

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE
SECURITIES AND EXCHANGE COMMISSION
ASSET MANAGEMENT ADVISORY COMMITTEE

Tuesday, January 14, 2020

9:00 a.m.

U.S. Securities and Exchange Commission

100 F Street, NE

Washington, D.C.

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1	PARTICIPANTS:
2	
3	Asset Management Advisory Committee:
4	Edward Bernard, Committee Chairman
5	John Bajkowski
6	Michelle McCarthy Beck
7	Jane Carten
8	Scot Draeger
9	Mike Durbin
10	Gilbert Garcia
11	Alex Glass
12	Paul Greff
13	Rich Hall
14	Neesha Hathi
15	Adeel Jivraj
16	Ryan Ludt
17	Susan McGee
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19	Joseph Savage
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22	Ross Stevens
23	Rama Subramaniam
24	John Suydam
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1	PARTICIPANTS (CONT.):
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3	Panelists:
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6	Alex D'Amico, McKinsey & Company
7	Stephanie Drescher, Apollo Global Management
8	John Finley, Blackstone Group
9	Raquel Fox, Office of International Affairs, SEC
10	Michael Goldstein, Empirical Research Partners
11	Colby Penzone, Fidelity Investments
12	Ben Phillips, Casey Quirk - Deloitte Consulting
13	Paul Roye, Capital Group
14	Jason Vedder, Driehaus Capital Management
15	Dan Waters, Independent Director and Consultant
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1	PARTICIPANTS(CONT.):
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3	Asset Management Advisory Committee(cont.):
4	Mark Tibergien
5	Russ Wermers
6	
7	Securities and Exchange Commission:
8	
9	Jay Clayton, Chairman (via video)
10	Robert Jackson, Jr., Commissioner
11	Hester Peirce, Commissioner
12	Elad Roisman, Commissioner
13	Allison Herren Lee, Commissioner
14	Dalia Blass, Director, Division of
15	Investment Management
16	Paul Cellupica, Deputy Director,
17	Division of Investment Management
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PROCEEDINGS

1 MR. BERNARD: Wow, that's a very fine group.
 2 Thank you.
 3 Welcome, everyone, to the first meeting of the
 4 Asset Management Advisory Committee. I'm Ed Bernard. I've
 5 been asked to be the initial chair of the committee.
 6 And I'm actually -- I think it's pretty self-
 7 evident we have a quorum. So I'll just skip with the
 8 parliamentary procedure.
 9 I'd first like to thank the Chairman and the
 10 Commissioners for approving this committee. And Chairman
 11 Clayton is unable to be with us, but -- where did Sean go?
 12 Oh, Sean Memon from his office -- I'll just turn it over to
 13 you to kick us off, if I could.
 14 MR. MEMON: Great. Thanks, Ed. Hello, everyone.
 15 My name is Sean Memon and I am the Chairman's chief of
 16 staff. And with me is Eric Diamond, Senior Adviser to the
 17 Chairman.
 18 To the members of the committee and those members
 19 of the public that are joining us in person and online, we
 20 are very glad to welcome you to the SEC. We are very
 21 excited that you are all here.
 22 Chairman Clayton regrets that he can't be in
 23 person today, as he is currently out of the country,
 24 representing the agency in meetings with foreign regulators.
 25

1 But he wanted to make sure to welcome you here himself, and
 2 we are pleased to be able to share with you some video
 3 remarks that he recorded before his departure.
 4 So, without further ado, we can roll the video.
 5 CHAIRMAN CLAYTON (via video): Good morning. I am
 6 delighted to welcome you in this new year to the inaugural
 7 meeting of the Commission's newest advisory committee, the
 8 Asset Management Advisory Committee, or the AMAC. I
 9 apologize that I am not there to speak to you in person. I
 10 am in Europe for meetings with my international counterparts
 11 on matters that relate directly to the evolution and
 12 globalization of the asset management industry, including,
 13 one, whether there is a mismatch in investor expectations
 14 and market realities regarding liquidity depth in various
 15 equity, fixed income and alternative asset markets; and,
 16 two, issues raised by the reference rate transition and the
 17 discontinuation of LIBOR.
 18 I am pleased, however, that my fellow
 19 commissioners are joining you this morning. I thank them
 20 for their support of the AMAC.
 21 I believe we have all benefitted from the insight,
 22 perspective and experience that advisory committees have
 23 brought to the Commission in recent years. I would like to
 24 thank all of the committee members for your willingness to
 25 serve. I recognize that all of you have significant demands

1 on your schedules. And a special thanks to Committee
 2 Chairman Ed Bernard, who has already undertaken significant
 3 work on behalf of the committee. I would also like to thank
 4 Dalia Blass and her team in the Division of Investment
 5 Management, as well as the Office of General Counsel for
 6 conceiving and then helping to form the AMAC. Ideas are one
 7 thing, execution is another. And I know bringing this
 8 experienced and thoughtful group together was no small task.
 9 It is incumbent upon the Commission to hear from
 10 those with experience and expertise from outside this
 11 building. The AMAC was established to do just that, to
 12 provide informed, diverse perspectives and related advice
 13 and recommendations, which will inform the Commission's
 14 policy decisions. More specifically, I believe the AMAC
 15 will help ensure that our regulatory approach to asset
 16 management meets the needs of retail investors and market
 17 participants at a time when the asset management industry
 18 and our markets more generally are rapidly evolving.
 19 In my posted remarks, I have provided some
 20 statistics regarding how significant a role the asset
 21 management industry plays in helping Main Street investors
 22 achieve their financial goals. These numbers make clear
 23 that, on a macroeconomic level, Main Street investors are a
 24 primary driving force of not just the asset management
 25 industry but the broader capital markets. And on a

1 microeconomic and far more personal level, the ability for
 2 these investors to access our markets on fair terms is
 3 central to their ability to meet their long-term financial
 4 needs.
 5 That tens of millions of Main Street investors
 6 entrust their hard-earned money to the capital markets and,
 7 in particular, to fund complexes and other investment
 8 professionals, is a stark reminder of why the issues you
 9 will address are so important. Indeed, this is why we have
 10 focused a significant part of our regulatory agenda on
 11 advancing policies designed to promote access and choice for
 12 Main Street investors, including more recently focusing on
 13 ways to increase access to the private markets while at all
 14 times ensuring appropriate investor protections.
 15 I am happy to see that the committee is going to
 16 begin its own discussion of this topic today and I applaud
 17 the Commission Staff, including the Division of Investment
 18 Management, for their significant efforts to improve the
 19 investor experience to date. I am hopeful that the
 20 committee will focus on this perspective, promoting access
 21 and choice for our long-term Main Street investors, while
 22 ensuring appropriate investor protections.
 23 As you provide your advice and recommendations, I
 24 also ask that you be candid. Tell us where we can improve
 25 our markets and our regulations. Strive to identify ways we

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1 can promote efficiency, capital formation and investor
 2 protection. History shows this is not a zero-sum game and
 3 viewing it as such is unnecessarily limiting and, frankly,
 4 can lead to suboptimal policy decisions.

5 Markets today provide more investor protection,
 6 are more efficient and provide more investor choice than
 7 they did 30 years ago. My hope and focus is that a decade
 8 from now, our capital markets will provide more investor
 9 protection, be more efficient and provide more opportunities
 10 for our Main Street investors than they do today.

11 I am also very pleased that this committee will be
 12 focusing its efforts on ways to promote diversity and
 13 inclusion in the asset management industry. For the same
 14 reasons that hearing from the diverse perspectives of the
 15 members of this group is critical to the success of the
 16 committee, it is critical that the asset management industry
 17 include women and men with diverse backgrounds and
 18 perspectives. As you may know, the Commission recently
 19 announced the appointment of Robert Marchman as senior
 20 policy adviser on diversity inclusion. Robert will help us
 21 develop and implement strategies to promote diversity
 22 inclusion both within the Commission and through external
 23 engagement with agency partners and market participants. I
 24 encourage the committee to engage with Mr. Marchman, Pam
 25 Gibbs, the director of our Office of Minority and Women

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1 Inclusion, and me in this area.

2 I'll close by saying that I also look forward to
 3 continuing to work with my fellow commissioners to ensure
 4 that our regulatory approach to the markets is sound and
 5 continues to meet the needs of Main Street investors and
 6 other market participants. Thank you and enjoy the day.

7 MR. MEMON: Great. I'd like to thank the
 8 audiovisual team for helping with that video. And now I
 9 would like to turn the microphone over to Commissioner
 10 Roisman.

11 COMMISSIONER ROISMAN: Good morning everyone. I
 12 am truly happy to be joining you today in this inaugural
 13 meeting. Our expert Commission Staff worked hard to
 14 establish this committee, making sure to include members
 15 that are distinguished in their careers and rich in their
 16 experience. I'm grateful to Director Dalia Blass and her
 17 team in the Division of Asset Management for all their work
 18 in getting us here today. And thank you, obviously, to the
 19 committee members for agreeing to serve. We really look
 20 forward to your input.

21 You are here because of the insight you can offer
 22 about what's going on in the real world, whether you invest
 23 for yourself or for others, design investment products, run
 24 investment businesses, offer products or services to those
 25 firms, or study this industry, you have a unique perspective

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1 on current dynamics in the asset management industry and how
 2 these trends could ultimately affect investors. Let me also
 3 thank our knowledgeable panelists for being here today and
 4 sharing your wisdom.

5 Insight that each of you in this room can share
 6 with us is incredibly valuable to me, as a commissioner, and
 7 undoubtedly to our SEC Staff as well. It has not taken long
 8 serving in my role to see that the asset management industry
 9 is undergoing fundamental changes. Technology has
 10 introduced new opportunities, new risks and new costs. New
 11 or amended regulation, whether from this agency or
 12 elsewhere, has altered the landscape of compliance and
 13 clients' preferences are constantly involving. After all,
 14 today's investor base includes those whose baby pictures
 15 were taken on the iPhone as well as those who fought in
 16 World War II.

17 Related to all these and other changes, a trend of
 18 consolidation has swept through the financial industry. The
 19 biggest firms have grown bigger and the smaller firms have
 20 found it harder to compete on their own. I want to know how
 21 these trends are affecting firms' ability to serve
 22 investors. In particular, are they able to innovate to
 23 serve customers and clients? Or are investors choices of
 24 products and services becoming more limited as these trends
 25 persist?

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1 I believe we need to maximize the investment
 2 choices available to people while enabling access to
 3 information or advice for them to make their financial
 4 decisions. From this group, I hope to learn what the SEC
 5 can do to help investors in this way. Where can we remove
 6 barriers to innovation at financial firms, alleviate
 7 regulatory burdens or other costs that may be accelerating
 8 consolidation, or otherwise reexamine aspects of our rules
 9 that ultimately work against the interests of investors?
 10 These are broad questions that I will be thinking about as
 11 you bring topics on your agenda to our attention.

12 Finally, as comprehensive as your experience and
 13 viewpoints are, I hope you will seek to hear from even more
 14 people. There are many working in different parts of the
 15 asset management industry and pursuing investment
 16 opportunities who do not have the time or opportunity to
 17 visit us in Washington, D.C. I encourage you to engage with
 18 these outside the political and financial centers so we can
 19 account for their viewpoints when considering policymaking.

20 Again, I really appreciate all of your willingness
 21 to take part in this committee and I look forward to all of
 22 your hard work and recommendations. Thank you again.

23 COMMISSIONER PEIRCE: Good morning. Welcome to
 24 all of you. It is a delight to be here with you to be here
 25 for the first Asset Management Advisory Committee meeting.

1 I appreciate your willingness to make the considerable
 2 investment of time and talent to participate in this
 3 committee. You will provide us an invaluable perspective as
 4 we sort through problems and potential regulatory solutions.
 5 The breadth of experiences represented by the
 6 committee's membership will no doubt provide the Commission
 7 with much-needed insight as we consider the many challenges
 8 that are facing asset managers as they seek to serve the
 9 investing public. As today's committee agenda evidences,
 10 you're set to tackle some of the thornier issues that the
 11 industry will be facing in the coming years, from the
 12 evolution of public and private securities markets to the
 13 globalization of asset management. An important part of the
 14 role that you can play is to draw our attention to the
 15 issues that are consuming your time and attention.
 16 Along those lines, if I may, I'd like to suggest
 17 one potential topic for you to add to the many that you will
 18 be able to consider. And that is various issues surrounding
 19 customer privacy and data protection and the unique and
 20 pressing challenges that these matters are now posing to
 21 asset managers. One of the aspects of my job as
 22 commissioner that I really enjoy is the chance to meet with
 23 a cross section of market participants. And the
 24 difficulties of complying with the ever-increasing
 25 obligations associated with customer privacy and data

1 protection are clearly among the issues that are at top of
 2 mind for the asset managers with whom I've met. And it's
 3 not surprising.
 4 Not only do asset managers have to grapple with
 5 GDPR, but there are many states that are now considering
 6 implementing or already have implemented customer privacy
 7 and/or data protection legislation. The most prominent of
 8 these just came online this year, that's California's
 9 Consumer Protection Act, which went into effect just in
 10 2020. And among other things, it effects businesses with
 11 more than 25 million in annual gross revenue. It grants
 12 consumers the right to request that their personal
 13 information be deleted upon the receipt of a verified
 14 request, as well as the right to opt out of having their
 15 data sold or shared and provides for a private right of
 16 action should there be a data breach. The CCPA could
 17 change. There are upwards of 10 bills that are now being
 18 considered in Sacramento that could further alter the CCPA,
 19 so there is a state of flux around that bill, as well as
 20 around legislation in many other states.
 21 Privacy regulations of this sort can be very
 22 difficult for investment advisers and others in the
 23 financial services industry who are also subject to
 24 extensive federal regulation. While it's true that some of
 25 the CCPA's obligations as well as those found in a host of

1 other state initiatives would be preempted under Reg SP and
 2 Gramm-Leach-Bliley, asset managers are still faced with the
 3 costs and potential liabilities associated with determining
 4 just where and how they are to comply with a growing
 5 multitude of overlapping regulatory regimes.
 6 As the Commission continues to consider how best
 7 to protect privacy and data security, having a greater
 8 understanding of what challenges asset managers and other
 9 market participants face will be invaluable.
 10 Your insights on these and other issues are very
 11 welcome. I look forward to following your discussions in
 12 person or later by video if I can't make it in person. I
 13 want to thank you, to the Division of Investment Management,
 14 particularly to Mark Uyeda, Christian Broadbent and Sirimal
 15 Mukerjee for making this committee a reality. Thank you.
 16 COMMISSIONER LEE: Thank you. I'll be brief so
 17 you can all get started with your work. I want to second
 18 the remarks of the Chair and my colleagues on how important
 19 the asset management is to American investors. Clients of
 20 all types, from retirees, retail investors, large
 21 institutions and pension plans rely heavily on the people in
 22 this room and your colleagues to manage their finances, help
 23 them save and invest for the future and exercise independent
 24 judgment in voting their shares.
 25 So I want to thank Director Dalia Blass for

1 helping to establish this committee, and I want to thank
 2 everyone here for your willingness to contribute your time
 3 and expertise.
 4 There are many issues worthy of this committee's
 5 attention and I do look forward to your assessment of how
 6 best to spend your time and resources. I want to highlight
 7 one area of increasing significance to the investors you all
 8 serve, and that is the ability to accurately assess, compare
 9 and invest in companies with sound policies on
 10 sustainability, ethical business standards and good
 11 governance. Evidence continues to mount regarding how
 12 critical this information is for investors in their
 13 decisionmaking process. Indeed, a recent academic survey
 14 indicates that over half of the institutional investors
 15 surveyed globally considered climate risk disclosure in
 16 particular to be as important as traditional financial
 17 disclosure. And yet it has been a decade since the
 18 Commission addressed climate-related disclosure. And I
 19 don't want to see us fall behind the rest of the world in
 20 ensuring that investors receive the sort of material
 21 information that the market is demanding.
 22 So as you start to think about this committee's
 23 agenda and how you can help both the Commission and the
 24 public, I hope you will consider some of these issues. How
 25 can the Commission ensure that asset managers and their

1 clients can meaningfully pursue their investment goals and
2 have access to critical and comparable information related
3 to climate risk and more broadly to ESG issues? What set of
4 standards will best serve investors and asset managers in
5 evaluating a company's exposure to climate risk and in
6 assessing and pricing that risk? What should it mean when a
7 fund calls itself an ESG fund? And how can the Commission
8 and investors ensure that asset managers are not only
9 investing in line with the long-term goals of their clients
10 but also voting in line with those goals?

11 So again, this is just one of a number of
12 important areas where I hope we will benefit from your
13 expertise. And I do sincerely thank each of you for your
14 time and deduction and I look forward to your analysis and
15 recommendations.

16 COMMISSIONER JACKSON: Thank you so much,
17 Commissioner Lee. And thank all of you for being here this
18 morning. I will also be brief.

19 I want to echo the comments of all of my
20 colleagues, and again by extending my tanks to Sean Memon
21 and the Office of the Chairman, the tremendous Dalia Blass,
22 our director of Division of Investment Management, for
23 putting together this truly exceptional group of
24 professionals and thinkers in this important space.

25 And my colleagues have said this already but, just

1 respect to the use of takeover devices in those funds, and
2 the degree to which that use protects or does not protect
3 individual investors who participate in that asset class.
4 Without making any judgment on that point, I hope you'll
5 lend your expertise to the subject. It's certainly
6 something that's been on my mind and may be something worthy
7 of our attention down the road.

8 With all that said, thank you so much to our
9 colleagues for bringing this group together and I look
10 forward to the conversation.

11 MS. BLASS: Good morning. I am also truly
12 delighted to be able to welcome you all here this morning
13 for this inaugural meeting of the Asset Management Advisory
14 Committee.

15 Since the beginning of my time as the director of
16 the Division of Asset Management, I have been focused on
17 ways to engage with and better regulate the constantly
18 evolving asset management industry. I believe that forming
19 this committee is a significant step towards creating
20 diverse investor and industry perspectives to the most
21 pressing issues facing the industry today.

22 This committee is the result of a tremendous
23 amount of effort by many people. I would like to thank the
24 committee members, all of you for being here today and
25 participating and willingly giving your time to this effort.

1 to make the point clear, by being here today you make a
2 sacrifice of your time and expertise that we appreciate
3 deeply, and it makes us better at our work and we are very
4 grateful for that.

5 My colleagues have highlighted several high-level
6 important issues and I am going to be much less interesting
7 and focus on a particular issue that's been on my mind over
8 the last few years and one that you might consider among the
9 many important, pressing issues that you will study over
10 your time together as a committee. And those issues have to
11 do with closed-end mutual funds, a subject that I have
12 published about and spoken about in the past.

13 Closed-end mutual funds are a crucial vehicle for
14 ordinary investors to participate in a number of markets
15 across the economy, whether it's fixed income type saving in
16 municipal securities with a unique liquidity profile or
17 other types of instruments that are important for retail
18 investors. The data show that retail investors are
19 overwhelmingly the holders of these funds and that they play
20 an important role in the marketplace. And among other
21 things, a study of that area is something that the
22 Commission hasn't undertaken for some time and may be worth
23 reevaluation.

24 In a study I released before I took this job, I
25 examined the effect of the Commission's determinations with

1 And Chairman Ed Bernard, your generosity in agreeing to
2 participate is truly participated.

3 I know that through your participation, the
4 committee is going to be an invaluable resource to the
5 Commission and ultimately our joint end client, Main Street
6 investors.

7 I also want to thank my team, Christian Broadbent,
8 Mark Uyeda and Sirimal Mukerjee and IM's managing executive
9 office. They were instrumental in getting us here today and
10 they worked tirelessly to help make sure that, hopefully,
11 this day goes off without a hitch.

12 I also want to thank all who are going to be
13 participating on today's panels. I expect the discussions
14 both to be highly informative as well as conversation
15 starters for issues that the committee may ultimately decide
16 to tackle.

17 Finally, I want to thank the Chairman and the
18 Commissioners for their support of the committee. Last
19 March, I announced the Division was considering the
20 formation of an asset management committee. I said that
21 many of the debates surrounding long-term trends in the
22 asset management industry, such as the rise of index
23 investing, increased globalization, increased scale and
24 trends in retirement funding would benefit from thoughtful
25 discussion among experts with diverse viewpoints. Today,

1 this committee is an important step forward in this
 2 discussion.

3 To put this discussion in perspective, let's
 4 consider changes in retirement trends for the post-
 5 millennials. After getting their first job, it's unlikely
 6 that they will have similar access to pension plans like
 7 their parents. Instead, for retirement savings, they will
 8 likely need to look to defined contribution plans. So right
 9 with their very first paycheck, they will need to know and
 10 understand how to access and invest in the markets, how to
 11 allocate those investments and how to monitor their
 12 allocations.

13 While some could choose to invest directly in the
 14 stock of a company or a bond, data shows that Main Street
 15 investors access the markets through the asset management
 16 industry. They invest in mutual funds, exchange-traded
 17 funds, business development companies and variable
 18 annuities. This enables them to build a diversified and
 19 professional managed portfolio, spreading cost and risk.
 20 Therefore, the asset management industry is a key player in
 21 helping investors to meet their retirement and other
 22 financial goals, and its role is growing.

23 This makes it critical that we approach potential
 24 trends and risks by engaging in thoughtful dialogue that
 25 hears from and accounts for diverse views. I believe this

1 is how we can discover effective and actionable solutions.
 2 To this end, this committee was designed with representation
 3 across the asset management industry. It includes members
 4 of different backgrounds, from different sectors of the
 5 market, fund sponsors, retail and institutional investors,
 6 broker-dealers, liquidity providers, fund directors, data
 7 providers, research analysts, index providers, custodians
 8 and auditors. The members come from all over the United
 9 States and the full spectrum of funds are represented here
 10 today, large, small, active, passive, alternative, closed-
 11 end, BDC and private equity. I cannot think of a better
 12 informed group of individuals to give us their thoughts on
 13 potential trends and risks.

14 As the Chairman noted, diversity increases
 15 familiarity with investors, enhancing access to the services
 16 provided by the industry. Therefore, the diversity of this
 17 committee is important to discovering effective and
 18 actionable solutions that I mentioned earlier.

19 Before the committee begins its work with today's
 20 panel discussions, I am delighted to introduce the chairman
 21 of the Asset Management Committee, Ed Bernard. I know most
 22 of you probably know Ed quite well. During his more than 30
 23 years at T. Rowe Price, Ed served in several capacities,
 24 including as vice chairman of the corporate board of
 25 directors and chair of the board of directors of the T. Rowe

1 Price mutual funds.
 2 For those who have had the opportunity to know Ed,
 3 underneath all the titles is an infectious enthusiasm for
 4 his work. And with that, Ed jumped in feet first from day
 5 one. He has spent quite a bit of time thinking about
 6 potential topics that may be of interest to the committee,
 7 talking with other committee members, thinking about and
 8 contacting potential panelists through discussions with the
 9 committee and planning today's agenda. So please join me in
 10 welcoming Ed to this inaugural meeting of the committee.

11 MR. BERNARD: Thank you for that kind introduction
 12 and thank you to the Chairman and all the Commissioners,
 13 both for your remarks and your support in creating this
 14 committee. And my especial thanks to Dalia and her team,
 15 who conceived it, worked it through the Commission, got
 16 approval, helped define the charter and so forth, and here
 17 we are.

18 I'm going to make just a -- we're doing okay. I
 19 am going to try to keep my remarks to about three or four
 20 minutes as well. I want to speak a little bit to why we're
 21 here and how we're going to operate and then turn it over to
 22 our first speakers.

23 Dalia mentioned actually the breadth of the
 24 committee, which I think is particularly exciting. And I
 25 would say that the committee has been designed with that

1 broad representation to create a strong, broad and balanced
 2 dialogue, contributing market perspectives to inform the
 3 work of the Commission. Over two years, we will prioritize
 4 issues and explore them in depth, via subcommittee work and
 5 in discussion, formal meetings like this, and seeking to
 6 create a strong public dialogue and raise the level of
 7 understanding of all stakeholders and make specific
 8 recommendations as and when appropriate.

9 I thought as chair -- I don't want to be
 10 overbearing but I thought I'd share just a couple principles
 11 of how I think about this. And certainly, as we get to know
 12 one another, I welcome other thoughts.

13 First, I think in any endeavor like this, our
 14 North Star is the investor. In all of our work, our
 15 ultimate goal should be to provide our best thinking, as
 16 measured by serving and protecting investors. You'll find
 17 that I always fall back to that.

18 Second, my experience has been that actively
 19 embracing diversity of thought and respectful debate leads
 20 to better ideas and solutions. The context of public policy
 21 work makes this all the more important, given the need for a
 22 balanced record reflecting multiple perspectives. So, as we
 23 identify areas for focus, we'll design work plans and
 24 discussions to ensure multiple perspectives. And in our
 25 discussions, I obviously hope you will all freely express

1 your own views. I will say one caveat. I doubt I need to
 2 say this. But on each point, I won't be polling the entire
 3 group for a point of view; we will just have it be a natural
 4 evolution of engagement.

5 And actually, I would echo both the Chairman and
 6 now Dalia have mentioned the broader issue of diversity.
 7 And in my view, that remains an important challenge for the
 8 industry. And I hope to find a way for us to bring some
 9 thought to that as a group.

10 The final view that I wanted to share is my view
 11 that effective regulation is a neighborhood issue. And what
 12 I mean by that is, while our committee includes varied and
 13 sometimes competing interests by design, our ultimate stake
 14 in this is a collective one. And that calls for us to seek
 15 the greater good. Asset management is a business of trust
 16 and, when that trust is damaged by any participant, whether
 17 by poor execution or bad behavior, it damages trust for the
 18 entire industry.

19 So with that, we've been given a fairly broad
 20 mandate and we concluded for this first meeting, if you'll
 21 forgive the industry jargon or the consulting jargon, we're
 22 going to zoom out in order to zoom in.

23 We've structured this meeting to examine broadly
 24 significant trends and certainly don't plan to fully
 25 prosecute those issues today. Rather, we hope to provide a

1 fact-based foundation to support the committee's future
 2 discussions and development of priorities to pursue in
 3 subcommittees. Today's emphasis is on understanding key
 4 dimensions of industry evolution based on observed trends
 5 and the likely trajectory of these trends into the future.
 6 I think we can limit our time on the past and try and focus
 7 on what would be useful input for the future.

8 Seeking to shed light on potential implications of
 9 that, I would suggest that we avoid the temptation to link
 10 every issue or trend back to regulation. Linkages and
 11 implications can be developed as appropriate in more focused
 12 work to come, and that obviously will be a key focus of our
 13 work. But there are many factors that drive evolution of
 14 our industry that aren't regulatory.

15 So after discussions with each of you, other
 16 industry experts and observers and especially with Dalia and
 17 her term, we have organized today's meeting around three
 18 broad topics. The first is the evolution of asset
 19 management and, if you will, the asset management value
 20 proposition from circa 1980 to present. You may have
 21 noticed there's been a fair bit of change. I'm going to
 22 guess, and Michael will probably tell us, in 1980, there was
 23 probably 400 or 500 billion in assets under management in
 24 the entire mutual fund industry. It's now 21 trillion,
 25 something like that.

1 The evolution of public versus private securities
 2 markets. Globalization of asset management -- and there, we
 3 will have an emphasis on regulatory aspects, given the
 4 breadth of that topic to avoid, forgive the cliché, of
 5 trying to boil the ocean.

6 We will also have some administrative work for
 7 those on the committee over lunch, with some briefings from
 8 various offices of the SEC, and we will talk about our
 9 bylaws.

10 So unless there are any questions from the
 11 committee members, I am going to introduce our first two
 12 speakers and we're one minute behind time. So we're doing
 13 well so far. We've got a long day ahead, though.

14 EVOLUTION OF ASSET MANAGEMENT AND VALUE PROPOSITION

15 MR. BERNARD: So the Evolution of Asset Management
 16 and Value Proposition, if I had to sum up the last three to
 17 four decades in our industry in one word, I think I would
 18 use the word "change" on just about every dimension. And in
 19 this first session, we wanted to capture a robust view of
 20 that as a foundation for our work.

21 I can't think of two better people to guide us
 22 through it. They each bring lots of informative data and,
 23 more importantly, given their expertise, we've asked them to
 24 focus on what they view to be important trends and the
 25 trajectories of those trends.

1 Michael Goldstein is managing partner of Empirical
 2 Research Partners, an independent research firm and broker-
 3 dealer. It's subsidiary, FMMI, provides research on the
 4 business of money management, and has done so for, what, 35
 5 years, something like that. He's been looking at it for a
 6 while. Over 75 of the top hundred equity holders in the
 7 U.S. are clients of his firm, so he's had great success with
 8 that. And, importantly, Michael has followed the money
 9 management industry since the early part of his career in
 10 the early '80s.

11 Ben Phillips on Michael's right is senior
 12 principal with the Casey Quirk practice at Deloitte
 13 Consulting, also has over 25 years' experience consulting
 14 with asset management firms and wealth managers.

15 So the way we've elected to do this, I think
 16 rather than get bogged down with questions, we've asked them
 17 each to speak for about 20 to 25 minutes, just share their
 18 thoughts with us, and then we should have a good half hour
 19 left for us to engage in discussion. So with that, Michael,
 20 I think you're up first.

