 It also gives people a reason to give them a 6 lower allocation. I believe a firm allocation that is a 7 percentage of the portfolio is appropriate, so the firm 8 can grow as the total fund goes. 9 Just -- I just want to hit on some common 10 misconceptions before I close. A common misconception: 11 diverse firms cost more. No, their fees are in the 12 range for active managers in the asset class. 13 Another common misconception is you need 14 special staff, or more staff to hire diverse managers. 15 No, a majority-owned fixed income manager and a minority 16 or women-owned fixed income manager have the same 17 components. 18 Another misconception: performance is lower 19 for diverse firms. The Knight Foundation provides 20 statistics to dispute that issue. And just for myself, 21 a recent article in The Dallas Morning News listed the 22 Dallas CRF as the second-highest performing public fund 23 for the 10-year period. And through that entire 10-year 24 period we have had women and minority firms play a 25 meaningful role in the portfolio.</p>

<p style="text-align: right;">Page 186</p> <p>1 And the last one: diverse firms are hard to  2 find. And what I've told my peers is I believe that a  3 CEO who can find a private equity deal in Latin America  4 and Asia can find a minority or women-owned firm in the  5 U.S.</p> <p>6 So to conclude, my recommendations: I  7 reviewed the SEC's strategic plan for diversity  8 inclusion for 2020 to 2022, so I'm going to tie my  9 recommendations to some of your language.</p> <p>10 One is to create and implement a  11 communications strategy that further elevates diversity  12 and inclusion as a key strategic priority, and reinforce  13 a leadership commitment. The SEC has taken the first  14 step with the formation of this committee. So I would  15 encourage you to develop a formal communication plan to  16 provide guidance on this issue for your members.</p> <p>17 The second one is transparency. Your language  18 says, "raise awareness by including information about  19 diversity inclusion on the SEC's external website, and  20 maintaining a diversity dashboard." Although I think  21 you are referring to your own employees, providing  22 guidance on a diversity scorecard, adopting a scorecard  23 for your members, is appropriate, because whatever is  24 measured is managed.</p> <p>25 And the final is using quantitative and</p>	<p style="text-align: right;">Page 188</p> <p>1 Advisory Committee for focusing on diversity and  2 inclusion as a top priority. And I thank you for  3 including me and my organization to provide our  4 perspective.</p> <p>5 You will find, when it comes to diversity  6 inclusion, there is much to learn, much to discuss, and  7 much to do.</p> <p>8 Second, I would like to give a little  9 background on my organization and the employees,  10 beneficiaries, and retirees it represents in order to  11 provide you with perspective on my comments and  12 recommendations to the committee today.</p> <p>13 New York State Common Retirement Fund is the  14 third-largest pension plan. We have a little bit over a  15 million. We have a little bit over a million employees,  16 retirees, and beneficiaries. We are approximately \$220  17 billion assets under management.</p> <p>18 The emerging manager program is a separate  19 platform and initiative at New York State, managing  20 approximately \$7 billion across 125 underlying managers,  21 with 8 program partners covering all asset classes.  22 That includes equity, global equities, real estate, real  23 assets, credit, and fixed income.</p> <p>24 Historically, we've always recognized the  25 importance of this platform. But now, more than ever,</p>
<p style="text-align: right;">Page 187</p> <p>1 qualitative data to evaluate programs and processes and  2 identify barriers that may deter inclusivity and  3 opportunity. And I think what you realize is that data  4 provides a foundation for meaningful discussion. I  5 believe in the intelligence of the boards that manage  6 these funds and the senior teams to adopt policies and  7 procedures, and hopefully develop new best practices for  8 the industry.</p> <p>9 So, in summary, just what is the North Star?  10 In my opinion, the North Star is a fair and equitable  11 market that all segments of American society can  12 compete. I think this is a first step, and I want to  13 thank you so much for your time.</p> <p>14 MR. GARCIA: Cheryl, thank you. I'm giving  15 you two thumbs up.</p> <p>16 I'm not going to call on Mr. Hernandez, A.J.  17 Hernandez.</p> <p>18 MR. HERNANDEZ: Good afternoon. Thank you,  19 Gilbert.</p> <p>20 Mr. Chairman, Commission, the Commission  21 staff, committee members, ladies and gentlemen, my name  22 is Anyori "A.J." Hernandez, and I am the director of the  23 emerging manager program at New York State Common  24 Retirement Fund.</p> <p>25 First, I applaud the SEC Asset Management</p>	<p style="text-align: right;">Page 189</p> <p>1 given current events, the emerging manager program has  2 never been more relevant than it is today. Diversity  3 has always been part of our fabric. It has always been  4 part of our DNA. It certainly has been a part of my  5 DNA.</p> <p>6 Thinking about current events, the unrest, the  7 instability that has gripped the country over the past  8 few months has only highlighted how thoughtful we have  9 to be in expanding our commitment to diversity and  10 inclusion, and to the emerging manager community at  11 large.</p> <p>12 We have not stopped investing. We continue to  13 increase the availability of capital and to accelerate  14 diverse leadership and management in our emerging  15 manager and core portfolio.</p> <p>16 When I think what has made our program  17 successful, and lessons that folks can take away, there  18 are two stand-outs.</p> <p>19 The first, which has been mentioned a couple  20 of times here today, is tone at the top. That makes all  21 the difference. The support that I receive from the CIO  22 and the controller gives me the confidence to execute my  23 strategies.</p> <p>24 And two, having a dedicated emerging manager --  25 dedicated team for the program.</p>



<p style="text-align: right;">Page 190</p> <p>1 This team is responsible and held accountable</p> <p>2 for the successes and execution of the emerging manager</p> <p>3 program.</p> <p>4 Some of the lessons learned, if you're running</p> <p>5 an emerging manager program, and have consultants and</p> <p>6 advisors that act as an extension of your staff, make</p> <p>7 sure they truly understand how to underwrite for newer</p> <p>8 and smaller managers. It makes all the difference</p> <p>9 between having a successful performing program, and one</p> <p>10 that, uh, will underperform.</p> <p>11 And two, truly understand the diversity</p> <p>12 throughout the organization you work with. Understand</p> <p>13 the gender diversity, ethnic diversity, diversity in</p> <p>14 leadership position, diversity in workforce, just to</p> <p>15 name a few. Get the whole picture. It is my philosophy</p> <p>16 than an asset manager, or any organization for that</p> <p>17 matter, is at risk if it does not have a diverse and</p> <p>18 inclusive culture.</p> <p>19 Which brings me to my recommendation. As you</p> <p>20 know, the topic of diversity and inclusivity is multi-</p> <p>21 faceted, and there's much to consider and much to learn,</p> <p>22 and I would say that seldom there is one -- there is one</p> <p>23 solution for such a complex problem. So, I offer the</p> <p>24 following suggestion, and ask you to reflect on them in</p> <p>25 addition to any policy changes that are needed, uh,</p>	<p style="text-align: right;">Page 192</p> <p>1 Continue with what you're doing with this outreach. We</p> <p>2 are here to help</p> <p>3 And this brings me to my second</p> <p>4 recommendation. Similar to what we are doing on an</p> <p>5 annual basis here at New York State Common, include</p> <p>6 diversity in the SEC audits, particularly diversity at</p> <p>7 the top echelons of funds and businesses. This is a</p> <p>8 subtle yet powerful message. It sends a tremendous</p> <p>9 message that the SEC is cognizant of the value add of</p> <p>10 diverse teams in businesses. At a minimum, diversity</p> <p>11 prevents groupthink.</p> <p>12 Eventually you can develop a comprehensive</p> <p>13 metric system that measures diversity at every level,</p> <p>14 from the most junior staff to the senior leaders and</p> <p>15 from owners. This is a way to add continued</p> <p>16 transparency to diversity and inclusion by businesses.</p> <p>17 I hope my message is clear. The lack of women</p> <p>18 and minority representation represents a risk, because</p> <p>19 it effectively creates an abyss, and we just witnessed</p> <p>20 what happens when inequality reaches a breaking point</p> <p>21 and social unrest is unearthed. Let's start addressing</p> <p>22 the issue now so that we are no longer at that breaking</p> <p>23 point in the future.</p> <p>24 In closing, I'd like to go on record saying I,</p> <p>25 along with my colleagues today and those that came</p>
<p style="text-align: right;">Page 191</p> <p>1 transparency, uh, that is crucial, uh, engagement, which</p> <p>2 you have been doing thus far, and accountability, which</p> <p>3 we all expect.</p> <p>4 Um, I have two specific recommendation where</p> <p>5 the SEC can take immediate action -- sort of the low</p> <p>6 hanging fruit, if you will. One, increase diversity in</p> <p>7 personnel within the SEC, particular in decision making</p> <p>8 position.</p> <p>9 Today, the lack of diversity is the enemy of</p> <p>10 our organization as we saw earlier this year,</p> <p>11 particularly in government where there is so many</p> <p>12 important decisions being made for the country, we want</p> <p>13 to see the face of America in our civil service</p> <p>14 workforce, diversity not only on race and gender and</p> <p>15 ethnicity, but also people of different views and</p> <p>16 experiences, how a person approaches a challenge, how a</p> <p>17 person solves problems, and how a person sees the world.</p> <p>18 In my opinion, diversity prevents groupthink. It helps</p> <p>19 us understand and learn multiple viewpoints, it helps us</p> <p>20 grow, and it benefits everyone.</p> <p>21 Your website indicates that the SEC is more</p> <p>22 than a workplace. It's united by a core set of values,</p> <p>23 and is a career with conscience. SEC staff members play</p> <p>24 a critical role protecting investors, making markets</p> <p>25 fair and efficient, and helping companies grow.</p>	<p style="text-align: right;">Page 193</p> <p>1 before me are here to support and assist you. The SEC</p> <p>2 Has a powerful voice. Let it be heard promoting</p> <p>3 diversity inclusion, and I thank you. Back to you,</p> <p>4 Gilbert.</p> <p>5 MR. GARCIA: Mr. Hernandez, thank you very</p> <p>6 much. I'm giving you two thumbs up. Thank you, my</p> <p>7 friend. Now for our last speaker, is Mr. Michael</p> <p>8 Frerichs, who is the treasurer of the state of Illinois,</p> <p>9 and I think he really is the example of doing an</p> <p>10 exemplary job in your government service while at the</p> <p>11 same time focusing on diversity issues, that they're not</p> <p>12 mutually exclusive, and in many ways they go hand in</p> <p>13 hand, and you can do both, and you can do both great,</p> <p>14 and that's what he's doing. Mr. Treasurer?</p> <p>15 MR. FRERICHS: Thank you.</p> <p>16 MR. GARCIA: It's all yours.</p> <p>17 MR. FRERICHS: Gilbert, thank you for that</p> <p>18 very kind introduction. So, good afternoon to you, Mr.</p> <p>19 Chairman, members of the asset management advisory</p> <p>20 committee, and all of our guests here today. My name is</p> <p>21 Michael Frerichs. I am the Illinois state treasurer.</p> <p>22 In Illinois, that's an elected position by the great</p> <p>23 people of the state of Illinois. It's an honor to be</p> <p>24 invited to speak with you today.</p> <p>25 Now, the Illinois state treasurer performs man</p>

<p style="text-align: right;">Page 194</p> <p>1 roles. Chief among them, I'm the state's chief  2 investment and banking officer. In that role, we  3 actively manage approximately \$35 billion. This  4 portfolio includes 16 billion in state funds, 13 billion  5 in retirement and college savings plans, and 6 billion  6 on behalf of local and state governments.</p> <p>7 As an institutional investor, we have an  8 obligation to pursue value. This pursuit encouraging  9 corporate boards includes -- pursuit includes  10 encouraging corporate boards to adopt external and  11 internal strategies to promote growth.</p> <p>12 Today, I wish to address strategies designed  13 to increase diversity and inclusion numbers across the  14 financial services industry in the companies in which we  15 invest.</p> <p>16 Specifically, I call your attention to  17 approaches to increase diversity within the financial  18 services industry workforce. It's utilization of  19 diverse firms, and its service to communities dominated  20 by people of color.</p> <p>21 This is not new territory for this committee.  22 The committee was formed to provide the Commission with  23 diverse perspectives on asset management and related  24 advice and recommendations. Nor is this new territory  25 for the Commission. Indeed, the SEC requires public</p>	<p style="text-align: right;">Page 196</p> <p>1 Opportunity Commission. We also know that too many  2 companies in the financial services sector refuse to  3 provide this data.</p> <p>4 In 2018, the SEC received only 38 responses  5 from 1,500 registrants who were asked to complete a  6 diversity assessment report. We can only assume this  7 refusal is embedded in either embarrassment or deceit.  8 Embarrassment is corporate leaders know the numbers do  9 not reflect their stated commitments to reduce barriers  10 of entry into their workforce, promotional  11 opportunities, and leadership positions.</p> <p>12 Deceit is corporate leaders know the public  13 pressure to promote unrealized diversity goals is a  14 hollow effort without an enforcement mechanism. Today,  15 we know it is possible to create dramatic change across  16 the financial industry sector with relative ease,  17 without increasing cost or sacrificing any level of  18 service. It only takes a willingness to acknowledge  19 past failures, and sincere desire to change.</p> <p>20 Institutional investors, and investment  21 consultants we utilize, also have a pivotal role in  22 advancing diversity. We should be constantly evaluating  23 the diversity of our management teams and staff. We  24 should vote proxy statements, and align it with fair and  25 equitable corporate practices. We should invest in</p>
<p style="text-align: right;">Page 195</p> <p>1 companies to disclose meaningful financial and other  2 information to the public. This provides a common pool  3 of knowledge for all investors to use, to judge whether  4 to buy, sell, or hold a particular security.</p> <p>5 Only through the steady flow of timely,  6 comprehensive, and accurate information can people make  7 sound investment decisions. Commissioner Allison Herren  8 Lee made this point in her statement on regulation SK  9 and ESG disclosures just last month. The Commissioner  10 pointed to the growing body of research showing the  11 strong business case for diversity, and the importance  12 of this issue to investors managing trillions of dollars  13 in assets. And she pointed to research from S&amp;P  14 indicating that racial injustice has become a material  15 issue with a potential to change evaluations and credit.</p> <p>16 Clearly, this must include diversity and  17 inclusion data throughout the financial services  18 industry and the companies in which we invest. The  19 public must be able to see how those in the financial  20 industry are addressing gaps affecting people of color  21 within their workforce, their customers, and their  22 communities.</p> <p>23 We know this data is available. All private  24 employers with 100 or more employees are required to  25 report diversity data to the Equal Employment</p>	<p style="text-align: right;">Page 197</p> <p>1 investment funds led by women and people of color. We  2 should invest in diverse-led businesses addressing  3 issues in communities of color, and we should hire  4 financial service firms with a proven track record of  5 equity, diversity, and inclusion.</p> <p>6 So, I put a slide up for you to see here  7 today. Using diverse investment firms is not only about  8 creating growth and opportunity in our communities, but  9 it's integral to increasing our investment returns. How  10 do we know this? Because in Illinois, inside the  11 Illinois Treasurer's Office, we did just that.</p> <p>12 First, consider asset managers. We increased  13 our assets managed by diverse owned firms from 18  14 million in December 2014 before I took office to \$3.9  15 billion as of last month. That's a 216 fold increase.</p> <p>16 Next slide, second, consider broker dealers.  17 In 2014 before I took office, only one percent of assets  18 were brokered by diverse owned firms. This last fiscal  19 year, 92 percent of assets were brokered with diverse  20 owned firms. To put it another way, our total assets  21 brokered by diverse owned firms increased from 603  22 million in '14 to \$43 billion in fiscal year '20.</p> <p>23 We also engage our portfolio companies to  24 increase corporate board diversity, which is vital to  25 performance. We lead the mid-west in Investors</p>

<p style="text-align: right;">Page 198</p> <p>1 Diversity Initiative, which is a coalition of</p> <p>2 institutional investors dedicated to increasing racial,</p> <p>3 ethnic, and gender diversity on corporate boards of</p> <p>4 companies headquartered in the mid-west. The initiative</p> <p>5 has undertaken 54 company engagements, 40 of which added</p> <p>6 diverse board members, and 32 adopted a diverse search</p> <p>7 policy.</p> <p>8 We are also a leader of the 30 percent</p> <p>9 coalition, which is a national coalition of</p> <p>10 institutional investors advocating for diversity on</p> <p>11 corporate boards. The 30 percent coalition has</p> <p>12 successfully engaged over 300 companies that have now</p> <p>13 appointed diverse board members.</p> <p>14 Finally, we take various actions to advance</p> <p>15 equity, diversity inclusion in all the financial</p> <p>16 services industry. First, all financial investment</p> <p>17 firms that do business with our office, or seek to do</p> <p>18 business with our office, must disclose how their firms</p> <p>19 promote equity, diversity, and inclusion.</p> <p>20 This includes a 360 degree evaluation conduct</p> <p>21 through an annual assessment that simultaneously</p> <p>22 examines and promotes diversity among board members or</p> <p>23 owners, executive leaders, owners, and suppliers.</p> <p>24 Second, we partner with key organizations both</p> <p>25 nationally and locally, making real progress increasing</p>	<p style="text-align: right;">Page 200</p> <p>1 minority and women inclusion is committed to ensuring</p> <p>2 that diversity and inclusion are leveraged throughout</p> <p>3 the agency to advance the SEC's mission to protect</p> <p>4 investors, maintain fair, orderly, and efficient</p> <p>5 markets, and facilitate capital formation.</p> <p>6 There is also the Office of Equal Employment</p> <p>7 Opportunity, which works to ensure the agency's</p> <p>8 professional staff come from diverse backgrounds.</p> <p>9 Therefore, I believe it is time for the committee to</p> <p>10 recommend four concrete steps that forcefully show the</p> <p>11 Commission's responsibility to diversity and inclusion.</p> <p>12 Step one, Mr. Garcia, I think you'll</p> <p>13 appreciate this one. Encourage you to adopt the Garcia</p> <p>14 Rule, and require regulated entities and issuers to</p> <p>15 consider enterprises led by women and people of color</p> <p>16 when selecting firms, including broker dealers and asset</p> <p>17 managers, and to consider at least one woman and person</p> <p>18 of color when nominating directors and selecting</p> <p>19 executive officers.</p> <p>20 This must include a consistent and required</p> <p>21 evaluation explaining why women or people of color were</p> <p>22 not chosen, and the steps needed to improve future</p> <p>23 applications.</p> <p>24 Step two, mandate the disclosure of data by</p> <p>25 regulated entities and issuers showing diversity within</p>
<p style="text-align: right;">Page 199</p> <p>1 the representation of diverse individuals at all levels</p> <p>2 within the financial services industry. This includes</p> <p>3 the financial services pipeline, and the Advancing</p> <p>4 Equity in Banking Commission, both of which convene</p> <p>5 leading institutions from the public and private sector</p> <p>6 to address longstanding gaps and devise practical</p> <p>7 solutions.</p> <p>8 Mr. Chairman and members of the Asset</p> <p>9 Management Advisory Committee, change will only come if</p> <p>10 it is required. The Commission has this authority in</p> <p>11 its rule-making power, and along with numerous other</p> <p>12 institutional investors, I have previously petitioned</p> <p>13 the Commission to exercise this power. More importantly</p> <p>14 however, the Commission itself recognizes the critical</p> <p>15 importance diversity brings to an organization.</p> <p>16 Consider the Commission's own offices, which include the</p> <p>17 office of the advocate for small business capital</p> <p>18 formation. Among this independent office's</p> <p>19 responsibilities, is recommending changes to mitigate</p> <p>20 capital formation issues, and promote the interests of</p> <p>21 small businesses and their investors.</p> <p>22 Within the SEC itself, there is the office of</p> <p>23 minority and women inclusion that is responsible for all</p> <p>24 matters related to diversity in management, employment,</p> <p>25 and business activities at the SEC. The office of</p>	<p style="text-align: right;">Page 201</p> <p>1 the workforce, including race, gender, ethnicity,</p> <p>2 religion, nationality, disability, veteran status, and</p> <p>3 sexual orientation. Data utilization rates for outside</p> <p>4 vendors should also be disclosed. I believe this</p> <p>5 disclosure must be made every two years.</p> <p>6 Step three, require regulated entities and</p> <p>7 issuers to publicly disclose the race and gender of</p> <p>8 directors, nominees, and executive officers annually.</p> <p>9 Step four, commission a study to evaluate the</p> <p>10 practices of investment consultants, including but not</p> <p>11 limited to the systemic and structural barriers for</p> <p>12 diverse investment firms.</p> <p>13 Now, I recognize that my perspective and call</p> <p>14 to action will not be warmly greeted by everyone, and</p> <p>15 that is disappointing. At a time when the leader of the</p> <p>16 free will is ordering the dismantling of diversity</p> <p>17 training because he believes it to be un-American, we</p> <p>18 must show our country and the world that barriers to</p> <p>19 entry must be removed. Doing so is better than good</p> <p>20 business. It is the right thing to do. Mr. Chairman</p> <p>21 and members of the Committee, thank you for your</p> <p>22 invitation to address you today, and I am ready and</p> <p>23 willing to answer any questions.</p> <p>24 MR. GARCIA: Mr. Treasurer, thank you so much.</p> <p>25 I'm speechless, other than to say I'm hugging you over</p>

<p style="text-align: right;">Page 202</p> <p>1 the phone -- I mean, over the video camera. I'm hugging</p> <p>2 you. Let's see -- thank you so much, Mr. Treasurer.</p> <p>3 Let's see what questions we have from the AMAC committee</p> <p>4 members for our recent three speakers, as well as some</p> <p>5 of the others that might still be on, but I encourage</p> <p>6 you, you've got an incredible list of panelists, so</p> <p>7 please ask any questions.</p> <p>8 MR. FRERICHS: I'll just say I was glad to be</p> <p>9 the diversity candidate here to show you that all</p> <p>10 Michael's last names do not begin with M.</p> <p>11 (Laughter.)</p> <p>12 MR. FRERICHS: I mean, half of the panelists</p> <p>13 today were Michaels.</p> <p>14 MR. GARCIA: Yes, we appreciate that, Mr.</p> <p>15 Treasurer. Team? Well, let me say this. I'm going to</p> <p>16 ask a couple questions of my own, which is, Cheryl, is</p> <p>17 there anything that you did along the way that you said,</p> <p>18 golly, I wish I had not done that? You know, sometimes</p> <p>19 lessons learned -- some of the things that -- the bumps</p> <p>20 you learned are sometimes some of the best lessons of</p> <p>21 all. For other plans out there, for another Cheryl</p> <p>22 that's listening to you?</p> <p>23 MS. ALSTON: Well, I'm trying to think of</p> <p>24 anything I would not have done, though -- I think we</p> <p>25 tried to be agile in terms of that, and I just really</p>	<p style="text-align: right;">Page 204</p> <p>1 he approved the firm to do trades from -- throughout --</p> <p>2 for all clients, and as a -- as a result, they were in</p> <p>3 the top quartile for brokerage firms.</p> <p>4 So I think one of the lessons learned is</p> <p>5 don't -- make sure that everyone knows the rules of</p> <p>6 engagement. Make sure that everything is fair, because</p> <p>7 sometimes -- and I'm not going to say they set them up</p> <p>8 to fail, but I think that just taking the first data and</p> <p>9 saying, oh, I could have just walked away and said, oh</p> <p>10 well, it didn't work, but I think really digging in and</p> <p>11 making sure that everyone understands the rules and that</p> <p>12 we are committed to this, and I applaud Illinois for</p> <p>13 their progress in terms of using minority brokerage</p> <p>14 firms, but I think as CIOs and as leaders, we're</p> <p>15 obligated to follow up and make sure that everyone is</p> <p>16 playing with the same playbook, and that they can --</p> <p>17 everyone can compete.</p> <p>18 MR. GARCIA: Thank you. Mr. Treasurer, first,</p> <p>19 as it relates to the Garcia Rule, that I think is the</p> <p>20 best rule ever, I think it's important to realize -- for</p> <p>21 people to realize that just because you put one forward</p> <p>22 doesn't mean they have to be chosen. The -- at the end</p> <p>23 of the day, what it means, it just gives -- everybody</p> <p>24 wins.</p> <p>25 It gives the new firm exposure they probably</p>
<p style="text-align: right;">Page 203</p> <p>1 want to applaud Illinois for a lot of their leadership</p> <p>2 in this -- in this effort. I think that one of the</p> <p>3 things that I learned along the way, and you brought up</p> <p>4 a great point about minority brokerage firms. You know,</p> <p>5 we had asked our asset management firms to use a</p> <p>6 minority brokerage firm, and within a quarter, when they</p> <p>7 came back they were in the bottom quartile, and when we</p> <p>8 talked to the firm, they said they're giving us, you</p> <p>9 know, the kind of the random trades. They're not giving</p> <p>10 us the good and the bad trades. They're just giving us</p> <p>11 the bad trades, and we don't know how they're evaluating</p> <p>12 us.</p> <p>13 So we sat down and we -- with the -- with the</p> <p>14 asset management firm, and we said let's go through what</p> <p>15 the scorecard is. Let's talk about the evaluation</p> <p>16 criteria, and then I approved for this brokerage firm to</p> <p>17 do all of our trades, right? So, the good and the bad,</p> <p>18 let's see how they do.</p> <p>19 Two quarters -- now two quarters later, they</p> <p>20 were in the top three out of the 20 brokerage firms in</p> <p>21 terms of performance. And so with that one of the</p> <p>22 things that I did was took that data, went to the CEO of</p> <p>23 the firm, because it was -- I've realized it was the</p> <p>24 trading booth that was kind of blocking this issue, and</p> <p>25 I went to the CEO, gave him the data, he filed it, and</p>	<p style="text-align: right;">Page 205</p> <p>1 would not have had otherwise. It gives the plan sponsor</p> <p>2 exposure to a firm they probably wouldn't have had</p> <p>3 exposure to otherwise. Everybody wins, and even if the</p> <p>4 manager is not selected, or the person for a board</p> <p>5 position is not selected, just by going through the</p> <p>6 process, they'll be better prepared for the next round.</p> <p>7 MR. FRERICHS: Got you.</p> <p>8 MR. GARCIA: It's just about just fairness,</p> <p>9 expanding the envelope as much as possible, and you</p> <p>10 know, the consultants in my view, it's their job to</p> <p>11 source good people, to source good managers, and so at</p> <p>12 the end of the day if it's a little bit of work extra,</p> <p>13 well, that's what they're paid to do.</p> <p>14 So Mr. Treasurer, my question to you is, you</p> <p>15 know, number one, how can we clone you to be all over</p> <p>16 America, but number two, what's happening with other</p> <p>17 treasurers? I mean, how do we get the -- I'm going to</p> <p>18 just use this term -- the Illinois Miracle out there?</p> <p>19 MR. FRERICHS: So, a couple things, I want a</p> <p>20 brief explanation for those who are aware, this is based</p> <p>21 off of the Rooney Rule in the NFL. You had a period</p> <p>22 where more than half of the players in the NFL were</p> <p>23 African-Americans, and yet there was not a single black</p> <p>24 coach in the NFL, and part of it was just exposure and</p> <p>25 experience, and if you -- when you force them to at</p>

<p style="text-align: right;">Page 206</p> <p>1 least hire -- or not to hire but to interview at least  2 one person of color, what we found was their eyes were  3 opened, and now we have done better. Still a long way  4 to go, with the financial services industry, the same  5 idea, although Gil, I will tell you that within the  6 state of Illinois, my chief investment officer I believe  7 likes to claim the Garcia Rule as named after him,  8 Rodrigo Garcia.  9 MR. GARCIA: And of course, let me disclose.  10 No relation.  11 MR. FRERICH: Yes. So, to how we clone me,  12 there's no need to clone me, but I am the product who  13 came before me, and I am the product of people who work  14 under me. So, two things. One, before I served as  15 treasurer, I served on the -- in the Illinois State  16 Senate, and every year, the Illinois State Senate would  17 host diversity hearings for the pension and investment  18 committee.  19 I was on that committee, and it was Senator  20 Kwame Raoul, now our attorney general, who invited me to  21 participate and talk with me about some of the faces --  22 some of the problems that these businesses were facing.  23 Before him, you had leaders like James Clayborne.  24 So people helped educate me as I was coming  25 along, and to the extent we've had great successes, I</p>	<p style="text-align: right;">Page 208</p> <p>1 And then the secret is to find those people,  2 create a vision for them -- our vision was to increase  3 access for people of color, and two, to give them the  4 resources they need to get this done, and because others  5 came before me and led the way, and because there are  6 people who are on this call who are doing most of the  7 legwork, I get to sit here on this call and to receive  8 your praise, but really it's a big team effort.  9 MR. GARCIA: Excellent. I think we have time  10 for one more question or so. If I don't see a hand, I  11 have one. Okay, AJ, let me ask you this. AJ, you were  12 at New York, you left, and you came back. Was there  13 anything you saw that changed your view of things? I  14 mean, was there -- you know, what did you see or learn  15 that's, like, you know, that has energized you or  16 changed your or anything? Are there any lessons there  17 to share?  18 MR. HERNANDEZ: Thank you, Gilbert. The  19 answer is yes. I actually -- when you first started the  20 program, you know, back in 2008, we were just learning,  21 you know, how do we -- how do we get into this program?  22 You know, how do we expand it from private equity to all  23 the asset classes? I think what happened over time, you  24 know, as we expanded, we were just thinking about the  25 program in just one way, and having very tight</p>
<p style="text-align: right;">Page 207</p> <p>1 think those slides we showed show that we have, this is  2 one of the things we did first and foremost in my office  3 was to make sure that our senior leadership reflected  4 the diversity of Illinois.  5 Now, part of Illinois secret is of all 50  6 states, our demographic is more closely aligned with  7 federal demographics than any other state. So that some  8 states will have a larger Hispanic population than we do  9 in Illinois, but our numbers mirror the federal, and  10 some might have a larger percentage of African-  11 Americans, but we really reflect the state.  12 And so diversity has been an important issue  13 in the state of Illinois, and when I was forced to go  14 out campaigning for this office, you campaign at all  15 those different communities, but then when I got into  16 office, what I found was a lot of the businesses we  17 worked with who were receiving the benefit of our tax  18 dollars didn't look like the people I had just  19 campaigned in front of.  20 So the first step was hire people who reflect  21 the state, because I think other speakers have pointed  22 out, when you have different voices with different  23 perspectives, you're less inclined to engage in  24 groupthink, and you're less inclined to miss out on  25 opportunities.</p>	<p style="text-align: right;">Page 209</p> <p>1 parameters around those -- you know, those programs.  2 When I left, what I started learning was that  3 while it made sense when we first began the program,  4 because we were just learning how -- you know, how to  5 execute, how to make sure that it's done right, what I  6 did learn was, you know, we left out flexibility, and  7 you know, Clayton from Leading Edge alluded to it  8 earlier. Flexibility for my manager of managers,  9 flexibility my fund of fund managers, flexibility for  10 staff being able to use a fund of fund manager, being  11 able to go on a direct basis.  12 So when I came back that was my first  13 priority: how do I give flexibility to allow my -- to  14 allow my manager of managers or fund of fund managers to  15 execute and get the best in class managers, and that's  16 what I've been doing every since.  17 Same thing for staff. You know, how do we  18 also in addition to having the extension of staff with  19 my fund to fund managers, how do we also do that on a  20 direct basis so that we're able to take a manager, not  21 just put them -- put them in an emerging manager  22 program, but also move them directly into the core  23 portfolio?  24 So to me it was important, especially, you  25 know, you know, leaving -- when you leave for five years</p>