21 MR. GOLDSTEIN: Thanks, Ed. Thanks for having me
 22 attend. My day job involves giving advice to money managers
 23 about what to do in the stock market, which I've been doing
 24 for about 35 years. As an avocation, I've followed what's
 25 gone on in the money management business over that period of

1 time and have advised CEOs on business strategy.
 2 I brought along a presentation today consisting of
 3 40 slides and I have 25 minutes, so I am going to have to
 4 move right along. I have no way to change the slides, so I
 5 hope they are magically going to move forward.
 6 So we can turn to number two, which is the topics
 7 I brought along today. Given we only have 25 minutes, I'm
 8 not going to talk about everything. I'm going to start with
 9 a review of the very big picture or talk about indexing and
 10 what's driven the rise of indexing in particular, then talk
 11 about what constitutes advice and how that may have changed
 12 over time.
 13 Turning to slide three, the next slide, this
 14 looks --
 15 MR. BERNARD: Actually, I'm not sure who's driving
 16 slides. But I will tell you from experience, Michael moves
 17 like a buzz saw through the slide, so I would keep your
 18 finger on the button.
 19 MR. GOLDSTEIN: Yes, things are going to move
 20 right along.
 21 The green bars look at the size of the U.S. money
 22 management industry. We think at the end of 2019, it was
 23 between 45 and 50 trillion in size. Since the value of
 24 financial assets has grown faster than the economy, the
 25 relationship to GDP has gotten bigger, which is reflected in

1 the black bars. And the money management industry is just
 2 over twice the size of U.S. output at any year.
 3 Turning forward, this slide looks at the makeup of
 4 assets at the end of -- thank you, do it myself -- at the
 5 end of 2018. In the upper right are institutional monies,
 6 in the upper left are retail monies of various categories.
 7 And at the lower right are various forms of retirement
 8 assets controlled by individuals. So you can see, the
 9 traditional institutional business is now about a quarter of
 10 the industry itself. This looks at the evolution of those
 11 components.
 12 If you go back to 2000, the institutional business
 13 was about a third of the assets of the industry and it's now
 14 a quarter. That share has gone to retirement assets
 15 controlled by individuals directly, primarily IRA accounts.
 16 And the retail share shown at the top has been largely flat.
 17 So as was mentioned earlier, it looks like the
 18 defined -- traditional defined benefit plans sponsored by
 19 corporations are in hospice care. So you can see here, the
 20 number of participants is back to what it was in 1975. Just
 21 over a third of those are still employees of the company.
 22 So only about 7 percent of the private sector work force is
 23 covered by a traditional pension plan, so the dynamic that
 24 long drove the industry of institutional buyers making bulk
 25 decisions has faded quite dramatically.

1 Turning forward, the history of the industry is
 2 one of booms. Something happens to make something hot.
 3 Either it's interest rates, regulation, deregulation,
 4 changes in the global economy itself. And this looks at the
 5 major booms since the late '70s. Money market funds, equity
 6 mutual funds, hedge funds, and the two booms of this decade,
 7 the rise of ETFs and the rise of private equity. Once
 8 again, the bars -- the black bars at the right relate those
 9 to the size of the U.S. economy. You can see at the far
 10 right, the flows in traditional equity mutual funds and ETFs
 11 have been puny in this decade compared to the categories
 12 that boomed, shown to the immediate left. So consistent
 13 with the history of the industry, something has been hot.
 14 And those two things have been ETFs and private equity.
 15 So this looks at their share of the industry,
 16 which is the yellow and black bars respectively. If you go
 17 back to 2000, each was less than 3 percent of the size of
 18 the industry and now they're both about 9 percent of all the
 19 assets. So this has been a pretty dramatic transformation
 20 in the makeup of what constitutes money management that's
 21 not dissimilar from what's happened in prior decades.
 22 When one tries to figure out how people make
 23 decisions, past returns seem to have something to do with
 24 it. So this looks at trailing 20-year returns, which is
 25 probably the right horizon to figure out long-term

1 decisionmaking. The blue line is the returns of the S&P 500
 2 on a trailing 20-year basis and the green line, I guess, are
 3 Treasury bonds. So people like bonds because they've been
 4 better than stocks for 20 years. There are many other
 5 reasons, but this has something to do with it.
 6 Interest rates have also had a lot to do with
 7 institutional behavior. The green bars are the rate of --
 8 spending rates of endowments, how much they plan to spend
 9 each year as a share of their assets, and the black line is
 10 the yield of the U.S. bond market. So today, the yield is
 11 about half the spending rate. So you try to manufacture
 12 yield, which has been one of the driving dynamics of the
 13 money management industry over the last 15 years. If it's
 14 not there, you figure out some way to create it, sometimes
 15 with some unexpected consequences.
 16 Another big aspect of all of this has been
 17 demographics. You just can't get rid of the Baby Boomers.
 18 So they still -- the Baby Boomers and their predecessors
 19 still control between 70 and 75 percent of all of the
 20 financial assets in the U.S. under the direct control of
 21 households. So people always bring up to me millennials.
 22 It's a very interesting group. But from the point of view
 23 of the money management business, the basic problem is they
 24 don't have money; the Baby Boomers still have the money.
 25 And so the inertia created by this has been sizeable.

1 The other reality of the money management business
 2 is that the business and policy issues are not at all the
 3 same. Because the money management business is essentially
 4 an asset-weighted business and the assets are very skewed
 5 towards the top end of the wealth distribution. So you can
 6 see here on the order of 80 percent of the assets come from
 7 the top 10 percent of the distribution. So this has had a
 8 big impact on how the industry has evolved over time because
 9 the distribution has become more upwardly skewed over the
 10 modern history of the industry.

11 What's also happened is this looks at inheritances
 12 by age and wealth. So the blue line looks at the
 13 probability of getting an inheritance for people in the top
 14 10 percent of the distribution. So most of the inheritances
 15 go to wealthy people that are in their sixties. So what's
 16 happened is the Baby Boomers' parents have died off, those
 17 assets have gone to the top end of the distribution,
 18 furthering the trends already in place.

19 So this has had a big impact on the rate of change
 20 in the industry. I believe the demographics have had the
 21 effect of slowing the rate of change because inertia among
 22 the existing asset holders has remained the dominant dynamic
 23 up until this point. So this chart looks at a survey where
 24 they asked people, what do you like better, people or
 25 machines? So the blue bar tells you they like people

1 of it is you sell companies from one private holder to
 2 another because the private pool is so much bigger than it
 3 was before. There has also been a melding of the channels
 4 here. This looks at what share of venture capital-based
 5 IPOs was money from mutual funds over time. So what's
 6 happened is the traditional mutual fund channel has become
 7 involved in the venture capital world in a very material way
 8 and so the two are no longer distinct; rather, they're
 9 operating in much the same space on the margin.

10 There are all kinds of consequences of this. One
 11 thing I've learned is when things get bigger, they change
 12 their character. And I think this is the character of the
 13 private capital business. So this chart looks at the
 14 sectoral mix of debt. The red bar is the sectoral mix of
 15 the leveraged lending market and the green bar is the
 16 sectoral mix of the debt of publicly held companies. So
 17 increasingly, the private market looks like the public
 18 market because it's gotten bigger and bigger and it has a
 19 decidedly pro-cyclical bias to the mix of debt, which may
 20 have consequences in the next recession.

21 I am now going to turn to the topic of indexing
 22 and price sensitivity. The blue and black bars respectively
 23 here look at what share of the mutual fund and ETF business
 24 is indexed. So you can see, if you go back to 2000, the
 25 share was about 10 percent and now it's very close to half.

1 better, the black bar tells you they like machines better.
 2 And so younger people prefer machines. Older people kind of
 3 like them too, but not to the same extent. So the
 4 demographics have had the effect of slowing what would have
 5 been disruptive change in the business.

6 The private equity business has had a real boom.
 7 This looks at private equity and venture capital investments
 8 divided by the capitalization of the entire U.S. stock
 9 market. And you can see the investments have equated to
 10 about two and a half percent of the cap of the equity market
 11 every year of this decade. This is kind of a remarkable
 12 chart because the history of these businesses is you want to
 13 buy near the bottom. You make the most money when you buy
 14 immediately after a recession when multiples are their
 15 lowest and so are interest rates. But you can see here,
 16 this has been a very different dynamic. The money is coming
 17 consistently because it has been a fundraising success and
 18 it has become very material to the size of the economy and
 19 the industry itself.

20 What's also happened is companies stay private
 21 longer than they used to, in part having to do with
 22 regulatory changes that date back to the mid-'90s and for
 23 many other reasons as well. And so this has also changed
 24 the dynamic. It used to be they would go public after three
 25 or four years; now it's about double that length. And part

1 This is the biggest thing to happen in the history of the
 2 money management business, in my opinion. And the striped
 3 bar at the right looks at the index share of institutional
 4 monies with professional decisionmakers.

5 I tried to figure out why has this gone on? And
 6 one thing I did is I just looked at ETFs and I said what is
 7 their Morningstar ranking? And I noticed if you look at the
 8 various ETFs, they have four stars. So I think making no
 9 decision has become a viable decision because the base index
 10 is very well regarded. And so it has been a combination of
 11 cost, political correctness and performance itself that
 12 produced this outcome.

13 There are a number of reasons for it. The most
 14 obvious is, since the financial crisis, active managers in
 15 every category have been unable to beat their benchmarks.
 16 And so the index has become the dominant source of
 17 investment flows because it, in fact, was the winner over
 18 what is now more than a decade.

19 We tried to figure out why that is. And active
 20 managers always have some deficits. Some of it is they hold
 21 cash, so if the market is going up, that's a problem, which
 22 is the orange bar. The yellow bar is they charge fees.
 23 What's been different in this period is, as you've had
 24 globalization, U.S. funds are more likely to hold non-U.S.
 25 stocks. And in the last decade, that's been the wrong thing

1 to do. So it's been about a 50 basis point drag on domestic
2 fund performance by active managers was the freedom to go
3 global has actually sort of backfired. So that's also part
4 of the story.

5 There are a couple of other reasons. The green
6 bar here looks at what share of the time the economy did
7 better than people thought it was going to do. And the red
8 bar is what share of the time it underperformed economists'
9 expectations. So if you look at the period in which active
10 management was ascendant, the economy was consistently
11 beating expectations and you wanted to have a value bias,
12 because the surprises were largely to the upside, and this
13 went on for 30 years. What's gone on since 2000 is the
14 economy has largely fallen short of expectations. So having
15 a value bias was wrong and active managers have
16 systematically paid the price of that exposure.

17 One of my associates put together this analysis.
18 This looks at did you want to be active. One of the ideas
19 that has sprung up in the money management industry, dating
20 to the mid-2000s, is the idea of active share. That you
21 want the fund that you're managing to be considerably
22 different than the index itself, so you have a bigger chance
23 of winning. Well, paradoxically, the outcome was, having
24 more active share has been a huge problem. So if you look
25 at this decade, the sectors with the lowest tracking error

1 that had the biggest impact on the index were the best
2 performers, to a degree never seen before. So being active
3 was more problematic than at any time in the history of the
4 stock market, which also has been deterministic to the way
5 things have gone.

6 Finally, there's the real economy itself, which is
7 the most important thing that tells the story. The green
8 line here are the free cash flow margins of companies in the
9 top quintile of capitalization, the very biggest companies
10 in the market. And the dotted line is everything else put
11 together.

12 So what's happened is the biggest companies are
13 now considerably more profitable than everyone else, to a
14 degree heretofore never before seen in the history of public
15 companies. They also grow faster and have lower capital
16 intensity. So all of this has made the cap-weighted index
17 extremely hard to beat because of the concentration of
18 profitability of relatively few companies.

19 So one of the upshots of all of this is pricing
20 has become a determinant to investor behavior in a way that
21 was heretofore not seen. The green bars look at what share
22 -- look at the flows, rather, going into funds with the
23 lowest 20 percent of expense ratios, and the black bar is
24 the bottom 80. So ever since the index became dominant,
25 price became a very critical determinant of investor

1 behavior and you can see the last five or six years has been
2 decidedly different from what came before.

3 This is a survey done of ETF investors in 2018.
4 And they asked them, what's most important to you? And you
5 can see the first two things are, it's cheap. The next two
6 things are, I've heard of it. And I noticed Morningstar
7 ratings came in 10. That's not what was I was particularly
8 used to in the history of the industry. So you've largely
9 changed the dynamic having to do with the fundamentals of
10 the economy itself.

11 So my clients are professional equity investors.
12 So one thing they frequently ask me about is, is the tail of
13 the dog now big enough to wag the dog? Has the rise of
14 indexing changed price formation in the market such that the
15 flows into index funds are deterministic?

16 This is a very hard thing to figure out. We've
17 concluded, on an investment basis, if you look out a year,
18 that's not the case. One reason is shown here. This looks
19 at what share of the money, either from institutions in
20 green or retail products in blue, what share of the
21 capitalization of the entire equity market is into index
22 vehicles. And while it's up, it doesn't look up enough to
23 create the kind of effects on an investment horizon that
24 people are fearful of. Although on a day to day basis, I
25 would say the issue is far more debatable.

1 I think one other issue raised by all of this is
2 if you give people liquid assets that are narrowly defined,
3 they can mistime. So the history of the business is the
4 biggest problem is people buy high and sell low. And over
5 time, it got to be smaller as they had more diversified
6 portfolios and made fewer decisions. What's happened
7 though, as you fragment the ETF business into more narrowly
8 defined products that are in and of themselves liquid and
9 susceptible to trend following, you could raise the
10 mistiming element in the equation, which we believe is
11 what's gone on, which is the bar at the far right.

12 Finally, I am going to talk about what constitutes
13 advice. I came across this survey a little while ago and
14 they asked financial advisers, how do you describe yourself?
15 And I thought the interesting thing about it is, nobody
16 thinks they're a broker anymore. Everybody is either a
17 wealth manager or a financial planner, which should probably
18 tell you something about something. Then, on the next page,
19 I took a look at what share of the holdings of these various
20 channels of distribution of their mutual fund and ETF
21 holdings are indexed. And you can see, in most of the
22 channels, the indexed holdings are now the majority. So it
23 seems to me this is one of the biggest changes in the
24 history of the business, because instead of picking
25 something, you're now buying an exposure, making asset

1 allocation a much bigger part of the value equation because
 2 the picking part of it has largely disappeared. At least
 3 for the moment.
 4 Turning forward to slide 34, this looks at the
 5 history of pricing as a share of the underlying assets. The
 6 black bars are the fees for giving investment advice divided
 7 by the assets in custody of the largest brokerage firms
 8 going back to the mid-'80s. And the red bars are the asset-
 9 weighted expense ratios of mutual funds and then, at the far
 10 right, ETFs. So if you go back to the mid-'80s, the 10-year
 11 Treasury bond yielded 10 and a half percent and the price of
 12 advice was 100 basis points and the price of mutual fund
 13 management was 70. By 2000, the Treasury bond yielded six
 14 and they both had prices of 82 basis points. Flash forward
 15 to today, the Treasury bond yields two, the price of mutual
 16 fund management is 50 and the price of advice is 60. If you
 17 buy an ETF, the price is 17. So there have been pricing
 18 declines as rates have fallen for three decades.
 19 My guess is that the price of advice is going to
 20 come under more pressure for a variety of reasons. One, is
 21 there's all kinds of competition for advice, including from
 22 computers. So this looks at the various asset-weighted fees
 23 based on size of the client relationship. And then I looked
 24 at the pricing of robo-advisory services, both by the
 25 largest firms themselves that offer full-service advice, and

1 by other providers. And generally, the price of automated
 2 advice is something less than half the existing pricing
 3 level.
 4 There's a service that tracks robo-advisers of all
 5 sorts. And I took a look at the latest results. The yellow
 6 bar describes, for the 13 major firms, what share of the
 7 asset allocation is in stocks, and the black bar is what
 8 share of that stock allocation is in U.S. equities. What
 9 struck me about this chart is all the bars looked alike.
 10 There wasn't like a really big difference that I could
 11 observe. Then I looked at the two-year trailing returns.
 12 COMMISSIONER JACKSON: Sorry, just one quick
 13 question. So in this slide, you show that there is a low
 14 standard deviation among the trailing two-year returns among
 15 the various robo-advisers. Is that surprising?
 16 MR. GOLDSTEIN: No, because they have the same
 17 asset allocation. That's the point.
 18 But I think there's another point, which is as you
 19 automate things, you are creating a de facto benchmark.
 20 Because the more times you -- you convey this information,
 21 the more things you have to compare to. So I've kind of
 22 thought one of the more important implications of technology
 23 is to liberate the information and create comparators that
 24 were not there before, which have had a big effect on
 25 pricing in the history of this business. That's the point

1 of this slide.
 2 Finally, there has been, I would say, convergence
 3 between money management and distribution. The green bar
 4 here looks at retail assets held by these various
 5 organizations at the end of 2017 and the black bar is at the
 6 end of '18. So if you add up the individual assets of the
 7 Vanguard Group and Blackrock's iShare business, today they
 8 are probably about \$6 trillion, which would make them almost
 9 three times the size of the largest brokerage firm. So I
 10 think there's just great convergence as you've kind of
 11 changed what constitutes advice and you've brought more
 12 technology into defining that outcome.
 13 So to summarize -- oh, I have one last slide, on
 14 page 39.
 15 I came across this survey the other day, which I
 16 thought was kind of very telling. They asked sponsors of
 17 defined contribution plans, do you think you have a
 18 responsibility for employee financial wellness? I'm not
 19 even sure what that means; maybe I'm not very well educated.
 20 But I noticed that most think they do. And I think this is
 21 the other element of change in the business, that what
 22 you're responsible for keeps changing and expanding, which
 23 has been a real challenge in the defined contribution
 24 business, and it looks like there's further to go along that
 25 direction.

1 So to summarize, on page 40, in following the
 2 money management business over many years, I don't think
 3 it's distinct from the economy itself, rather it's a
 4 byproduct of it. So what we've seen in the last 10 or 15
 5 years is largely a reflection of what's happened in the
 6 global economy, the rise of mega-profitable companies,
 7 falling interest rates, globalization. And those things are
 8 all showing up in the way the money management business in
 9 fact operates.
 10 I finished in 25 minutes.
 11 (Applause.)
 12 MR. BERNARD: I do think that's noteworthy. You
 13 don't see many people get through 39 slides in 25 minutes.
 14 If I can ask people to be -- that was phenomenal,
 15 Michael. Thank you so much.
 16 If I can ask people to sit on your hands for a
 17 little bit, I think it would be best if we let Ben go
 18 through his remarks first. And then I think we'll have a
 19 good, solid half hour for discussion.
 20 MR. PHILLIPS: Thank you, Ed. I would like to
 21 thank the Commission and the committee for giving me the
 22 opportunity to speak today.
 23 As expected, Mike led us through an excellent
 24 review of the asset management industry. My colleagues and
 25 I have assembled something similar. These slides are more

1 from the perspective of the asset managers themselves. They
2 are the industry actors that we advise as a practice. They
3 are the ones that the Commission regulates. And most
4 importantly, they are going to be the industry actors that
5 Americans use and trust going forward.

6 Ed framed the situation for the industry very well
7 at the beginning. The past 40 years have been a different
8 story for the asset management industry. It's one where a
9 manufacturing paradigm was what drove a lot of the decisions
10 made in it. Investment management firms took their
11 intellectual property, packaged it up, put it on the loading
12 dock, intermediaries backed up trucks and took it away
13 somewhere. Like most American industries over the past
14 century, that is now changing for a variety of reasons and
15 the industry is now adapting more of a service paradigm,
16 which is creating a lot of different and new situations and
17 decisions to make for the asset managers, for their
18 customers, and for all the parties that are in the ecosystem
19 of asset management in the United States.

20 So that's the main theme that will drive through
21 my slides today, is that transition from product to service.
22 I think it is something that, in a variety of ways, either
23 obliquely or directly, the committee will continue to
24 address as you go through your work over the coming months.

25 There's a data summary in the front of the deck,

1 This dynamic has a lot of psychology embedded in
2 it. Younger Americans tend to be more indebted, awaiting
3 inheritances, in general have a different view of capital
4 markets than their parents. And usually, as a result, and
5 somewhat counterintuitively, are more risk averse. Older
6 Americans like to carry risk, but they like it expressed in
7 income. All of this means that you have a wide variety of
8 changing needs that have created a more multifaceted
9 consumer demand than we've had for the first 40 years of the
10 industry, where most of the demand boiled down to
11 accumulation as a primary driving force.

12 And that leads to slide six, which is a second big
13 change in demand throughout the industry, which is the
14 advent of advice being demanded in customized, outcome-
15 oriented forms. So if you look at some of these factoids on
16 this slide, three quarters of U.S. investors now value
17 specific outcomes more than they would asset appreciation in
18 their portfolio. This derives from income needs; this comes
19 from having specific cash flow obligations to meet. And as
20 a result, what you're seeing is the more complicated set of
21 metrics that individual investors are bringing to their
22 asset managers to fulfill.

23 Four fifths of investors in the United States
24 value outcomes that don't only extend from investments but
25 actually embed a whole host of other services, so tax

1 for those playing along at home. But I might ask the
2 committee to turn to page 5 and we'll use the data slides to
3 walk through some of the discussion points today.

4 Again, three acts in this story: changing demand,
5 changing supply, and the impact on the asset management
6 industry. So spending a little time to begin with talking
7 about changes in demand.

8 As Mike rightly pointed out, the Baby Boomers have
9 inertia in this industry and continue to drive a lot of its
10 shape and direction. However, increasingly, they have some
11 people coming along for the ride. As you can see on this
12 slide, it's a growing proportion of the industry. Nearly
13 half of its wealth by 2030 is going to come from post-
14 Boomers of one age or another. They don't have money now;
15 they're slowly accumulating it. But increasingly, their
16 needs and wants are going to become part of what asset
17 managers and intermediaries have to think about and service.

18 More importantly, the Boomers are still that
19 driving force. But how they drive is a little bit different
20 because by 2025, nearly half the wealth in the asset
21 management industry or in retirement funds that are part of
22 the asset management industry will come from retirees, not
23 pre-retirees. Which means the shift from accumulation and
24 deaccumulation is no longer a tangential part of the
25 industry, it could become more front and center overall.

1 management, debt and liquidity management, and effective
2 protection through insurance. What they're looking for is
3 the answer to a question, not outperforming a benchmark.
4 Help me pay for my kids' college, help me make a certain
5 retirement income. While the industry has always talked
6 about meeting these needs, they've mostly done it through
7 the asset appreciation lever. Now they have to think about
8 other ways to do it to meet demand.

9 This is going to require customization. When we
10 talk about benchmarks, we think of them as peer groups.
11 When individual investors increasingly talk about them,
12 regardless of their age, they're thinking about themselves.
13 They are the benchmark. And as a result, the need and the
14 desire to have financial services and financial advice
15 customized for a specific person, creates a profitability
16 challenge for providers in the industry and an
17 implementation challenge throughout the industry to be able
18 to meet that demand by individual investors.

19 Slide seven talks about the impact of that on the
20 market structure in the demand side of the industry. If you
21 think about where advice is provided, as Mike pointed out,
22 there's lots of people who provide it, calling themselves
23 all sorts of names. At the end, a lot of this
24 decisionmaking tends to be centralized for economies of
25 scale. And if you believe that providing advice is becoming

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1 a more customized effort, that requires two things. It
 2 requires more technology to give you that mass
 3 customization, and it requires more heft in enterprise
 4 services that provide the fiduciary protection, the
 5 compliance and the legal and the regulatory and the
 6 financial oversight to ensure that advice meets demand
 7 specifications and meets legal requirements.

8 Put that together and you are seeing that there is
 9 a scale dynamic unfolding among those centralized
 10 gatekeepers of advice, those investment decisionmakers. By
 11 2021, we expect the number of these decisionmakers will drop
 12 by about 40 percent. Part of that is, as the traditional
 13 providers of this advice, brokers, leave the system through
 14 retirement. But part of it is as the platforms that provide
 15 the advice consolidate.

16 The net result of that also on the right-hand side
 17 of this slide is that the types of intermediaries that are
 18 thinking about that customer demand for holistic advice,
 19 which is consultant speak for bringing in tax, debt and
 20 liability management, applying advice across multiple
 21 financial sectors and silos to achieve a single result. The
 22 centralized gatekeepers that provide that at scale, and the
 23 types of those, would be the private banks, would the home
 24 office groups within broker-dealers that can handle a lot of
 25 the centralized advice provision through their sales forces,

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1 outsourced chief investment officers, which now control a
 2 rising proportion of U.S. endowment assets, and customized
 3 401(k) provision within U.S. defined contribution schemes.

4 Going forward over the next five years, we feel
 5 that they will represent, these types of intermediaries,
 6 will represent most if not all the organic growth in the
 7 U.S. asset management industry. The traditional
 8 institutional buyers of defined benefit plans and the
 9 traditional retail advising through broker-dealer sales will
 10 be on the decline as a result. Again, partly reflecting
 11 market structure but also partly reflecting the changing
 12 demand of the customers, both at the retail and the
 13 institutional level.

14 There are economic results from this. Slide eight
 15 talks about two of them. The first, on the left-hand side,
 16 is fee sensitivity. And, as Mike pointed out, with lower
 17 returns historically, larger fees come out in sharper
 18 relief, so there's clearly already traditional pressure on
 19 fees. There's also demand-oriented pressure on fees that
 20 increasingly, if investors in the United States value the
 21 outcome and asset managers are just one of the actors
 22 providing that outcome, they may not receive as much of the
 23 fee budget going forward. And as a result, we'll see in
 24 some upcoming slides, that has an impact on the value
 25 proposition and the so-called value chain of how these

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1 services are delivered.

2 In general, this is accelerating. Earlier in the
 3 decade, fees fell about 3 percent per annum, compounded. In
 4 the last few years, they've started to fall about 5. Part
 5 of this is due to indexing, but not the majority. Most of
 6 it is simple same-store discounting. It is that, by and
 7 large, the wholesale acquirers of asset management products
 8 and services are demanding deeper and deeper discounts. In
 9 the institutional world, the rack rate discount now on offer
 10 is an average of 15 percent. So it's not only structural on
 11 the rack rate but increasingly as part of the sales dynamic
 12 in the wholesale part of the industry, fee pressure is
 13 becoming an always and everywhere phenomenon.

14 On the right-hand side of this slide, if you add
 15 up all of these factors of demand and you start to say
 16 what's the impact overall for the industry at a global
 17 level, one key takeaway is that the organic growth in the
 18 industry will begin to slow. For most of the first decades
 19 of the industry, the first 30 years, you would see organic
 20 growth in the industry at about 6 percent per annum. That's
 21 new money coming in on top of what's already being managed.
 22 Going forward, this will be more about 1 to 2 percent, due
 23 to the fact that you have most pools of assets being
 24 collected worldwide, be they sovereign funds, pension
 25 schemes, individual investors, private assets are now

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1 already tapped by asset managers for professional
 2 management. And as a result, there are very few new worlds
 3 to conquer.

4 So those are some of the trends that are changing
 5 demand in the asset management industry. So let's take a
 6 look at those demand trends as they change are actually
 7 revealing some fundamental shifts in how suppliers are
 8 acting in the asset management industry. If you look at how
 9 asset managers have grown over the past 40 years, they've
 10 done so reliant on tail winds from that organic growth. But
 11 going forward, if that growth is slowing, they'll have to
 12 compete with one another to grow and realize value for their
 13 shareholders. So if the story used to be about a rising
 14 tide lifting all boats, then going forward it's going to be
 15 much more about naval warfare. Asset managers will have to
 16 find ways to continue to grow their economics by culling
 17 assets from one another rather than waiting for new money to
 18 show up into the industry.

19 As a result, there's probably several trends that
 20 are impacting how the suppliers are acting. We've picked
 21 five to look at here, beginning on slide nine. One is the
 22 simple and sheer oversupply of vendors in the industry. The
 23 death of active management has probably been exaggerated.
 24 As you can see from the left-hand side of page 9, about 41
 25 percent of the assets in the industry still exist in

1 investment strategies where there has been consistent excess
2 return net of fees over the past 10 years. However, it's a
3 concentrated bunch of vendors that can deliver that. Only
4 about 23 percent of the strategies that are in -- only 23
5 percent of the strategies in the asset management industry
6 hold those assets. And if you think about how firms are
7 built, barely 4 percent of asset management firms are able
8 to deliver that type of performance across their entire
9 product set.

10 What the shifts in demand plus the capped organic
11 growth have revealed is a glut of vendors in the asset
12 management industry, which is further illustrated on slide
13 10. You continue to have, because there are still
14 relatively low but rising barriers to entry into the
15 industry, you've got more asset managers pouring into a
16 constrained environment and fewer and fewer are able to
17 realize positive net inflows, which reflects the competition
18 that's beginning to develop within the industry.

19 Part of what has challenged active asset
20 management to some degree is the changing capital markets,
21 not just in the U.S. but in most developed markets
22 worldwide. So if you look at slide 11, what you see is that
23 the number of quoted U.S. companies over the past 20 years
24 has fallen by about half. Yet you've seen just in the past
25 four years, nearly a one third increase in the number of

1 investment products that are being brought to market in the
2 United States. There's too many stock pickers chasing too
3 few stocks. And as a result, what you have are some of the
4 phenomenon that led to indexing. But you've also had
5 throughout the industry the beginning of a discussion of
6 trying to figure out, how do we reinvent investment
7 processes for this new world, not just in quantitative
8 easing but in figuring out how to work when there's fewer
9 and fewer listed companies.

10 Slide 12 is something that Mike spoke a lot about,
11 which is indexing, another big supply side trend that has
12 redefined the industry. No need to go further into detail
13 here. But in short, the numbers will match Mike's. The
14 flows into index products have doubled.

15 Some of this is cyclical but more and more of it
16 is secular. Again, if you believe that outcomes are what
17 investors buy, then the net result of that is that what
18 they're looking for is the asset allocation and how the
19 portfolio is put together and that's where the value is.
20 And there is increasing secular usage of indexes to create
21 exposures underneath those allocations. So this is not just
22 a matter of a pendulum back and forth between active and
23 passive. There's probably some portfolio construction and
24 structural issues as well taking place in the industry.

25 So from the supply side economic impacts, they end

1 up being pretty self-evident. Rising fixed costs. Again,
2 technology and enterprise services. If asset managers are
3 no longer portfolio managers and salespeople but actually
4 have to think through the technology to support more mass
5 customization and they have to think through all the
6 business-related aspects of being an enterprise in a more
7 competitive world, their fixed costs, their non-salary
8 costs, begin to rise. And this is something that is new for
9 the industry. It has always been viewed as very inherently
10 scalable. And the net result of that has been that there
11 has been a lot of investment in many ideas that have turned
12 out to be subscale in the long term. There is now a lot of
13 review of financial prudence in how asset managers are run.