<p style="text-align: right;">Page 210</p> <p>1 and you come back, you come back with a different take  2 and perspective. I think I would also add one last  3 thing, fees. Understanding that, you know, one of the  4 things that I've seen in the past where, you know, we've  5 really looked at the fees that, you know, we asked the,  6 you know, the -- or the lack of fees that, you know, we  7 want to pay. You know, we typically -- you know, you  8 typically see 2 and 20, and we're asking an emerging  9 manager who needs all the capital that they can get in  10 order to build an institutional quality back office, mid  11 office, and front office.</p> <p>12 I think my approach now is somewhat different.  13 I think the approach now is I work with the manager,  14 depending whether they are a first time manager, second  15 time manager, a third time manager, and now I think more  16 about, you know, instead of just getting a good deal  17 from the very -- from the very start, which may be  18 actually detrimental to my capital, especially the fact  19 that I'm a fiduciary and I need my capital to be  20 properly managed, especially, you know, with a manger  21 with a -- with a background. And so now I look at first  22 time managers, and I think -- I just don't think about  23 it in terms of fees. I just think about it in terms of  24 relationship and the big picture for the portfolio.  25 So I would say those are the two things that</p>	<p style="text-align: right;">Page 212</p> <p>1 we just do the right thing. Thank you very much. Mr.  2 Bernard? All yours.</p> <p>3 MR. BERNARD: Thank you, and let me first  4 thank all of our speakers, since that was a terrific set  5 of panels, and Gilbert for your continued high energy  6 and insightful leadership, so thank you very much. We  7 are now going to change gears just a little bit to pick  8 up on some previous work of the Committee, and we've got  9 two different discussions, one to be led by Ryan Ludt,  10 and one by Mike Durbin.</p> <p>11 I'm going to -- as a heads up to the tech  12 team, we're actually scheduled to take a break at 3:30,  13 and I'm looking at the afternoon and thinking we put our  14 break too late in the day. So after we get done with  15 this next half hour, I'm going to suggest we take a  16 quick break then, and then we'll come back for our final  17 half-hour session, and then the lightning round. So,  18 I'm not sure if you need to make any technical  19 adjustments for that or not, but I'll give you the heads  20 up.</p> <p>21 So as I had mentioned this morning, the final  22 two sessions are for the past work we've done, and this  23 first one, Ryan is going to provide an overview of draft  24 recommendations that he already sent to you regarding  25 exchange traded products, and open it up for questions</p>
<p style="text-align: right;">Page 211</p> <p>1 coming back, you know, between flexibility and looking  2 at fees very differently.</p> <p>3 MR. GARCIA: AJ, thank you. Mr. Bernard, I'm  4 going to just do one quick comment, and then I'll turn  5 it over to close if I may, and that is, again, let me  6 just say thank you to Chairman Clayton, all the  7 commissioners, Dalia Blass, and again to you, Ed, for  8 really making this a priority, giving me and this  9 committee -- this subcommittee such great flexibility  10 and runway, and I'm going to end with a quote from one  11 of my favorite movies about diversity, and it stars  12 Spike Lee, and of course, Ozzy Davis, a great actor, and  13 Spike Lee is a pizza delivery man, and he's walking  14 through the neighborhood to deliver a pizza, and Ozzy  15 Davis who of course is the Obi-Wan of the neighborhood,  16 and they call him Da Mayor, called him over, and he  17 says, Mookie, and Mookie came up, and he says, always  18 remember, do the right thing. And Mookie looked at him  19 and said, that's it? And he says, that's it.</p> <p>20 And I think the moral to that is sometimes we  21 get so caught up in our daily lives that we just  22 sometimes stray from, just do the right things, and I  23 think we have a chance to really set things on a right  24 path and to really address some of the barriers of  25 entry, old injustices, old mindsets, all those things if</p>	<p style="text-align: right;">Page 213</p> <p>1 and comments, and I would love during the course of this  2 conversation to get a sense of whether we're generally  3 supportive and ready to move forward, or you have  4 questions or issues that you'd like to -- Ryan to work  5 on a little bit further. So with that, I'll hand it to  6 Ryan to kick off the discussion.</p> <p>7 MR. LUDT: Great. Thank you, Ed, and thank  8 you to all of you as well, right? This is certainly a  9 group effort. There's been a lot of engagement from a  10 variety of entities from you all on the committee with  11 me, folks at your firms, and others around the industry,  12 including some staff from the Commission, so thank you  13 for all of that.</p> <p>14 As Ed mentioned, this is a follow on from the  15 work that we did in May, and the panel that we conducted  16 around market volatility associated in March with the  17 Covid pandemic.</p> <p>18 We hope that we've crafted recommendations  19 here that we can continue to talk about or revise, or  20 perhaps move on, the idea being that these are truly  21 recommendations on behalf of the committee. So this is  22 not at all supposed to sound like the voice of any one,  23 or a few -- a few folks. I definitely want to say thank  24 you to Jeff Ptak, who is obviously very, very busy and  25 involved in a number of initiatives for the AMAC. He</p>

<p style="text-align: right;">Page 214</p> <p>1 participated in the panel and helped us really shape  2 where this memo is, and also Reggie Brown, who was part  3 of the panel from GTS, and you know, specifically helped  4 us to kind of shape the beginning stages and ongoing  5 efforts around this panel.</p> <p>6 All along, this process feels like we're  7 continuing to try to take this learning approach, where  8 we're in this learning mode, right? We're not in fixing  9 mode yet. In many regards, and in fact as Commissioner  10 Roisman said this morning, this crisis is ongoing, and  11 we feel that it's appropriate to continue to gather  12 experts and data before launching into too many specific  13 actions.</p> <p>14 I think what we hope to get out of this and  15 really convey is the SEC and the FINRA are probably the  16 most and the best well positioned to lead these efforts,  17 and so that's why we have recommendations involving  18 each.</p> <p>19 As mentioned, we've worked with each of you,  20 and these are really our preliminary recommendations.  21 You've seen -- you've seen a bit of a draft in mid-  22 August. Following on from that draft we heard from a  23 majority of you actually either saying we're in good  24 shape, no further changes, while others offering a few  25 topics to consider for adjustment, and we've had some</p>	<p style="text-align: right;">Page 216</p> <p>1 breakers, and what they looks like to the market.  2 So we've suggested a round table. I think  3 this is where, you know, we're going to -- we're going  4 to come up with ideas as to how we can bring experts  5 together and study data. We don't want to be too  6 prescriptive, so if a round table is not exactly how we  7 pursue this and it becomes something that's more  8 analysis and data gathering and research, that's fine.  9 We don't want to necessarily say that this has to be a  10 round table, but it felt like it was appropriate to ask  11 experts to come together around the market-wide circuit  12 breakers.</p> <p>13 Also related to how equities work and how the  14 market works is an exchange traded classification  15 system. So, there's been a number of different groups  16 working in the industry. Some industry led, some like  17 the coalition and others.</p> <p>18 Our peer committee really, the FIMSAC, I don't  19 know if I can call them a peer committee, but the  20 FIMSAC -- the fixed income market structure committee,  21 they're also looking at a classification system, the  22 idea being is what else can we do to help further just  23 add clarity and add transparency as to what's going on  24 in the exchange traded space as that grows. So those  25 would be the two equity market structure items.</p>
<p style="text-align: right;">Page 215</p> <p>1 conversations ongoing following that.  2 Those as I get to the -- kind of the memo  3 itself and summarize -- what I hope to do is summarize  4 kind of the types of recommendations that we're making.  5 They've really fallen into three main themes around  6 trading characteristics for exchange traded products,  7 equity market structure considerations, and fixed income  8 market considerations.</p> <p>9 As it relates to the trading characteristics,  10 this really goes back to -- if you remember the  11 conversation we had around exchange traded products and  12 as they were trading in the market, mostly fixed income  13 products. You had some discussion during that panel  14 thinking about the diversions that we saw between fixed  15 income market -- fixed income ETFs, ETPs that are market  16 price, and their NAV, and we think that certainly  17 warrants some more review and gathering some information  18 there.</p> <p>19 The next two categories are around structure  20 and how the markets work and how I guess asset classes  21 work. We do feel like the market worked pretty well --  22 it worked very well, actually, as you would hope as far  23 as trading characteristics and dynamics work. But we  24 also would like to see -- I think there's a way to bring  25 some folks together and think about market-wide circuit</p>	<p style="text-align: right;">Page 217</p> <p>1 And then the last three -- so we have six in  2 total -- the last three items are around fixed income  3 market structure, two, regarding trades, that has to do  4 with trading transparency and how and when trades are  5 reported, and what information and how that's available  6 for bids and offers in the fixed income space, and then  7 lastly looking at more broadly the characteristics of  8 the fixed income market, and are there areas that we can  9 continue to evolve there that would help with  10 transparency, price discovery, and liquidity? So, those  11 are our six recommendations following on from the work  12 really bucketed into those three areas around trading  13 characteristics and market structure.</p> <p>14 So hopefully each of you have had a chance  15 again to look at where we are with the memo that's been  16 shared for a few days. We really value your input and  17 your feedback. We're happy with where we've gotten to  18 now, but we'd love to hear what questions or thoughts  19 you have.</p> <p>20 MR. BERNARD: Any questions, comments,  21 concerns, suggestions?</p> <p>22 MR. LUDT: And I'll try to thumb through the  23 grid as well. I -- let me know if you see anybody, or  24 please speak up. So, I see Rama with a question?</p> <p>25 MR. SUBRAMANIAM: Yes. A couple of related</p>

<p style="text-align: right;">Page 218</p> <p>1 questions. I notice on the -- you know, the</p> <p>2 recommendations on the equity market structure, you</p> <p>3 referred to a fixed income market structure ladder, and</p> <p>4 then similarly, you know, the last lot of</p> <p>5 recommendations around fixed income market structure, I</p> <p>6 would have thought overlaps maybe with some of the work</p> <p>7 on the fixed income market structure committee. What's</p> <p>8 the -- maybe it's a process question, or maybe not that</p> <p>9 important, but you know, it seems to me that this kind</p> <p>10 of falls between maybe the two committees, and what's</p> <p>11 been the dialogue with them if anything, or have they</p> <p>12 considered similar things? I'm just trying to work out</p> <p>13 the overlap.</p> <p>14 MR. LUDT: Yeah. I'll take a shot at the</p> <p>15 beginning of that. We have not had -- we have not had</p> <p>16 conversations specifically with FIMSAC. We're certainly</p> <p>17 aware of the work that they're doing, and how they're</p> <p>18 thinking about approaching those aspects in the market.</p> <p>19 From a process question as to whether it relates to our</p> <p>20 committee or theirs, it certainly is independent of</p> <p>21 those two.</p> <p>22 We viewed it -- I viewed it as we would want</p> <p>23 to make the recommendations independent of or regardless</p> <p>24 of what another committee is thinking about, and</p> <p>25 hopefully each of us is kind of working in parallel or</p>	<p style="text-align: right;">Page 220</p> <p>1 actually undertake to have the markets go through what</p> <p>2 they went through, and to see what kind of stresses were</p> <p>3 revealed.</p> <p>4 I think the recommendations also speak to the</p> <p>5 unique position of the SEC to bring together the</p> <p>6 different players and parties in the ecosystem to, as</p> <p>7 Ryan says, continue to advance the learning. So, I'm</p> <p>8 going to ask three questions. Since -- because of the</p> <p>9 format we're in, we're not all in the same room. I'm</p> <p>10 going to ask if you're in support of moving the memo</p> <p>11 ahead, if you approve it. I'm going to ask for any that</p> <p>12 don't approve, and/or any who abstain.</p> <p>13 So, I'll go through all three of those to see</p> <p>14 where we are so that no one is left out, and the only</p> <p>15 way I know to do it is to ask everybody when I do that</p> <p>16 is to ask you to unmute so we can hear your answer, and</p> <p>17 if there's echoes it's okay. We just need to hear</p> <p>18 yesses and nos. So with that, if everyone who is</p> <p>19 supportive of moving this forward as a formal set of</p> <p>20 recommendations, please say aye.</p> <p>21 (Series of ayes.)</p> <p>22 MR. BERNARD: Okay, and with anyone who is not</p> <p>23 supportive or still has concerns, please say nay. And</p> <p>24 anyone who would like -- choose to abstain from the</p> <p>25 vote, please acknowledge. I think you got it done,</p>
<p style="text-align: right;">Page 219</p> <p>1 in tandem to bring ideas and thoughts to the SEC.</p> <p>2 MR. BERNARD: Any other questions or comments?</p> <p>3 Can I -- I get a sense -- so that this is our first stab</p> <p>4 at approving actual recommendations. I think we all</p> <p>5 agree that it's -- you need a team to go away and draft</p> <p>6 something -- a document such as this, and I think</p> <p>7 they've done a superb job as opposed to having it</p> <p>8 drafted by 22 people, but we do want to have the</p> <p>9 input -- and Ryan, as I said -- as he said, has gotten a</p> <p>10 fair bit of input from folks and support from the</p> <p>11 committee.</p> <p>12 Does anyone have any concerns with the</p> <p>13 document as written? Let me -- so, apparently know.</p> <p>14 Can I just sort of see nodding heads? Are people</p> <p>15 generally in agreement and supportive of what they see</p> <p>16 here? Now I do see lots of nodding heads. In that</p> <p>17 case, I'm not sure I need to belabor it. Maybe I'll</p> <p>18 just ask. I think I'll ask us to formally approve this</p> <p>19 to go forward as recommendations.</p> <p>20 In my view what I think is great about this</p> <p>21 is that first of all, I think the panel in May was</p> <p>22 superb in terms of helping us hone in on the key</p> <p>23 friction points that were experienced and sort of the</p> <p>24 issues that were highlighted by the activity. This was</p> <p>25 the ultimate tabletop exercise that no one would ever</p>	<p style="text-align: right;">Page 221</p> <p>1 Ryan.</p> <p>2 MR. LUDT: We got it done. We did.</p> <p>3 MR. BERNARD: So I thank you -- thank you all</p> <p>4 very much for that. I'll take an audible on the field</p> <p>5 here. I promised to take a break at this point. Should</p> <p>6 we go ahead and do that, and then have time for Mike to</p> <p>7 do his piece? I'm seeing some thumbs up for break.</p> <p>8 It's 2:45. It's come back at 2:55, at five minutes to</p> <p>9 3:00.</p> <p>10 We'll take a 10-minute break, get away from</p> <p>11 our screens, and then we'll come back and have a similar</p> <p>12 session with Mike Durbin, and then do our lightning</p> <p>13 round, and if we get done a little bit early today, that</p> <p>14 would be terrific. So, we'll be back in 10 minutes.</p> <p>15 Those on the -- who are watching on the webcast, you'll</p> <p>16 see the holding screen -- the holding slide for about 10</p> <p>17 minutes. Thank you.</p> <p>18 (Whereupon, at 2:45 p.m., a short break was</p> <p>19 taken.)</p> <p>20 MR. BERNARD: All right, thank you all. I'll</p> <p>21 sort of be mindful of the breaks in the future and get</p> <p>22 those in the right place.</p> <p>23 So we've got one final session discussion led</p> <p>24 by Mike Durbin and then we'll do our lightening round,</p> <p>25 and if we get out a little early that will be terrific</p>



<p style="text-align: right;">Page 222</p> <p>1 I'm sure.</p> <p>2 So for this final discussion you will recall</p> <p>3 in May another of the panels around operational issues</p> <p>4 that Mike led, and like Ryan with ETP he graciously</p> <p>5 agreed to sort of continue the work there, because again</p> <p>6 we think there was so much evidence provided by the</p> <p>7 response to the pandemic. And in this case it wasn't</p> <p>8 just the volatility in the markets, but it was also</p> <p>9 operational issues such as essentially everyone being</p> <p>10 forced to work remotely and the impact that had on a</p> <p>11 whole range of issues.</p> <p>12 Mike is in a slightly different place and</p> <p>13 asked to take advantage of having the group together to</p> <p>14 seek some input. So I think what Mike is going to serve</p> <p>15 up here, I'll let him tee that up, but it's more a sense</p> <p>16 of here are the priorities that he and the drafting team</p> <p>17 are focused on and he wants to get input from the group</p> <p>18 on are these the rights priorities and any color</p> <p>19 commentary on that, and then he'll come back to us with</p> <p>20 a draft.</p> <p>21 And let me just with that actually, rather</p> <p>22 than steal your thunder, Mike, let me turn it over to</p> <p>23 you.</p> <p>24 MR. DURBIN: Thank you, Ed. Everyone can see</p> <p>25 this okay and here me okay? So thank you, Ed, and to my</p>	<p style="text-align: right;">Page 224</p> <p>1 relief items that the SEC and others did give to the</p> <p>2 industry, honestly on a very timely, practice,</p> <p>3 productive and healthy basis in those earliest day of</p> <p>4 the pandemic.</p> <p>5 So we're going to offer, you know, the draft</p> <p>6 recommendations that are going to follow here after this</p> <p>7 slide in order to improve, you know, as Ed alluded to,</p> <p>8 select core processes that were impacted due to</p> <p>9 specifically the health and safety concerns brought</p> <p>10 about by COVID 19.</p> <p>11 These recommendations seek to minimize the</p> <p>12 need for physical processes in favor of leveraging more</p> <p>13 efficient, and safe, and increasingly adopted digital</p> <p>14 alternatives. As mentioned, the recommendations to be</p> <p>15 discussed are designed to be permanent regulatory</p> <p>16 changes that provide viable long term solutions for</p> <p>17 investors and the industry and not just short term</p> <p>18 relief for the duration of the pandemic.</p> <p>19 We do think it's important to really</p> <p>20 specifically flag here that care has been taken to only</p> <p>21 flag those areas for consideration which have clear</p> <p>22 attribution back to the pandemic related issues or</p> <p>23 concerns. That's a fancy way of saying that we didn't</p> <p>24 take advantage of the invitation by the Commission to</p> <p>25 make a series of recommendations and throw things into</p>
<p style="text-align: right;">Page 223</p> <p>1 fellow AMAC members as well as the Commission on, you</p> <p>2 know, being given the chance as Ed said to update</p> <p>3 everyone on the work that we've undertaken regarding the</p> <p>4 series of operational challenges that manifested</p> <p>5 themselves pretty acutely in those early stages of the</p> <p>6 pandemic.</p> <p>7 I want to particularly thank Neesha Hathi, my</p> <p>8 partner in a lot of this work, but also believe it or</p> <p>9 not members of many of your firms that this work has</p> <p>10 been able to reach into over the last several months.</p> <p>11 So I represent a fairly complex effort around this.</p> <p>12 It's by no means mine alone, but you're going to have to</p> <p>13 listen to my voice for the next few minutes if that's</p> <p>14 okay.</p> <p>15 So again as mentioned here already this</p> <p>16 morning and just now, you know, we're not here to</p> <p>17 approve a final set of recommendations, but I'll</p> <p>18 endeavor rather to update you on our work and then how</p> <p>19 our refined set of priorities ha emerged since we first</p> <p>20 talked about these at the end of May, which based on the</p> <p>21 feedback either today or what follows today will form</p> <p>22 the basis of the more formal step of recommendations</p> <p>23 that we'll ask the AMAC to consider in the coming weeks.</p> <p>24 The overarching theme to what I'm going to</p> <p>25 share is really to make permanent a number of temporary</p>	<p style="text-align: right;">Page 225</p> <p>1 the consideration set that are not explicitly tied back</p> <p>2 to the issues that were incurred by virtue of the</p> <p>3 pandemic. So we tried to be disciplined there.</p> <p>4 The recommendations that we're likely to put</p> <p>5 forward, but ask your continuing consideration and</p> <p>6 comment about, fall into these five broad categories,</p> <p>7 which if you'll indulge me just because I'm unmuted and</p> <p>8 have the screen I'm going to run through in their</p> <p>9 entirety and then we'll open it up for discussion.</p> <p>10 Working left to right, the first starts with E</p> <p>11 delivery. It again bears mentioning that our AMAC voice</p> <p>12 here is but one of many that the SEC is hearing, has</p> <p>13 been hearing around this broad topic of E delivery. So</p> <p>14 it's in that context, you know, we likely will submit</p> <p>15 the SEC could update its rules and interpretations</p> <p>16 incorporating appropriate investor protection</p> <p>17 principles, which I'll come back to, to permit firms to</p> <p>18 use an investor's digital address, such as an email or</p> <p>19 Smartphone phone number as the primary or default</p> <p>20 address when delivering regulatory documents, and should</p> <p>21 work closely with FINRA and the MSRB to evaluate and</p> <p>22 importantly harmonize their SRO rules with any SEC</p> <p>23 digital delivery amendments that they choose to take on.</p> <p>24 Similarly, the SEC could amend its rules that</p> <p>25 currently include requirements to provide investors</p>

<p style="text-align: right;">Page 226</p> <p>1 certain documents in writing instead of the requirements</p> <p>2 to furnish or provide such documents, which would</p> <p>3 recognize transmittal through these more digital means.</p> <p>4 And again as I referenced, any recommended</p> <p>5 policy changes should incorporate essential investor</p> <p>6 protection principles that include, you know, things</p> <p>7 like clear notice, alerting investors of a switch to</p> <p>8 electronic default delivery, that permit an investor to</p> <p>9 affirmatively choose paper and change that preference at</p> <p>10 any time at their discretion, and that provides</p> <p>11 safeguards to address invalid or inoperable digital</p> <p>12 contact information.</p> <p>13 So that's E delivery in a nutshell, and again</p> <p>14 I'm going to keep plowing ahead and we'll cycle back</p> <p>15 here to any of these if you'd like when we open it up to</p> <p>16 discussion and Q&amp;A.</p> <p>17 Second column here is really around</p> <p>18 recommendations related to this remote work paradigm.</p> <p>19 So, you know, the pandemic did trigger an unprecedented</p> <p>20 shift in the workforce for all Exhibit A here, you know,</p> <p>21 the work from home paradigm for many financial services</p> <p>22 employees, including importantly registered employees in</p> <p>23 this context.</p> <p>24 So the shift has created a series of</p> <p>25 challenges, including the inability to comply with</p>	<p style="text-align: right;">Page 228</p> <p>1 to make permanent remote testing capabilities for the</p> <p>2 Series 63, 65 and 66 securities licenses, and expand</p> <p>3 online testing capabilities to cover all qualification</p> <p>4 exams.</p> <p>5 And the finally the SEC could further extend</p> <p>6 the relief for mutual funds from the requirement to vote</p> <p>7 on certain matters at in person board meetings. We may</p> <p>8 also recommend, it should be an interesting one, that</p> <p>9 Congress, because it would take an act of Congress,</p> <p>10 consider amending the Investment Company Act of 1940 to</p> <p>11 remove the express statutory requirement for in person</p> <p>12 board meetings. These are the elements of this</p> <p>13 environment that are just quite tough.</p> <p>14 So that is the second broad category around</p> <p>15 the remote work paradigm. If I move on to the middle</p> <p>16 column here, recommendations related to more of an E</p> <p>17 authorization sort of standing. The pandemic has</p> <p>18 increased the difficulties, there's a theme here,</p> <p>19 associated with obtaining customary types of</p> <p>20 authorizations that are required by the SEC, FINRA and</p> <p>21 state rules and regulations. These include the manual</p> <p>22 signature requirements pursuant to, by example, SEC</p> <p>23 rules and regulations like a Broker/Dealer Focus Report,</p> <p>24 Form 144, et cetera, notarization requirements including</p> <p>25 for IRA purposes and the medallion program that's used</p>
<p style="text-align: right;">Page 227</p> <p>1 existing obligations, by example FINRA Rule 3110(c), to</p> <p>2 perform onsite inspections of a branch office.</p> <p>3 So acknowledging the unacceptable health risks</p> <p>4 of onsite inspections due to the pandemic, FINRA</p> <p>5 provided welcome temporary relief extending the period</p> <p>6 in which broker/dealer firms can permit their 2020</p> <p>7 annual branch onsite inspections to March 31st of 2021.</p> <p>8 However, due to the continuing nature of this</p> <p>9 pandemic and likely future travel restrictions and</p> <p>10 health and safety concerns, this extension is unlikely</p> <p>11 to be sufficient. So again it's in that context that</p> <p>12 we're considering the recommendation to adopt more</p> <p>13 permanent relief.</p> <p>14 So specifically the SEC could direct FINRA to</p> <p>15 modernize the internal inspection requirements of FINRA</p> <p>16 Rule 3110(c) to permit remote technology assistance</p> <p>17 inspections by firms. The SEC could direct FINRA to</p> <p>18 revise its branch office registration and inspection</p> <p>19 requirements, including the very definitions of branch</p> <p>20 office, office of supervisory jurisdiction, and the</p> <p>21 inspection requirements that are attached to those</p> <p>22 designations in light of advances in technology and</p> <p>23 telecommunications.</p> <p>24 The SEC also could direct the North American</p> <p>25 Securities Administrators Association or NASAA and FINRA</p>	<p style="text-align: right;">Page 229</p> <p>1 as a valid signature on many documents, including those</p> <p>2 related to corporate actions and negotiable documents</p> <p>3 such as physical certificates and related paperwork.</p> <p>4 So again the SEC has provided flexibility</p> <p>5 regarding manual wet signatures in the current</p> <p>6 extraordinary environment, however the safety and</p> <p>7 security of industry employees and investors requires</p> <p>8 minimizing the need for physical processes or physical</p> <p>9 artifacts in an era of rapidly improving and utilized</p> <p>10 digital alternatives.</p> <p>11 So the SEC could permanently adopt rules that</p> <p>12 allow for more, these more digitized methods of</p> <p>13 authorization, including those related to manual wet</p> <p>14 signature requirements, notarizations and medallion</p> <p>15 stamps, and they can importantly in coordination with</p> <p>16 FINRA, other regulators, including at the state level</p> <p>17 where applicable because same of these are applicable at</p> <p>18 the state level. That is E authorization.</p> <p>19 On the fourth column here, recommendations</p> <p>20 around dematerialization, this experience group knows</p> <p>21 that although most U.S. securities are offered in</p> <p>22 paperless form certain asset classes continue to issue</p> <p>23 physical certificates of ownership. And so while the</p> <p>24 number of physical certificates process has declined</p> <p>25 over the years, the fixed infrastructure to process</p>