14 And if you have rising fixed costs and revenues
15 are capped by organic growth, as you can see on slide 14,
16 you have shrinking margins as well. Which most of the
17 people on the committee and in the audience will realize is
18 becoming a larger hallmark of this industry over the past
19 five years.

20 So based on that, changes in demand and supply,
21 that's the operating environment. The question would be,
22 what does that mean for asset managers and how they compete
23 going forward? And then also for members of the committee
24 and the Commission, how do they think about regulation and
25 how do they think about how industry actors interface with

1 one another in that new world? And there's probably a whole
2 host of impacts here but we've selected six to concentrate
3 on.

4 The first on slide 15 is probably the most
5 important. And that has to do with the change of the value
6 proposition in investments, more from the actual stock
7 selection and the product component, using the old paradigm
8 of asset management, and more into having that advice be
9 what's valued. As slide 15 indicates, if you look at the
10 part of the fee budget which is under, as Mike pointed out,
11 compression globally, but you look at the part of the fee
12 budget that might be under less compression is becoming a
13 greater part of how investors are allocating what they pay
14 for fees to providers it's going toward the advice
15 component, the providers that put together the portfolio
16 that underpins the outcome.

17 The asset management, the actual portfolio
18 construction and assembly, stock picking, bond picking, the
19 securities selection aspect of this whole process is under
20 -- is going under the most pressure. The net result of this
21 has been a real rethink of the industrial model among asset
22 managers in the U.S. and globally, which is increasingly
23 perhaps part of their work is not full dependence on
24 intermediaries and a wholesale dynamic but increasingly
25 directly providing more and more of these advice components

1 to the clients they serve, both because it protects their
2 fee budget but it also gives them access to information and
3 influence about and over the client, which is becoming for
4 many of them a competitive advantage, a competitive
5 necessity.

6 So if advice is becoming the broader proposition,
7 the question is what does that mean for those the industry
8 has worked in a wholesale dynamic. One potential impact
9 will be less registered product being used in the industry
10 over time. If you have this ongoing demand for
11 customization aided by technology innovations, turnkey
12 managed account platforms, streamlined ETF clearing,
13 potentially distributed ledger technology, what that will
14 result in is the need for less registered product going
15 forward and more delivery of the investment industry's
16 intellectual property as a service.

17 So over the past four years, you have already
18 started to see this in terms of mutual fund assets
19 flattening out within the adviser channel and increased use
20 of individual securities in managed accounts. Going
21 forward, those numbers will continue to diverge. So in a
22 world with less registered product, it becomes an
23 interesting question about how asset managers organize how
24 they get their IP to market and how that market is policed.

25 Going forward to slide 17, in an industry where

1 if more decide to go down this model and run intermediaries.

2 A couple of definite impacts of that would be two
3 things. One is, you would see a lot more automation driving
4 advice delivery among asset managers, as depicted on the
5 left-hand side of 19. The goal of that would be mass
6 customization, try to profitably dispense as customized
7 advice as possible to a wide group of retail investors. It
8 also fits within that increasingly harsh fixed cost
9 environment that's starting to develop for asset management
10 firms.

11 It also raises the question of data. As you can
12 see on the right-hand side, increasingly, asset managers
13 rely on data analytics about clients, and the data comes in
14 from all levels, on how they manage their business, how they
15 prospect for clients and how they serve them. This leads to
16 issues about data usage, data transparency and how to get
17 that data, the actual competitive dynamic of securing the
18 information either through third parties or directly.
19 Increasingly, competitive advantage isn't measured by assets
20 under management in this industry, but it's about data under
21 management, which is becoming a profound and different way
22 for new actors to potentially get into the asset management
23 industry.

24 Slide 20, and Mike also talked about this, if we
25 have shrinking numbers of quoted companies in the United

1 you had asset growth and accumulation being core drivers, ad
2 valorem fees aligned interests potentially more correctly.
3 Going forward with outcomes, that may not necessarily be the
4 case. And as a result, you see on the left-hand side about
5 35 percent of asset managers in the U.S. and Europe have
6 already started to explore, either proactively or
7 reactively, using fees that may not just depend on assets
8 under management but a whole variety of things, particularly
9 around trying to create the outcomes that customers seek.
10 And it's a rising proportion of the business dynamic, as
11 well.

12 These are difficult to implement, they're
13 difficult to measure. But increasingly, they stand out as
14 differentiators and ways to realign asset managers with what
15 clients are demanding and needing.

16 If you have performance fees coupled with the
17 desire to provide an outcome and get the credit for it from
18 the investor, understandably, asset managers as depicted on
19 slide 18 to some extent, will look at how do they get more
20 direct distribution to clients. Mike had similar data in
21 his presentation about people who prefer technology, meaning
22 mostly younger investors, versus older investors. The
23 takeaway here is technology has now opened the door further
24 for asset managers to have more direct access to clients.

25 The question is, what are the repercussions to the industry

1 States, the issue going forward is that you'll see a large
2 component of the industry relying more and more on private
3 markets to meet the outcomes that are required for customers
4 and to serve as product offers. If you look at forward
5 growth of industry revenues, out to 2024, more than 40
6 percent of the growth in revenues will come from private
7 market offers and that potentially won't just be big buyout
8 firms, but it will also be more democratized and individual
9 approaches to try to get exposure to private markets, which
10 creates a huge number of industrial issues to think through.
11 It's about transparency, it's about liquidity, it's about
12 the technology to make it more diverse and allow people to
13 invest at lower account sizes. The industry is seeing where
14 the growth in economics and will make a lot of innovations
15 to try to tap this market and align it with broader and
16 broader client bases and that will reshape a lot of the
17 business decisions that are made by asset management firms
18 over the next few years.

19 Two -- one final point, or actually -- if I can
20 turn this -- one final point. If we are thinking about a
21 world where there is an oversupply of asset managers and
22 they're trying to differentiate themselves from one another,
23 many of them will not only rely on investment performance
24 and advice but also additional ways to innovate what they
25 offer as active asset management. If you couple this with

1 changing demands from investors in some quarters regarding
 2 social impact, leadership diversity and board management and
 3 board performance, you'll see the asset management industry
 4 increasingly start to portray their active asset management
 5 processes as not only around pure investment performance but
 6 other types of ESG criteria. This raises a lot of long-term
 7 questions because it will create a lot of claims and
 8 expectations in the marketplace, all of which are going to
 9 be needed to be assessed and verified by somebody. So that
 10 raises a number of issues going forward for how active asset
 11 managers are compared to one another. It won't just be on
 12 investment performance but potentially on a broad range of
 13 issues which will create opportunities for firms to figure
 14 out how to measure that and compare asset managers to one
 15 another.

16 In conclusion, it's -- there's a lot of data here
 17 but I would focus on the narrative. And the narrative is
 18 that the demand and supply changes that I outlined are
 19 secular in nature. They're not really dependent on cyclical
 20 market performance. They've taken multiple decades to make
 21 and they'll have impacts for multiple decades. Asset
 22 managers are going to need to redefine their industrial
 23 model around client service expectations and, as they do
 24 that, they are going to have to think about how they make
 25 their IP relevant in an outcome oriented and much more

1 advice-dependent world. And this is going to probably --
 2 not probably, it's going to definitely redefine how they act
 3 with one another, redefine how they act with intermediaries
 4 and certainly it will create a number of issues that
 5 regulators, not just in the U.S. but globally over the next
 6 several years will have to consider as they start to think
 7 about what their marketplace and what their actors look like
 8 going forward.

9 So thank you very much for your time.
 10 (Applause.)

11 MR. BERNARD: Thank you. And, as promised, we've
 12 got plenty of time for discussion. But Dalia wanted to make
 13 a quick comment.

14 MS. BLASS: Just really quickly, just for myself
 15 and Staff members as well, I should have given a disclaimer
 16 that anything you hear from us today are our own viewpoints.
 17 We don't -- for myself and other Staff, it's our viewpoints,
 18 not the views of the Commission, the commissioners or our
 19 fellow colleagues on the Staff. So disclaimer made, if any
 20 of our colleagues in OGC are here.

21 MR. BERNARD: And with that, first of all, thank
 22 you both very much. I've done a lot of talking already, so
 23 I was going to actually look to the committee. Maybe if
 24 someone wants to kick us off with a question? Russ?

25 MR. WERMERS: Michael and Ben, I very much enjoyed

1 your super presentations. Michael, I had heard you before,
 2 I think at a Wharton conference, and I was very happy to see
 3 that you're here today.

4 One thing I wanted to see if you could comment on
 5 specifically that I think you danced around a little bit,
 6 was the impact of increasing technology speed of computers,
 7 more dense DRAM chips, 5G, et cetera. And I kind of think
 8 of the impact of technology as more hitting on supply side
 9 offerings of lower fee funds, rather than demand side,
 10 demand for lower fee funds. I think it's just cheaper to do
 11 active management, especially now with technology. Passive
 12 management, a little bit cheaper. But I think active
 13 management has really been hit, you know, with lower costs
 14 in a very good way. And so if you could comment on that a
 15 little bit? And also whether this -- whether technology has
 16 kind of done the opposite of what we thought it would do,
 17 which is it -- in my view, it's concentrated the leverage of
 18 technology in larger asset management companies rather than
 19 democratizing asset management. It's actually created this
 20 huge economy of scale. So I don't know what you thought
 21 about that.

22 MR. GOLDSTEIN: Well, I think the biggest impact
 23 of technology has been on the economy itself and the way
 24 that played into the stock market. So it ended up the
 25 biggest companies aren't capital intensive and they seem to

1 have the possibility of almost infinite scale, which is
 2 different than the known history of investing. And so
 3 you've ended up with this market that's very top heavy in
 4 the technology leadership of the economy itself in a way
 5 we've never seen before. So this has fed into the hegemony
 6 of indexing and all kinds of things that have gone on. So
 7 in my mind, that is the single determinant trend that has
 8 driven everything. And then, as you point out, you can do
 9 things cheaper at scale. And so that has played into it,
 10 too.

11 We see another impact in our base business, which
 12 is that the competition for information has totally changed.
 13 So it is very hard to be first because you're competing with
 14 a machine that's also trying to be first. And so the very
 15 nature of money management has been transformed, where you
 16 have to be more right on the longer term thesis about
 17 something because your ability to get a short-term edge is
 18 less because the amount of competition has grown
 19 dramatically. So I think there have been all kinds of
 20 consequences having to do with the scalability of technology
 21 being different than other businesses.

22 MR. PHILLIPS: Mark, you bring up a really good
 23 point. There's a cost of delivery aspect to this that, in a
 24 fixed cost intensive environment is clearly resonating with
 25 chief investment officers throughout asset managers. So

1 that's number one. Number two, though, there's an
2 investment quality component that's rising as well. If we
3 have fewer public companies and alpha is harder to find,
4 which we can debate as a committee, increasingly finding
5 alternate data, finding signals faster, these are all
6 becoming investment quality issues.

7 Five years ago, had we as advisers gone into chief
8 investment officers of many asset managers and said, we
9 should think about automation and technology in your
10 process, we would have been thrown out of the room. Now,
11 we're actually being invited in to discuss these things.

12 But there are two important contexts behind that.
13 One is -- I think I have this number right and, if not,
14 somebody is going to correct me right away -- it's one of
15 the largest CFA classes in history. So obviously, human
16 capital is still driving a lot of the IP in this industry.
17 So that's number one.

18 The second is, you bring up a good point about
19 technology being a scale, a force multiplier here, which
20 means that could edge out a lot of the boutiques that have
21 been the IP in asset management historically. That's
22 potentially true. But two things. One is, there's going to
23 be a lot of third party technology providers that begin to
24 create that core platform on which IP can sit in one way or
25 another. I think that will become a disruptive set of

1 market entrants. The other is potentially technology firms
2 realizing that they can, too, use an already sunk cost in
3 big technology projects and leverage that into the industry
4 for new clients. That may create some disruption. It's
5 quite likely that, in 10 years, we will be looking at a lead
6 table of asset managers that looks quite different because
7 of that. If firms have already made the sunk cost into
8 technology, it's easier for them to build a value
9 proposition potentially than for some firms through retro
10 engineering.

11 MR. SIRRI: Ben, you in one of your early slides
12 talked about investors wanting outcomes, outcome-oriented
13 things, which I take to mean life cycle solutions, college,
14 housing, those sorts of things.

15 MR. PHILLIPS: Or even more basically, income.
16 Most of it is cash flow defined.

17 MR. SIRRI: Well, then you pointed out that we're
18 going to go to an asset allocation model. Security
19 selection hasn't done as well, asset allocation seems to be
20 where, at least, in your presentation, you talked about the
21 importance of it. It just wasn't clear to me how asset
22 allocation solved outcome problems.

23 MR. PHILLIPS: It doesn't. I think the industry
24 has tried to move toward that for years, thinking that
25 everything in the investment silo somehow can be harnessed

1 to create that -- that outcome. But go back to the equation
2 that the investors are demanding, the slide where we talked
3 about what they want. And four fifths of them get that.
4 They say, if you give me just a life cycle fund or asset
5 allocation, that's not going to do it. You're not doing
6 anything about my debt or liquidity. And for many
7 Americans, liquidity management is the primary financial
8 concern they have. You're not talking about protection at
9 all, which is this is great until everything falls out so
10 how is that going to get protected. And then, most
11 importantly, you're not talking about tax. Although the
12 industry, the asset management industry as a whole, has
13 become better about thinking through tax-effective
14 investing.

15 So for the asset management industry, the big
16 question is this, will you continue to try to develop
17 market-based solutions on the existing skillset so asset
18 allocation, security selection to generate income? Or will
19 you open up your business model and say, we actually need to
20 things to do that. We can be the advisers but either we are
21 going to have to figure out some way to provide tax advice,
22 some way to provide debt management advice, or we'll have to
23 bring that in. Those are really some of the decisions CEOs
24 with asset managers are grappling with right now, as many of
25 you know, which is their investment proposition alone

1 probably does not get them to the outcome most -- most
2 Americans demand when they say, I want cash flow. So I
3 think you're spot on. If you think of asset allocation more
4 holistically, pulling everything together, that's the goal.

5 MR. GARCIA: Ben, this is for you, too. If you
6 were thinking in our chair, do you think it's the SEC's role
7 to somehow standardize ESG goals among managers themselves
8 as managers continue to try to differentiate themselves on
9 how they run their own business?

10 MR. PHILLIPS: I don't know if any regulator
11 should be in the role of saying what the ESG standards
12 should be. Somebody has to be responsible for puncturing
13 claims of people who say they are and aren't. That's the
14 role that I think regulators are now grappling with
15 globally, particularly in Europe where ESG has taken off
16 from the demand side more effectively. Which is the biggest
17 problem for breaking fiduciary trust will be if firms say
18 they're compliant with some sort of ESG standard that
19 they're putting forward and they're actually not or the
20 standard doesn't make sense.

21 How greenwashing is addressed and punished, if
22 that needs to be taken that far, is probably the principal
23 regulatory question that the Europeans are grappling with
24 right now. So does the SEC have to set those standards?
25 That's a policy decision for the SEC. But I think some

1 actor in the ecosystem has to be responsible for saying,
2 this firm said they are compliant, or this firm said they
3 are socially impactful, and they are not. Whether that's
4 outsourced to third party policers or not is a good
5 question.

6 MR. GARCIA: What are the lessons that the
7 Europeans are learning on all this? Have they outsourced to
8 anyone yet?

9 MR. PHILLIPS: That it's harder than they thought.
10 The lessons have been leaving it up to demand, so leaving it
11 up to the large sovereigns and parastatals in Europe to set
12 the guidelines isn't good for a couple reasons. One is, if
13 you do that without any influence, it could be bad on market
14 structure. What if all ESG participants began using
15 negative screens? You would basically start to shrink
16 capacity of an already shrunk stock market by knocking out a
17 lot.

18 And the second is, how do you then -- how do you
19 then test to see whether this is actually true? ESG is not
20 a product, it's an investment process. So how do you audit
21 an investment process for ESG? Is this something that Big
22 Four auditors should do? Is this something that other third
23 parties should do? Is there an auditing function that has
24 some public oversight that may be the result of this? I
25 don't know. The Europeans don't know, either. That's the

1 outcomes, you know, when the defined benefit plans started
2 to go away, I'm not sure that it was the participants in
3 them that didn't want them; it was the companies who didn't
4 want the additional burden. So if outcomes of having, you
5 know, known check a month is something that people actually
6 still want, do you think -- is the insurance industry that
7 can come in? Or, I mean, are there other players. We've
8 seen the SECURE Act passed in the last few weeks, and that
9 focused on the insurance role. What do you think is the way
10 to replace that lifetime income?

11 MR. PHILLIPS: It's a great question. And from
12 our aspect, it's a jump ball. It's not just insurers. With
13 multi-employer plans now being a greater component, a
14 possible greater component in the marketplace, you can see
15 that retirement service providers may start to say that they
16 hold the data and the information to do this. Asset
17 managers will argue that investors will need returns for
18 longer than they think in a low interest rate environment
19 and therefore they should be in the driving seat.

20 Retirement income has been like the weather for
21 the past 20 years. Everybody talks about it and nobody does
22 anything about it. We're to the point where the
23 demographics are showing somebody has to do something about
24 it, particularly if entitlements globally begin to become
25 less and less. So I do think the biggest industrial

1 issue that's starting to unfold now, as everybody is
2 realizing it's pretty easy to put three letters on a
3 marketing campaign and off you go.

4 MR. GOLDSTEIN: Yeah, I'd like to say something
5 about this. We have a group at Empirical that advises
6 people on ESG and has studied it. And I would say what
7 we've concluded is it's very confusing. If you look at the
8 various providers of ESG and what they call ESG, they are in
9 no sense the same. I don't think anyone even knows what it
10 is.

11 I think a second problem with ESG investing is
12 it's conflated with other things. So if you look at the
13 last 15 years, what's worked is businesses that have low
14 capital intensity. That has been the dominant trend in the
15 market. Which also looked good on ESG screens. The two may
16 not actually have a causal relationship.

17 So despite our considerable efforts in advising of
18 people on this topic and studying it, I think we've had a
19 great deal of difficulty defining exactly what it is. I
20 tell our clients; we don't have a client that's not an ESG
21 investor. Everybody is. But the flows into dedicated ESG
22 funds are trivial. So it seems like there's a very big gap
23 between the rhetoric and whatever the reality is going to
24 end up to be.

25 MS. BECK: The discussion you're having about

1 question that crosses not just asset management but crosses
2 most advisers right now is, who are the natural providers
3 for that? Because I think without some form of access to
4 protection, it becomes financially risky to offer and
5 somewhat infeasible for people to believe.

6 But conversely, if you don't have a component that
7 allows for market activity and some flexibility in delivery,
8 you're not going to be able to add all the value that
9 investors say that they need from advisers going forward.

10 Mike, I don't know if you'd add to that?

11 MR. GOLDSTEIN: With the 10-year Treasury bond
12 yielding below 2 percent, I don't think there is any answer
13 to the problem. I think the only way is to systematically
14 sell down assets in an intelligent fashion. There's no
15 other answer.

16 MR. TIBERGIEN: Ed, I have a question here. So
17 it's interesting, as you lay out the data, as if when the
18 last Boomer dies, the world will come to an end is pretty
19 much the conclusion of some of the demographics. I'm a
20 little bit concerned about the age demographics and how it
21 reflects in some of the data. As an example, when we show
22 the reduction in fees at the brokerage firms in particular,
23 generally that may be happening because firms are pushing
24 people to deal with older, richer clients and Gen X and Gen
25 Y is not being dealt with. Secondly, it's reflected in

1 basis points and not in dollars, and clients may be paying
2 for it.
3 So one of the questions that each of the
4 commissioners raised was how do we be relevant to the
5 consumer and how do we ensure protection? One of the things
6 that seems to be missing from the discussion is exactly the
7 answer to that question. It seems like we can deal with the
8 retirement assets or preretirement assets. But what do we
9 do in terms of choice in accumulation and how is this
10 reflected in any of the data now we think about this?

11 MR. GOLDSTEIN: The reason -- one of the reasons
12 the composite is down is the average account size is up a
13 lot. And so you've decided to focus on the big ticket high
14 end and that's what's showing up in the data.

15 In terms of providing cheap advice or
16 understanding the cost of advice, it seems like there's a
17 lot of possibilities there as you go to more automated
18 alternatives, because my kind of view is the degrees of
19 freedom on advice actually aren't that large. That's why
20 the robo advisers all have the same asset allocation. So I
21 actually think there's a big prospect to change the way
22 things work with technology, important to like you said the
23 forthcoming generations more than the Boomers themselves.

24 MR. PHILLIPS: Mike's spot on. I think that it's
25 -- it's not only about consumer finance not really having a

1 solution yet but it's also where is the right point of
2 entry. So if you think about the 99 percent below that 1
3 percent that holds a big chunk of the asset management
4 industry's products and services, is the right entry point
5 in that traditional format or is it more about debt and
6 liquidity management? So in other words, student loan
7 providers start providing advice. Banks off liquidity
8 management start providing advice.

9 So technology is a big lever here to allow that
10 mass customization. The technology now exists to do it,
11 which is why this is becoming a more feasible question. If
12 we had the discussion 10 years ago, all of this is nice to
13 talk about but really unfeasible at a profit. Consequently,
14 though, I think what that does is it creates much more
15 competition and confusion in the industry because the people
16 who naturally would have hold of these clients aren't the
17 asset managers because they gravitated away, they gravitated
18 upstream. So have their intermediaries. It's going to be
19 other financial services providers that probably have the
20 data to start offering this advice.

21 MR. BERNARD: If I could, I will actually jump in.
22 So both of you -- maybe I'll start with you, Mike. But your
23 data is -- it's a very interesting case of a lot of things
24 that have evolved have evolved because of the underlying
25 market trends, the market structure and so forth and not

1 necessarily the relative skills of the various actors
2 involved in it, right? Despite what they might claim,
3 right?

4 So what I'm thinking about is, as you think about
5 the trends in place and their trajectory, back to my North
6 Star of the investor, and the relative -- so where the puck
7 is moving and the relative skills of who's going to have the
8 puck, what does that portend for the end investor and what
9 watch-outs might you say to this committee, boy, you guys
10 might want to take a look at this, this is a scary mismatch?

11 So, for example, retail advisers doing asset
12 allocation. Is that an okay thing?

13 MR. GOLDSTEIN: Yeah, that's an issue. Because
14 it's kind of hard to be right, because you get very few
15 swings at the plate. And you usually want to be in a game
16 where you can swing a lot of times. But in asset
17 allocation, inevitably, you can't. So I'd say it's a hard
18 game to play. It's like calling the market.

19 I don't know. It just seems to me there's been
20 two basic trends. Declining interest rates to very low
21 nominal levels and the rise of an elite set of corporations
22 dominating the market which has shown up in the index. If
23 anything changes one of those two things, something is going
24 to happen here that is going to be surprising to most
25 people, given how you got to this point of the size of the

1 allocations that have developed over the last 18 to 19
2 years. So it ended up that the new economy era of the '95
3 to 2000 era was correct in its proposition about what was
4 going to happen in the U.S. economy and how that's played
5 out over 20 years and it's been embedded into all of these
6 things. Anything that changes it, which could be
7 regulation, it could be so many different things at a larger
8 scale, will have big consequences because you've been
9 compounding the same trends for 20 years in one direction.
10 And that's what shows up here.

11 And you're right, it is better to be lucky than
12 good.

13 MR. PHILLIPS: I think Mike's right. The downside
14 risk of errors early on in any of these advice processes, so
15 if you think about consumers at the millennial level, now
16 giving them advice, it's very hard to correct it going on.

17 The other big issue which I think the committee
18 should keep in mind is that asset managers and
19 intermediaries don't know anything about their clients.
20 This value chain, supply chain, however you want to describe
21 it, has become so hyper-extended in the past 40 years, and
22 as a result asset managers believe that all investors act
23 like the professional gatekeeper that they're interfacing
24 with. That end user data link doesn't exist. And, as a
25 result, what you've started to see asset managers realize is

1 if we can actually find out from investors enough data to be
2 able to tell them what they need -- because asking investors
3 what they need, asking anybody what they need, does not give
4 you a fully articulate response. Most people don't know.

5 By getting that data, then they will have the
6 chance to actually build the offer in a way that will
7 immediately start that cycle, rather than trying to guess in
8 the dark at it. Or try to leverage something that's built
9 for a wealthier, bigger client that won't be applicable to a
10 smaller client.

11 I think that goes back to what the commissioners
12 all said in their opening statements to varying degrees
13 about data. That becomes the new war for asset managers to
14 compete with one another. How much can we know about the
15 end users? Which really upsets the current competitive
16 dynamic. Because before, you only needed to know the
17 intermediary at the top of the house to get the supply chain
18 started. Now, you need to know the data that the
19 intermediary probably doesn't want you to see. So that
20 becomes a very difficult tug of war among industry
21 participants that formerly cooperated to mark things up the
22 chain as fee budgets were spent.

23 MR. BERNARD: Other questions? Jeff?

24 MR. PTAK: Thank you for the presentations this
25 morning. They were very informative.

1 I wanted to build on Ed's question, maybe through
2 the prism of disclosure. You talked about the primacy of
3 advice and how it will be increasingly important for asset
4 managers as they wage battle against one another to
5 differentiate on the basis of holistic advice. But then as
6 we reflect on, for instance, the current reporting and
7 disclosure regime, which is very product centric, it's
8 designed to help the investor to assess the risk and reward
9 the type of exposure, the objective, it's not so much about
10 advice, it's about a particular product. And so as you
11 think about the comprehensiveness, the adequacy of
12 disclosure today and what will be relevant in the future as
13 you anticipate asset managers, for instance, trying to
14 deliver more holistic advice to compete, do you think that
15 we're going to need to shift meaningfully in terms of the
16 information that we're making available to investors so that
17 they can make an assessment of how good an advice provider
18 an asset manager is?

19 MR. PHILLIPS: I do think yes to that. But
20 there's even a bigger shift that has profound repercussions,
21 which is the customer's data and how it's disclosed and when
22 they choose to disclose it is going to become a bigger
23 component of this dynamic of this competition as well. And
24 what I mean by that is, if you look at what the Indian
25 government and Indian parties are starting to experiment

1 with this year, it's the idea that having a financial data
2 set that the regulator sets up but gives the citizens the
3 right to disclose as and when they want, they open up their
4 data to let advisers use. So it becomes less about we have
5 products, here's all the disclosure information, you choose,
6 customer. It's more about, you give us the data about
7 yourself and your needs and your current financial situation
8 and then we will use that data that you allow to react and
9 solve.

10 That gets to the data privacy, data usage, data
11 communication issues. And I think also shifts from product
12 to service because the product disclosed information matters
13 somewhat to audit and tests that everybody is doing what
14 they're saying they're doing. But the biggest dynamic in
15 actually providing the advice is the consumer data.
16 Regulators and data providers worldwide are grappling with
17 the fact that throughout financial services, it's less about
18 what's in each market silo, which is how we've typically
19 policed financial markets as the cops walking around,
20 insurance, as the cops walking around banking. But it's
21 more about how does the client get protected, how does the
22 consumer get protected? Which means, if the consumer is
23 revealing the data and gives that proactive permission,
24 suddenly that's the framework in which to operate.

25 MR. BERNARD: Thank you. Sorry, Russ. Go ahead.

1 MR. WERMERS: So for the bottom 90 percent of
2 wealth, I guess, portion of your slides, Michael and Ben,
3 for these consumers if they have -- or these individuals, if
4 they have retirement savings at all, they probably have
5 retirement savings in a 401(k) plan and that's probably
6 about it. You know, and beyond that, they have maybe Social
7 Security, they have Social Security and they might have a
8 house.

9 So how does this intermediary, 401(k) plans and
10 their fiduciaries, how does that affect this, the landscape
11 ahead? And I think this is probably especially relevant for
12 millennials who, I think, have been born into a 401(k)
13 defined contribution society?

14 MR. GOLDSTEIN: I guess that's why they say
15 they're going to be interested in financial wellness. Look
16 at the picture and tell somebody how they're doing. Which
17 seems like probably the limit on what they can do.

18 The other thing that's happened is the cost of
19 providing those services to the end participant has fallen
20 dramatically over time. But I think it's pretty limited
21 what's actually going to happen for the bottom 90 percent,
22 given the reality of what you're talking about. Because
23 you're right, it's a pretty simple problem that comes down
24 to a couple things.

25 MR. PHILLIPS: I would agree. I mean, it's -- the

1 401(k) provision, it's only going to be a minority of what
2 millennials need to think about for their long-term savings,
3 if they use it at all. Which is another issue is, do
4 takeout rates start to drop? So as a result, if that
5 happens, what I think will star to happen is 401(k)
6 providers, so the platforms involved in the space, will have
7 to start thinking about, okay, the assets themselves aren't
8 really the core proposition here. What other information
9 can we glean? We have the participant. We might have data
10 if they disclose it to us. What other things can we
11 provide?

12 If you look at industry M&A over the last the past
13 five years in that space, it's starting to move in that
14 direction, which is, how can we get the various components
15 of the life cycle of somebody who's saving for retirement
16 including, most importantly, rollover, which is where a lot
17 of this can either break down or get solved, and think
18 through what other services can we inject into that if we
19 know what to do and where to do it. But I don't think you
20 can see a structural 401(k) change dramatic enough to do it.

21 The Australian government, as most of you if not
22 all of you know, already forces 12 percent compulsory
23 contributions into 401(k)-like systems and everybody is
24 still short, everybody is still short. Exactly, the
25 superannuation guarantee. So I think the industry centering

1 on 401(k) makes sense because they have a participant that
2 has a somewhat, depending on the jurisdiction, mandatory or
3 at least encouraged effort to utilize it. But it's not
4 going -- it's necessarily but not sufficient.

5 MR. SUBRAMANIAM: A question for both of you but,
6 you know, Ben, you kind of described it as a demand change
7 and a supply chain change. On the demand side, the
8 requirement for solutions and income. On the supply side,
9 there seems to be a narrowing of choices, right, in the
10 traditional investments. Michael referred to fewer public
11 companies, very large companies, not really high dividend
12 paying stocks. Interest rates very low, zero, negative in
13 some countries for the foreseeable future.