<p style="text-align: right;">Page 230</p> <p>1 physical certificates remains. Therefore, the cost to  2 process the physical certificates that do remain has  3 increased, with many of those costs being passed along  4 to investors.</p> <p>5 Moreover, and that's why we're talking about  6 it from a risk management standpoint, an industry  7 decision to immobilize physical certificates in a  8 central location has been problematic during events such  9 as 9/11, super storm Sandy, and our own COVID 19 when  10 market participants have experienced issues regarding  11 the ability to gain timely access to the inventory of  12 those physical certificates.</p> <p>13 So it's not lost on us that this theme, this  14 dematerialization, you know, is a theme that would  15 require intense coordination across multiple industry  16 stakeholders. So our recommendation is really -- is  17 likely to submitted in that context, you know, to be  18 reflective of the complexity. So as we state here on  19 the slide the SEC really could hold, starting with a  20 staff roundtable on the topic of further  21 dematerialization of physical paper, inviting the views  22 of all these various stakeholders, which include, you  23 know, issuers, transfer agents, broker/dealers, clearing  24 corporations, banks, investors, regulators, various  25 industry experts to help inform future continued SEC</p>	<p style="text-align: right;">Page 232</p> <p>1 cetera.</p> <p>2 So those are the five broad categories.</p> <p>3 Hopefully, a bit of texture or detail around, you know,  4 some of the underlying attributes around each of these  5 broad five categories that we would like to pursue in  6 the context of a future, more formal recommendation. We  7 do tee up here just in the spirit of trying to get a  8 conversation going or in the interest of answering any  9 questions anyone has.</p> <p>10 If you think about those five categories some  11 of the more detailed ideas that I've laid out here, that  12 we've laid out, are just the mouthpiece. Are there  13 additional areas that we should have considered, have we  14 missed anything, you know, blatant? Do the above  15 considerations strike the right balance? Because we  16 fell pretty passionately that there should be an  17 appropriate balance here. And how would, or should, or  18 could the AMAC prioritize, you know, these areas in our  19 recommendation to the SEC, to the extent that we feel  20 that a further prioritization would be necessary or  21 prudent.</p> <p>22 So, Ed, I'll pause there and in that spirit  23 invite any questions or debate.</p> <p>24 MR. BERNARD: Okay, great. If that's you  25 sharing -- yeah, there you go. I think if you give us</p>
<p style="text-align: right;">Page 231</p> <p>1 action on this topic.</p> <p>2 And then the fifth and final, rounding it out  3 here, and I'm going to pick up a little bit from the  4 Garcia Rule of lessons learned, which he asked, you know  5 the panelists, in our view great organizations are  6 learning organizations and great learning can come from  7 detailed after action reviews.</p> <p>8 The reality is a lot went very right, you  9 know, by the SEC and others in the darkest moments of  10 the crisis but, you know, but like many other industry  11 participants already are doing, you know, could the SEC  12 similarly conduct and document a more fulsome after  13 action review of the steps taken, the sequence pursued,  14 the parties needed to convene, et cetera, in a way that  15 would provide incremental efficiency and in the, I hate  16 to say it, in the event we find ourselves in a future  17 crisis situation, would perhaps provide a bit of a head  18 start.</p> <p>19 So this is no way meant to hold ourselves or  20 the Commission out to s standard to have a detailed  21 playbook for each and every unimaginable future crisis,  22 but rather again accounting -- an accounting of the  23 broad steps taken or that could have been taken to  24 ensure, you know, maximum sort of efficiency around  25 communication, mobilization, transparency, relief, et</p>	<p style="text-align: right;">Page 233</p> <p>1 the screen back.</p> <p>2 First of all, I'm glad I was -- stopped  3 talking and stopped stealing your thunder because your  4 remarks were considerably more cogent than mine. So I  5 thought that one slide captured a lot, and appreciate  6 the work that's been thus far.</p> <p>7 Now is a great opportunity for the Committee,  8 since this is still work in progress, any questions,  9 comments, anything, including if you think it's on the  10 right track. I mean, it's not just if there's confusion  11 or something, just to help Mike move this forward.</p> <p>12 Again, given the immediacy of the events, how  13 quickly the SEC responded to it in the midst of -- in  14 real time, and as Mike mentioned the fact that other  15 voices are beginning to weigh in, and I think I  16 mentioned this this morning, I'll work through the  17 procedural details with Christian, and Dalia, and  18 others, but my expectation and hope based on the input  19 from this group is that Mike and team will bring this  20 together fairly quickly and we will call a very brief  21 meeting, not a full day meeting, sometime later this  22 fall rather than wait for our December meeting to act on  23 formal recommendations.</p> <p>24 So this would be a great time to weigh in with  25 any questions, comments, or concerns.</p>

<p style="text-align: right;">Page 234</p> <p>1 Thanks. Scot.</p> <p>2 MR. DRAEGER: Yeah, thank you, Ed, and thank</p> <p>3 you, Michael, and everyone who worked on this</p> <p>4 spectacular work product. This is exactly what we</p> <p>5 needed and right when needed it. So I just affirm</p> <p>6 everything that you've put forward.</p> <p>7 My question for you is just about segregating</p> <p>8 the things where maybe time is of the essence versus the</p> <p>9 things that may require, you know, suggested roundtables</p> <p>10 or deeper deliberations and studies.</p> <p>11 I know that a lot of us, and Mike you and I</p> <p>12 talked about this, I know personally we're very -- you</p> <p>13 know, and it weighed heavy on our hearts that some of</p> <p>14 the folks in the mailrooms, and printshops, and</p> <p>15 paraprofessionals trying to track down the wet</p> <p>16 signatures for trust agreements and things were the</p> <p>17 people being required or asked to take the greatest</p> <p>18 risks during the heightened elements in the pandemic.</p> <p>19 Knowing that we may very well be back in a situation</p> <p>20 closer to what we experienced in the spring as we head</p> <p>21 into the winter, do you envision segregating the efforts</p> <p>22 on things like E delivery to prioritize, you know, those</p> <p>23 type of things, wet signatures, things like that out to</p> <p>24 try to get the Commission to move on some of those</p> <p>25 things, maybe even a little further along than they</p>	<p style="text-align: right;">Page 236</p> <p>1 Michele.</p> <p>2 MS. BECK: Just a brief comments. I really do</p> <p>3 appreciate the points about branch inspections. It is</p> <p>4 the time of year where we try to figure out will we have</p> <p>5 to employ a surge labor force to go out to people's home</p> <p>6 in the first quarter of the year before that timeline</p> <p>7 runs out. So that's -- the planning is now and so we</p> <p>8 really appreciate the issue being raised now.</p> <p>9 MR. BERNARD: Ryan.</p> <p>10 MR. LUDT: Hey, yeah, I'll just add another</p> <p>11 brief comment, and Mike sorry I haven't gotten comments</p> <p>12 on each of these back to you yet. Our initial look</p> <p>13 certainly prioritizes that E delivery topic as probably</p> <p>14 numbers one, two and three. That certainly feels like</p> <p>15 the highest priority for us, and I can just simply say</p> <p>16 we're working with others in the firm now. I'll get you</p> <p>17 comments back as soon as possible on the other items.</p> <p>18 MR. DURBIN: That's great. Thanks, Brian.</p> <p>19 MR. BERNARD: Anybody else?</p> <p>20 Great, and can I just sort of, like, from like</p> <p>21 a nod of heads, do I have agreement that if we can turn</p> <p>22 this document around and get a meeting on the calendar</p> <p>23 that we -- you would be comfortable moving this forward</p> <p>24 promptly. Okay, I'm seeing lots of thumbs up and</p> <p>25 nodding heads.</p>
<p style="text-align: right;">Page 235</p> <p>1 have, and then have things like dematerialization</p> <p>2 studied a little further?</p> <p>3 So I'll stop there and also just say thank</p> <p>4 you.</p> <p>5 MR. DURBIN: Well, thank you, Scot for your</p> <p>6 comments and the question. Yes, you're term, you know,</p> <p>7 sort of segregation or segmentation is really another,</p> <p>8 another riff on prioritization.</p> <p>9 And so if you believe in subliminal</p> <p>10 advertising, to my fellow AMAC members, those buckets of</p> <p>11 five categories left to right, there's an implicit</p> <p>12 prioritization that we think could be actionable there.</p> <p>13 And it is -- they've been drafted exactly, Scot, along</p> <p>14 that dimension, things that are quite timely and would</p> <p>15 have, you know, the desired impact for sure, and a</p> <p>16 little dose of inexecutable, you know, so there's both</p> <p>17 sort of a supply side and the demand side element, you</p> <p>18 know, to the prioritization. It's implicit in how those</p> <p>19 five categories have been laid out there.</p> <p>20 The dematerialization or future crisis</p> <p>21 playbook, you know, they have less of that urgency and</p> <p>22 are complicated, you know, to do, particularly in the</p> <p>23 case of dematerialization just given the range of</p> <p>24 stakeholders that would have to be involved.</p> <p>25 MR. BERNARD: Other questions, comments?</p>	<p style="text-align: right;">Page 237</p> <p>1 I do want to also just close this -- I won't</p> <p>2 stretch it out if people seem to be comfortable with the</p> <p>3 direction, to pick up on something Mike said, that a lot</p> <p>4 of this is about making permanent some temporary rules</p> <p>5 that the SEC put in place to allow for orderly function</p> <p>6 during the crisis.</p> <p>7 Two things. One, in fairness to the SEC,</p> <p>8 doing a permanent rule requires probably a heavier lift</p> <p>9 than a temporary, so we understand that there will be</p> <p>10 some work to be done on these recommendations. But</p> <p>11 really to come back to we all know from direct</p> <p>12 experience what it's like to drink from that firehose</p> <p>13 when it's happening in real time, and I have to say from</p> <p>14 everything I can see the SEC and their partners at FINRA</p> <p>15 were extremely responsive in the moment to help the</p> <p>16 industry do what we were supposed to do, which is to</p> <p>17 serve and protect our investors.</p> <p>18 So kudos to all of them for that and for their</p> <p>19 colleagues at the Fed for helping keeping the financial</p> <p>20 markets open and so forth. But I think interestingly</p> <p>21 this list is something of a tribute to how much they got</p> <p>22 done in a very short period to enable us to operate.</p> <p>23 So if there's nothing else on that, as</p> <p>24 promised we were -- we're ahead of time, which is a</p> <p>25 wonderful place to be, we'll finish out with the</p>

<p style="text-align: right;">Page 238</p> <p>1 lightening round. And to refresh you on our standard  2 approach to lightening round, I'd like to -- and I'll  3 just, actually I'll give a heads up. I'm going to go  4 -- I went reverse order time, I'm going to go -- if  5 you're looking at the participant list I'm going to go  6 alphabetically by the screen name, which in most cases  7 is first name.</p> <p>8 So Alex Glass, you're going to be up first.  9 But it's real simple. Just take no more than a minute  10 to share one or two things you heard that struck you  11 today. In addition to what we discussed for today I'd  12 be particularly interested at the three issues that you  13 would prioritize for further work by AMAC.</p> <p>14 And to be clear, if what struck you is the  15 same as the six people before you, that's fine. This is  16 not a creative writing exercise. You can feel free to  17 say the same thing. That will actually give us a sense  18 of, boy, that was a really dominant theme. So don't  19 worry about redundancy, just speak what's on your mind.  20 But of course feel free to raise new issues if you'd  21 like.</p> <p>22 So with that, and I'm going to go through the  23 list and then I'll see if I missed anybody. It's kind  24 of hard to work from this participant list, but I think  25 I've got it. So Alex, you're up first if you would.</p>	<p style="text-align: right;">Page 240</p> <p>1 that Mike was adamant that all changes must have that  2 investor protection component and safeguards, and I  3 really look forward to those continuing discussions to  4 look for ways to be innovative and make some of these  5 temporary solutions permanent.</p> <p>6 MR. BERNARD: Great, thank you. Aye Soe.  7 MS. SOE: Thanks. I thought -- well, I was  8 very interested in the discussion on the ESG as well as  9 private assets.</p> <p>10 With regards to ESG I agree that the  11 advertising of ESG funds, and in particular what is  12 concerning is in light of COVID 19 crisis and the  13 performance, the fact that they beat the benchmark is  14 being used to attract, you know, assets and used to  15 promote, to highlight the effectiveness of ESG when if  16 you dig into the research it indicates something else.  17 I think that part needs to be understood, so the  18 advertising probably needs to be looked at.</p> <p>19 In terms of private assets I'm a bit torn  20 because I do believe it's one area where more and more  21 capital is flowing and it's important for regional  22 investors to have access to returns. At the same time,  23 you know, I was very interested in the presentation by  24 the academics on some of the pitfalls and also the use  25 -- the metrics to measure and how do you compare private</p>
<p style="text-align: right;">Page 239</p> <p>1 MR. GLASS: All right, very good. Can you  2 hear me?</p> <p>3 MR. BERNARD: Yes.</p> <p>4 MR. GLASS: All right, great. So again I  5 thought the discussions were spectacular again today. I  6 always take a lot from these meetings. As a regulator  7 I'm always looking at the topics in the lens of investor  8 protection, which is also -- while also being cognizant  9 of a lot of the impact on the industry that I think was  10 talked about today.</p> <p>11 So then a few things that really struck me  12 today, and going all the way back to the beginning of  13 the meeting talking about ESG, is degree is a very  14 important topic to determine what's meaningful for  15 investor disclosure. I second Joe's comments about the  16 advertising and marketing is something that really needs  17 to be considered because investors really don't dig into  18 those prospectuses, so it's something that really needs  19 to be out front for those investors.</p> <p>20 And then on Mike's operations discussion, very  21 supportive of -- I'm very supportive of innovation in  22 Indiana, and you can see that from a lot of the actions  23 and things that we've done over the past several years  24 that help both the industry and regulators while  25 maintaining that proper investor protection. So I like</p>	<p style="text-align: right;">Page 241</p> <p>1 returns to public market returns.</p> <p>2 So there's a whole chemistry, but that's my  3 personal takeaway from that.</p> <p>4 MR. BERNARD: Great, thank you. Erik Sirri.  5 MR. SIRRI: Yeah. I just -- relative to Mike  6 Durbin's presentation, I thought the wet signature was  7 definitely an issue. I know from talking to our complex  8 it's kind of a high priority. I don't know anything  9 about how complex it is, but I know it was quite a  10 sticking point in just getting work processes done, so I  11 think they will be glad to see that there.</p> <p>12 On privates I just observed that, you know,  13 while there's some real issues with disclosure and  14 reporting potentially on the performance and risk side,  15 there does seem to be a colorable case for including  16 privates in a retail portfolio. I think before long  17 that group is going to have think about the details of  18 what form such an investment would take, what are some  19 of the -- you know, what kind of pooled vehicle it would  20 be. So in that sense we've got our work cut out for us,  21 but I think it's probably worth starting on that  22 process.</p> <p>23 MR. BERNARD: I'm just going to leave myself  24 unmuted. Gilbert Garcia.  25 MR. GARCIA: Sure. Thank you. I guess for me</p>

<p style="text-align: right;">Page 242</p> <p>1 the privates also was very interesting, but I guess I'm</p> <p>2 of the view I think getting retail involved is going to</p> <p>3 be a lot harder than we realize for them to have the</p> <p>4 actual, all the sophistication or all the disclosure,</p> <p>5 and I just want us to be careful that we're not sowing</p> <p>6 the seeds for the next bailout or something of that</p> <p>7 nature.</p> <p>8 MR. BERNARD: Nobody likes the word bailout so</p> <p>9 --</p> <p>10 MR. GARCIA: No, noted.</p> <p>11 MR. BERNARD: Jane Carten.</p> <p>12 (No response.)</p> <p>13 MR. BERNARD: I think we've lost your sound</p> <p>14 again, Jane. Are you muted?</p> <p>15 I see her saying no. Given what we went</p> <p>16 through before, Jane, I'm just going to keep going if</p> <p>17 that's okay. Can you give me a thumbs up? Sorry about</p> <p>18 that.</p> <p>19 Jeff Ptak.</p> <p>20 MR. PTAK: Yeah, thanks. I think the previous</p> <p>21 respondents have covered it pretty well, so I won't</p> <p>22 belabor any of the things that they already covered</p> <p>23 other than to say I found the, you know, the private</p> <p>24 markets discussion reinforcing in some ways. I think,</p> <p>25 you know, it's a laudable goal to expand access to</p>	<p style="text-align: right;">Page 244</p> <p>1 attributes. So -- so it just -- it helped me to</p> <p>2 appreciate some of those tradeoffs in an even fuller</p> <p>3 way. So that was my main takeaway. Thanks.</p> <p>4 MR. BERNARD: Great, thanks. Adeel, you're</p> <p>5 next. Your last name is on the list.</p> <p>6 MR. JIVRAJ: Sure. So first of all I thought</p> <p>7 today's agenda was great and certainly covered a broad</p> <p>8 range of topics. It reaffirmed the complex issues that</p> <p>9 we're exploring, whether it's ESG, private investments,</p> <p>10 or diversity and inclusion.</p> <p>11 On the ESG topic I was just wondering if third</p> <p>12 party verifiers could play a role in the trust and</p> <p>13 verify aspect of it if a framework is ultimately</p> <p>14 developed. It might help from the advertising or the</p> <p>15 disclosure aspect of it.</p> <p>16 I'm also looking forward to regrouping with</p> <p>17 the private investment subcommittee and to debrief on</p> <p>18 what we learned today from our panelists. Certainly, a</p> <p>19 lot of was shared on the advertising front from Ludo as</p> <p>20 well as some of the benefits of including the fact the</p> <p>21 last two weeks of investors. So I do think and I agree</p> <p>22 with Josh Lerner that there might be a place for these</p> <p>23 types of investments in an appropriate structure, but</p> <p>24 certainly willing to learn more as we debrief and we</p> <p>25 further explore it in the subcommittee.</p>
<p style="text-align: right;">Page 243</p> <p>1 private markets so that, you know, so-called retail</p> <p>2 investors can also partake in it but, you know, it's</p> <p>3 also fraught with some complexity and difficulties, you</p> <p>4 know, as we saw several of the panelists kind of delve</p> <p>5 into that, whether it's advertising or the very</p> <p>6 definition of the performance stream that an investor</p> <p>7 has been able to realize over the course of their</p> <p>8 investment.</p> <p>9 There's just a number of pitfalls. They're</p> <p>10 not sort of the sort of thing that I would say preclude</p> <p>11 consideration of it, but it does highlight I think some</p> <p>12 of the tradeoffs that, you know, the industry will have</p> <p>13 to, you know, basically confront as they're bringing</p> <p>14 this to the broader investing public.</p> <p>15 As I may have noted at our original AMAC</p> <p>16 meeting, it does give me some pause just knowing what</p> <p>17 we've observed investors using, you know, mutual funds,</p> <p>18 liquidity products. I feel like a progress has been</p> <p>19 made there, you know, in part attributable to</p> <p>20 innovations like the target day fund, which I think</p> <p>21 ultimately served to simplify the investing experience</p> <p>22 and remove some of the complexity and decision making</p> <p>23 that would otherwise attend to it.</p> <p>24 And this kind of goes to the other direction,</p> <p>25 though it does boast a number of other salutary</p>	<p style="text-align: right;">Page 245</p> <p>1 And then lastly I just want to commend the</p> <p>2 Committee in creating a subcommittee on diversity and</p> <p>3 inclusion and certainly looking forward to continuing</p> <p>4 work in that area of the Committee as a whole.</p> <p>5 MR. BERNARD: Great, thanks. Joe Savage.</p> <p>6 MR. SAVAGE: Thanks, Ed. So I thought all the</p> <p>7 panels were great. On the ESG panel, I thought they did</p> <p>8 a really, really good job of kind of showing the</p> <p>9 complexity of the issues that are in there.</p> <p>10 But, you know, my view, and I think it</p> <p>11 probably reflects their views as well is that, you know,</p> <p>12 you don't want to let the perfect be the enemy of the</p> <p>13 good, and I think one of the, one of the panelists said</p> <p>14 that. So it's going to be kind of an incremental</p> <p>15 approach my guess and it's, you know, you'll have to try</p> <p>16 some things that may work, it may not work, but I do</p> <p>17 think it's worthwhile moving forward and finding ways to</p> <p>18 standardize or at least better disclose ESG funds so</p> <p>19 people kind of get the message better.</p> <p>20 And then like Adeel I'm on the subcommittee</p> <p>21 for private investments and I really liked that panel as</p> <p>22 well. I think we really need to -- you know, if we're</p> <p>23 going to expand access to retail improving advertising</p> <p>24 standards, performance standards, disclosure standards,</p> <p>25 and any curation that needs to occur needs to go hand-</p>

<p style="text-align: right;">Page 246</p> <p>1 in-hand with that. It can't just be an open door. So</p> <p>2 just speaking for myself. Thanks.</p> <p>3 MR. BERNARD: All right, thank you. John</p> <p>4 Bajkowski.</p> <p>5 MR. BAJKOWSKI: Yeah, again, a number of</p> <p>6 really wonderful and interesting panelists today. In</p> <p>7 regard to the ESG thing I have to really just -- again</p> <p>8 the notion of disclosure, the use of the AMAC, it was</p> <p>9 revealing to understand the impact of even the use of</p> <p>10 ESG, whether it is an asset class and whether funds are</p> <p>11 held accountable for what they do with it, truth and</p> <p>12 labeling issues. I think the disclosure with some sort</p> <p>13 of standardizations of disclosure is very helpful in</p> <p>14 that regard.</p> <p>15 And with the private investment, I mean you</p> <p>16 can't ignore that. There's a tremendous growth in</p> <p>17 assets under management through private investment. The</p> <p>18 challenge is how do we open up that market to the retail</p> <p>19 investor in a way that they understand the risks. You</p> <p>20 know, there's not even a clear understanding of whether</p> <p>21 or not there's an outperformance of them, whether or not</p> <p>22 there's an addition to return or diversifications seems</p> <p>23 to be a benefit that.</p> <p>24 So I think there's a lot of work to be done as</p> <p>25 far as the element of disclosure and protection of any</p>	<p style="text-align: right;">Page 248</p> <p>1 I'm particularly struck by this healthy</p> <p>2 tension I guess between the ratings or disclosure issue</p> <p>3 at the fund level versus the underlying issuer level.</p> <p>4 We just submit that we as a non to the issuer level</p> <p>5 remember that some of this ESG enthusiasm will be</p> <p>6 rendered outside the context of a fund or an investment</p> <p>7 adviser relationship. It will find its way in brokerage</p> <p>8 too. I want a basket of green stocks.</p> <p>9 And so getting to the issuer level I think has</p> <p>10 a role there, certainly on, you know, sort of disclosure</p> <p>11 if not, you know, an underlying rating system.</p> <p>12 Privates, Erik Sirri, thank you for asking.</p> <p>13 You asked before I did about liquidity because that --</p> <p>14 we talked a lot about a lot of different things except</p> <p>15 liquidity and I think that is a principal fulcrum around</p> <p>16 just how inclusive do we make privates. Because people</p> <p>17 can tolerate liquidity, illiquidity until the day they</p> <p>18 want their liquidity.</p> <p>19 And then on D&amp;I, Gilbert, you know, kudos to</p> <p>20 your panelists because to hear directly from consultants</p> <p>21 and major public pension investors of just how in motion</p> <p>22 they are on this issue is, you know, another very</p> <p>23 healthy wakeup call that we're well on our way. So I</p> <p>24 thought those were excellent perspectives, you know,</p> <p>25 from real life, real business going on, so thank you for</p>
<p style="text-align: right;">Page 247</p> <p>1 investors that want to participate in private</p> <p>2 investments, private equity, and understand that there's</p> <p>3 a time element to it. So I think there's -- it's</p> <p>4 interesting information, but the question is how, how</p> <p>5 can we safely open up those markets to the retail</p> <p>6 investor and understand that their knowledge is an</p> <p>7 ability to understand those risks and is quite various</p> <p>8 over, over different groups.</p> <p>9 MR. BERNARD: Great, thank you. John Suydam.</p> <p>10 MR. SUYDAM: Yeah, very good panels,</p> <p>11 interesting discussion in lots of different areas. The</p> <p>12 thing I was most struck by was on the ESG third party</p> <p>13 validation. What struck me most about it is it doesn't</p> <p>14 seem like there at this point is enough coalescence</p> <p>15 around what's being looked at, how it's being measured,</p> <p>16 you know, which maybe a limiter on any standardization</p> <p>17 in the area, and I think we probably need to get some</p> <p>18 better understanding of that as we move along with any</p> <p>19 potential recommendation.</p> <p>20 MR. BERNARD: Great, thanks. Mike Durbin.</p> <p>21 MR. DURBIN: Yeah, just one, one quick</p> <p>22 observation on three broad topics. First on the ESG,</p> <p>23 echo the views of other AMAC members. Really hats off</p> <p>24 to the team for wading into the deep end of complexity</p> <p>25 there. It was impressive.</p>	<p style="text-align: right;">Page 249</p> <p>1 those.</p> <p>2 MR. BERNARD: Michelle.</p> <p>3 MS. BECK: Great, thank you. The private</p> <p>4 assets panel was fantastic, really enjoyed all the</p> <p>5 points made there.</p> <p>6 And it occurred to me when we're looking at</p> <p>7 this question of do the returns align between private</p> <p>8 and public markets. Liquidity was one piece that should</p> <p>9 cause a different. You should get a premium for private</p> <p>10 assets because of the illiquidity in them.</p> <p>11 But there was another element that I was</p> <p>12 struggling with, which is the appraisal based nature of</p> <p>13 the NAV calculations in private equity and private</p> <p>14 assets versus the constant price discovery going on in</p> <p>15 the public assets.</p> <p>16 So I think there's a second premium that you</p> <p>17 should expect with private assets. And so it's nice</p> <p>18 that there are times when they do outperform, but boy</p> <p>19 they better because those two premiums need to be baked</p> <p>20 into hat return stream.</p> <p>21 So it also made think about, you know, the</p> <p>22 question about what kind of liquidity should the retail</p> <p>23 investor have. So with mutual funds daily liquidity is</p> <p>24 in place, even for retirement funds. Now you move your</p> <p>25 retirement funds sometimes when you reallocate, but the</p>

<p style="text-align: right;">Page 250</p> <p>1 idea that you need constant liquidity even in those  2 kinds of funds is sort of expected, and yet it is a  3 question mark for me. You know, there -- people can  4 earn a premium by taking less liquid assets on those  5 monies they should need the cash out too quickly.  6 And it's just worth thinking about, is it the  7 case for the retail investor that we always expect them  8 to be able to cash out very quickly, in which case  9 private assets are not a good choice for them. But if  10 we're able to tolerate a little bit more illiquidity for  11 the retail investor then there might be a spectrum which  12 should placed in, you know, illiquid assets and the  13 like.</p> <p>14 So when it came to the diversity and inclusion  15 panel I am still thinking about how do you -- how do you  16 consistently address the larger institutions that are --  17 and make sure that -- one metric that's terribly  18 important, you know, women, minority owned businesses,  19 over 51 percent or I've heard 25 to 49 percent, but what  20 do you do for the big companies, what are you looking  21 for. And what occurred to me as I heard folks speaking  22 is it is terribly important to focus on the senior ranks  23 rather than broader measures of inclusion because the --  24 there's still quite a group as folks were telling us,  25 there's still quite a difference in the senior ranks in</p>	<p style="text-align: right;">Page 252</p> <p>1 complex, great topics today.</p> <p>2 Starting with the ESG, I think, actually I  3 think it was Michelle you said this around, as the next  4 step, getting more investor feedback with regards to  5 where we go. Because I think one of the things that  6 really struck me is, you know, talking about disclosure  7 versus things like naming and rating. I think about,  8 you know, the mainstream that we serve disclosures, you  9 know, are one thing, but it's really different when it's  10 very obvious in naming and rating. There are things  11 that we'll use a shorthand to make sense.</p> <p>12 So that sounds likes a really great next step  13 and clearly a very complex topic.</p> <p>14 I really enjoyed the private investment panel  15 and I think from the standpoint of, you know, if we  16 believe that retail investors should have choice and  17 should have access to where wealth is being created, I  18 think, I think I would suggest that this is an area that  19 we should continue to pursue. I wonder when we do that,  20 and I actually -- some of the comments just made me  21 think about, you know, what are the steps that could be  22 taken sooner rather than later to begin to create the  23 type of environment that would allow a retail investor  24 to have the information they need to make educated  25 decisions, so, you know, the transparency needed around</p>
<p style="text-align: right;">Page 251</p> <p>1 a lot of companies than there are across the company  2 overall.</p> <p>3 So I thought that it would be good to folks on  4 more than one metric and it would be good to hear the  5 panelists talking about more than one metric would be a  6 useful tool to ensure diversity of decision making.</p> <p>7 I was also reminded that there's a great book  8 called "The Hour Between Dog and Wolf" that talks about  9 gender diversity and actually age diversity in the  10 workforce based on some of the different biology of  11 people of different ages, and very structured studies of  12 risk taking behavior that differs between genders and  13 between ages. It's worth a read again for people that  14 may be skeptical about diversity and decision making is  15 really as much of a value as we're placing it to be. I  16 think there's some really good empirical proof that it's  17 a good thing to be looking at. The book is a very  18 entertaining read.</p> <p>19 MR. BERNARD: Thanks for that. We'll have to  20 add reading recommendations to future lightening rounds.  21 That's great. Neesha. I think you're muted.</p> <p>22 MS. HATHI: Hi, sorry about that. I was just  23 writing down Michelle's recommendation. I thought I had  24 read every D&amp;I book out there, so thanks for that. I'll  25 echo the sentiments of everyone else, just really</p>	<p style="text-align: right;">Page 253</p> <p>1 pricing, the transparency needed around valuation, you  2 know, potentially the metrics around IRR and other kind  3 of advertising uses to talk about the performance of the  4 investment.</p> <p>5 So I just thought that there was a lot to do  6 there before maybe we could take the step of really  7 making them broadly available.</p> <p>8 And then on the D&amp;I side, the comment that  9 really sat with me was the embarrassment versus deceit  10 that I think our panelists, the Illinois treasurer  11 mentioned. And I, you know, I just -- I think it's kind  12 of something that we continue to talk as a data driven  13 industry that we're not really getting the data in an  14 area that, you know, would really probably be helpful,  15 and then once you have the data you can decide how to  16 operate. But right now the data is still in terms of,  17 you know, the actual D&amp;I practices within the industry  18 are still just a little --</p> <p>19 And I think you all know where I stand on the  20 operation topic that Mike already walked us through, so  21 I won't say anything more about that. Thank you.</p> <p>22 MR. BERNARD: Great, thanks. Paul Greff.</p> <p>23 MR. GREFF: Thanks, Ed. So, yeah, just a  24 couple comments. I'm thrilled to be invited to be a  25 member of the diversity and inclusion subcommittee.</p>