14 Can you give some thoughts on -- you sort of
15 touched on bridging that gap. We talked about private
16 markets. We talked about tokenized investments. But
17 there's a whole swath of, you know, real estate and other
18 private credit investments, making those somehow more
19 available, accessible in 401(k) plans has to be part of the
20 solution, with guardrails, obviously. But I'm not sure how
21 else you, you know, in the next 20 years, bridge that gap
22 between the supply side sort of narrowing and having less
23 choice with very low rates and the demand side, you know,
24 having a demand for income and solutions.

25 MR. PHILLIPS: I would agree with that. I think

1 your next panel will talk about the private markets provide
2 a lot of tools. But the biggest tool would be if people
3 saved more. I mean, that's the reality of the situation
4 here. The biggest lever to bridge those income gaps is
5 catching -- and there's a lot of data that shows this -- is
6 the program by which people put money aside to do it.
7 That's actually the most influential component in driving
8 retirement portfolio size.

9 So to some extent, the asset management industry
10 can continue to innovate toward that solution. But as Mike
11 said, with Treasuries as low as they are, it's going to
12 require more than just the asset management market solution
13 to bridge that gap. It's going to take a full-court press.

14 And I think private markets play a big role. I
15 think technology allows us to have the discussion about
16 injecting them into things like 401(k), injecting them at
17 smaller and smaller investment sizes. It raises a whole
18 host of issues for how you police, monitor, price, regulate.

19 MR. GOLDSTEIN: Could I say something about that?
20 I would be cautious on this front. You know, interest rates
21 went from 11 to 1.5. And the 1.5 is what's imbued the
22 valuation of these alternative asset classes, because
23 everyone wants the same thing. So now, after 30 years in
24 one direction, we're going to liberalize at 1.5 percent
25 interest rates as the coupon rate to let everyone get

1 involved. So I would be particularly cautious about
2 changing the asset allocation paradigm after the decline in
3 rates has, in fact, already occurred.

4 MR. DRAEGER: Thanks, Ed. Before we get to the
5 first break here, I just want to say thank you so much to
6 the commissioners, the Staff and to Ed for putting this
7 together. Humility is such an impressive leadership trait
8 and this initiative really reflects an earnest demonstration
9 of that trait. So thank you.

10 I have a question. So Ben and Michael, as a group
11 of industry and government leaders who are trying to support
12 the shifting and reshaped landscape of the value proposition
13 that you guys so eloquently highlighted, in the manner that
14 we can best serve and protect investors, I'm interested in
15 your view on the impact of the scale and consolidation
16 that's happened in the industry and the business models that
17 are in pursuit of that scale, and whether there is a
18 decreasing utility to that evolvment for the alternate
19 investors, given that scale generally decreases the ability
20 to provide customization and creates distance from your
21 client?

22 MR. PHILLIPS: I think it comes down to -- I think
23 you're right. I think scale does create that distance.
24 It's very difficult to mass customize, the bigger you are.
25 Mass scale does provide the technology to give you more and

1 more leverage to do that, but it still makes you more
2 distant from the client.

3 I think what you'll start to see in the industry
4 is not necessarily a full hundred percent shift toward a
5 consolidating number of players. But you will see a number
6 of asset managers, wealth managers, all providers of advice,
7 let's call it, and begin to segment the type of clients they
8 want to cover so they can mitigate this.

9 The asset management business model to date has
10 been all things to all people. And there hasn't been a lot
11 of selective segmentation because, with low barriers to
12 entry and high margins, you could afford a lot of projects.
13 That is no longer the case. And as asset managers look at
14 how do they maintain profit margins, they also look at are
15 there certain types of clients that we ring fence around,
16 certain types of products that we ring fence around.

17 It's going to involve a dynamic where a number of
18 the asset management firms that we know now decide that they
19 would much rather work on a business model where they
20 subcontract purely what they have as asset management skills
21 and accept those economics. Others will point out that that
22 if they have the client data and the advice, that's what
23 they'll focus on and they'll outsource other components to
24 other providers.

25 So I think there's consolidation in the industry

1 in the sense of the same business models are coming under
2 pressure and starting to pull themselves together. But I
3 think what we're starting to see at least the early stages
4 of is asset management firms saying, maybe we should only do
5 one part of this or maybe we should only focus on one client
6 base and therefore maintain a degree of size that allows us
7 to have a higher touch interaction with clients while at the
8 same time maintaining enough mass customization elements to
9 remain profitable.

10 MR. GOLDSTEIN: Well, I guess the reason the
11 biggest firms are the biggest is they're the cheapest. That
12 that's been the commonality that drove them to this level
13 and this environment. So I personally think that's probably
14 been a good thing, on balance. But I do think it changes
15 the dynamic in the industry itself. I've always thought
16 there would be segmentation in the money management
17 business. But I've been wrong on that for 35 years running
18 now. So I'm going to be cautious on that forecast because I
19 haven't been right so far.

20 Basically, it's ended up that what you wanted was
21 a solution that was pretty easy to understand. And cheap
22 was easy to understand, especially when it had the best
23 returns. And so until something really changes, I'm
24 guessing that is it.

25 MR. BERNARD: So as a slightly different angle on

1 that, I wanted to come back to a point that was raised
2 earlier. What do you think is the current environment for
3 small asset managers to survive, thrive or whatever? And
4 how much does it matter to innovation in asset management?

5 MR. GOLDSTEIN: Well, it does matter to innovation
6 because the history of the industry is somebody is either
7 smart or lucky or both and they start small and become big
8 through one idea. And I'm guessing that will remain the
9 case. But I do think the environment is less open to that.
10 I think what fostered that was the defined benefit pension
11 plan era, that the cost of marketing was quite low compared
12 to the fees because you were acquiring very large accounts.
13 And that is what fostered the rise of many small firms.

14 Now that you're -- that has become a de minimis
15 part of the industry and involves reaching many people at a
16 time, I think you are right about that, Ed, it is less open
17 to creating that kind of an outcome because the business
18 itself is structurally different.

19 MR. PHILLIPS: I would agree. The long-term issue
20 with scale in investment management is the type of people
21 who create the lightning in the bottle, those who can create
22 alpha, those who are good active managers, tend to like to
23 work in certain ways. The one correlation over the last 40
24 years is a partnership ownership model is the one that's
25 correlated with better performing asset managers.

1 The question is how do you scale that. And when
2 you can't scale it any further, what decisions, what
3 tradeoffs do you make. And for many of those boutiques,
4 most of them will say, we're more than happy to take the
5 portion of economics from just being a subcontracted part of
6 other people's advice chains and advice offers because we're
7 quite happy with those economics as individuals and as a
8 team we know what we're doing to generate that talent.

9 The question is whether the rest of the industry
10 finds ways to accommodate, cooperate and work with those
11 types of businesses going forward, in which case you have a
12 vibrant, IP-driven set of vendors. The question will be
13 whether you have the advice providers believe that they can
14 comfortably outsource that component and continue to retain
15 the clients' interests, most of the client fee budget and,
16 more importantly, the client data.

17 I think increasingly, more and more firms will
18 realize they are good at some things and not others and
19 adapt their business model accordingly.

20 MR. BERNARD: We're out of time. But Neesha, did
21 you want to close this out with a quick question?

22 MS. HATHI: Yeah, I was curious, both of you have
23 talked about the -- kind of the broadening of the value
24 proposition. So not just on the product but on the service
25 and tax and debit/credit management. But this is an

1 industry that implicitly has priced based on asset
2 management fees traditionally. And you talked a little bit
3 about performance fees as a growth. I think we have talked
4 about different fee models for a long time but there hasn't
5 been much traction there. I'm curious if you see that
6 happening in other places or if there's a catalyst that you
7 see coming that will drive different value -- different fee
8 models into the industry?

9 MR. PHILLIPS: I mean, it is about 35 percent of
10 U.S. and European asset managers now offer them and they are
11 becoming more prevalent. They're not becoming as widely
12 prevalent as many people would have you think, primarily
13 because they're difficult to implement. Performance against
14 what? How do you measure it? Where are collars, where are
15 hurdles? And the technology and the numbers that you need
16 to record that are not operationally easy.

17 If we move toward a case where asset managers view
18 their propositions as more of a service, then they will
19 start to think through, is there a way we can differentiate
20 ourselves and offer pricing that is more like that and more
21 of a subscription, more of an ongoing fee. The math here is
22 really illusive right now because you still have this back
23 book of business that needs to be charged ad valorem fees.

24 But I think the industry as a whole is starting to
25 put a lot of effort into figuring it out. Clients like the

1 we'll see how our discussion goes.

2 But clearly a trend we've all observed, and we
3 heard a little bit about in the first panel is the outsized
4 growth of private companies and investments, even as the
5 number of public companies has shrunk materially. And that,
6 of course, affects the raw material available to asset
7 managers to create returns for the investors they serve and
8 the ways they do that.

9 There's a host of reasons, including liquidity
10 risk, funding practices, regulations that private
11 investments are typically available to a narrower -- a much
12 narrower set of qualified investors. And there is growing
13 discussion, including at the SEC, as to whether that should
14 change, what guardrails you would need and so forth.

15 So it seemed a topical -- a timely topic to have
16 on our first agenda. We are delighted to have three
17 speakers to help us think about that.

18 Stephanie Drescher is a senior partner and global
19 head of client and product solutions at Apollo Global Asset
20 Manager and her colleague, John Suydam, is a member of our
21 committee, and serves on the firm's management committee.
22 She oversees product development innovation, as well as
23 fundraising, ongoing client management relationship for the
24 firm.

25 John Finley to her left is senior managing

1 idea. They don't necessarily understand how it's
2 implemented but they like the idea that they get -- that the
3 asset manager gets paid when the client benefits. And so I
4 expect it will be an ongoing discussion for the next several
5 years and something that regulators will have to start to
6 think through, because both the industry and the consumer
7 side will bring these ideas forward. But it's not an
8 overnight transition. It's not how the book of business
9 works now and, particularly in an upward market that we've
10 had in the past several years, there's not a lot of
11 motivation to shift to a different system.

12 (Applause.)

13 MR. BERNARD: So we are now scheduled for a break.
14 And I know facilities and so forth are right outside the
15 door.

16 If you'll forgive me, I'm going to be that tough
17 chairman that says we're going to start at 11:15 sharp
18 because our next panel has sort of a tight schedule.

19 So thank you all very much. And we will be
20 reconvening in 13 minutes.

21 (Recess.)

22 MR. BERNARD: So as promised, I am going to get us
23 going on the next panel, who have a pretty tall order in an
24 hour and 15 minutes. And I think if we slip a little into
25 lunch break, it will be okay. We'll keep an eye on that and

1 director and chief legal counsel at Blackstone and serves on
2 that firm's management committee.

3 And Colby Penzone to his left is head of
4 investment products at Fidelity Investments, focusing on the
5 product strategy development and management and positioning
6 of Fidelity Investments' products to retail, intermediary
7 and institutional clients. So I think he will bring us a
8 good perspective across the continuum of clients.

9 So in effect, I think, I'm not going to -- I don't
10 want to put collars around them, but Stephanie and John will
11 bring the perspective of providers and I think Colby will
12 speak more to the investor segments and the users, the
13 investors who look to those products.

14 So with that, I think we've asked them each to
15 speak for about 15 to 20 minutes, and if you do the math if
16 it ends up being 15 or 20, that will leave us 15 to 20
17 minutes for discussion. So we'll see how it goes. So
18 Stephanie, I think you were going to kick us off.

19 EVOLUTION OF PUBLIC AND PRIVATE SECURITIES OFFERINGS

20 MS. DRESCHER: Yes, good morning, and thank you all for
21 having me here. It's a privilege to be part of the
22 inaugural committee, and obviously a distinguished group
23 that we have here as members, along with leadership from the
24 SEC. So as Ed mentioned, just as context, I have
25 approximately 25 years in the industry, almost all of it

1 focused on alternative investment investing, the last 15
 2 years at Apollo and prior to that, 10 years at JP Morgan.
 3 So my role, as referenced, is to focus on the
 4 segments of the business that touch our clients, our third
 5 party investors and the products that we design for them.
 6 And just to give you a little bit of context on the firm,
 7 very briefly, so as we approach our thirtieth anniversary,
 8 we are over 300 billion now in assets, focused primarily on
 9 private equity, credit and real assets. When I joined 15
 10 years ago, just to give you context of the industry at that
 11 time, we had approximately 15 billion under management. So
 12 quite an evolution over that time frame. And hopefully,
 13 that just gives you context from here.
 14 If you look at the next page -- let me advance the
 15 slide -- the product offerings of the firm, again
 16 illustrative of the industry overall, have continued to
 17 develop meaningfully, over the last 10 years, I'd say, in
 18 particular, a trend we've seen in private markets more
 19 broadly. So when you look at this slide, you see a number
 20 of underlying asset classes that we can offer our investor
 21 base globally. And many of the talented professionals that
 22 we now have that are looking to originate from these
 23 underlying asset classes joined us around, during, kind of
 24 right post the financial crisis which, when you think about
 25 it, was a time where the banks were no longer in a number of

1 these businesses and those talented professionals were
 2 looking to join firms such as ours that had the appropriate
 3 longevity of capital and structures to match the liquidity
 4 or illiquidity of the underlying investments.
 5 So if you think of nonperforming loans or
 6 aviation, insurance among other opportunities, you can see
 7 how this spectrum of opportunities has filled in over time.
 8 And when you do look at risk/reward, the span within private
 9 markets is quite broad, from the most liquid, at least as we
 10 offer it, of the senior loans, for example, to more
 11 illiquid, private equity types of opportunities with
 12 respective return profiles that are appropriate for the
 13 underlying investments.
 14 The majority of our investors, what I may refer to
 15 as limited partners, access our funds through private
 16 limited partnerships. And those are typically commingled.
 17 They can be bespoke. Those that are looking to deploy in
 18 scale and look to create mandates that are specific for
 19 their objectives can have managed accounts that we offer as
 20 well.
 21 So here is a look at our third party investor
 22 base, which complements that of our affiliated insurance
 23 balance sheets. So approximately 85 percent is
 24 institutional and about half of that is from public pensions
 25 and/or sovereign wealth funds. The balance, 15 percent or

1 so, is made up of wealth management partners, such as the
 2 private banks, wires, RIAs, where their underlying client
 3 base are sophisticated, high net worth individuals. In
 4 addition, we have a growing number of family offices that we
 5 do interact with on a direct basis and we have four publicly
 6 listed vehicles in the realm of credit, BDCs, mortgage
 7 REITs, et cetera.
 8 So it sounds from Ed's commentary that the prior
 9 session did reference shifts in the public markets, both
 10 equity and potentially fixed income. I thought as the first
 11 panelist within the alts framework that I would just speak
 12 very briefly to some of these market trends. Specifically,
 13 the passive to -- the role of active shifting to passive
 14 and/or alternatives. And then importantly, the role that
 15 alternatives are playing in the portfolios of our investor
 16 base today, kind of why and how.
 17 So just very high level, clearly, we're all taking
 18 note of the shift that we're seeing to passive and to alts.
 19 And the beneficiaries of that in part are the alternative
 20 managers, where we can ideally be able to provide additional
 21 incremental return with that exposure versus active public
 22 managers, at least in the equity space in particular, that
 23 have had their challenges in beating the benchmarks. And
 24 I'll showcase some of that outperformance in a moment.
 25 So within alts, I think there's a growing

1 appreciation that, for certain strategies, daily liquidity
 2 just simply may not be in the best interest of investors and
 3 returns can be maximized or certainly excess return can be
 4 achieved if some illiquidity is taken through longer term
 5 structures. And happy to speak more about that in time.
 6 In addition, obviously, a trend of overall decline
 7 in the number of public companies, 40 percent decline when
 8 we look over a 20-year period, and while there has been some
 9 growth in public companies off of a lower base in the last
 10 five years, the growth clearly pales in comparison to that
 11 in the private markets, where you can see the very
 12 considerable rate of growth. So multiple drivers are behind
 13 that, where there's more private capital available to
 14 companies, a preference among certain companies and
 15 management to maintain control or their entrepreneurialism,
 16 and a view that potentially the public market structure is
 17 not best suited for their company, given a shorter term view
 18 or potentially a larger competitor in the public space,
 19 among other reasons.
 20 What's interesting is, when we look at it, out of
 21 our private equity pool of capital, five of our most recent
 22 seven investments that we have made through our current
 23 private equity fund have been bought by -- basically, take
 24 private, so public-to-private transactions which we see as
 25 an attractive source of opportunities as we think about the

1 risk/reward and value equation that's present in the markets
 2 today.

3 By the way, looking at the credit markets before I
 4 go into the investor perspective, I thought this chart was
 5 interesting on page 7, where you can see the increasing
 6 percentage of private debt as it contributes to the total
 7 pie of total debt raised annually. So you see the CAGR for
 8 private credit including leverage loans at approximately a
 9 14 percent level, so strong growth. And we do see reason to
 10 believe that will continue to increase.

11 Now, that said, overall context is that the
 12 private credit markets are still relatively small in
 13 comparison to public, so half a trillion, let's say,
 14 accounts for 14 percent of the volume out there in the debt
 15 markets. And issuers of higher quality companies are
 16 increasingly interested in speaking about private capital
 17 solutions and playing a strategic role in their companies.

18 So with that as a backdrop in terms of what we're
 19 seeing in the public markets and some shift to alternatives,
 20 I thought maybe I would turn to the investor lens a bit and
 21 look at what our investors are evaluating in terms of
 22 relative returns and risks in the marketplace. So as I
 23 speak to investors globally, and we have a very healthy
 24 cross section of investors, the common theme is the search
 25 for yield. So I'm sure no surprise to you.

1 LP's of different types each have the liabilities
 2 that they are trying to achieve based on their portfolio
 3 needs or funding requirements. And the environment has been
 4 a challenge. If we think about where the markets currently
 5 stand, there's still about 12 trillion of negative yielding
 6 debt globally out there. So investors are looking for
 7 opportunities to generate the returns that they need. And
 8 when we look historically over pretty long periods of time,
 9 five and 10-year data, the allocations to private equity
 10 and/or private credit has created meaningful outperformance
 11 relative to their public equivalents, typically roughly the
 12 300 basis point return profile in excess of the publics.

13 And while this outperformance clearly is kind of a
 14 strong indicator, let's look at the worst five-year periods
 15 over the last 23 years. And this is data supplied by
 16 Hamilton Lane, who sees a very healthy cross section of
 17 alternative allocations. And when you look at the data,
 18 interestingly, even the worst five-year periods for buyouts
 19 and private credit have generated positive returns, in
 20 contrast to what you see for -- for the public markets. In
 21 the case of real assets, the private options for infra and
 22 real estate have offered more metered downside than their --
 23 the public market options.

24 So as we look at asset classes on a risk adjusted
 25 basis, which of course is important to do, we thought it

1 would be helpful to look at data that highlights Sharpe
 2 ratios. And again, this is compiled by the same source.

3 And, as you all know through your day-to-day evaluation of
 4 investments, Sharpe ratios continue to help investors
 5 perform decisions based on evaluating the return of an
 6 investment compared to its risk, often measured by
 7 volatility. So the higher the Sharpe ratio, obviously, the
 8 better. And as this data shows, each case, in each case,
 9 the private markets, whether it's private equity, credit or
 10 real assets are showing Sharpe ratios here that are more
 11 than double that of the market benchmarks. And for those
 12 that might be thinking, well, when are they priced? How
 13 often can you measure that volatility, they do have an
 14 approach and a methodology that accounts for that kind of
 15 de-smoothing of volatility for the private markets. So I
 16 thought this was just interesting context as we think about
 17 the relative not just absolute returns but relative returns
 18 of asset classes. And this generally holds true over long
 19 periods of time. So if we look over 15 years, looking at
 20 that data, it's a very similar trend.

21 So over my career, turning to page 11, we've
 22 certainly seen the continued broadening of the investor
 23 base, both by number of organizations, geography,
 24 allocations and maybe through this process we'll continue
 25 that broadening. We'll see. But the institutional investor

1 world today, as we look at it and this data shows, about 76
 2 percent, so more than three quarters of the investors
 3 globally today are invested in alternatives, one or more of
 4 the underlying asset classes. And private equity and real
 5 estate seem to be the most commonly held, where two thirds
 6 are investing in those asset classes while obviously many
 7 more are rounding it out with other exposures, hedge funds,
 8 real assets, et cetera -- other real assets.

9 And given the impact on portfolio returns, turning
 10 to the next slide, both absolute and risk adjusted, we're
 11 continuing to see strong flows of capital to alternative
 12 managers. And over the past five years, we've seen greater
 13 inflows than any prior five-year rolling period.

14 On page 13, if we look more holistically across
 15 allocations to private markets, they have expanded
 16 meaningfully. And this data shows that there is continued
 17 and significant interest in the investor population to
 18 allocate to these underlying areas of exposure and at
 19 meaningful rates, often doubling or tripling in size of the
 20 exposures to private markets. But that said, I think
 21 important to keep in context, the total AUM of private
 22 markets today, depending on your source, is roughly five and
 23 a half, six trillion of dollars under management, that's
 24 typically by NAV and unfunded commitments. In the context
 25 of the global listed equities and debt markets, it's roughly

1 6, 7 percent. So lots more room to grow in these asset
2 classes, certainly on a relative basis, where they're only
3 call it one eighth of the size of the global public markets
4 today.

5 As we look one level down at a particular type of
6 investor in our base today, I thought it might be
7 instructive to take a quick look at the allocations made by
8 U.S. pension, just by way of example, and the role that it's
9 played in their portfolio. So not surprisingly, significant
10 increase, you can see, over the last 10 years from, on
11 average, 7 percent to 26 percent. And on the next page,
12 let's take a closer look at an illustrative view as to why.
13 So just looking at the role private equity can play in a
14 client's portfolio, the top portion of this slide shows
15 funding status. And you can see that with private equity,
16 the funding requirements were able to be met in this
17 illustrative example. And without the allocation to private
18 equity, they could only achieve 67 percent of the funding
19 liability. So that's a significant gap that would be
20 created but for the allocation to private equity. And
21 therefore, probably not surprisingly, that over 90 percent
22 of the U.S. pension in the U.S. allocate to private equity
23 and are frankly able to do so.

24 So in closing, before I pass it over to John, on
25 the last slide you can see the continued interest from the

1 community of investors in alternatives today. This is a
2 survey of a very robust number of allocators, investors,
3 managers that include alternatives in their portfolio and
4 really across the asset classes, you can see desire and
5 interest in continuing to add to their exposures, I'm sure
6 in large part based on many of the trends that I spoke about
7 thus far.

8 So, with that, I will pass it over to John.

9 MR. FINLEY: Thank you very much for having me
10 here today. You are really dealing with the big issue that
11 is reflected in the concept release. And, before I go any
12 further, do you have my written materials? Yeah, fine.
13 Just checking that got out.

14 You know, the public markets are shrinking. The
15 returns are terrific in the private markets. And yet you
16 want to be cautious and one wants to -- certainly at
17 Blackstone, we want to be cautious in providing access to
18 those better returns. And so, as part of that, very pleased
19 to, you know, trying to provide assistance in giving you
20 information from our perspective. I will say, inspired by
21 Dalia, and in case you give a question that's too tough, the
22 views that I express are not necessarily those of Blackstone
23 but are mine also.

24 We have -- with Stephanie, we tried to make sure
25 we complemented each other rather than go over the same

1 material. So in my materials, you will see there is a fair
2 amount also on the returns that are available in the private
3 markets, which I won't go over. The one point I'll make
4 which Stephanie mentioned is that the volatility is actually
5 lower in the private markets, private equity for example,
6 and that's really for two reasons. One, the valuations are
7 often done as a function of DCFs and so they don't swing
8 like the public markets. But maybe even more fundamentally,
9 with private investing, you have the ability to intervene
10 and anticipate in ways that you can't with passive
11 investing. And that allows -- that anticipation can
12 sometimes provide an ability to smooth things out. And
13 that's one of the reasons why the volatility is lower. And
14 there's actually, in a way, you could say less risk
15 associated with the private markets.

16 So just a bit about Blackstone and myself. I'm
17 the general counsel at Blackstone, and so we are very much
18 -- I am very much on the front lines in dealing with, in
19 coordination with our head of regulatory affairs, Wayne
20 Berman, these frontiers, these issues, what is available,
21 what would be -- how should we be thinking about what -- how
22 to offer private markets to a more retail customer.

23 Blackstone, the only two points I'd make that come
24 out of looking at Blackstone is, number one, it's much more
25 -- much broader than a private equity firm. And, in fact,

1 as we'll talk a little bit later, alternatives are already
2 being available in the public marketplace through real
3 estate, through liquid credit and through hedge funds. So
4 there are alternatives and private market opportunities that
5 are not available. But the breadth of the firm and what's
6 available is already -- is already out there.

7 Skipping pages, because I'm going to again try and
8 not hit some of the same thoughts that Stephanie did.

9 So if we move to page 10, page 10 is talking about
10 the global retail investor demand. And as you can see from
11 that chart, the mass affluent, a million to five million, is
12 about 20 percent of that retail investor universe. They're
13 over -- in the U.S. alone, there are over 18 million
14 millionaires in the United States, according to data
15 provided by Credit Suisse. And that retail demand for
16 alternatives as you see on the right-hand side is quite
17 strong and, as you see -- I'm sorry, on the left-hand side
18 of that. And on the right-hand side, you can see the
19 declining in mutual funds and in money markets, another way
20 of looking at the perspective of what we've been talking
21 about.

22 But at the same time, with that demand ramping up
23 into alternatives, you will also see that the allocation to
24 individual investors for alternatives is much lower than
25 pensions and endowments. And this is something that maybe

1 was referred to earlier today that has relevance in the
 2 401(k) space, but not only. Which is that if you're saving
 3 through a pension plan, you've got great exposure to
 4 alternatives. If you're saving through a 401(k) or even
 5 outside a 401(k), you're looking to the future, that
 6 tradeoff of illiquidity and returns is resulting in a great
 7 -- a lack of returns, but there is also a tremendous under-
 8 allocation. And that only with a greater allocation to
 9 alternatives can you match those kinds of returns that you
 10 might be getting if you did participate in a pension plan
 11 which is, of course, declining.

12 So there is a great under allocation. Then the
 13 issue comes back to what we were talking about. Which is,
 14 can you manage the risk of getting that greater allocation
 15 to individual investors? Because clearly, the most
 16 sophisticated investors in the world are investing more in
 17 alternatives.

18 Page 12 is really getting back to what's framing
 19 this issue, which is less access to private companies,
 20 meaning retail investors are missing out on the
 21 opportunities. And if you flip back -- I won't do it on the
 22 overhead but if you flip back to page 3, this notion of the
 23 private markets, the private markets offer less correlated
 24 returns. They are much more manager driven, they are much
 25 more -- greater innovation by the manager and it tends to

1 that, in a sense, the pre-IPO market has become the IPO
 2 market of the past. And you see this with companies like
 3 Amazon, Google and Facebook, who the returns relative from
 4 investing in their IPO over the years, you get much less on
 5 a Facebook than you do on Amazon, because Amazon came to
 6 market much quicker. So these opportunities are much less
 7 available, the strength of the opportunity.

8 From a Blackstone perspective, private wealth is
 9 about 8 percent, which doesn't seem incredibly impressive
 10 relative to the whole. Except for the fact that over the
 11 time I was there, it's kept pretty constant. But when I
 12 joined, the assets under management were around 100 billion,
 13 close to 10 years ago. And now it's 550 billion. So that
 14 ability to drive into the private market has expanded, which
 15 is the only reason that it's been able to keep up at that
 16 kind of percentage.

17 In terms of where we are seeing the demand, and
 18 we are seeing the demand, it really comes through the
 19 independent broker-dealers, the registered investment
 20 advisers on behalf of their clients. And to date, the
 21 typical products have more been, let's say, for example,
 22 talking about the mass affluent, more on the BDCs, the non-
 23 traded REITs. But we do feel that there would be, if this
 24 product were available, there would be the demand from these
 25 areas.

1 have more patient capital. And so that then comes back
 2 again to the extent that liquidity and low fees are
 3 everything, you're going to be missing out on the private
 4 markets because there is a tradeoff, particularly for the
 5 alternatives that are not available today, to getting some
 6 less liquidity.

7 Page 13, you've really seen so I'll skip over
 8 that. It's just the decline in the listed companies
 9 relative to the market cap.

10 On pages 14, the shrinking of the public markets,
 11 why is it happening and the implications, the real point
 12 that I wanted to raise from this is that this is really here
 13 to stay. This is not a temporary or a regulatory burden
 14 that is causing this. There have been fundamental shifts of
 15 the domination of institutional investors who have less
 16 interest in small and microcap firms, the loosening of
 17 regulation on the private market, that private companies can
 18 now get ample funding and don't need to do the IPO route.
 19 And therefore, this is going to be a persistent issue that
 20 either will be addressed or won't be addressed in terms of
 21 the access to these markets. And moreover, you even have
 22 increasing liquidity in the private markets which makes it
 23 even more accessible.

24 So this is a fundamental change that regulators in
 25 the industry will have to deal with. And it's reflected

1 And as we focus on delivering, so what are we --
 2 when we look at the product that we're offering to the
 3 public, what we're trying to do is offer products that are
 4 fully drawn up front, perpetual with periodic liquidity,
 5 1099 reporting, income-oriented investments, potentially
 6 one-stop multi-asset solutions, which we have the ability to
 7 deliver given the breadth of our investments, institutional
 8 quality performance, perpetual capital structure,
 9 transparency. These are what have driven our ability to
 10 date to be able to do registered products for retail
 11 investors.

12 So if you take, for example, the one on the top,
 13 BREIT, that's an alternative product. It's stabilized,
 14 income generating, commercial real estate. It offers
 15 periodic liquidity through a repurchase program. And it has
 16 been, as I'll get to, extremely well received by the public,
 17 a lot of demand for that.