<p style="text-align: right;">Page 254</p> <p>1 Thank you, Gilbert. It's an area of great interest to 2 me to be a worthy contributor.</p> <p>3 My second comment echoes a comment made by 4 Commissioner Crenshaw in her opening remarks. I will be 5 interested to see how, if at all, the ESG Subcommittee 6 considers the output of other federal regulators, such 7 as the Department of Labor, the CFTC's Climate Related 8 Market Risk Subcommittee when developing its final 9 recommendation, because both have put out statements 10 recently that are quite divergent. So I will be 11 interested in that.</p> <p>12 But kudos that team for putting forth another 13 ridiculously through presentation. So thanks, Ed.</p> <p>14 MR. BERNARD: Thanks. Rama.</p> <p>15 MR. SUBRAMANIAM: Thanks, Ed. The ESG panel 16 was very interesting for me. I think a couple of, a 17 couple of things for me like the name standard what's 18 left out I found surprising. There's a lot of 19 complexity there and they're trying to wade through that 20 complexity and get some, some standardized disclosure I 21 think is important. But there seems to be, like, a lot 22 of things that I know Michelle is working through and 23 almost kind of narrowing the focus I guess is one of the 24 hardest things. It's such a wide area.</p> <p>25 On the private investments subcommittee, the</p>	<p style="text-align: right;">Page 256</p> <p>1 panel. That's a topic that's important to UTAMCO, and 2 actually we were acting on it before it really came to 3 the forefront of all of our minds in the spring and 4 summer. It was on our management team's annual 5 priorities a year ago.</p> <p>6 So thanks to Gil for bringing, you know, 7 resources and thinkers on this topic to our attention 8 and everybody's attention. It's super helpful.</p> <p>9 You know, we responded, we -- I don't know how 10 many of you are aware but Congressman Kennedy and 11 Cleaver sent an email to a lot of the top endowment 12 asset managers and asked what our exposure was to 13 diverse, diverse managers. So we responded to that. 14 You know, I would say we benchmarked well relative to 15 the industry's current -- you know, the status that 16 basically is called out in the Knight Foundation. But 17 we recognize that there's more to go and we're focused 18 internally and externally on how we expand our firm 19 diversity and then the diversity of the managers that we 20 employ.</p> <p>21 I do agree with Michelle that I think we 22 should consider how to be a little bit more expansive 23 and inclusive in what we're looking at, right, when you 24 get to the large firms that we kind of default and have 25 to work with some large firms because we have a lot of</p>
<p style="text-align: right;">Page 255</p> <p>1 panel was even better than I had expected and kudos to 2 Erik for moderating that and, you know, I wish we had 3 more time for questions.</p> <p>4 I would encourage people to respond to a short 5 questionnaire that we will be sending out, Joe Savage 6 will be sending out, to elicit feedback on the design 7 principles. I think everyone, most people at least are, 8 you know, getting to that key topic of balancing 9 investor protection with investor choice and, you know, 10 how do you balance that, how do you find, you know, the 11 right middle ground that if we find a way forward. So 12 it's really good to hear from people.</p> <p>13 You know, as Ludo himself said there is a very 14 well developed disclosure regime in the mutual fund 15 world, which is the registered investment company, 16 right. So we should, we should not be put off by, you 17 know, some of the comments about the advertising and IRR 18 because all those are disclosure points, which are 19 solvable within the right framework. And so I encourage 20 people to provide their feedback on the design 21 principles that will help us take that topic forward.</p> <p>22 MR. BERNARD: Great. Rich Hall. Technology 23 is working.</p> <p>24 MR. HALL: I guess there were two areas that I 25 wanted to react to, one was the diversity and inclusion</p>	<p style="text-align: right;">Page 257</p> <p>1 money that we're trying to manage and we have a very 2 small staff to do it. So we can't have a lot of small 3 investments just -- it's to a degree inefficient.</p> <p>4 So how do we, how do we look at the large 5 firms and how do we look at expanding that threshold. 6 Maybe we should have used the same parameters when we 7 responded to the Kennedy and Cleaver letter and applied 8 25 to 49 percent, and I think our numbers would have 9 increased even further. But we should be mindful of 10 that. Let's not put too much form over substance. 11 Let's make sure we're really getting into the 12 inclusiveness of it.</p> <p>13 And the second thing that struck me was the 14 private conversation, private assets, a scenario where 15 I've spent a lot of time in my career. I think we 16 should first try to decide how or if the investor 17 universe will be expanded and do that before you decide 18 on what regulatory changes you want to make.</p> <p>19 The sophisticated investors, you know, if 20 you're in the institutional or accredited investor 21 category, you should have the resources to be able to 22 understand what is being put in front of you, and if you 23 don't understand you shouldn't do it. That's the bottom 24 line in terms of untangling the various performance 25 claims that are made and understanding what you're</p>

<p style="text-align: right;">Page 258</p> <p>1 likely to get at the end of the day.</p> <p>2 The reason I say that we should figure out</p> <p>3 first whether we're going to expand the investor</p> <p>4 universe before you do more regulation is that</p> <p>5 regulation comes with a cost and ultimately UTAMCO and</p> <p>6 the pension funds, we're the ones who bear the cost and</p> <p>7 it gets passed back through, to us to a large degree it</p> <p>8 gets passed back through to us in the management fee and</p> <p>9 all of the charges that flow through a partnership</p> <p>10 agreement.</p> <p>11 And so you're taking money by forcing more</p> <p>12 regulation. You know, you're taking money out of the</p> <p>13 pockets of the pensioners or, you know, the students who</p> <p>14 benefit from the scholarships that we're trying to</p> <p>15 invest, and preserve, and grow. So I would just say</p> <p>16 let's be thoughtful about that before we add cost into</p> <p>17 the system. That's all I've got.</p> <p>18 MR. BERNARD: Okay, great. Those are helpful</p> <p>19 thought, thanks. Ross Stevens.</p> <p>20 MR. STEVENS: Sure, Ed. First of all thanks</p> <p>21 to all of the fellow AMAC members for preparing the</p> <p>22 panels today. I thought they were very, very</p> <p>23 interesting.</p> <p>24 I'll pick for comments on the ESG panel</p> <p>25 specifically and just four quick areas as the</p>	<p style="text-align: right;">Page 260</p> <p>1 the ESG factors. In addition, those change all the</p> <p>2 time. Sometimes value is booked to price, sometimes</p> <p>3 it's earnings to price, and letting the market sort</p> <p>4 itself out as to how it wants to define these factors,</p> <p>5 even returns, is it the best year, is it the best five</p> <p>6 years.</p> <p>7 Over the last twenty or thirty years that --</p> <p>8 those definitions have changed quite a bit and I think</p> <p>9 before we think about imposing standards on definitions</p> <p>10 of what E is, and what S is, and what G is we should be</p> <p>11 mindful given how even less hard to pin down they are</p> <p>12 than value, method and size, letting the market kind of</p> <p>13 figure what we mean by ESG is important.</p> <p>14 On the topic of disclosure, I thought</p> <p>15 Commissioner Roisman made an important point. Companies</p> <p>16 are already required to disclose material risks, and I</p> <p>17 would just underscore that the market doesn't really</p> <p>18 hesitate to penalize firms that don't disclose material</p> <p>19 risks. They just -- the market does that pretty</p> <p>20 quickly. So I'd be careful in mandating disclosure,</p> <p>21 particularly because it could be misleading. If people</p> <p>22 think that they've got a disclosure around ESG risks but</p> <p>23 they just filled out a form and checked a box, we're</p> <p>24 actually going to lose information.</p> <p>25 And then lastly on actions, you know, we're a</p>
<p style="text-align: right;">Page 259</p> <p>1 subcommittee thinks about next steps, one around</p> <p>2 performance, another around factors themselves,</p> <p>3 disclosure, and then action.</p> <p>4 On performance, I think it's -- we should</p> <p>5 tread cautiously on performance and tread cautiously</p> <p>6 about making claims that somehow ESG funds or firms are</p> <p>7 better or worse. It's really hard to keep that kind of</p> <p>8 thing a secret from the market. So if certain kinds of</p> <p>9 firms are really better or perform better that secret is</p> <p>10 going to get out and prices will get bit up, and it's</p> <p>11 very hard to imagine those kinds of things persisting.</p> <p>12 So on performance I would just from a committee</p> <p>13 perspective tread cautiously on any kind of statements</p> <p>14 we make about performance related to those factors. We</p> <p>15 would be wise to do that.</p> <p>16 On factors I think what we're saying is ESG</p> <p>17 are characteristics or returns, so why bother to talk</p> <p>18 about them. That's one of the reasons the recent stock</p> <p>19 funds value momentum and size being characteristic of</p> <p>20 stock returns. So is the stock a value stock, is it a</p> <p>21 large stock, is it a momentum stock or not.</p> <p>22 And a couple of things on that. One is those</p> <p>23 relative to ESG are very clear cut. You know, how much</p> <p>24 will your stock return, how big is it market cap wise.</p> <p>25 It's very hard to think about that kind of clarity in</p>	<p style="text-align: right;">Page 261</p> <p>1 group of people around this committee where, quote, do</p> <p>2 nothing is -- it doesn't feel good. It's sort of not</p> <p>3 our natural state. But even if we chose to, quote, do</p> <p>4 nothing there's lot and lots and lots of stuff that's</p> <p>5 going on now in ESG.</p> <p>6 And doing anything we have to remind ourselves</p> <p>7 we're basically encouraging the heavy hand of the state,</p> <p>8 the federal government, to bring down its standards on</p> <p>9 the whole country. That's a pretty high bar. And so I</p> <p>10 just don't think do nothing should be used pejoratively,</p> <p>11 I think it can be used not pejoratively. So I hope</p> <p>12 Michelle and the team take those comments onboard. I</p> <p>13 really appreciated the discussion.</p> <p>14 MR. BERNARD: Thanks, really helpful thoughts.</p> <p>15 Russ.</p> <p>16 MR. WERMERS: Thanks. I would be remiss if I</p> <p>17 didn't cite a couple of academic papers. So for the ESG</p> <p>18 panel, Jillian Grennan at Duke University has a paper</p> <p>19 that, empirical paper that points out that E and S and G</p> <p>20 kind be at odds with each other. For example you may</p> <p>21 have an independent, a very independent board that works</p> <p>22 hard for short term shareholder value and yet if we do</p> <p>23 so it costs an employee good wealth.</p> <p>24 Another paper is a paper by Lubos Pastor from</p> <p>25 the University of Chicago with a couple of co-authors.</p>

<p style="text-align: right;">Page 262</p> <p>1 This is a theory paper, but I urge you to read it</p> <p>2 because it has some -- it has a lot of math in it, but</p> <p>3 it has some really great insights in there about that</p> <p>4 ESG might be thought of as a risk factor to hedge</p> <p>5 against.</p> <p>6 And it says a lot to do with what Ross just</p> <p>7 said about this, is that ESG, heavy investments or</p> <p>8 investment funds may earn a lower raw rate of return but</p> <p>9 perhaps that's fair given that they're a hedge against</p> <p>10 future climate risks or just that they're preferred by</p> <p>11 investors, doing well is preferred by investors and</p> <p>12 they're happy to take this non-pecuniary benefit.</p> <p>13 Fragmented investor, so of course I enjoyed</p> <p>14 that. I was still left wondering what, what are the</p> <p>15 panel's thoughts about mutual funds that hold more than</p> <p>16 15 percent private investment, but not 100 percent, and</p> <p>17 think here my question was misunderstood. And I bring</p> <p>18 this up because I think given the dwindling pool of</p> <p>19 public, public securities it has to happen. I mean,</p> <p>20 defined contribution plans continue to grow. At some</p> <p>21 point funds are going to have to take on more private</p> <p>22 investments either through buying buildings, or</p> <p>23 investing in private equity funds, or whatever.</p> <p>24 So I was still left wondering, you know, are</p> <p>25 the risks that we've seen still applicable if the SEC</p>	<p style="text-align: right;">Page 264</p> <p>1 do they need to know, and how do we have transparency in</p> <p>2 that work as we go forward.</p> <p>3 And on the D&amp;I topic, I thought it was great</p> <p>4 to hear from both the consulting world and from the</p> <p>5 asset owner world. I think that gave us kind of a</p> <p>6 complete picture there.</p> <p>7 And I think I've heard a few times throughout</p> <p>8 each of the sessions today that we do anticipate by, you</p> <p>9 know, December or the first quarter of next year to be</p> <p>10 looking to make more recommendations and do some more</p> <p>11 things. So back to that taking action I think it's</p> <p>12 fantastic to know that that's out there and we're</p> <p>13 getting to that stage in these topics. Because there's</p> <p>14 been a lot of thought and effort and getting those,</p> <p>15 getting those done will be fantastic.</p> <p>16 MR. BERNARD: Great, thanks. Scot, Scot</p> <p>17 Draeger.</p> <p>18 MR. DRAEGER: Thank you, Ed, and thank you to</p> <p>19 everyone who put work into today's presentations, they</p> <p>20 were all spectacular and very thoughtful.</p> <p>21 Starting on ESG, a couple of things there.</p> <p>22 One, I'd be curious in the course of the work of the</p> <p>23 subcommittee to know how any recommendations that we</p> <p>24 might make relate and integrate with any global any</p> <p>25 standard setting that's going on in Europe or through</p>
<p style="text-align: right;">Page 263</p> <p>1 raises the threshold and mutual funds end up holding</p> <p>2 more of this along with their public securities as their</p> <p>3 liquidity buffer.</p> <p>4 The final last thing, a plug for Gilbert.</p> <p>5 We're trying to settle on a date in November. I'm</p> <p>6 having a webinar on financial policy. I was so</p> <p>7 impressed with Gilbert last time that I'm holding a</p> <p>8 webinar with him in November. We're still working out</p> <p>9 the dates, I think, Gilbert. It will give me one more</p> <p>10 chance to hear you and to question you. Very well done.</p> <p>11 MR. BERNARD: Thank you, Russ. Ryan.</p> <p>12 MR. LUDT: Yeah, great. Thanks, Ed, and</p> <p>13 thanks again to all the committee members for the work</p> <p>14 that we've been getting done.</p> <p>15 I think each of the committees or each of the</p> <p>16 panels were great today. From the subcommittees it's</p> <p>17 fantastic to see the D&amp;I topic officially become a</p> <p>18 subcommittee and congrats to Gilbert and all those</p> <p>19 working on that.</p> <p>20 Maybe two things that really seemed to emerge</p> <p>21 to me from the ESG and private investment were around</p> <p>22 transparency and education. So we heard it during the</p> <p>23 panels, and others here had mentioned it, I just think</p> <p>24 that has to be spinal to what we're doing as we continue</p> <p>25 that work is thinking about who are we educating, what</p>	<p style="text-align: right;">Page 265</p> <p>1 IOSCO or other bodies who have been considering these</p> <p>2 same issues.</p> <p>3 I know that the Office of International</p> <p>4 Affairs at the Commission at the IOSCO bodies probably</p> <p>5 have a significant number of resources to draw upon,</p> <p>6 including some relationships. I guess I would just</p> <p>7 encourage that subcommittee to utilize those resources</p> <p>8 that are there.</p> <p>9 Second, on the ESG, I think I -- we all share</p> <p>10 the hope that we can stem investor confusion in this</p> <p>11 area a little bit, and I think investor confusion or</p> <p>12 confidence with flow from truth in marketing and</p> <p>13 advertising as Joe hit on much more than it will from</p> <p>14 any details that we require in new prospectus</p> <p>15 disclosures.</p> <p>16 So I would say to capitalize on that</p> <p>17 opportunity we're probably going to have to lean toward</p> <p>18 tightening up the nomenclature that is used, the broad</p> <p>19 use of ESG and SRI type terms in marketing and</p> <p>20 advertising rather than -- I think if we leave it to</p> <p>21 fund managers to have the latitude to define these terms</p> <p>22 however they want to interpret them, I think we will</p> <p>23 have missed an opportunity to reduce confusion by the</p> <p>24 retail investment community. So that's just my two</p> <p>25 cents on that.</p>