18 Most of the products, as you see here, are more
 19 heavy on either liquid credit or real estate. But that is
 20 partly a function of what the regulatory framework offers.
 21 There are challenges in broadening that. The investment
 22 portfolio flexibility within a retail structure, to the
 23 extent that you want to invest, the fees are up front. So
 24 you have to deal with, to deal with the fees being up front,
 25 you have to deal with things like buying secondaries so that

1 people don't have the J-curve problem, having a lot of fees
 2 up front while they wait for the investments to be made.
 3 There are complicated tax diversification requirements that
 4 we have to deal with in terms of good income versus
 5 diversification. Sometimes, you have to block certain
 6 income and that can raise a diversification issue for
 7 registered investment companies. You have the inability to
 8 compensate on a carry basis, contingent compensation, which
 9 in a way could drive those who can't get institutional money
 10 and carry to be the ones that are offering. And they're
 11 happy to just take retail money for a fee. And affiliated
 12 transaction rules, which make it difficult from an equity
 13 standpoint. For example, you can't do follow-on investments
 14 with equity.

15 So it is a lot easier with credit, for example,
 16 than it is right now for equity in the framework that's
 17 there now.

18 BREIT is just a good example because it's an
 19 alternative. We started -- if you look at where it was in
 20 terms of the demand, 742 million in 2017, 10.6 billion now.
 21 So there is a thirst for this kind of product. This is a
 22 product we could do within the existing framework. But it
 23 is reflective of the demand out there for that product and
 24 we believe we've developed compelling returns with a very
 25 strong institutional quality.

1 I'd also say that when we invest in these areas,
 2 we -- a lot of education goes into it. We have a Blackstone
 3 U for dealing with the independent broker-dealers, the
 4 financial advisers.

5 Coming close to trying to wrap up with my time.
 6 So what could be done to change the framework that would
 7 make a difference? One would be eliminating the accredited
 8 investor -- I'm up on page 21 now -- eliminating the
 9 accredited -- this is what commenters have put in and this
 10 is sort of summarizing where it would make a difference and
 11 what could change. Eliminating the accredited investor
 12 threshold for offering regulated funds of private funds.
 13 For the moment, offerings of more than 15 percent in private
 14 funds require accredited investors.

15 Right now, a registered open fund can't invest
 16 more than 15 percent of its net assets in illiquid
 17 securities. This is a real issue for target date funds.
 18 And a target date fund, which is dealt with in more detail
 19 on the next page, is really a way of replicating a pension
 20 fund, in a way. That is, it's more illiquid in the early
 21 years for a long-term investor, more liquid in the later
 22 years, and can replicate on an allocation basis the kind of
 23 allocation you'd see in a pension fund. But you can't do
 24 that now because you're limited to 15 percent on the
 25 illiquid securities.

1 Allowing carry for certain retail funds would also
 2 provide more flexibility.

3 The next page, 22, is just more detail on the
 4 target date funds which, again, the one thing that is pretty
 5 interesting about that is that quote from the top comes from
 6 ILPA, ILPA which is institutional investors commenting on
 7 this, that they thought that these target date funds are
 8 really a terrific way to go for the retail investor, and an
 9 interesting perspective from a party that is no self-
 10 interested in the outcome.

11 Finally, I would say that we have, certainly at
 12 Blackstone, and mostly I have just tried to reflect what the
 13 commenters have been putting in -- we have absolutely no
 14 interest of an expansion unless it's done right. Not only
 15 would it not be good for the investors, which is not good,
 16 it wouldn't be good for Blackstone and it wouldn't be good
 17 for the industry. So we think this does need to be done
 18 carefully. You know, doing it through regulated funds
 19 provides a layer of protection because you have a registered
 20 investment adviser who owes a fiduciary duty to the fund.

21 And the other is providing access through
 22 experienced managers. One way is through scale and
 23 experience. But if you didn't do it through that way, you
 24 also could restrict the retail that they can only invest
 25 through funds that have a substantial institutional

1 component. That allows the retail investor to leverage off
 2 of the institutional investor, provides an alignment that
 3 also could be an attractive way to provide additional
 4 protection.

5 So with that, let me turn it over to Colby.

6 MR. PENZONE: Thanks, John. I am going to
 7 actually deliver some verbal comments here. I had the
 8 benefit of the earlier presentation. I think you've all
 9 consumed well over 100 pages of data. Hopefully there's no
 10 quiz afterwards.

11 As Ed mentioned, I lead the investment product
 12 group at Fidelity Investments. I would also like to start
 13 by thanking the Commission and the advisory committee for
 14 having me here today, as well as the rest of the panelists
 15 to discuss -- this is a pretty important and obviously very
 16 interesting topic.

17 I thought as part of my introductory comments, I
 18 would briefly provide a little bit of background on our
 19 firm, in our experience, working with individual investors
 20 to meet their goals and objectives. And then I'm going to
 21 touch on a couple areas that I think are particularly
 22 relevant to today's subject. And specifically, I want to
 23 hit on two topics.

24 First, I did want to provide an overview of how
 25 our customers currently access alternative investments and

1 specifically private equity through the Fidelity ecosystem
2 and working within the current regulatory framework that
3 we're operating under. And then I want to spend some time
4 highlighting what I think are some of the key questions that
5 we should collectively be considering as we explore
6 opportunities to further broaden access to the private
7 markets, in particular private equity beyond qualified
8 purchasers and accredited investors.

9 In the interests of time throughout the rest of my
10 prepared remarks, I'll refer to those higher net worth
11 individual investor segments as QPAI, just to shorten that
12 down. And then all other individual retail segments as non-
13 QP, non-AI investors.

14 So a little bit of background. As of September
15 2019, Fidelity serves more than 22,000 businesses managing
16 employee benefit programs, more than 13,500 financial
17 advisory firms and more than 30 million investors. These
18 customers hold \$7.8 trillion in assets under administration
19 with Fidelity. And that figure includes about \$3 trillion
20 of assets that are managed by Fidelity on a discretionary
21 basis.

22 All told, these assets, both the administered and
23 managed assets, span across a total of 72 million customer
24 accounts. So we have a long history of working with
25 investors of all types. And, as Ed mentioned, both

1 through our existing active equity mutual funds and
2 collective investment trusts.

3 So working within the current regulatory framework
4 that exists today, those funds opportunistically invest a
5 modest portion of their assets in later stage pre-IPO
6 private equity investments. And so while current '40 Act
7 regulations allow for up to 15 percent of a mutual fund's
8 assets be held in illiquid securities, the prospectus for a
9 typical Fidelity growth equity fund limits that to around 10
10 percent. And generally speaking, we're holding a lower
11 allocation than that in our funds.

12 And the reason I just point that out is we
13 currently have the ability, operating under the existing
14 regulatory framework, to expand access to pre-IPO private
15 equity investments for the benefit of mutual fund investors
16 at Fidelity, assuming our investment team feels that that's
17 in the best interests of our shareholders. I think it's
18 also worth noting that those equity funds and collective
19 investment trusts which allocate a portion of their assets
20 to private equity investments today have over six million
21 shareholders, with average customer fund position size of
22 approximately \$60,000. So there is a broad swath of our
23 existing individual investors who already have an indirect
24 exposure here. And, you know, we think that it's an area
25 that's not very well known to the community at large.

1 institutional intermediary as well as retail clients, to
2 meet their long-term goals and objectives and their needs
3 and preferences in particular.

4 So I think particularly relevant to today's
5 discussion is that, you know, we have been serving the needs
6 and preferences of millions of retail investors for decades.
7 And certainly, we're always trying to provide the best
8 customer experience we can for those investors. And we do
9 look for opportunities to innovate, to enhance customer
10 outcomes, and certainly to provide as much choice and value
11 as we can to our clients. At the same time, we're keenly
12 focused on ensuring our customers are provided the highest
13 level of investor protections and oversight of their
14 investments.

15 So it's with those objectives in mind that we look
16 forward to working with the Commission and the advisory
17 committee as we further explore opportunities to broaden
18 access to the private markets.

19 So let me spend a few minutes on how Fidelity's
20 individual investors access alternative investments today.
21 Let me start by telling a little bit more about some of the
22 characteristics of our asset management business. They're
23 not particularly well known. And what I'm referring to is
24 the fact that millions of our customers already are
25 indirectly invested in pre-IPO private equity companies

1 So additionally, I would just mention that we
2 offer a number of multi-asset class solutions, both mutual
3 funds as well as CITs, including the Fidelity Freedom Funds,
4 which invest in underlying equity fund building blocks,
5 which also have a modest portion of their assets allocated
6 to late-stage, pre-IPO private equity investments.

7 In our retirement plan business, which we refer to
8 as workplace investing, there are nearly four and a half
9 million participants holding an active or blended target
10 date solution that invests in those building blocks. And
11 the average participant position size in one of those target
12 date funds is approximately \$40,000. So again, I think this
13 just demonstrates that a large segment of our existing
14 401(k), 403(b) retirement plan participants are already
15 benefitting from a modest indirect allocation to late-stage,
16 pre-IPO private equity investments.

17 So I think, generally speaking, it's been, you
18 know, our historical experience that these active equity and
19 multi-asset class mutual funds, again, operating within what
20 is the existing regulatory framework, have been pretty
21 effective delivery vehicles for delivering non-QP, non-AI
22 individual investors with access to private equity
23 investments for a modest portion, of course, of their assets
24 in a diversified, suitable and, I think importantly, a cost
25 effective manner.

1 I'm certain that most of you in this room already
 2 know this but I thought it would be helpful to reiterate
 3 some of the key benefits and protections the mutual fund
 4 structure provides today. Daily liquidity, which is
 5 valuable to individual investors. And, you know, individual
 6 investors don't always know when they're going to need to
 7 access their savings due to a life event, such as a job loss
 8 or a sickness. And so daily liquidity is important, and the
 9 mutual fund structure provides that.

10 The professional active management of a mutual
 11 fund by an established market participant does provide
 12 access to attractive private market investment opportunities
 13 to the non-QP, non-AI retail investors that likely they
 14 would otherwise not be able to access. And even if we
 15 broaden access further, the question becomes are those
 16 investors going to get access to the best investments and
 17 the best opportunities in the private markets?

18 Mutual funds minimize concentration risk and they
 19 ensure appropriate diversification across holdings in the
 20 portfolio for the investor. And, you know, our active
 21 growth equity funds provide investors both public market as
 22 well as private market exposure at attractive fees, and
 23 there is no minimum investment required. So these are
 24 extremely accessible vehicles today for getting access to
 25 both parts of the market.

1 And then finally, it's worth noting that retail
 2 investors that have accounts that are held on our Fidelity
 3 personal investing platforms, so our retail direct-to-
 4 consumer platform, have access to more than 100 liquid
 5 alternative investment options that are managed by third
 6 parties in the mutual fund structure. And they can be
 7 purchased in their accounts with no transaction fees. So
 8 for clients that are looking to diversify their portfolios
 9 with exposures that have a lower correlation to traditional
 10 asset classes such as stocks and bonds, they do have options
 11 available to them today in the marketplace. And these
 12 liquid alternative products include long-short equity,
 13 market-neutral equity, options-based strategies, currency,
 14 long-short credit, et cetera, and multi-alternative
 15 strategies. So the breadth of what's available to retail
 16 consumers in the market is considerable today.

17 As far as individual investor demand for private
 18 security investments, you know, the qualified purchasers and
 19 accredited investors we serve have demonstrated some
 20 interests in dedicated private equity vehicles such as
 21 limited partnerships that my colleagues were referring to
 22 earlier. In our direct-to-consumer platform, we serve more
 23 than 45,000 qualified purchasers today and over 700,000
 24 accredited investors directly. And we provide those
 25 customers under the current regulatory framework with access

1 to private funds through either proprietary vehicles or
 2 referral to third parties that manage those solutions for
 3 them. And, you know, this is an area we're certainly quite
 4 focused on continuing to expand in and expand our capability
 5 set, in order to make sure that we're providing the high net
 6 worth investors with access to a comprehensive set of
 7 investment options.

8 I'd say in contrast, we have not historically
 9 observed a tremendous amount of demand from non-QP, non-AI
 10 investors with lower assets for dedicated, illiquid private
 11 funds. Now, certainly, they're not accessible to them
 12 today, so that's probably driving that demand profile a bit.
 13 But we're not hearing from our non-QP, non-AI investors that
 14 there's a huge demand here.

15 Rather, I think it's safe to say that many if not
 16 most of these retail investors tend to gravitate towards
 17 goal-based, outcome-oriented diversified investment
 18 solutions. They are helping them meet a life need, such as
 19 saving for a house or saving for retirement, saving for
 20 college. And what was discussed earlier, I think, in
 21 particular generating enough income in retirement to ensure
 22 that they can live comfortably and cover their health care
 23 costs.

24 So I think with all that said, I would just
 25 reiterate, you know, we certainly look forward to working

1 with the Commission and the advisory committee to explore
 2 additional opportunities to further broaden access. But as
 3 we collectively sort of explore this opportunity, I think
 4 there are a number of questions and considerations that
 5 should be at the forefront of these deliberations. And
 6 that's where I wanted to spend the remainder of my remarks.

7 So here are some additional questions for
 8 consideration by this group. So first, what is the optimal
 9 allocation of an investor's assets to private equity or
 10 other alternative investments? For an individual investor,
 11 the appropriate allocation to any asset class is typically
 12 determined by multiple variables, including their time
 13 horizon, their liquidity requirements, their investment
 14 objectives and their risk tolerance. So determining the
 15 allocation to alternative investment exposures including
 16 private equity should be approached in a very consistent
 17 manner as we go forward. We should be very thoughtful
 18 before making a general assumption that all retail investors
 19 are underallocated to alternative investments, including
 20 private equity. It's not likely a one-size-fits-all
 21 solution. And we need to make sure that we're cognizant of
 22 the individual investors' needs and preferences as well as
 23 where they are in their life stage and what their goals and
 24 objectives are.

25 Second, specific to private equity, does it

1 provide an appropriate portfolio level diversification
 2 benefit to the individual investors? Over the last 10
 3 years, Cambridge Associates Private Equity Index has had a
 4 pretty high correlation of .77 with the U.S. public markets.
 5 So the question would be, are there other alternative asset
 6 classes that might provide a better diversifying exposure?
 7 For example, direct real estate, commodities and other
 8 things that happen to have a lower correlation to U.S.
 9 public equity markets than private equity.

10 The third point, staying on the topic of
 11 diversification, should a retail investor diversify their
 12 equity investments further geographically prior to
 13 increasing their allocation to illiquid U.S. private equity
 14 securities? So while it's true the number of listed
 15 companies in the U.S. has dropped from a peak of just over
 16 8,000 in 1996 to approximately 4,400 at the end of 2018,
 17 during that same period of time the number of listed public
 18 companies globally including the U.S. has grown from just
 19 over 36,000 to 43,000. So there remains a significant
 20 opportunity for investors to continue diversifying their
 21 equity investments in the public markets globally. And
 22 we've found, through our experience with retail, self-
 23 directed investors in particular in our direct-to-consumer
 24 platform that they're often quite underweight to
 25 international and emerging markets public equities. So what

1 is the hierarchy, if you will, of diversification that we
 2 need to think about for those customers?

3 Fourth, you know, can we broaden access in a
 4 manner that ensures reasonable and transparent fees that
 5 investors understand and that are commensurate with expected
 6 returns? For example, as of June 30, 2019, the Russell 1000
 7 Growth Index outperformed the Cambridge Associates Private
 8 Equity Index on a one-year, a three-year, a five-year and a
 9 10-year basis. A Fidelity retail investor can purchase an
 10 indexed mutual fund benchmarked to the Russell 1000 Growth
 11 Index for as low as three and a half basis points with no
 12 minimum initial investment. They can purchase an active,
 13 large-cap growth equity fund managed by Fidelity that's
 14 outperformed the Russell 1000 Growth Index on a three, five
 15 and 10-year basis for less than 100 basis points with no
 16 minimum initial investment. And, as an aside, that fund
 17 invests a modest portion of its assets in private equity
 18 today. So we need to be confident that a dedicated private
 19 equity vehicle for non-QP, non-AI retail investors would
 20 compare favorably to these types of existing investment
 21 options from a fee and expected return perspective.

22 Next, what is the optimal delivery vehicle and
 23 client experience for achieving broader access? Is a
 24 dedicated, illiquid vehicle of private equity investments
 25 appropriate for a non-QP, non-AI investor? Or is a

1 professional managed fund, fund of funds, multi-asset class
 2 solution or managed account with daily or periodic liquidity
 3 a more appropriate delivery vehicle for providing exposure
 4 to private equity and other diversifying alternative
 5 investments? I mean, those vehicles often today provide
 6 access to alternative asset classes and in some instances to
 7 private markets.

8 Next, if we broaden access to dedicated, illiquid
 9 private market funds, can we ensure that the lower asset
 10 retail investors in those funds receive similar access to
 11 attractive investment opportunities that QPAI clients
 12 receive today? The current regulatory framework governing
 13 pooled vehicles such as open-end mutual funds enables
 14 individual investors to leverage the scale of large market
 15 participants like Fidelity to gain access to the most
 16 attractive late-stage private equity investments. Dedicated
 17 illiquid private equity funds that accept investment from
 18 non-QP, non-AI investors, if we broaden access there, should
 19 provide a similar experience.

20 And then finally, if we broaden access to illiquid
 21 private funds, can the client experience be streamlined and
 22 simplified for the individual retail investor? Private
 23 funds often have very complex terms and legal documentation
 24 requiring costly review by an attorney prior to investing
 25 and this may be cost prohibitive to retail investors.

1 Furthermore, individual investors may struggle to understand
 2 all of the terms associated with private funds, in
 3 particular the concept of capital commitments, capital calls
 4 and lockup periods. Additionally, private funds can have
 5 complex tax treatment that results in delivery of K-1s and
 6 often requires utilization of a tax professional for
 7 incorporation into an investor's returns. This can be
 8 pretty confusing and costly to even the most sophisticated
 9 individual investor. So in this space, investor education
 10 is going to be critical.

11 So I think, you know, to summarize those seven
 12 questions, I think it's, you know, in short, it's going to
 13 be very crucial that we are able to deliver a streamlined,
 14 transparent, digestible and affordable end-to-end customer
 15 experience for non-QP, non-AI investors if we are going to
 16 broaden access to that population. And that's just really a
 17 sampling of the questions that I think this committee and
 18 the Commission will need to consider as we think about this
 19 particular question.

20 And I just close with my opening remarks and we
 21 can take questions by stating that, you know, Fidelity has
 22 always supported customer choice and our history shows, you
 23 know, we've made a lot of innovations that provide greater
 24 access to a range of investment strategies, products,
 25 solutions, vehicles, structures. And those values are going

1 to continue to guide our approach to customer service and
2 the development of investment products and solutions for our
3 customers. And I think when it comes to how to broaden
4 access to the private markets and in particular to private
5 equity for non-QP, non-AI investors, there are a number of
6 complex issues that this group is going to need to consider.

7 But it is instructive to recognize to the extent
8 at which individual investors already benefit from access to
9 pre-IPO equity through mutual funds and other pooled
10 vehicles offered by Fidelity and some of the other firms
11 represented here today.

12 And with that, I'd just say that, you know, we
13 look forward to further exploring this interesting
14 opportunity with the group. Thank you.

15 MR. BERNARD: I thank the panelists for covering a
16 ton of material. And sure enough, they kept to their time.
17 We still have 20 minutes for questions.

18 So, Joe.

19 MR. SAVAGE: Thanks, Ed. I'm Joe Savage, I work
20 for FINRA. And I just wanted to give a similar disclaimer
21 that whatever I say here doesn't necessarily reflect the
22 views of the FINRA board or FINRA staff or my wife and kids,
23 for that matter.

24 So listening to these presentations, I kept having
25 a question go through my head constantly. Which is, what do

1 we mean by private equity? And you know, obviously, there's
2 tons of -- you know, millions of, you know, unregistered
3 private companies in the United States, ranging from
4 unicorns down to one-person LLCs. I'm assuming this data
5 doesn't cover the one-person LLC.

6 But more than that, the reason this hits home for
7 me is one of the things FINRA does is it reviews certain
8 private placements. And these -- these are not the deals
9 that just go to the, you know, the institutional investors
10 and venture capital funds. These tend to be the deals that
11 go down to the retail investors who meet the AC definition.
12 Some of these deals are situations where the issuer has
13 already used up all of its venture capital. The VC fund
14 says, sorry, that's it, so they look for other investors and
15 they're going after retail investors at that point. Some of
16 these entities are not going concerns anymore so you're kind
17 of wondering what they're going to do with the money.

18 So I'm wondering, do you -- can you explain, at
19 least for my benefit, what does private equity mean? Is it
20 -- what are the thresholds? Are there asset sizes or
21 revenue thresholds or does it depend on who the investor is?

22 MR. FINLEY: Well, just distinguishing, so you
23 start with private markets, private equity. Private markets
24 can be anything, real estate, private debt, natural
25 resources, infrastructure. So then if you go to private

1 equity, that can include different stages. So venture --
2 for Prequin, which does these stats, usually includes
3 venture as part of private equity. You'd have venture,
4 you'd have growth which is later stage, and then you'd have
5 private equity, which can be middle market shops, it can be
6 the big shops like Apollo and Blackstone, and that's the
7 range. And that is going to take up, you know, virtually
8 almost any firm that you run across.

9 Now, it may be at FINRA you're going to see some
10 firms that wouldn't be the 98 percent of what I just
11 covered, but that's the basic core of private equity.

12 MR. PENZONE: I would just add, when I was
13 referring to sort of pre-IPO venture capital, private
14 equity, sort of start with what I think one of the general
15 problem statements or considerations here has been, which is
16 companies are staying private longer. And therefore, how do
17 we get access to later stage companies that maybe
18 historically would have been public entities already for
19 customers who don't have access to them today? And as I
20 mentioned, currently, a number of not just our products but
21 funds from across the industry, some from T. Rowe Price, for
22 example, as well, invest in those deals. And so it's a
23 mechanism for what I was referring to as sort of late-stage,
24 pre-IPO venture capital.

25 MR. FINLEY: The only other -- one other -- there

1 are thousands of private equity firms. And that's one of
2 our concerns, which is as you expand into the retail
3 universe, how do you make sure that retail investors are
4 protected and there is the adequate transparency and
5 experience and scale? Some of it, that's one of the
6 advantages of the target date fund, because you have an
7 intermediary and you also can -- the target date fund
8 investor, you could restrict the way it happens. That is,
9 the private equity firm that can come into a target date
10 fund or could be a fund of funds would be -- would be only
11 funds that have substantial institutional capital. Because
12 that way, you are avoiding funds that are 100 percent retail
13 that can't attract institutional capital.

14 MR. GARCIA: So, John, I'm going to follow up with
15 you, if you don't mind. So is it the SEC's role to somehow
16 standardize these documents or standardize all the legal
17 paperwork and so forth so these investors are protected?
18 Who is going to protect them? And how do you make sure they
19 have the right information to make choices among all these
20 different funds?

21 MR. FINLEY: The SEC is both in the protection
22 business and the choice business. So these are -- like
23 what's the definition of negligence? These are all -- they
24 require a balance. And from our point of view, the SEC in
25 looking at the protections, what are the ways as they make a

1 change that there can be adequate protections and yet
 2 preserve choice? And so as it is with reporting generally,
 3 there can be transparency that they put in. There can be --
 4 that are required. But I'll come back to, again, I think
 5 the best protection for retail investors is you allow
 6 private equity, would be firms that have a very strong
 7 institutional component. Because then the retail investor
 8 is leveraging off of, drafting off of the institutional
 9 player.

10 And I also -- it's a pretty easy fix. You know,
 11 providing more flexibility for either target date funds is a
 12 very discrete way of doing it in a pretty safe way of
 13 allowing more entry into private equity. It addresses
 14 Colby's concerns, whether they're overstated or not, others
 15 can address. But certainly by putting it through a
 16 registered investment adviser into that target date fund,
 17 you get both diversification and the additional layer of
 18 protection.

19 MR. DURBIN: Since the mic's on, Stephanie for you
 20 and John in particular, perhaps, I'm assuming but I'm happy
 21 to have others debate this, that if we see a further -- a
 22 greater democratization of access to these products, it
 23 likely passes through an intermediary rather than a leap to
 24 broader direct to consumer as the leapfrog. I'm assuming
 25 that likely shows up through professional intermediaries

1 exposures to the underlying private markets.

2 So the evolution, as I've seen, having started off
 3 actually at JP Morgan in the alternative investment group
 4 that was that intermediary was a learning curve of education
 5 and it's obviously quite significant in those populations to
 6 date. I'm sure that, just building off of some of the
 7 comments that Colby made, that there would be a natural
 8 evolution in education in the additional channels that would
 9 then start thinking about this exposure as a percentage, as
 10 appropriate, with suitability, et cetera, as those
 11 conversations were potentially allowed to evolve.

12 So clearly, there is one framework right now for
 13 allocations and diversification without -- without the kind
 14 of regulatory changes that could be potentially envisioned
 15 where there would be an evolution over time. So education
 16 clearly would continue in channels where it's less relevant
 17 today.

18 MR. FINLEY: I would just circle back to one of
 19 the points I made before, which was the role of the
 20 intermediaries is critical and we play a big role in
 21 educating those intermediaries with something called
 22 Blackstone U and we bring in the intermediaries to inform
 23 them about the products, educate them about the products.
 24 When we have independent broker-dealers, we work with them
 25 in terms of what materials are provided to investors,

1 first on its way to broader consumer access.

2 If you believe that, can you two comment on what
 3 you think is the state of the financial intermediaries'
 4 ability to position these kinds of exposures in portfolios?
 5 You know, how steep is the learning curve, what you're doing
 6 to try to educate? Because it's a short path to these being
 7 sales practices issues, if you agree my assumption, my
 8 assertion that they pass through financial intermediaries.
 9 I observe that the curve is still quite steep to really
 10 understand how to engineer some of these exposures into a
 11 portfolio. I'd just love your comments on what you're doing
 12 to help with that learning curve and the state of that
 13 curve.

14 MS. DRESCHER: Sure, I'm happy to start and pass
 15 it to John. So can everyone hear me? So look, a lot of the
 16 interactions that we've had to date, admittedly with more of
 17 the high net worth buyer of today, is through
 18 intermediaries, whether it's the banks, private banks,
 19 wires, increasingly RIAs. Multi-family offices, I think, is
 20 another form of intermediaries. And that base of education
 21 is quite strong.

22 I think even in Colby's remarks, as he speaks to
 23 the experience at Fidelity in different ways through
 24 different structures, also a good wealth of experience that
 25 could be expanded over time to include more variety of

1 oversight of those materials.

2 And taking one of the points you made, the
 3 combination of the intermediary and putting investors in
 4 more funds that have more diversification, whether through
 5 multi-asset or the fact that it's the target date fund, is
 6 really -- it may not be the end point but it is a way to
 7 sort of move down what ILPA was saying, which obviously
 8 doesn't represent retail investors. Saying, look, the way
 9 we think, we look at it, we think the target date funds make
 10 the most sense.

11 But in that, it would be independent broker-
 12 dealers who really are the ones that we see are dealing with
 13 the mass affluent going from, let's say, 100,000 to a
 14 million, that independent broker-dealer working with them,
 15 overseeing them, is a major part of how we would see it
 16 playing out. And that really goes to thinking through,
 17 well, how do you -- let's say you say to yourselves; you
 18 know, I don't have any worries about Apollo doing this but,
 19 you know, we've got thousands of firms out there. That's
 20 another area to be thinking about, as you open up the
 21 floodgates.

22 You saw the bad experience in the REIT area, in
 23 the entre to REIT area. Now BREIT, really, one of the big
 24 selling points we had, we're going to bring in
 25 institutional, high quality, lower commission framework to

1 that industry. How do -- as you sort of look at it, how do
2 you channel ways in which that can happen?

3 MS. BECK: Speaking of suitability, one of the key
4 things I think about a lot is how -- how do these fit in a
5 portfolio? How do you bring things that don't have mark to
6 market alongside those that don't?

7 Stephanie had a Sharpe ratio slide, where you
8 talked about volatility de-smoothing. I was wondering, what
9 are your thoughts about how do you make sure there's not
10 misleading combining of these assets together in portfolios
11 and portfolio risk and performance metrics? How do you
12 approach it?

13 MS. DRESCHER: Look, the experience to date has
14 been more on the institutional side, although clearly
15 there's data points and experience throughout the products
16 that have been offered in the channels that we've spoken
17 about. So private banks work through this, the RIAs work
18 through it. Increasingly, others will. So the context that
19 I shared is reflective of a broad data set of underlying
20 investors, predominantly institutions, that are taking
21 advantage of the asset class to date.

22 I think going forward, and I don't spend, you
23 know, my time on kind of portfolio construction, so I am
24 sure there are others that can give you that much more
25 insight. But clearly, there's work to be done to make sure

1 assertion that riding on institutional investors' coattails
2 is an appropriate safeguard for a retail investor. Because
3 institutionally, we think very comprehensively about the
4 risks that we're taking when we do invest in private market
5 vehicles. The underlying leverage that's used in the
6 investments, the lack of liquidity. The overall
7 diversification scheme that we employ in investing our
8 clients' money and what this brings to that diversification
9 scheme in total in terms of return and risk.

10 So, number one, why is it appropriate to just ride
11 on the institutions' coattails? And then, secondly, what
12 else do you suggest should be added to this safeguard,
13 because that can't be the only one.

14 MR. FINLEY: The context in which I'm looking at
15 the institutional investor is not simply, well, if an
16 institutional investor can invest in the fund, then private
17 equity investors should be able to invest in the fund. So
18 that's sort of the test as to whether it's a fund that's
19 accessible. I was really thinking it more if you were to
20 have either a target date fund or a multi-asset fund,
21 because right now in terms of the fund of funds, you have to
22 be an accredited investor to get into that as you manage
23 funds. And if you had an intermediary investing funds and
24 then picked funds that had that, the intermediary picked
25 funds that had the institutional, to me that would provide

1 that we focus on the right percentages of the whole. And
2 that's been done for decades now, for the institutions and
3 high net worth individual investors that are taking
4 advantage of private market exposure, as broadly defined,
5 private equity, credit, infra, natural resources, and
6 understanding the liquidity or illiquidity and correlation
7 or lower correlation of each of those and how it relates to
8 their time horizons, their objectives in terms of liability
9 needs and making sure that there's an overlay, understanding
10 their specific objectives.

11 So it absolutely has been done and can be applied
12 more broadly, depending on the needs to that underlying
13 investor.

14 MR. HALL: I wanted to follow up with John a
15 little bit. Because in your initial comments and in your
16 subsequent comments, you've talked a lot about how being
17 able to kind of ride on the coattails of institutional
18 investors is a great protection for retail investors who
19 want to access private equity. So professionally, I've
20 spent a lot of time on private equity, working through the
21 two asset allocators or three asset allocators that I've
22 represented over time and that exposure has definitely
23 suggested to me, you know, I'd love on an individual basis
24 to have access to these returns.

25 But I'm curious why you are so strong in your

1 an additional layer of protection because that, as a target
2 date fund, if you then are picking funds that institutions
3 have looked at the fees and the transparency and all the
4 other issues like that, that would provide a level of
5 protection. Of course, you have to make an independent
6 decision, am I going to make this fund available to -- a
7 registered investment adviser would have to make -- you'd
8 have really two layers. You'd have an investment -- an
9 independent broker-dealer with fiduciary duties who's
10 saying, I think it makes sense to put my customer in here,
11 and you'd have to have a manager who's saying, I think it
12 makes sense to be able to market this to retail. To me,
13 that provides some layer of protection.

14 In terms of what else protections that you need,
15 not being exhaustive with it but, again, as we think about
16 we want to change the definition of accredited investor or
17 provide more flexibility, we don't put bells and whistles on
18 that but it's only for a certain -- like how are we going to
19 provide an additional layer of protection? We rely on the
20 investor expertise, we rely on the adviser, either the
21 independent broker-dealer or the registered investment
22 adviser to provide more expertise, and that provides layers
23 of protection.

24 MR. PENZONE: I would like to just add something
25 to that, because there's a lot of discussion around target

1 date funds on this particular topic. And I think our
2 experience, we manage a reasonably sizeable target date
3 franchise. And it has certainly been our experience on the
4 institutional side of that where we will have very large
5 institutional clients, plan sponsors, you know, large
6 companies and consultants, that have occasionally requested
7 certain exposures to alternative investments, which you can
8 deliver, you know, in a customized fashion. Historically,
9 that's largely been sort of small exposures to real estate,
10 or direct real estate, versus private equity or increased
11 private equity.

12 But I think there's something to keep in mind
13 that's very practical from an implementation perspective on
14 target date products. Which is, the defined contribution
15 market and the clients in that market, plan sponsors and
16 consultants, tend to be very focused on, A, their fiduciary
17 responsibilities and, B, pricing is very important to them.
18 And so whether or not there is a significant expansion in
19 the regulatory framework to allow increased amounts of
20 illiquid investments into a target date structure, and that
21 can be debated, of course, by the group and the Commission,
22 but I think the practical uptake of that is -- is likely to
23 be somewhat muted, simply because these investment exposures
24 have fairly significant manager selection overhead. Right?
25 So you need to make sure it's the right managers managing

1 the exposures. And it can be very expensive. And so
2 therefore it can change the pricing dynamic and increase the
3 overall expenses associated with that target date exposure.

4 And I think as some of the previous panelists
5 said, the surest path to success or a good outcome in saving
6 for retirement is saving more, saving frequently, staying
7 invested and being diversified. Now, certainly, I think
8 there can be a lot of debate around increased
9 diversification to other types of asset classes could
10 provide a very positive risk premium that is good for the
11 overall outcome. But I think that has to be balanced with
12 the practical implementation considerations of increased
13 cost and perceived fiduciary risk associated with increasing
14 that type of exposure.

15 MR. FINLEY: Can I respond to that? Yeah, so
16 that's true, if you're looking at 401(k)s, you're looking at
17 the DOL space, it is a lowest cost provider is often the
18 route. But that's partially because that is what's
19 encouraged by our courts and litigation, and that and
20 inertia. And there has not been -- those who have sort of
21 stepped out a little bit to offer a higher-priced product
22 have gotten hit. And it's really an issue whether DOL would
23 want to focus sponsors, that we really need to look at cost
24 on a net basis.

25 And you're right, on a net basis, if it's higher,

1 so be it. But if you're just looking who's providing the
2 lowest fees and encouragement that that's not really the way
3 to look at it. You really need to look at a level of return
4 based on cost relative to that level of return that's
5 available. Because it -- right now, the 401(k) space is
6 limited to CITs. Certainly, that's another area the SEC
7 could look at, expanding to mutual funds, which have their
8 own benefits, and it's outside the scope generally of DOL.

9 But in the 401(k) space, that certainly is an area
10 that, if you look at somebody who's young, who's not in a
11 defined benefit plan, trying to replicate what they can get
12 through a pension plan with higher exposure to alternatives
13 on a cost effective basis, on a net basis, if it's not the
14 right solution, so be it. But it shouldn't be because of a
15 discouragement and a fear of litigation.

16 MS. HATHI: I actually had a question for Colby.
17 So you talked about the protections of the mutual fund
18 structure and the 15 percent limit on the private
19 investments, and that Fidelity funds, in the prospectus, you
20 limit to 10. And then typically, a lot of your funds are
21 actually much lower.

22 And I'm curious, if you think about if there was a
23 demand from your mass affluent client base, your retail
24 investor client base, to have more exposure to private,
25 would that change the way that you manage those portfolios?

1 And is that -- and what has driven the below 10 percent?
2 And is that an opportunity, if there is a desire to get more
3 access to the private markets?

4 MR. PENZONE: Yeah, so a couple of things there.
5 So I think, first and foremost, you know, the mutual fund
6 structure in our growth equity portfolios are typically, you
7 know, positioned as largely being public market exposures.
8 And so that's, you know, what we view we're delivering to
9 our clients. And the private piece of it is often an
10 opportunistic investment. So when there's opportunity in
11 the marketplace to make an investment that is incrementally
12 beneficial from the potential for driving alpha in the
13 portfolio, they're going to make that. But I think
14 liquidity concerns, ensuring that there's always appropriate
15 level of liquidity in the portfolio, how the fund is being
16 positioned, which is typically relative to a public market
17 benchmark, and making sure that there is an opportunistic
18 opportunity, you know, in the portfolio and in the
19 investment is what we're primarily looking at.

20 So I don't think that if there was increased
21 demand in the mass affluent space where customers were
22 saying we want more, that it would necessarily drive it.
23 But I think the most important thing is that we certainly
24 have opportunity to increase it if we feel that it's in the
25 best interests of our shareholders and that's a decision

1 that's being made by the investment organization and the
 2 investment managers of those particular products.
 3 MR. SIRRI: I just wanted to try and understand
 4 how correlated these assets were. I think, John, you
 5 mentioned -- excuse me. Colby, you mentioned 77 percent --
 6 MR. PENZONE: Point seven seven.
 7 MR. SIRRI: Yeah, I'm sorry, .7, but John, you had
 8 mentioned they were relatively uncorrelated.
 9 MR. FINLEY: I was saying private markets. And I
 10 think what you're -- what Colby's point was about private
 11 equity more -- and I was saying that private markets was not
 12 highly correlated. Again, private equity is still not an
 13 overlap with the S&P; otherwise, it wouldn't show higher
 14 returns over time. And Colby mentioned time frames of one,
 15 three and 10 years. We tend to look more 15, 25, 30 years.
 16 Just because, you know, the market's long. Some of the
 17 studies go back to the '30s.
 18 So a little bit how much correlation and how much
 19 it's the same, whether it's competing is when you turn the
 20 faucet on. And if you turn the faucet on one and three
 21 years, you're just going to get a very different answer than
 22 20 and 30 years.
 23 MS. DRESCHER: And when you look at underlying
 24 asset classes, because what you're hearing is, I think, a
 25 need to speak about alternative investments, private

1 investments, and then within that, numerous underlying asset
 2 classes. If you remember the beginning of, maybe slide two
 3 or three of my presentation, when you look at the
 4 risk/return spectrum and you look across what you can see
 5 within private equity, credit, real assets, is a number of
 6 underlying exposures where it's not one size fits all. It's
 7 different, depending on the needs of the investor and where
 8 it fits in the portfolio.
 9 So I know we're using lots of labels. I think
 10 maybe one -- one goal is you kind of go through and looking
 11 for analysis is that appreciation of the breadth of
 12 opportunity that now exists --
 13 Just quickly summarizing, I was mentioning that
 14 private markets is quite broad now and has great depth in
 15 what it can offer an investor, broadly defined. So labels,
 16 I think, are something to make sure that we parse through.
 17 because when you look at private markets, they can offer
 18 different correlations, depending on the underlying asset
 19 classes. They offer different liquidity both based on the
 20 nature of the asset as well as the structure that they're a
 21 part of. And they have different characteristics. So
 22 credit versus private equity versus real assets and the
 23 options within those areas are all within kind of an
 24 umbrella but offer the underlying investor a variety of
 25 different attributes.

1 MR. SUBRAMANIAM: A couple comments. I get the
 2 sense from Colby everything is okay. But I'd say, you know,
 3 the fact that you have illiquid investments in a daily
 4 liquidity vehicle just seems incongruous, right? I think
 5 that's one point. So I think it's a very imperfect solution
 6 that mutual funds can have some unlisted investments.
 7 To Stephanie and John, obviously, you know, biased
 8 the other way of great access to private markets. I take
 9 issue with the Sharpe ratio, as well, the smoother Sharpe
 10 ratio. And I Cliff Aston has had a comment on this in the
 11 last couple of weeks about you don't get smacked with the
 12 volatility, there's no market price and therefore your
 13 volatility is lower.
 14 I think the main issue is actually transparency of
 15 pricing of those investments and the lack of liquidity, and
 16 whether it's a combination of educating people in the lack
 17 of liquidity as the quid pro quo for investment returns,
 18 whether it's trying to bring more liquidity to some of these
 19 markets. You know, the REIT space is relatively easy, even
 20 some of the private equity markets when late stage
 21 companies, pre-IPO, you can think about -- and there are
 22 some marketplaces out there for them.
 23 But I didn't hear a lot about, you know, kind of
 24 the price of illiquidity as a tradeoff, and probably a fair
 25 tradeoff, for the returns on these investments, and somehow

1 trying to -- trying to measure that as one of the ways of
 2 measuring relative performance as well as trying to bring
 3 liquidity to some of these markets.
 4 MR. FINLEY: Two points. One, if you're saving
 5 for retirement and you're a 25-year-old, whether you're in a
 6 401(k) or outside a 401(k), the idea that as you save for
 7 retirement you want to maintain 100 percent liquidity for
 8 the entire period makes no sense to me. So you have to
 9 sacrifice some illiquidity and it makes sense if you're
 10 convinced you can get better returns overall and a better
 11 composite mix of investment to have a better return over
 12 time. That's like one of the things you have to decide as
 13 you sort of look at this. Number one, the private markets
 14 do offer better returns.
 15 There is a -- in our materials, we show that you
 16 do get better returns with more illiquidity. There is an
 17 illiquidity premium, in effect. And with the mutual funds
 18 that provide, whether it's 10 percent, 15 percent, 25
 19 percent, that liquidity in my mind still can be managed
 20 pretty well. I think you -- it sounds like you're a little
 21 bit skeptical that you move up, have a fund that has 15
 22 percent liquidity -- illiquidity and be able to manage
 23 redemptions. But I don't think it's any different than a
 24 bank being able to manage the fact that it's put out some
 25 money and it can't meet the demands of the day.

1 The one thing I would let you -- you should take a
 2 look at the stats, because it's sort of interesting, by
 3 analogy in the 401(k) space. The actual amount that people
 4 look for to take the loans and to get loans because they
 5 have that emergency, it's extremely low. And in fact, the
 6 degree to which people transfer securities is extremely low.
 7 It may not be as low as below 1 percent, but it's in the low
 8 single digits. And it's reflective of again, as you
 9 approach this and you look at this, you know, to what extent
 10 do we want to provide liquidity at the cost of returns?
 11 Because that really is a fundamental issue that you just
 12 raised. How much of a benefit are you getting? Some of the
 13 materials show that you get better returns with more
 14 illiquidity. And is it worth it? Is it worth the cost?

15 And as you look at that, the degree to which
 16 people look for liquidity on average, which I think is the
 17 relevant way to look at it, is something that you should
 18 study. And I think the 401(k) space offers an interesting
 19 insight into that, given the numbers are so low.

20 MR. BERNARD: So we're 10 minutes past time. I
 21 think it was 10 minutes well spent. So thank you all for
 22 that engaging conversation.

23 But at this point, I'm going to ask if we could
 24 thank our presenters?

25 (Applause.)

1 industry speakers. And I'm particularly grateful that
 2 Raquel Fox, who is director of the SEC's Office of
 3 International Affairs, will join us for this discussion. So
 4 let me quickly introduce everyone and then we will just take
 5 it from the top.

6 So Alex D'Amico, who is next to Raquel, is a
 7 senior partner in McKinsey's asset management insurance
 8 practices. He'll provide the foundation, addressing gross
 9 scale key trends for global asset management, much as we did
 10 this morning largely with the U.S. market. There were a few
 11 brief mentions of global markets. So he's going to cover
 12 the world. But we've only given him 15 to 20 minutes to do
 13 that. But I saw he had an exceedingly brief deck. But I'm
 14 sure it will be more than four minutes.

15 And then the director of the SEC's Office of
 16 International Affairs, Raquel Fox, will then take -- we
 17 really only allocated her five minutes and she graciously
 18 agreed -- to explain the role of her office and the current
 19 scope of the SEC's activities engaging with regulators
 20 around the world. And to be clear, while we have limited
 21 time today, the reason for that is we wanted the committee
 22 to be aware of it as and when we as a group decide to do
 23 further work on global regulation and maybe form a
 24 subcommittee around it. We will obviously take time to have
 25 a better understanding of what they're already doing, so

1 MR. BERNARD: And we are going to take a lunch
 2 break and be back at 1:45.

3 (Whereupon, at 12:40 p.m., a luncheon recess was
 4 taken.)

5 AFTERNOON SESSION
 6 GLOBALIZATION OF ASSET MANAGEMENT

7 MR. BERNARD: We will reconvene. Thank you all
 8 for being prompt.

9 As our SEC colleagues can attest, gone are the
 10 days when overseas regulators just followed the example of
 11 U.S. markets and regulators. I suspect there was a
 12 particular turning point with the global financial crisis
 13 and lots of fingers being pointed. But nevertheless, that's
 14 no longer the case, if it ever was.

15 They are increasingly active in advancing their
 16 own views and regulations that don't always align with U.S.
 17 practice. This is a vexing challenge for global asset
 18 managers, and I would argue it has material impact for U.S.-
 19 only managers as well, because it impacts the structure of
 20 the market, it impacts the ways regulations have to be
 21 managed and so forth. So I've thought for some years that
 22 it's ill advised for a U.S.-only manager to think that this
 23 doesn't affect them.

24 We think it's important to understand this dynamic
 25 as we begin our work. And I'm delighted to have four

1 that we're not recommending to them things that they already
 2 do. But this is more just to make an introduction for the
 3 office, if you will.

4 After Raquel, Dan Waters is a Harvard-trained U.S.
 5 securities lawyer who has spent over 20 years working for
 6 U.K. regulators, the FSA, now FCA, including as the asset
 7 management sector leader. More recently, he was the
 8 founding managing director of ICI Global, the international
 9 arm of the Investment Company Institute in the U.S. So he's
 10 been dealing with regulators all over the world. And he has
 11 the tough task of summarizing global regulatory trends in 20
 12 minutes.

13 And after those three speakers, we've asked our
 14 other two speakers to discuss a mini case study regarding
 15 MiFID II and the specific issue of payment for research,
 16 which I was saying over lunch to someone -- and, if you can
 17 imagine, giving them each 10 minutes. This is craziness. I
 18 am grateful to them for taking on this task. It is, to me,
 19 one of the more vexing compliance issues I've seen in my
 20 career. So they will each have 10 minutes and provide an
 21 example of the significant impact of foreign regulations as
 22 well as how they can affect different firms differently. So
 23 we've got a large firm and a smaller firm telling us how
 24 something like MiFID II is affecting them.

25 So those two folks, Paul Royce is the senior vice

1 president and senior counsel of the Funds Business
2 Management Group of Capital Research and Management Company.
3 You may have heard of them. Prior to joining Capital in
4 2005, he was the director of the Division of Investment
5 Management at the SEC.

6 And Jason Vedder, to his right, is head of the
7 domestic and international trading function and a member of
8 the business management committee at -- is it Driehaus,
9 Jason? -- Driehaus Capital Management.

10 So I think we've got a great panel. And with
11 that, Alex, if you could sort of get us oriented to what's
12 going on around the world?

13 MR. D'AMICO: I thought I would do two things this
14 afternoon. I would talk a bit about where the markets are
15 today and what they'll look like in about five years, just
16 from a total AUM flow standpoint. And then to highlight
17 five trends that we see unpacking the markets and the asset
18 management industry more broadly. Many of these are
19 operating in the U.S. What I will do is try to give an
20 international patina to them. There are some important
21 differences obviously between the U.S. and other markets.
22 And even within regions, we're seeing some pretty meaningful
23 differences I'm going to call out.

24 I am going to share some data that comes from our
25 global growth cube. It's a proprietary model that looks at

1 net flows. And so when I'm talking about net flows, I'm
2 talking about inflows minus outflows, or net new money. We
3 think that's actually the best measure of organic growth for
4 our market. We don't pay as much attention to money in
5 motion. That is, essentially, you know, one pocket to the
6 other. That said, obviously, there's real differences in
7 velocity of money in motion across markets. But we're
8 simply looking at inflows minus outflows, right? So just
9 the quantum of assets that are coming in. You look at
10 inflows minus outflows, you look at asset appreciation, that
11 gives you change in AUM.

12 And again, these are all third party managed
13 accounts. And it does include money market funds, excludes
14 cash deposits. And it excludes things like a pension fund
15 running an S&P 500 strategy on its own. We would say that's
16 a non-managed account. You know, an insurance general
17 account running a fixed income strategy on its own, again,
18 non-managed account. Right? Non-third party managed.

19 So with that in mind, a couple of comments on the
20 overall market. First, 104 trillion is where we think we
21 ended the year at 2019, still doing the final number
22 crunching. This is a significant, significant improvement
23 over the end of 2008, where we were at 42 trillion. Right?
24 So by any stretch of the imagination, if you look at the
25 highest, you know, sort of, you know, highest number

1 possible AUM, the industry has recovered, recovered nicely
2 from the financial crisis. That said, we would say, in
3 terms of the industry's performance, very interesting in
4 terms of operating leverage and margins across the industry,
5 as you all feel every day, it's a more pressured industry.
6 Right?

7 And so while AUM has recovered nicely, we are
8 seeing two things that are actually putting real downward
9 pressure on margins. First is just fee pressure. And fee
10 pressure is a function both of the rotation to passive but
11 also rotation to cheaper share classes and what we just call
12 gross fee concessions. In fact, about 80 percent of fee
13 pressure we're seeing today is generated by the first two
14 share classes and rotation to passive, this is globally.
15 It's actually much less around just gross fee concessions in
16 the market.

17 Look, the other thing we're seeing is the industry
18 does have an issue with its cost structure. And the fastest
19 growing line items in terms of cost continue to be
20 technology. Both investment technology, so core investment
21 infrastructure as well as investment in what I call
22 artificial intelligence and data analytics north of the
23 trade. Right? But also distribution analytics,
24 distribution technology, digital engagement, customer
25 engagement, you know, all of that customer experience south

1 of the trade, right, those two are the fastest growing line
2 items, along with technology as well as regulation and
3 compliance. And that actually explains the fact that we're
4 not really seeing much operating leverage in the industry
5 despite the significant run-up in assets. And that is a
6 global phenomenon. In fact, the U.S. has weathered it
7 remarkably well compared to, for instance, Europe, where in
8 western Europe we're seeing operating margins in the low
9 teens.

10 Now, nobody is going to shed any tears for the
11 industry. But the reality is that it's a less economically
12 creative place to be than we've seen in a while.

13 So the next page takes the global -- the global
14 view and looks at it by region. And we are seeing some
15 pretty meaningful differences across regions. So at the
16 headline number, we'll say that APAC is really driving --
17 driving global flows. And by APAC, I'm including Australia,
18 I'm also including Japan. I'll talk a bit about Japan in a
19 second.

20 But if you go back roughly to 2014, 2015, over 50
21 percent of net flows in the industry have actually come out
22 of APAC, right? And that's actually off of a significantly
23 smaller base. APAC today is roughly 20 trillion, 20 percent
24 of the global market, right? But it's still accounting for
25 roughly half of the -- half of the gross flows -- or net

1 flows, I should say, over the past five years.
2 Interestingly, western Europe, despite the
3 macroeconomic challenges that western Europe has encountered
4 over the past five years, western Europe has actually
5 outpaced the United States in net flows by over a trillion
6 dollars since 2014, a very significant -- significant amount
7 of flows in western Europe.

8 A couple of implications. First, for U.S.
9 managers, if you want to grow and you're looking at this
10 sort of chart, the growth is actually overseas. And so your
11 ability to operate and engage with overseas regulators,
12 reach overseas customers, has never been more important than
13 before. Right? Otherwise, you really are playing a home
14 game, and in reality, growth has been more muted in the
15 United States.

16 The second implication is you do need to look
17 underneath the covers on each of these regions to understand
18 that there are some pretty meaningful differences by region,
19 by country, by geography. So let's talk about the active
20 versus passive split, right?

21 So in the United States today, roughly 21 percent
22 of assets are passive, third party assets are passive, 79
23 percent are active. In APAC, right, that split is 91
24 percent active, 9 percent passive. Except in Japan. That's
25 APAC ex Japan. In Japan, it's actually 39 percent active,

1 percent in equities. So you can expect to see some degree
2 of rotation out of money market funds in APAC countries and
3 into equities.

4 We also, interestingly, will note though that it's
5 actually the growth of alts in these emerging APAC countries
6 that's particularly noticeable. They have the highest
7 percentage of third party managed assets invested in alts of
8 the four major groups I've talked about today. So nearly
9 one in five dollars in APAC ex Japan is invested in third
10 party alts, whereas in the United States, it's actually only
11 12 percent today and as low as 6 percent in Japan. So we do
12 expect to see growth in alts, and we do look at APAC ex
13 Japan as actually an interesting test case for more of how
14 frontier markets may evolve and perhaps some things that we
15 can learn domestically.

16 Finally, in terms of net flows, as we peer into
17 the future, everything I've talked about has largely been
18 rearward looking. The dark blue arrows on this screen --
19 and I apologize, if you don't have the chart in front of
20 you, it can be a bit hard to read. The dark blue area shows
21 our projected net flows. These are compound annualized
22 growth rates from 2020 to 2024, so where they think the
23 future growth is going to be. I'll start by saying North
24 America is essentially going to be trending in the same
25 direction it has for the past few years, you know, largely

1 61 percent passive.

2 In western Europe, right, which is -- we are
3 seeing a real pickup in the past couple years of passive
4 strategies. It's still 86 percent active, 14 percent
5 passive. By the way, and look under the covers there. Some
6 of you guys saw just recently, it was really very
7 interesting. Switzerland, right, is roughly 30, 35 percent
8 passive, 70, 65 percent active. Conversely, Germany, right,
9 just to the north, an equally industrialized, equally mature
10 economy, it's actually only 10 percent active. So we're
11 seeing meaningful differences -- sorry, 10 percent passive,
12 excuse me. We're seeing meaningful differences by country
13 and by region in terms of the pickup of passive activity.

14 Another point, couple points I'll make quickly,
15 APAC ex Japan continues to be a much less mature market.
16 We're seeing -- as evidenced by the following. So 16
17 percent of the assets are actually in money market funds,
18 compared to in the U.S. which is only 8 percent. We expect
19 that over the next five years, as the mass affluent -- group
20 of mass affluent consumers grows in these emerging market
21 economies, they're going to move increasingly out of money
22 market funds and towards, you know, less liquid strategies.

23 Interestingly also in APAC, only 23 percent of
24 managed assets are in equities, whereas 42 percent of them
25 are in equities in North America, and in Japan it's also 44

1 anemic growth rate, 1 percent.

2 In western Europe, we do think it's going to slow
3 somewhat, down to 1.7 percent. The growth really is going
4 to come from China and the rest of Asia, where we see
5 sovereign wealth funds, high net worth individuals and,
6 again, the mass affluent community that I had talked about,
7 as well as insurers with retirement-linked offerings
8 continuing to see truly significant growth. And if you look
9 at a place like mainland China, which has been experiencing
10 double digit growth in the asset management industry, we
11 think that's going to continue, right, along with a couple
12 of the other emerging markets.

13 So we do think that the story for the industry in
14 terms of growth, albeit off of a lower -- lower base is
15 going to be in Asia, with continued intense competition in
16 western Europe and North America, where the bulk of the
17 assets continue to reside.

18 I'll close with five quick trends that we're
19 paying attention to in terms of how the world is going to
20 evolve on a global basis. The first is barbell. We do
21 believe that barbell -- what I mean by barbell is
22 essentially the rotation toward passive strategies as well
23 as alts and solutions. We believe that barbell is going
24 to continue. We think that the movement to alts is a global
25 phenomenon that's not going to abate, particularly illiquid

1 alts. We think that's driven by some pretty significant
 2 need for return from liability-driven investors.
 3 We see passive most pronounced obviously in the
 4 U.S. and Japan, but rapidly growing in Europe. And we're
 5 starting to see evidence in places like mainland China with
 6 the growth of ETFs of a real acceleration of passive as
 7 well. So we don't think that passive is showing any real
 8 signs of deceleration, particularly outside the United
 9 States.

10 The next trend we're focused on is fee pressure.
 11 We do think fee pressure is going to continue. We think
 12 there's structural excess capacity in this market and that
 13 we expect to see continued mergers. Interestingly, the
 14 number of managers, the number of asset managers has grown
 15 over time. Where we're seeing real pressure is in the
 16 midmarket. Right? So if you're managing call it 250
 17 billion to a trillion, that's a metric for midmarket. But
 18 that's the area where we see the business models most
 19 pressured. We're seeing growth and success with boutique
 20 managers that are typically more niche and illiquid
 21 strategies. And we're seeing the growth of the trillion-
 22 dollar-plus-club managers that have and are able to exploit
 23 real scale. If you think forward though in five years, what
 24 happens to those managers in the middle, those shops in the
 25 middle? We think that there's going to be continued

1 consolidation and some folks will merge for scale and others
 2 will essentially fall slowly, slowly down to the more
 3 boutique type of structure.

4 Third broad category we're paying attention to is
 5 the disruption from technology, digital and analytics. We
 6 think this is going to work through the industry value chain
 7 in a number of ways. At the retail level, we're seeing the
 8 real growth of robo offerings, both in the United States but
 9 this is actually a global phenomenon. We're seeing it in
 10 Europe and we're seeing it in Asia, in China. Immediately,
 11 we think that this actually does put real pressure on target
 12 date fund, right, the wrap solution. Interestingly, what a
 13 managed account or robo fund does is essentially unbundles
 14 what the management overlay was doing in terms of asset
 15 allocation. And so that has actually some pretty profound
 16 -- profound implications for managers that have gone big on
 17 target date funds and bundled solutions. If you actually
 18 look in the U.S. with our 401(k) market, the fastest growing
 19 segment in the market is managed accounts. We think that's
 20 a harbinger for things globally.

21 And it also calls into question what the future of
 22 wealth management and traditional advisory will be. We did
 23 a survey of 10,000 highly affluent and affluent investors
 24 and asked them how comfortable they would be working with a
 25 remote adviser, so not a robot, not a pure algorithm but a

1 remote adviser. And what was quite surprising is we ran the
 2 survey in 2016, we did it again in 2018. What's quite
 3 surprising is, across affluence levels, so starting with,
 4 you know, 250,000 in assets all the way over 5 million in
 5 assets, as well as age, everybody showed significant
 6 increase in acceptance and willingness to work with a remote
 7 advisory model. So we do think in the future the way retail
 8 investors are being served is going to be through this
 9 remote advisory type of system, where it's going to be human
 10 intervention plus something else, right? And if you look to
 11 markets like China, right, we're seeing real evolution
 12 there. And it's on the back of some very dynamic companies
 13 that we can all name that are essentially building platform-
 14 based ecosystems that are open architecture in nature, are
 15 holistic in terms of the advice that they provide. So it's
 16 not simply going to the platform to get your asset
 17 management or investment advice. You're going to go get
 18 your insurance, your banking, a broader, holistic financial
 19 wellness. Right? And they've been actually able to
 20 aggregate eyeballs and consumers at a rate that's actually
 21 quite stunning. And with that comes real market power,
 22 right? So who's actually able to get on their product
 23 shelf, who's not. Their ability to extract economics from
 24 product manufacturers as a platform provider is actually
 25 quite -- quite fascinating. And again in a market -- in

1 some of these emerging markets where, frankly, the market is
 2 less -- less stable and so you can come to market and
 3 disrupt things more quickly, we are seeing some very, very
 4 disruptive plays in the way that assets are getting -- asset
 5 management is getting intermediated by third parties.
 6 Right? We think that's actually a real harbinger of things
 7 to come here.

8 Similarly, we think technology is going to
 9 unbundle the value chain in a very subtle way. So we're
 10 seeing this across financial services. But the emergence of
 11 what I would just call utilities, so middle back office
 12 utilities that essentially are going to be aggregating so
 13 much of the value chain and allowing asset managers to focus
 14 on core competencies. In the case of active managers,
 15 that's obviously security selection. But things like AWS
 16 with the cloud is an example of a utility which is
 17 essentially providing the big data or the infrastructure for
 18 technology backbone for the industry and extracting
 19 economics along the way.