<p style="text-align: right;">Page 266</p> <p>1           The retail access to private investments, I</p> <p>2       would, I would agree with Erik Sirri that there was an</p> <p>3       opportunity here somewhere to get to a place where</p> <p>4       something appropriate is available to a retirement plan</p> <p>5       or other areas of retail access. I guess I would just</p> <p>6       say that at the moment, from everything that we've been</p> <p>7       educated on thus far, there seems to be more danger than</p> <p>8       there is a real taste that retailers really need access</p> <p>9       to this to round out their portfolio.</p> <p>10       And I would -- I think we can't underestimate</p> <p>11       the liquidity needs. I mean, if you look at -- there</p> <p>12       are studies out there that show how much retail</p> <p>13       investors are using their investment funds for emergency</p> <p>14       healthcare funds and things like that. I think when we</p> <p>15       think in the context of some of the liquidity needs of</p> <p>16       mainstream investors, you know, those are, those are</p> <p>17       real things to consider.</p> <p>18       And then the average 401(k) plan sponsor</p> <p>19       doesn't have access to the Hamilton Lanes and the</p> <p>20       Cambridge firms of the world. Those firms are obviously</p> <p>21       the most, among the most reputable sources of due</p> <p>22       diligence in the world, but I think we have to be</p> <p>23       realistic about the segments of the market, which is</p> <p>24       about 95 percent, that will never have access to that</p> <p>25       level of diligence.</p>	<p style="text-align: right;">Page 268</p> <p>1       the burdens that any recommendation might have.</p> <p>2       And then the other comment I had was on</p> <p>3       diversity and inclusion. You know, we -- this is a good</p> <p>4       idea, it's a good thing that we all, you know, as a</p> <p>5       society need to embrace. We talked at the last meeting</p> <p>6       about how do we translate this into a possible</p> <p>7       recommendation to the SEC.</p> <p>8       There were two comments that came out of the</p> <p>9       panel today that I thought really spoke to us as a</p> <p>10       panel. I've enjoyed that. One of them was teaching or</p> <p>11       teaching your underwriters how to look at smaller</p> <p>12       managers since these diverse management firms tend to be</p> <p>13       smaller, I thought that was really good, and also hiring</p> <p>14       personnel within, more of a grassroots, you know,</p> <p>15       approach to things.</p> <p>16       However, I really enjoyed the Illinois</p> <p>17       Treasurer because he did give us some, some points to</p> <p>18       consider. Do we want -- are these things that we would</p> <p>19       like to recommend to the SEC, is it something that the</p> <p>20       SEC, you know, can tackle or is this best left to, you</p> <p>21       know, to other avenues.</p> <p>22       But those were my comments for today.</p> <p>23       MR. BERNARD: Great. Last time I missed</p> <p>24       somebody, I think it was Ryan that I missed last time</p> <p>25       with the way the lists were kept. Have I missed anybody</p>
<p style="text-align: right;">Page 267</p> <p>1       So -- and then finally I just want to say,</p> <p>2       Gilbert, you just inspire the heck out of me. I mean,</p> <p>3       just every time you're here and what you're putting</p> <p>4       together I'm so excited to be in this with you. Today</p> <p>5       we focused on the asset aggregators and allocators. I</p> <p>6       think, you know, as we've talked about a little bit</p> <p>7       before the vast majority of firms are serving individual</p> <p>8       families with sometimes individual stocks and bonds. So</p> <p>9       I'm excited to get to the place where we figure out how</p> <p>10       we encourage diversity as a value among those firms in</p> <p>11       addition to the asset aggregators of the world.</p> <p>12       Thank you, Ed.</p> <p>13       MR. BERNARD: Thank you. Susan McGee.</p> <p>14       MS. McGEE: I'd like to thank the committees</p> <p>15       today as well. They did a phenomenal job.</p> <p>16       I was very pleased with the ESG panel and</p> <p>17       their slide presentation and balancing out pros and cons</p> <p>18       with different stages of proposals. I'm very cautious</p> <p>19       about throwing regulations out there as, hopefully as a</p> <p>20       cure all because they do have a lot of costs and they</p> <p>21       are -- they can be very burdensome.</p> <p>22       So I realize that something needs to be done</p> <p>23       with the confusion and the clarity on ESG. I just hope</p> <p>24       that we as a committee focus on recommending something</p> <p>25       that's very efficient and keep an eye on the cost and</p>	<p style="text-align: right;">Page 269</p> <p>1       today or did we get everybody? Great.</p> <p>2       And Jane, I assume we still can't hear you, so</p> <p>3       I'm going to let you go. I'm not sure what happened, so</p> <p>4       I won't go back.</p> <p>5       I guess it does come to me. I'm going to have</p> <p>6       a slightly different reaction. I'm not going to try and</p> <p>7       add to all the insights that everyone just shared about</p> <p>8       the presentations. I actually want to react to today</p> <p>9       and just say I continue to be humbled by the talent of</p> <p>10       this group. I thought everything we saw and heard today</p> <p>11       was just of the very highest quality. We're dealing</p> <p>12       with some really complex issues, and you're taking on</p> <p>13       the complexity head on, and I'm -- in addition to that</p> <p>14       humility I'm grateful for the -- there's an enormous</p> <p>15       amount of work that goes into all this and will continue</p> <p>16       as everyone can tell with what these teams are taking</p> <p>17       forward.</p> <p>18       So I'm grateful for that and to the point that</p> <p>19       was just made about getting to action, I think we're</p> <p>20       getting there. We just did our first formal</p> <p>21       recommendations today. I think we'll see some more</p> <p>22       within a month's time and we'll start to see more even</p> <p>23       in December.</p> <p>24       So with that I just want to thank everyone for</p> <p>25       your participation today. I know it's a long day on a</p>

<p style="text-align: right;">Page 270</p> <p>1 screen. I think it was an extremely valuable day and</p> <p>2 thank all the subcommittee leaders, the members, and</p> <p>3 those who put together the panels today.</p> <p>4 And with that I will turn to Dalia to see if</p> <p>5 you would like the last word.</p> <p>6 MS. BLASS: Yes. And cognizant of the fact</p> <p>7 that I'm in between you and getting away from your</p> <p>8 screens and have a few words, but just a few things.</p> <p>9 One is there were five very distinct topics</p> <p>10 and each one of them extremely complicated. And, you</p> <p>11 know, the presentations have the tradition of very</p> <p>12 thoughtful, very thorough presentations. And the</p> <p>13 panelists that you all invited today, they were subject</p> <p>14 matter experts. Their presentations were data driven</p> <p>15 and they shared their experiences. All the</p> <p>16 subcommittees, you know, you shared with us, like, a</p> <p>17 framework for how you're approaching your work, which is</p> <p>18 extremely helpful.</p> <p>19 I also would like to commend the AMAC for</p> <p>20 taking on diversity and inclusion as a formal</p> <p>21 subcommittee. It's a critical issue for the asset</p> <p>22 management industry and society as a whole. And I also,</p> <p>23 and Gilbert your enthusiasm, your energy through the</p> <p>24 panel is just truly, truly amazing. I'm looking forward</p> <p>25 to the work, you know, from the subcommittee.</p>	<p style="text-align: right;">Page 272</p> <p>1 you know, as much as the presentations were all data</p> <p>2 driven, every single one of them also reflected the lack</p> <p>3 of data and the importance of data. So something that</p> <p>4 really kind of was really a takeaway for me is to what</p> <p>5 extent we do need more data.</p> <p>6 And finally on the operations workstream,</p> <p>7 very, very thoughtful presentation. I will say, you</p> <p>8 know, could have ever anticipated the operational</p> <p>9 challenges and the posture that we're all in today.</p> <p>10 Technology has been amazing. I mean, look at what it's</p> <p>11 enabled us to do today, but also today by the way look</p> <p>12 at all the technological issues that we have faced. So</p> <p>13 there are pros and there are cons. It can do so much,</p> <p>14 but it does -- it may have shortcomings here and there.</p> <p>15 So something that, you know, just to keep in</p> <p>16 mind as we sort of, you know, go forward in this but</p> <p>17 really critical areas that perhaps had not risen to the</p> <p>18 forefront really have become really important for us to</p> <p>19 sort of think about and move forward.</p> <p>20 I would just add, I hate to add to your list</p> <p>21 because it was a very fulsome list, but one thing</p> <p>22 perhaps to take into consideration as technology becomes</p> <p>23 more important is the cyber risk. It really adds</p> <p>24 something that will just be fundamental to any</p> <p>25 technology. Cyber risk is something that I just kind of</p>
<p style="text-align: right;">Page 271</p> <p>1 Michelle and the ESG subcommittee, I thought</p> <p>2 your initial, you know, lead in May was just really</p> <p>3 extraordinary. I was -- today you even stepped it up</p> <p>4 more. The presentation, what you -- how -- the</p> <p>5 framework that you guys have laid out I'm really</p> <p>6 interested in seeing where you take it.</p> <p>7 Particularly for me I was really interested in</p> <p>8 your analysis in the names rule and the value versus</p> <p>9 values. I thought that was really laid out in a very</p> <p>10 interesting format.</p> <p>11 I will say that as you consider your work in</p> <p>12 this area one thing to also keep in mind is that, you</p> <p>13 know, it's not work in a vacuum. There are other</p> <p>14 participants in this conversation. For example in</p> <p>15 Europe there is a tremendous amount of work going on</p> <p>16 there at the regulatory level in terms of sustainable</p> <p>17 finance and work in other jurisdictions because of the</p> <p>18 global nature of the asset management industry as of now</p> <p>19 does tend to come into our issues faced today and</p> <p>20 tomorrow. So something to keep in mind as you continue</p> <p>21 that work on the different areas that you're exploring.</p> <p>22 For that -- one other thing that really struck</p> <p>23 me is the ESG for the private access and for diversity</p> <p>24 and inclusion is how data driven, you know, the areas</p> <p>25 are and frankly also the lack of data. So something --</p>	<p style="text-align: right;">Page 273</p> <p>1 wonder if you had thought about that, if that's</p> <p>2 something you would explore.</p> <p>3 So I know that's a lot, but I was trying to</p> <p>4 get it through it pretty quickly so that you can close</p> <p>5 out. But thank you again for your time, for all the</p> <p>6 work that you are doing and continuing to do. For all</p> <p>7 the subcommittee heads, amazing presentations. And for</p> <p>8 the ETFs and the operations workstreams, thank you for</p> <p>9 that. I mean, this was -- operations workstreams, you</p> <p>10 guys put together quickly how the recommendations were</p> <p>11 put in ETF, truly, truly amazing work and thank you,</p> <p>12 appreciate it. Ed.</p> <p>13 MR. BERNARD: Great. Thank you, Dalia. That</p> <p>14 was really helpful input.</p> <p>15 With that I was hoping -- I'm going to give</p> <p>16 you back nine minutes. We were due to finish at 4:15.</p> <p>17 I'm -- it's important to me to finish on time and if we</p> <p>18 can finish early that's great.</p> <p>19 Be on the lookout for -- well, you may see</p> <p>20 some follow up notes from me or subcommittee leads</p> <p>21 seeking feedback and input. We always appreciate your</p> <p>22 being attentive to those.</p> <p>23 You will likely see a request from the SEC</p> <p>24 team looking for a, what I think will be a very brief</p> <p>25 meeting sometime in, I'm going to say October timeframe,</p>

1 but let's just call it fall, to follow up on Mike  
2 Durbin's discussion.

3 The next full day meeting is scheduled for  
4 Tuesday, December 1st. I hope everybody has that marked  
5 in your calendar. And with apologies, although we all  
6 responded with the dates, that's the Tuesday after the  
7 week of Thanksgiving.

8 So in any case, thanks again to all of our  
9 speakers and leaders and to all of your participation  
10 and have a great day. My screen is flashing red and my  
11 screen time is over for the day, so I'm going to turn it  
12 off. Thanks everybody.

13 (Whereupon, at 4:07 p.m., the meeting was  
14 adjourned.)

15 \* \* \* \* \*

1 REPORTER'S CERTIFICATE

2  
3 I, Kevin Carr, reporter, hereby certify that the  
4 foregoing transcript is a complete, true and accurate  
5 transcript of the matter indicated, held on  
6 \_\_9/16/2020\_\_\_\_\_, at Washington, D.C., in the  
7 matter of:  
8 ASSET MANAGEMENT ADVISORY COMMITTEE MEETING.  
9 I further certify that this proceeding was recorded by  
10 me, and that the foregoing transcript has been prepared  
11 under my direction.

12  
13 9/17/2020

14 Kevin Carr  
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1 PROOFREADER'S CERTIFICATE

2  
3 In the Matter of: ASSET MANAGEMENT ADVISORY COMMITTEE  
4 MEETING

5 File No: OS-0916

6 Date: Wednesday, September 16, 2020

7 Location: Washington, D.C.  
8

9 This is to certify that I, Christine Boyce  
10 (the undersigned), do hereby certify that the foregoing  
11 transcript is a complete, true and accurate  
12 transcription of all matters contained on the recorded  
13 proceedings of the meeting.

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