20 We think things like data services, you know, also
 21 allow themselves -- lend themselves to more utility type
 22 providers. Obviously, custody services, as well. And so I
 23 think the question is, when you think about where the
 24 industry is going globally, do we have third parties that
 25 are coming in and essentially taking pieces of the value

1 chain and aggregating it, right? And leaving asset managers
2 actually fewer and fewer employees, you know, a smaller and
3 smaller cost base in terms of direct costs that they own,
4 and more focused competencies going forward. We think,
5 again, that's a trend that's going to work its way across
6 geographies and across financial services.

7 And the last two points I'll make. One is on
8 longevity and retirement. So if it's -- I think we're all
9 familiar with the Baby Boomers retiring in the United
10 States. Longevity issues are a global issue. They are
11 particularly manifested in a number of emerging markets.

12 China, due to the one-child policy, has got
13 significant longevity issues. Japan, obviously not an
14 emerging market, but I think everybody knows about the
15 challenges with the Japanese population growth rate. Russia
16 as well. A number of these markets are facing real
17 structural imbalances.

18 We're not seeing much innovation that's really
19 what we would describe as a game changer in terms of
20 retirement savings and addressing this longevity challenge.
21 You really have three levers. One is just inclusion, so
22 getting more people to save. Two is increasing the savings
23 rates. And three is hoping for returns. Can't really
24 control three. And, in fact, McKinsey Global Institute
25 published a paper a couple years ago that was, in fact,

1 there's a lot to be learned from inclusion.

2 I credit the states for trying to innovate with
3 state-run IRA programs. And the federal government has made
4 a couple runs at this. But this inclusion question is
5 something that continues to bedevil us and other countries
6 have got more innovative -- I would argue more innovative
7 and arguably more successful programs from an inclusion
8 standpoint.

9 And then finally what's going to be a successful
10 profile for asset managers in the future? And I'll conclude
11 my comments. We see three broad profiles. One is at scale
12 manufacturers, this is predominantly in passive, where you
13 are able to essentially manufacture passive strategies at an
14 extraordinary scale, right? And I think we're seeing the
15 growth of and the coalescence of a handful of manufacturers
16 that operate at that level.

17 I would also argue, by the way, in traditional,
18 long-only, you know, '40 retail-oriented mutual funds, you
19 know, that, too, we're seeing meaningful returns to scale,
20 in part because those shops that do have scale are, in
21 theory, better able to get a grip on their cost structure.
22 And in fact, what we have seen when we do asset management
23 benchmarking, is when you're able to run multiple strategies
24 at five billion or more in assets under management at a
25 strategy level, you actually do start seeing very meaningful

1 really quite bearish about real returns going forward. That
2 is going to push and is pushing liability driven investors,
3 which I include all of us in this room who are saving for
4 retirement as our own personal liability. That's going to
5 push more yield seeking, riskier activity that will need to
6 get regulated.

7 We can try to induce greater savings, which is
8 what China recently did, I would argue, with its third
9 pillar in its retirement -- retirement changes. And we can
10 try to push for more inclusion. I do think if there's one
11 thing that I would point to with inclusion, and I do credit
12 Australia with this, I think superannuation is actually
13 quite a better program in terms of convincing people to save
14 for retirement because it's not linked to the employer. In
15 superannuation, there's one of a, you know, handful of
16 platforms, it's portable, you don't lose your access to your
17 superannuation when you lose your job.

18 Here in the United States, we have a retirement
19 crisis that is in part precipitated by low levels of
20 inclusion within the 401(k) and defined contribution system
21 more broadly. If you work for a small employer, you have to
22 hope that that employer is going to provide access to a
23 401(k) or a 403(b) or a 457. The reality is many of them
24 don't. And many of our citizens are actually left outside.
25 So I do think looking at something like a superannuation,

1 returns to scale.

2 So you can be actually a highly profitable shop at
3 50 billion, highly profitable. You just need to have your
4 underlying strategies. You know, ideally, you would have a
5 handful of strategies all north of five billion. It's when
6 you start running long tail strategies under five billion,
7 that's where you become much less profitable. So we do see
8 scale at the strategy level really mattering.

9 Two, with sustained alpha generators, we think
10 that these are firms that are going to have privileged
11 access to investment opportunities, including origination of
12 their own assets. And so how -- how much does the asset
13 management industry merge with capital markets and start
14 looking much more like a capital markets type of play and in
15 some ways the capital markets industry, right? We're
16 already seeing in strategies like mez lending wherever
17 that's occurring already, are there other parts of the
18 industry where that can occur?

19 And then finally, we do think solutions providers
20 that are oriented towards outcomes will continue to have a
21 meaningful seat at the table and continue to be relevant in
22 the industry. It's not simply enough to say we're going to
23 target an asset allocation for you to achieve X by some
24 point in the future. Increasingly, people are going to be
25 looking for asset managers to come as close as possible to

1 delivering specific outcomes. That could mean, by the way,
2 partnering with balance sheet providers to deliver a
3 nonguaranteed -- or guaranteed components of a nonguaranteed
4 solution.

5 MR. BERNARD: Thank you, Alex. And actually, some
6 of you may not have seen our earlier panels. As we've done
7 with the earlier ones, we're going to go through the panel
8 and then have an open Q&A session. So Raquel?

9 MS. FOX: I want to thank Ed for inviting me to
10 speak. I have a brief period, so I will try to go through
11 this very quickly.

12 And Alex provided a great overview. And actually
13 his very first slide is probably the reason why I'm here, so
14 the sharp increase in the asset management industry.

15 So just the growth of the asset management
16 industry has really been a driving factor in the work plan
17 of international organizations such as the Financial
18 Stability Board and the International Organizations of
19 Securities Commissions, which is known as IOSCO. And so
20 it's a topic that we discuss extremely frequently with
21 foreign regulators, I mean just on a very regular basis.

22 So today, I'm going to focus on really two
23 aspects. And I will start with the SEC's engagement and how
24 our Office of International Affairs, which we call OIA,
25 coordinates on the Staff's engagements on these

1 international policy matters. Then I'll talk about the
2 importance of stakeholder engagement, particularly by
3 contributing concrete and relevant data to support your
4 views on some of these policy matters in the international
5 forum.

6 So before I go further, I will have to give the
7 standard disclaimer that, of course, these are my views,
8 they are not the views of any commissioner, Staff or any
9 others at the Commission. But I also want to start off by
10 saying that in the international arena, we've greatly
11 benefitted from Chairman Clayton's leadership and active
12 involvement in this space. He's actually, as you probably
13 heard, he's in Europe right now talking with our
14 counterparts about many of the issues that we're talking
15 about here today, which is why he can't be here. But he's
16 been a tremendous asset to us in all of our coordination
17 efforts in helping to build strong relationships with the
18 other regulators around the world.

19 So OIA helps to support Chairman Clayton's efforts
20 in a lot of ways. So we lead the SEC's cross-divisional
21 efforts on international initiatives that have a broad
22 scope, such as those involving data protection, so GDPR,
23 Brexit and then we did a lot of work with Dalia and her team
24 on MiFID. We also coordinate bilateral discussions with
25 foreign regulators, including in-depth meetings that focus

1 on the asset management sector, mainly talking about the
2 SEC's approach to regulation, our recent rulemakings and how
3 the U.S. market differs from markets around the world. We
4 also lead the SEC's engagement on international
5 organizations such as the FSB and IOSCO. As you know,
6 they've done a lot of recent work in the asset management
7 space, particularly with respect to liquidity and leverage.

8 But in practice, our work involves just daily
9 contact with foreign regulators on a wide range of topics in
10 order to advance the SEC's regulatory interest. And our
11 relationships, I would say, with our foreign counterparts
12 are very strong and they've been very good, which makes it
13 extremely productive and helpful.

14 So just turning to the international focus on
15 asset management, as Alex described of course this sector
16 has grown quite substantially since the financial crisis and
17 international bodies and our foreign counterparts are
18 looking at this very, very closely. For example, the FSB
19 recently put out their 2019 report on it's called Global
20 Monitoring Report for Nonbank Financial Intermediation.
21 It's actually a report that the SEC co-chairs and helps with
22 the drafting with quite substantially. But that report
23 found that the nonbank assets reported represented roughly
24 30 percent of global financial assets. And recently, the
25 Bank of England also put out a similar report, where they

1 said that the nonbank financial system accounted for about
2 half of the financial sector, both in the U.K. and globally.
3 So you will see that various organizations may define or
4 measure the nonbank sector slightly differently or view it
5 through a different lens, particularly if you are a
6 macroprudential regulator or a capital markets regulator,
7 which Dan is going to touch on in more detail later. But
8 the takeaway is that the growth of this sector has broad
9 implications for financial markets generally and it has come
10 under the microscope of international regulators and
11 international bodies.

12 So this is not all bad. The FSB has said that
13 this shift toward nonbank financing represents a welcome
14 increase in the diversity of the sources of funding and is
15 in line with the G-20 initiatives, provided that such
16 financing is resilient. So for those reasons, among others,
17 there is a strong desire among organizations such as the FSB
18 to analyze and evaluate the nonbank sector, test its
19 resilience and discuss potential policy approaches to
20 address perceived risk if any.

21 So this brings me to my final point, which is the
22 importance of market participants engaging in this
23 discussion. And really, proactive, ongoing engagement,
24 especially at an early stage, is really important in what
25 we're looking for. And there are several ways and

1 opportunities to engage with the international regulators,
 2 and really two things that we're looking at.

3 First, we want to know your perspective about the
 4 impact of foreign laws on U.S. regulated entities,
 5 particularly if you think that action by the SEC or SEC
 6 Staff is warranted. MiFID II is a good example. I think
 7 Dalia said that's our clearest recent example. So the SEC
 8 Staff, as you know, recently extended the no-action letter
 9 related to the MiFID II research provisions. But they also
 10 continue to emphasize the importance of feedback from market
 11 participants.

12 So we urge you not to wait until the expiration
 13 date of that letter. So don't wait until close to 2023 to
 14 start thinking about that. The time is really now to be
 15 coming in and thinking about providing input to those
 16 letters and what we should be doing and thinking about.

17 Second, we also want engagement and input on the
 18 work of international bodies such as IOSCO and the FSB.
 19 Engagement with these organizations really does have an
 20 impact and can help to inform their work and shape what
 21 they're thinking about and how they're approaching these
 22 issues.

23 So I will close with some examples of how you can
 24 actually get engaged and there are quite a few ways to do
 25 so. So the work plans of these international bodies is one

1 place to start.

2 So the FSB under the leadership of the current
 3 chair, Randal Quarles from the Fed, has emphasized
 4 transparency. And as part of this, he started publishing a
 5 detailed workplan of the FSB on the FSB's website. And it
 6 also includes an estimated schedule for their main
 7 publications. IOSCO has a similar process where they make
 8 their workplan available. If you have any questions about
 9 these workplans or the issues under consideration, I would
 10 urge you to come to us to talk about them. Our door is
 11 always open and we're willing and ready and able and do
 12 engage on these matters.

13 Another example is public consultations. So when
 14 international reports are published for consultation, we
 15 highly encourage you to submit written responses and, where
 16 possible, submit data or research that supports your
 17 perspectives and your analysis. IOSCO had a consultation
 18 last year about leverage in investment funds and it greatly
 19 benefitted from the input from market participants and
 20 stakeholders.

21 A few other ways that you can help. So workshops,
 22 the FSB and IOSCO hold workshops and stakeholder meetings
 23 with industry representatives. And we recently held a
 24 workshop here at the SEC for the FSB and it was all about
 25 ETFs. That workshop was incredibly valuable because it

1 actually helped change the course of the FSB's work. So it
 2 was really great, and we thought that it was productive.

3 IOSCO recently held a workshop on sustainable finance, and
 4 they issued a survey to market participants about
 5 sustainable finance. So stakeholder participation in these
 6 forums and surveys is valuable and it helps shed light on
 7 current market practices.

8 One final thing that I will say in closing is
 9 another opportunity is the FSB is undertaking a series of
 10 evaluations on the effects of various post-crisis financial
 11 regulatory reforms, including looking at money market fund
 12 reforms. So many of the FSB's evaluations will include
 13 public consultations and the opportunity to meet with them
 14 to discuss them.

15 So I look forward to engaging with the committee
 16 in the future and I hope that you engage with these
 17 international bodies, as I've outlined. I thank you.

18 MR. WATERS: Thank you very much, Ed, for the
 19 invitation. Thank you, Dalia, and to the Commission for
 20 setting up this committee. I think it's a terrific idea.

21 I'm offering a personal perspective today on these
 22 regulatory issues. I am not proposing to sort of do a
 23 comprehensive review of everything that's happening
 24 internationally in regulation in 20 minutes, which would be
 25 impossible. And, even if I could do it, would be

1 incomprehensible.

2 I am going to talk about principally regulated
 3 funds and ETFs and the retail side of that. Those are the
 4 markets and the investors that I know best. And I am just
 5 going to focus on, as I said, a number of key regulatory
 6 themes.

7 An underlying current in my remarks is that the
 8 investment funds industry is in some ways a victim of its
 9 own success. As Alex's presentation has made clear, the
 10 global industry is huge, both in absolute terms and in terms
 11 of its size relative to other sectors of the financial
 12 system. Even if the great financial crisis had not
 13 happened, central banks who are responsible for overall
 14 stability and security of the financial system, would have
 15 become very interested in mutual funds and wanted purview
 16 over them. But of course, the great financial crisis did
 17 happen. And to put it simply, the Financial Stability
 18 Board, as well as the IMF, the OECD and many others will
 19 never again look upon mutual funds as simple, benign
 20 investment structures. Which brings me to my first theme of
 21 regulation of fund management in the 2020s, which is that
 22 central banks will continue to take a close interest in the
 23 mutual funds industry and their view of the vulnerabilities
 24 and risks in mutual funds will continue to have a very
 25 important impact on how those funds end up being regulated.

1 So where are they coming from and why do they care
2 about mutual funds? Even after significant reform of the
3 money market funds after the crisis, the FSB, supported by
4 the IMF and others, pressed for further mutual fund reform,
5 pushing very hard to designate the largest funds and the
6 largest managers as systemically important financial
7 institutions. The need for this designation arose, it was
8 said, from their size and from a fundamental vulnerability
9 in the investments funds industry, namely the so-called
10 liquidity mismatch in open-end mutual funds.

11 This mismatch, it was asserted, is the disconnect
12 between the expectation and entitlement of fund investors to
13 redeem their shares on demand, and the reality that the
14 underlying fund assets might not be sufficiently liquid to
15 let them do that. And although the battle of the SIFI
16 designation was won at least for the moment by funds, the
17 focus on liquidity mismatches in mutual funds is very much
18 alive and well in the FSB and in central bank thinking
19 today.

20 Last summer, Mark Carney, the governor of the Bank
21 of England and the former very influential chair of the FSB,
22 responding to the collapse of the Woodford Fund in the U.K.
23 and also the difficulties in properties funds after Brexit
24 in the U.K., took aim at mutual funds with significant
25 exposure to illiquid assets. And he said, you can see

1 something that could be systemic. These funds are built on
2 a lie, which is that you can have daily liquidity for assets
3 that are fundamentally not liquid, end quote. Built on a
4 lie. Just let that sink in.

5 I think that means we must expect continuing major
6 focus on fund management liquidity in mutual funds. So
7 first of all, at the systemwide level. The Bank of England
8 has developed a systemwide stress testing model that
9 predicts threats to the stability of financial markets from
10 investor runs on corporate bond funds.

11 The IMF has already taken to using systemwide
12 stress testing of mutual funds in its work in its FSAP
13 program. The securities regulators themselves are, of
14 course, sensitive to these concerns. ESMA, the European
15 Securities and Markets Authority, published guidelines last
16 September on individual fund liquidity stress testing, which
17 included a recommendation of stress testing across a group
18 of funds with similar strategies. Both ESMA and the SEC
19 have very substantially ramped up their economic and
20 macroeconomic analytical teams and are themselves now
21 producing assessments of systemwide vulnerabilities.

22 But make no mistake, it's the central banks who
23 have the resources, the deep resources, and the level of
24 anxiety about mutual funds to match, who will continue to
25 push the thinking at systemwide level. I would expect to

1 see pressure for securities regulators to develop and
2 mandate such systemwide stress testing in their regulatory
3 frameworks.

4 Secondly, the individual fund level, liquidity
5 risk management will continue to be a major focus of fund
6 regulation in the 2020s. The IOSCO 28 report on liquidity
7 risk management announced a sensible, principles-based
8 approach to this issue. And securities regulators around
9 the globe have been addressing these challenges very
10 actively. The SEC led the charge with an elaborately
11 detailed set of requirements in 2016.

12 While I don't see evidence that other regulators
13 around the world are taking this prescriptive approach, it
14 is an area of intensive focus internationally. For example,
15 ESMA last September published its guidelines on liquidity
16 risk management for funds. The Australian Securities and
17 Investment Commission, ASIC, is reviewing its regime against
18 the IOSCO recommendations. The Hong Kong Securities and
19 Futures Commission, the SFC, a very influential and
20 respected regulator in Asia and globally, has been testing
21 funds' compliance with its own updated code.

22 But the bank regulators are not satisfied with the
23 work that has been done by securities regulators so far.
24 Dismissing the IOSCO work as inadequate, the Bank of England
25 last summer said that it would work with the U.K. Financial

1 Authority, quote, to examine the costs and benefits of
2 aligning redemption terms, including pricing and notice
3 periods, with the typical time it takes to realize market
4 prices for funds' assets in normal and stressed market
5 conditions.

6 There are potential threats here in terms of the
7 application of typical banking liquidity tools to a fund's
8 situation. Liquidity in the banking context, as everyone
9 will know, is something very different from liquidity in the
10 context of an individual fund and could quickly veer to
11 calls for liquidity buffers and the like.

12 Nonetheless, it may be that the Europeans, in
13 considering alignment of redemption terms in mutual fund
14 funds to the underlying liquidity of the investment assets,
15 might end up meeting the SEC coming from the other
16 direction. Namely, the SEC's consideration of whether
17 mutual funds ought to be permitted more liberal access to
18 private pools of wealth, notwithstanding the lack of
19 liquidity, as has been discussed, as I understand it, in
20 another session today.

21 That brings me to my second major theme for the
22 coming decade, and that is that securities regulators, I
23 think, will continue to focus on protection of retail
24 investors as a top priority. That seems obvious. But they
25 will be less reliant on disclosure as the cornerstone model

1 and more focused on investor outcomes. I see a number of
2 component elements to this.

3 First, a series of regulatory interventions
4 directly around investment products themselves. Second, an
5 unrelenting emphasis on the impact -- the impact -- of costs
6 and charges on investor returns, especially over the long
7 run. And, third, evidence of a growing interest in
8 assessing whether investment funds are providing value for
9 money to investors.

10 On the first component, MiFID II introduced a
11 strong focus around investment products that directed --
12 created new organizational and operational requirements
13 around governance arrangements around product design and
14 approval, identification of a product's target market
15 including analysis of attendant risks and alignment of
16 distribution strategy with that target market, provision of
17 adequate information by product manufacturers to their
18 distributors about products and target markets, and then
19 regular product reviews to ensure that the target market and
20 the distribution strategy continued to be appropriate.

21 The underlying purpose of these interventions was
22 a desire to try to minimize damage to investors from
23 misselling of products. The idea being that a product
24 should be well designed with a clear sense of who should buy
25 it. Seems sensible. This focus on investor outcomes is not

1 pension arrangements in their jurisdictions, that they
2 imposed a cap on fund and other fees.

3 There is a link here, I think, to the
4 active/passive debate. Regulators who are concerned about
5 information asymmetries, investor inertia, long-term saving
6 needs, et cetera, are attracted to low-cost funds. While
7 they may not outperform, and they don't, the best active
8 funds, the promise to deliver market-level return, I think,
9 looks simpler and perhaps less risky a proposition to the
10 regulators. Indeed, the FCA, in making recommendations
11 based on its asset management market study, was forced to
12 explicitly deny that it was advocating that investors should
13 choose passive funds over active funds.

14 In addition to worries about the impact of fund
15 fees, there's growing awareness about the impact of fees
16 right across the increasingly complex value chain, and
17 that's going to be an area of focus as well.

18 Then we come to the third element of this theme
19 and that is an evolution, in the U.K. at least, into a focus
20 on value assessment, sometimes called value for money.
21 Beginning at the end of this month, U.K. managers of U.K.
22 domiciled funds must publish a fund-by-fund assessment of
23 the value they provide to investors. This is a summary
24 report based on a detailed internal assessment on seven
25 mandatory criteria. I won't delve into those, but they are

1 just a European initiative though. Legislation in Australia
2 in 2019 picked up precisely the same investor outcome theme
3 very much following the MiFID II model.

4 There is a difficult and risky regulatory line to
5 walk here, I think, in discriminating between products that
6 are missold as opposed to products whose investment strategy
7 just didn't work out. Nonetheless, I would expect further
8 global regulatory traction on this line of thinking.

9 The second element is a firm focus on the impact
10 of costs and charges. Fund management regulators have been
11 focused on disclosure of costs and charges and a huge amount
12 of work has been done over several decades to improve the
13 quality of this. In recent years, however, I think there's
14 been a shift, with regulators focusing increasingly on the
15 impact of fund fees, on fund performance over the long term.
16 This is probably unsurprising, given the growing need for
17 investors around the world to contribute to their own long-
18 term saving needs, with longer lifespans as has been touched
19 on, growing pressure on government-sponsored pension
20 systems. This, in turn, has caused regulators to become
21 concerned about the adequacy of the long-term returns
22 investors are deriving from their investments.

23 In this regard, it's notable that U.K. authorities
24 and the Hong Kong mandatory provident authority were so
25 concerned about the possible impact of high charges on their

1 very much like the Gartenburg principles, which people in
2 this room will be aware of, used by the U.S. mutual fund
3 boards in doing their evaluations. I think this is going to
4 prove a quite interesting and challenging exercise for the
5 U.K. fund industry. I don't think that bland assertions
6 that value is being provided are going to be accepted by the
7 U.K. press. And those of you who know the London press will
8 know whereof I speak.

9 I would expect a quite robust debate about what
10 standards and what metrics should be used in making and
11 justifying these claims of providing value. I think we
12 should expect a high-profile discussion to emerge in the
13 U.K. around this process, which could be influential as in
14 thinking in regulators elsewhere in the world.

15 I link this regulatory shift to outcomes to an
16 underlying conclusion after nearly 30 years as a regulator
17 that many and probably most retail investors really don't
18 want to spend much time worrying about their investments. I
19 suppose that sounds shocking. I think they want to rely on
20 a trusted adviser or a brand to do it for them. Is that
21 unreasonable, given the complexities they face in these
22 decisions? But how to provide this support across so many
23 investors with relatively modest ability to save?

24 I think technological support for investors, and
25 this has been mentioned today, whether advised or otherwise,

1 is going to be critical in providing sound investment
2 outcomes for the future. Considering the growing scale of
3 mutual fund distribution in China by mobile phone, which is
4 surely coming globally, the challenge of providing low-cost
5 advice at scale suggests to me that a firm focus on products
6 that are likely to deliver good value quality outcomes will
7 be key.

8 Let me turn to the third and the last regulatory
9 theme, which is that ESG and sustainable investment
10 generally will become a major if not the major driver of
11 fund management regulation at global level in the 2020s.
12 ICI data on sustainable USITs and '40 Act funds shows a
13 growth in ESG funds from \$567 billion at the end of 2016 to
14 nearly \$2 trillion just two and a half years later. The
15 fund management industry at global level has responded very
16 proactively to growing demand from institutional investors,
17 intermediaries, underlying retail clients for more
18 sustainable investment products and investment
19 opportunities.

20 As climate change is the strongest driver of ESG
21 at the moment, let me just focus on that. I see two
22 principal regulatory risks here. First, divergence and
23 potential conflicts in regulation across jurisdictions.
24 And, second, inappropriate reliance on fund management
25 regulation to deliver through the back door, as it were,

1 outcomes that have not been fully articulated or agreed at
2 political level.

3 First of all, the risk of divergence and
4 conflicts, intensive work at global level on delivering the
5 commitments to the Paris Accord continues, albeit without
6 the support of the United States. Getting down to the more
7 nitty gritty deliverables, however, is proving very
8 challenging, as the outcome of the U.N. Climate Conference
9 in Madrid last month amply demonstrates. The Europeans,
10 however, are pressing ahead ambitiously and at speed on both
11 the legislative and regulatory levels in ways that will
12 directly shape fund management regulation globally.

13 I am pleased to see that in ESMA's advice to the
14 Commission on disclosure technical standards for funds and
15 fund managers, they have stuck to a principles-based
16 approach and one that keeps an assessment of material
17 financial impact as central to the analysis. And I think
18 this is absolutely key. But, to be clear, the work on
19 technical standards this year will yield detailed
20 requirements that will affect both issuers and fund managers
21 alike. The timeline for implementation of the new regime,
22 including these detailed requirements, is January 2022, two
23 years from now.

24 The takeaway point for us today is that the
25 Europeans are doing again what they've been doing. That is,

1 not waiting for anybody else including especially the United
2 States. The focus on sustainable investments is by no means
3 just a European initiative, it is global. IOSCO's growth
4 and emerging markets committee has developed a set of
5 recommendations directed to regulators in large growth and
6 emerging market economies like China and India. Proactive
7 approaches to mandatory financial disclosure are being taken
8 by the China Securities Regulatory Commission, the Hong Kong
9 Securities and Futures Commission and other regulators
10 globally.

11 Faced with significant new disclosure and
12 operational requirements in Europe and elsewhere, I would
13 expect global fund managers to do what they generally do,
14 that is, try to implement them in a manner that is
15 consistent with or at least doesn't damage their overall
16 global policies and operations. I fully expect that this is
17 going to mean that the E.U. sustainability requirements will
18 become the regulatory baseline from which global fund
19 managers will work. This brings a very significant risk of
20 clashing standards at global level, perhaps running as deep
21 as the scope of the fiduciary duty of asset managers, but
22 almost certainly setting up conflicts and inconsistencies
23 definitionally and operationally for fund managers. And
24 this underscores the importance now more than ever of the
25 global funds industry continuing to be closely engaged in

1 the development of E.U. legislative and regulatory policies.

2 The second major risk, and I wonder if I'm right
3 about this, but I do worry about it. I worry that the
4 regulation of investment fund disclosure could front run
5 agreement at political level on underlying definitions of
6 what is or isn't sustainable economic activity. Indeed,
7 Mark Carney made a remark like this just the other day in
8 his farewell interview at the F.T. One of the current
9 challenges for fund managers is the plethora of
10 international standards and systems for assessing whether
11 economic activity is sustainable or not in different
12 sectors. And there are all kinds of different bodies out
13 there with different approaches to this, as I'm sure you
14 know.

15 Getting agreement at a political level on a common
16 understanding of what is sustainable economic activity,
17 sector by sector, is very, very challenging as the failure
18 to reach consensus in Madrid demonstrates. In Europe, this
19 risk of disclosure regulation for funds front running
20 regulation that defines the criteria is already
21 crystalizing, actually. The E.U. disclosure regulation,
22 which sets the website and product disclosure requirements
23 for funds, has been agreed and detailed work under delegated
24 acts is ongoing on technical regulatory standards. This has
25 been running ahead of the taxonomy regulation, which is

1 going to define the criteria for what is and isn't
2 sustainable economic activity. The risk is that the fund
3 manager ends up more by accident than design being required
4 to make disclosures about things for which they do not have
5 and cannot obtain adequate, consistent and reliable
6 information.

7 To be fair, ESMA is aware of this disconnect
8 between the two regulations and has been urging the
9 Commission to ensure the necessary linkages are made as the
10 standards for both regulations are elaborated over the
11 coming year. This is one year for both of these
12 regulations. This is very, very intense.

13 The industry should remain alert to and engaged
14 with that interaction, I think, as they are both elaborated.
15 The SEC, as I am sure it knows, would do well, I think, to
16 keep apprised of what's going on here and maybe even try to
17 identify potential clashes as they begin to materialize, as
18 one might say.

19 And I hope that the SEC also stays close to IOSCO,
20 which is going to be looking at global guidelines and
21 frameworks in this area, too.

22 That concludes my remarks. I hope that my
23 thoughts about the role of central banks in asset management
24 regulation, the role of securities regulators and the
25 increasing focus on outcomes and the move to sustainable

1 you know, issues such as systemic risk, risk management
2 being a focus, particularly of the bank regulators who are
3 driving a lot of this, liquidity, leverage. We've heard
4 about privacy today, anti-money laundering and Dan talked
5 about ESG.

6 You know, Alex focused on, you know, from a
7 distribution standpoint where asset managers can go for
8 growth outside the U.S. I think one of the other themes
9 that you guys focused on today was, you know, how do asset
10 managers generate superior returns for their investors?
11 There are a shrinking number of U.S. companies. You can go
12 into private type investments; you heard a lot about that in
13 the earlier panel. But another way asset managers can
14 generate superior returns for their investors is to invest
15 globally, invest outside the U.S. And to do that, you've
16 got to have good research. Either they've got to go out and
17 develop the capabilities within your own company or you've
18 got to have access to good research around the world. And
19 that's where Jason and I come in.

20 As Ed alluded to, we've been asked to highlight an
21 issue that the Commission is wrestling with and trying to
22 navigate through, and that's the impact of the European
23 Union's Markets and Financial Instruments and Amending
24 Directive, which is referred to as MiFID II.

25 So effective in January of 2018, MiFID II required

1 investments has been helpful to the committee today. Thank
2 you.

3 MR. BERNARD: Thank you. If Raquel's
4 encouragement to get engaged wasn't enough, I think you've
5 now seen the case study for why you might want to get
6 engaged to work with the SEC. And if all of that wasn't
7 enough to brighten your day, we have now asked Paul and
8 Jason to talk about a particular case with MiFID II and
9 payment for research. And I think Paul has taken on the
10 unenviable task of explaining what I just said in simple
11 terms so that everybody is on the same page as to what the
12 regulation is we're talking about and then they can talk
13 about how it's impacted two very different firms.

14 MR. ROYE: Okay, thank you, Ed. And thank you to
15 the Commission and Dalia and members of the committee for
16 the opportunity to be here.

17 I was feeling good until I heard Dan. You know,
18 Alex talked about, you know, how there is a future for
19 active managers. Raquel talked about international
20 cooperation and how there's hope for international
21 regulators to work together. And then Dan just put a damper
22 on everything. So, wow.

23 So, you know, clearly, based on what you heard,
24 for global asset managers, navigating regulatory
25 complexities is a constant concern for us. You've heard,

1 asset managers subject to their jurisdiction to pay for
2 research services separately from execution services, and
3 either charge clients transparently through what they call a
4 research payment account, and these are accounts where you
5 negotiate with your clients how much they're going to pay
6 for research and set aside in a separate account, or the
7 firms would have to pay for the research themselves out of
8 their own resources or P&L. So therefore, it requires the
9 unbundling of research costs from execution costs.

10 Now the European Union's stated goals in enacting
11 MiFID II were as follows, to first improve accountability
12 over costs passed on to asset management clients, to improve
13 price transparency for both research and execution services
14 and reduce conflicts of interest of asset managers by
15 unbundling research buying decisions from trade execution
16 services. Now, these requirements apply to managers that
17 are located or domiciled in the E.U. or otherwise under
18 contract to comply with regulations in the E.U. such as now
19 MiFID II.

20 So I think as many of you know, historically,
21 asset managers globally got paid for third party research
22 with brokerage commissions in connection with equity trades.
23 So the result therefore is that U.S. regulations and MiFID
24 II requirements were exactly at odds, resulting in massive
25 uncertainty in the marketplace about how to comply with both

1 MiFID II and U.S. regulations when acquiring research. As
2 has been alluded to, to address this uncertainty, the SEC
3 stepped up and issued several no-action letters which
4 facilitated the continuing ability of U.S. and global asset
5 managers to access research from U.S. broker-dealers. In a
6 no-action letter to SIFMA, the SEC provided temporary relief
7 that permitted a U.S. broker-dealer to accept hard dollar
8 payments or payments from a research payment account for
9 research services, provided to an asset manager subject to
10 MiFID II requirements without being required to register as
11 investment advisers.

12 Now, the legal issue here is that, in providing
13 research services, U.S. broker-dealers operate pursuant to
14 an exemption from registration under the Investment Advisers
15 Act of 1940. And under this exemption, the performance of
16 such research services must be, quote, solely incidental to
17 their brokerage dealer services and they can't receive any
18 so-called special compensation for providing that research.

19 Now, hard dollar payments made in accordance with
20 MiFID II could be considered special compensation and
21 therefore disqualify broker-dealers from relying on the
22 broker-dealer exemption in the Advisers Act. Many broker-
23 dealers don't want to have to register as investment
24 advisers because it imposes additional burdens and
25 restrictions on their business. One of the principal one

1 is, again, principal transactions where there are special
2 requirements under the Advisers Act that they'd have to
3 adhere to. They don't, as a broker-dealer. And they don't
4 want to separate their trading from their research staff
5 into separately registered investment advisers because they
6 view this as substantially diminishing the unique value of
7 the research services provided by those who are actually
8 involved on a day-to-day basis in the markets.

9 What's been the response of various managers to
10 MiFID II and the SEC's relief? So some global managers have
11 determined to pay for research for their clients in the
12 European Union, because they are required to pay hard
13 dollars or use a research payment account, and I think the
14 actual result, and I think the FCA knew this, is that most
15 managers in the U.K. and in Europe, rather than trying to
16 negotiate with their clients about a research payment
17 account and how much the client is going to have to pay for
18 research, just elected to pay hard dollars for the research.
19 And even those who initially came out and announced that
20 they were going to charge clients for research, when they
21 saw the wave of other managers indicating that they were
22 going to pay hard dollars for it, they backed away. I think
23 the FCA, in their construct, my sense is they knew this was
24 going to be the result and they were going to drive the
25 payments for research out of hard dollars.

1 Now, other firms viewed this approach as unfair,
2 resulting in a subsidization, where only certain clients
3 benefit from an asset manager's willingness to pay the
4 expense of research. So some firms like my own firm, we
5 didn't think it was fair to pay out of our own pocket for
6 research in Europe but have our clients in the U.S. bear
7 those costs through brokerage commissions. So we set up a
8 situation or an arrangement whereby we pay -- in the U.S.,
9 we pay brokers through commissions and then we have a
10 reimbursement arrangement. We use a commission sharing
11 arrangement to facilitate that. We can see the credits that
12 are being used for research and then we reimburse those
13 payments for research to our clients, including our mutual
14 funds.

15 From a fund director standpoint -- you'll
16 appreciate this, Dan, as a fund director -- our fund
17 directors were ecstatic that we were stepping up and paying
18 the research costs and reimbursing the funds because this is
19 a cost that otherwise the fund shareholders would bear. But
20 again, we thought from a fairness standpoint, it made sense
21 for us to treat all our clients the same.

22 Unfortunately, we have to go through this
23 administrative process of calculating the credits and
24 reimbursing and, indeed, we filed comment letters with the
25 SEC, urging them to maybe provide some relief in that area

1 so we don't have to go through that administrative burden.

2 So other impacts and, you know, how are the
3 regulators analyzing this and thinking about this? There's
4 a lot of information and noise out there. Jason probably
5 has a better perspective because he's living this and
6 trading and having to interface with research providers.
7 But the FCA, Dan's old regulatory agency, major proponent of
8 unbundling in the E.U., they did a -- they published a
9 survey in September of 2019, findings from what they call a
10 multi-firm review of the impacts of MiFID II. But, Dan,
11 they only surveyed 40 funds, so I'm not sure -- so take it
12 for what it is. But the FCA found that most asset managers,
13 not surprisingly, have chosen to pay for research from their
14 own resources instead of using client funds. They assert
15 that this has resulted in investor savings in the U.K. in
16 their equity portfolios of around 70 million euros in the
17 first six months of 2018, and they estimate that there will
18 be a saving of one billion euros over a five-year period.

19 They did observe that budgets by firms to spend on
20 research have fallen on average 20 to 30 percent. But
21 despite those budgets for research falling, they -- a survey
22 indicated that these reductions, that in spite of these
23 reductions, that the asset managers still concluded they
24 were getting sufficient research to support their investment
25 process. They also assert that research coverage of small

1 and mid-size companies listed in the U.K. has not seen a
2 material reduction in coverage. But then they did
3 acknowledge that research pricing is still evolving and that
4 there were wide ranges being offered by brokers and
5 independent research providers. And they observed that, in
6 some cases, research providers seemed to be low pricing some
7 aspects of research and charging premium prices for other
8 aspects of research that they were going to monitor.

9 Now, the CFA Institute conducted a follow-on
10 survey one year after the effectiveness of MiFID II and this
11 one is a more robust survey. They surveyed 500 members of
12 the CFA in the U.K. -- E.U., U.K. and Switzerland. And
13 their survey suggested results of MiFID II are really mixed
14 at best. That most buy side respondents reported using less
15 research, and this is consistent with a report that came out
16 by Liquidnet that indicated that 61 percent of asset
17 managers surveyed reduced the number of research providers
18 dropping between 20 and 70 percent of the brokers that they
19 normally used or had previously used. The survey noted a
20 reduction in sell side analyst jobs, with many going to buy
21 side firms. And they also observed that this may be a
22 function of the application of technology and growth in
23 passive diminishing the demand for third party research.

24 The survey noted an average 6.3 percent decrease
25 in research budgets, with the percentage being higher for

1 my background and maximize my time to present but I will
2 spend a couple minutes describing what my firm specializes
3 in.

4 Driehaus Capital Management was founded in 1982.
5 We have five investment teams. U.S. growth equities, which
6 consist of micro-cap, small-cap, mid and life science
7 products; international growth equities; emerging markets;
8 alternative investments, which includes an active income
9 fund and an event-driven fund; and value equities. We spent
10 most of our investing life around the smaller cap space
11 across the entire globe. We are a boutique investment firm.
12 Our products are capacity constrained yet our investment
13 strategies touch more than two million investors. All of
14 the operations of our firm are based in Chicago.

15 In my 25-plus years of experience in this industry
16 in various capacities, I am always amazed at how our
17 industry has been able to adapt to the changing regulatory
18 landscape. We have seen U.S. rule changes transform many
19 components of this industry. People and firms have had to
20 reinvent themselves with a new role or a new product line.
21 The U.S. securities market is the most efficient and
22 transparent in the world. In fact, over the last 25 years,
23 I would posit that non-U.S. markets have tried to replicate
24 what we have created so far. But this is the first time
25 that I know of where a foreign regulating body has decided

1 larger firms managing over 250 billion euros. For those
2 firms, the budgets were reduced by 11 percent, the larger
3 firms.

4 Buy side respondents indicated that research
5 quality was unchanged, but 44 percent of sell side
6 respondents indicated that the quality of research for small
7 and mid-cap companies had deteriorated. And then 39 percent
8 of respondents asserted that the research marketplace is
9 more competitive.

10 Now, the E.U. itself is, I guess, and Raquel may
11 be familiar with this, is in the midst of doing a study on
12 the impact of MiFID II on research markets. And so we can
13 await that.

14 So again, there's a lot of information, you know,
15 floating around. I think that MiFID has been in place for
16 two years. I think it's fair to say things are still
17 evolving. And the SEC has indicated, as Raquel indicated,
18 extended the no-action letter relief for another three years
19 and is waiting to see how all this sorts out.

20 So with that, let me turn it over to Jason really
21 just to give his perspective from the smaller firm
22 viewpoint.

23 MR. VEDDER: Good afternoon. I want to thank Ed
24 and the entire asset management advisory committee for
25 inviting us to participate this panel. I will not go into

1 to implement a set of rules that have the potential to upend
2 global firms and cause disruptions to the individual
3 investor. It's the unintended consequences around MiFID II
4 that, if left unchecked, could end up leading to a global
5 marketplace left with a concentration of large asset
6 managers and bulge bracket brokerage firms.

7 When we started to engage with the asset
8 management community to understand how MiFID rule changes
9 would impact a U.S.-based firm like Driehaus, we along with
10 many other participants concluded that if a firm did not
11 have any MiFID in-scope clients, nor did it have any
12 operations in the E.U., the impact would be minimal. The
13 majority of our concerns centered around adjusting trade
14 processes and venues in Europe to maximize execution
15 efficacy for everyone. The concern was not too daunting,
16 simply because our industry has always done an exemplary job
17 of adapting to an ever-changing trading landscape. That was
18 our focus as the implementation date neared.

19 It wasn't until I was in Washington, heading to
20 this building in September 2017, that our opinion and
21 concern levels changed. Large U.S.-based global asset
22 managers decided to circumvent the operational headaches of
23 implementing these rule changes and pay for all their
24 research costs out of their firms' P&L wherever possible.
25 That was our uh-oh moment.

1 Our firm immediately knew that if we were told by
 2 our clients to pay for all of our research costs out of our
 3 P&L, it would significantly alter how our firm would look in
 4 the future. Our firm was now at a competitive disadvantage.
 5 If we were competing with larger firms that could easily
 6 absorb these increased costs, we would be a higher-cost
 7 option. The longer term concern is that our business model
 8 is not designed to pay for all our research costs with hard
 9 dollars. That is because we have commission sharing
 10 agreements in place with many of our executing broker-
 11 dealers which enable our firm to provide best execution and,
 12 at the same time, accrue soft dollar credits to pay for
 13 research our investment teams deem valuable.

14 When I got back to Chicago after my trip, our firm
 15 started to consider who else in this industry would likely
 16 be in the same situation as Driehaus? How many other firms
 17 would see a significant impact to their business models if
 18 in the future they were effectively forced to pay for
 19 research out of their P&L via competitive pressure, even
 20 though they may have no business in Europe?

21 The decisive action by the SEC to provide
 22 temporary relief just before MiFID II went into effect
 23 prevented what could have been an operational nightmare for
 24 large, global asset managers. These no-action letters
 25 provided much-needed support to these firms to pay their

1 global brokers for research with hard dollars. However, our
 2 primary concern continues to center around U.S.-based asset
 3 managers that can't afford to pay for research costs out of
 4 their own pockets in their entirety.

5 With asset management fee compression, increasing
 6 compliance and operational costs and growing competition
 7 from passive products, smaller U.S.-based asset managers
 8 will feel the brunt of MiFID II rules which may force firms
 9 to take draconian measures to stay relevant.

10 To support our concerns, we have highlighted the
 11 areas within the asset management universe that would most
 12 directly be affected by a change in who was paying for
 13 research. To look at this impact, we identified the
 14 variables of an asset manager's model that would affect the
 15 potential problem. They were, one, assets under management;
 16 two, average management fee on that assets under management;
 17 three, the amount paid for research on a basis points of
 18 assets under management; and, four, EBITDA margins of the
 19 asset managers.

20 To preface, we understand that having these
 21 variables will not create a complete picture. Furthermore,
 22 some firms will argue that they won't have a problem based
 23 on their knowledge of specific variables at their firm we do
 24 not have access to. That notwithstanding, the industry
 25 averages and public data we use to compile our calculations

1 should help frame the discussion around the impact to a
 2 specific set of asset managers if told to change their
 3 business model by their clients and should not go unchecked.

4 For our calculations, we assumed a general EBITDA
 5 margin of 32 and a half percent. We also believe most
 6 active managers on average would have management fees
 7 between 40 and 70 basis points. As for the amount paid for
 8 research, industry estimates put the average amount at
 9 around 5 basis points of AUM, though these can be as high as
 10 25 basis points or as low as sub one basis point.

11 We know that large asset managers and small asset
 12 managers don't have the same values for these variables.
 13 Just by sheer economies of scale, a large asset manager is
 14 not going to pay 15 basis points of their AUM to the sell
 15 side for research services. Nor is a smaller asset manager
 16 going to charge his clients 40 basis point management fee
 17 for an actively managed emerging markets vehicle.

18 With these assumptions, it is apparent that a firm
 19 with a larger AUM will be able to absorb research costs more
 20 easily. We found that firms below 30 billion in AUM with a
 21 65 basis point management fee and four basis points of AUM
 22 in research costs could see as much as a 20 percent
 23 reduction in their EBITDA profit by having to pay for
 24 research out of their own pockets. A firm with 10 billion
 25 in AUM, 65 basis point management fee and 10 basis points of

1 research costs, however, could see as much as 50 percent of
 2 their EBITDA being used to pay for research. Obviously,
 3 earmarking 50 percent of a firm's EBITDA is not a small
 4 impact that can be easily absorbed. This impact is
 5 transformative. Again, this exercise is not a perfect
 6 analysis and variables may be meaningfully different from
 7 firm to firm.

8 Other variables, most notably portfolio turnover,
 9 could also affect profitability potential. However, this
 10 reduction in profits clearly will impact a firm's strategic
 11 plans, including less money to reinvest into growing the
 12 asset manager, hiring new employees or creating new
 13 products. Worst case scenario, a firm sees their situation
 14 as fight or flight and chooses the latter as the necessary
 15 course of action.

16 The impact on the buy side of the industry will
 17 reverberate to the sell side as well. If asset managers see
 18 meaningful disruptions to the profitability because they
 19 have to pay for research entirely with hard dollars, the
 20 most logical business solution is to reduce those costs.
 21 We've already seen this play out in Europe. There have been
 22 studies done that already show the fallout of adopting MiFID
 23 II compliance protocols. Firms are consuming less research,
 24 but they are also starting to underperform their respective
 25 benchmarks.

1 This development should be a cause for significant
2 concern by regulators everywhere. Investment firms that
3 adapt their decisionmaking processes because they are too
4 concerned about their bottom line flies in the face of best
5 practices for the end investor.

6 What often goes unmentioned is that sell side
7 research not only helps a portfolio manager's conviction to
8 buy or sell an investment. The research also helps
9 portfolio managers avoid an investment that seems too good
10 to be true. Disrupting this process can lead to inferior
11 results and harm the end investor.

12 If research consumption declines, how do sell side
13 brokers deal with that reduction in revenue? Again, it
14 comes down to scale. The larger brokers will be able to
15 navigate the changing landscape, but the smaller boutique or
16 regional brokers will have a steep path. Many of these
17 firms provide excellent research on micro-cap and smaller-
18 cap companies, companies that may not hit the radar of the
19 larger brokers but are a vital part of the investment
20 ecosystem, where Driehaus Capital and many other asset
21 managers invest. This could also impact crucial capital
22 raising for smaller companies if regional or boutique
23 brokers have to change their business model as well.

24 I hope this presentation raises more questions and
25 helps start a discussion within this advisory committee and

1 was one study in Europe that indicated that it did have some
2 impact on European funds.

3 MR. GARCIA: It does.

4 MR. VEDDER: It was an ISI research report that
5 was done, I think, in April last year. Granted, it was a
6 smaller subset of performance after MiFID was implemented,
7 but --

8 MR. GARCIA: Are you able to educate your clients
9 that it will impact their performance and therefore turn
10 around and pass the costs on to them? Or does that not
11 work? Or is that not viable?

12 MR. VEDDER: It's a tough discussion to have with
13 an existing client or even a potential. Especially when you
14 have other firms that are, you know, talking about doing
15 it --

16 MR. ROYE: Let me elaborate a little bit. I mean,
17 there's -- you know, MiFID II is kind of a continuation of a
18 trend. You know, so in 2006, the SEC basically signed off
19 on commission sharing arrangements, which what commission
20 sharing arrangements do is allow transparency around what
21 you're paying for execution and what you're paying for
22 research. And, you know, I sort of think about it as, you
23 know, my kids, you know, when they were growing up and they
24 wanted a toy, when I was spending my money, it was okay to
25 spend it. But when I said, you've got to use your own

1 the SEC in general. The payment for research out of P&L
2 issue should be at the heart of the list of concerns this
3 committee tackles.

4 I look forward to more discussion and debate
5 around this topic and our market structure in general.

6 Lastly, I want to thank Director Blass and the
7 entire SEC for their inclusion of smaller firms within this
8 process. Including firms like Driehaus to add our
9 experience to the fact-gathering process is much
10 appreciated. We encourage other boutique firms to engage in
11 these discussions and help improve the overall dialogue the
12 SEC is requesting from our investment community. Thank you.

13 MR. BERNARD: Well, I'd say mission accomplished
14 on the case study. Thanks to the two of you. That was
15 terrific.

16 But I talk too much. So I'd love some questions.

17 MR. GARCIA: I'll start us off. Jason, I'm very
18 sensitive to your comment. I'm an entrepreneur myself at a
19 small firm.

20 So, Paul, do the statistics show or justify or say
21 when you cut back on your budgets and so forth on research,
22 that somehow that affects performance? I mean, have we seen
23 some statistical significance to that or not, one way or the
24 other?

25 MR. ROYE: Yeah, Jason referred to, I think there

1 allowance or your own money to pay for it, all of a sudden
2 the calculation was different in terms of whether or not
3 they bought that toy or not.

4 So I guess what I'm saying is, as my sense is
5 that, you know, there has been sort of overuse of research,
6 overcapacity, people employing research that really wasn't
7 needed because it wasn't transparent. In 2006, you started
8 to see a migration away from that because of use of
9 commission sharing arrangements and you started to see
10 research budgets come down. And so what MiFID II though has
11 done, where the regulators in Europe have said effectively
12 it has to be hard dollars. And our position is that we'd
13 like to see choice.

14 I mean, I appreciate Jason's, you know, concern
15 about their business model. But, you know, our view is it
16 shouldn't be hard dollars, necessarily. There should be
17 choice in terms of how managers -- if you elect to pay for
18 it in hard dollars, that's okay. If you elect to do it
19 through commissions, that's also okay, as long as your
20 investors understand.

21 MR. GARCIA: Let me just quickly follow up, if I
22 could. Was the information unique enough that you cannot
23 just get it yourself somehow on the internet or through
24 other sources? I think that's the key, information --

25 MR. ROYE: Well, that's -- but that's also another

1 factor, in terms of, you know, when you start seeing, you
2 know, reductions in number of analysts in places like that.
3 And this is where technology is coming in and disrupting.
4 There's a lot more information that you can access without
5 having to go through and pay for it.

6 So, you know, there are a lot of factors here that
7 are coming in. And, you know, the other issue you hear, you
8 know, that's, you know, people focus on is whether or not
9 small and mid-size companies are going to have adequate
10 research coverage. And I guess my own view is that, you
11 know, that the market will solve that issue. That if there
12 are companies that aren't being covered and you're providing
13 good, valuable research on those companies, you will be
14 sought out and you will be compensated for that.

15 MR. DRAEGER: Thanks, Ed. Jason and Paul, your
16 perspectives were great analogies. Just from the
17 perspective of another small firm, Jason, you know, our firm
18 also, we have internal research but it's heavily reliant on
19 outside research resources as well. And we did move to
20 entirely use of hard dollars to get access to the research.
21 And some of the examples that you were giving as far as AUM
22 and your assumptions on, you know, basis points for fees
23 were right on relative to our firm. But it didn't have the
24 dramatic impact, you know, that it may have on your firm or
25 others, and I'm just sharing that.

1 Because inside of our corporate board room, the
2 discussion was one where there was a recognition that it
3 wasn't the regulatory obligation to support a business model
4 that was reliant upon a conflict of interest. So we sort of
5 viewed it as not incongruous with the mission of the
6 Commission plus the market working itself out, as far as
7 what people were willing to pay for the research and how
8 much was needed to do their job.

9 So I guess I'm just sharing that as another
10 smaller firm but that maybe has a different perspective.

11 MR. ROYE: Yeah, I guess the thing that I would
12 add to that is, you know, you're probably hearing this,
13 Jason. But, you know, institutional investors, consultants,
14 I looked at a piece from Mercer saying the five questions
15 you should ask about, you know, your asset manager, one of
16 which is, you know, are they paying for research because we,
17 Mercer, think they ought to be paying for research. You
18 know, so the direction of travel here is toward hard dollar
19 payments for research. And I think that many -- many view
20 that as a best practice now.

21 MR. VEDDER: I was just going to say like I
22 understand, you know, the perspectives about everything in
23 terms of what you're saying. But it's a black or white
24 issue, it's not in the middle. It's not a negotiated --
25 say, you know, if our business model can't afford to pay for

1 all of our research costs, is there a middle ground that we
2 can come to with our clients? Say, can we pay for half of
3 it? Or can we -- can we push some of the 2080 eligible
4 services that we usually pay for through -- you know, that
5 may not be specifically broker research but other tools that
6 we use in the investment process, is there a way to do that
7 in terms of maybe coming to a common ground with the clients
8 or even with potential clients, if we're in a situation
9 where we're considered the higher cost option? But it's
10 black or white; there's nothing in the middle. And that's
11 where our concern is, is that if Mercer decides that they
12 want to have all their investment managers basically pay for
13 research out of their own pockets, then that's it.

14 MR. BERNARD: I'm curious, Alex, if you could give
15 us some perspective? We see the obvious and, I think,
16 understandable difference at scale of the impact. But in
17 your travels with all sizes of asset managers, how big a
18 blip is this on the radar? I mean, you know, you talk about
19 the cost of tech which is a ginormous number. Where is this
20 in that context?

21 MR. D'AMICO: We're seeing it candidly more as a
22 headache and I think it's direction of travel point, about
23 where is the overall market going, I think some folks are
24 accepting it as this is -- whether we get there explicitly
25 through MiFID II by itself or five years down the road,

1 there's more, you know, alignment from a regulatory
2 standpoint, this is the direction of travel. And so you're
3 seeing, I think, folks just getting on board with paying for
4 research directly. I fully appreciate the point that you're
5 making about boutiques and the economic drag.

6 Look, I will say one thing about research as it
7 relates to fees and overall fee structure that is important
8 to keep in mind here. We did an exhaustive analysis, looked
9 at I think 7,000 plus strategies and looked at were they
10 returning -- generating alpha net of fees. We looked at
11 institutional and retail. And what we found was quite
12 clear. Active management generates returns, generates
13 alpha. Particularly when you get institutional pricing.
14 You get retail pricing, it doesn't. Right? You flip a
15 coin, the average active manager on a retail pricing
16 structure does not generate alpha.

17 And so I think that there's this question around,
18 over the long term, A, what's in the best interest for
19 investors? It goes back to the fee point. And, B, can an
20 industry that's not systematically generating value survive?
21 And I would argue that when it's generating value on an
22 institutional pricing regime with institutional fee
23 structures versus a retail price regime with retail fee
24 structures, anything that's going to help correct this
25 imbalance and allow active managers to more consistently

1 generate alpha, right, is key to the industry's long-term
 2 viability.

3 MR. WATERS: Yeah, just that long-term viability
 4 point and the value point, I think one of the things -- one
 5 of the drivers of where the FCA ended up, I think, too, was
 6 its competition analysis of the market and its conclusions
 7 that really the retail investor themselves were really not
 8 performing much of a discipline on the market at all. And
 9 you kind of see that differential performance on the
 10 institutional side where there's a lot of very intense
 11 pressure. On the retail side, not so much. And I think
 12 that's some of the regulatory interventions are in that
 13 space.

14 MR. ROYE: One of the problems I've had in
 15 listening to the presentations today and the analysis, it's
 16 all aggregate numbers. It's all about, well, asset
 17 managers, active managers as a whole don't outperform. The
 18 trick for investors is to figure out which ones do and have
 19 done it over long periods of time.

20 And I think investors, some of the data I see
 21 where investors are focusing on funds that have low costs,
 22 good long-term results, are getting flows. So, I mean, I
 23 think there are some investors out there who have figured it
 24 out.

25 MR. D'AMICO: To be clear, there are funds that

1 are getting flows and there are shops that do tend to
 2 outperform. It gets harder, by the way, when you get over
 3 250 billion in assets at a complex level. It does.

4 But the percentage of assets that are not
 5 delivering value in this industry is very, very high. And
 6 the number of strategies in funds that are not delivering
 7 value are very, very high. And there is a lot of end
 8 investors out there that are, at the end, losing out because
 9 of the fee structure.

10 MR. ROYE: Well, maybe Regulation Best Interest
 11 will have some impact on that.

12 MR. BERNARD: So I might offer a comment also for
 13 the committee, as we think about -- and I'm about to get
 14 myself in trouble because I'm going to offer an observation
 15 for which I'm not qualified. And so Dalia and her team can
 16 correct me if I'm wrong.

17 But even if everybody in the U.S. decides to pay
 18 for research, they still have work to do. Because under
 19 this whole issue of broker-dealers who provide transaction
 20 services and research, if they accept payment, they still
 21 don't want to register as investment advisers. And I heard
 22 someone comment that you'd sort of have to drive a truck
 23 through the Investment Advisers Act to accommodate that. So
 24 there may still be work for us to do, if we choose to even
 25 focus on this, even if, despite Jason's best wishes, the

1 whole industry decides, you know what, let's just pay.
 2 Well, the counterparty doesn't want to receive the
 3 money without things changing. That's what's vexing --

4 MR. ROYE: I mean, to me, the policy that's in the
 5 Investment Company Act that says that you become a broker-
 6 dealer by the form of payment that you take, be it a
 7 commission is okay but if you take hard dollars, all of a
 8 sudden, that trips you over into investment adviser land
 9 makes no sense. Form of payment shouldn't dictate whether
 10 or not you have to register as an investment adviser.

11 MR. GARCIA: And it just has to be recognition
 12 that research is different for different asset classes, too,
 13 see? Like in the fixed income, it's hard to justify,
 14 because everything is so efficient in the investment grade
 15 space, it's hard to justify passing on any sort of research
 16 cost to clients. But that's because it's high quality fixed
 17 income. So not all money management is the same. So I
 18 think we've got to be sensitive to that, too.

19 MR. BERNARD: To that point, if we as a committee
 20 could define what research is, define what advice is and
 21 define what ESG is, we'd -- we'd probably all be in some
 22 kind of hall of fame.

23 MR. GARCIA: I'm sorry, can I go back to one more?
 24 I'm sorry. I'll be quiet. No, Erik, you.

25 MR. SIRRI: So I was going to just ask Dan, your

1 first point was about the influence of central banks on
 2 regulation. So I know you have a lot of familiarity with
 3 the U.K. We have a different structure here. We have
 4 multiple banks and have a securities regulator and
 5 derivatives regulator.

6 What are your thoughts on, if you've got a world
 7 where the central banks are coming to the fore and the U.S.
 8 has a different regulatory structure where the people in
 9 this room are not central bankers, what does that mean for
 10 our effectiveness, do you think? You know, we can come to
 11 the decisions we want or our recommendations, but we're not
 12 the central bank.

13 MR. WATERS: See, I guess what I would hope is
 14 that the central banks and the securities regulators would
 15 begin to collaborate more closely. I was encouraged to hear
 16 I think Raquel mention that the recent work of the FSB,
 17 where the SEC was itself involved in that, which is good.
 18 And the fact that the SEC and ESMA, as I mentioned, are
 19 building up their own capabilities in terms of macroeconomic
 20 and macroprudential analysis. Because if they do that, then
 21 you get a dialogue with the central banks that is informed
 22 by a deeper understanding of capital markets and an
 23 understanding that doesn't come from the banking perspective
 24 where everything, wearing my banking regulator glasses,
 25 everything is either a bank or a shadow of a bank and

1 there's nothing in between.
 2 And so some of that thinking has gotten improved
 3 by significant efforts by, among others, the SEC, the ICI,
 4 my former employer, and others. But in jurisdictions where
 5 capital markets finance is not yet as powerful, there is
 6 still a lot of that suspicion and a lot of that old
 7 thinking, the shadow banking thinking. And you don't have
 8 to look any further, unfortunately, than the European
 9 Central Bank, which is pretty important in this game. And
 10 there's a lot of education and work together that needs to
 11 continue to happen. Because otherwise, Europe is not going
 12 to get where it wants to get to in this kind of
 13 schizophrenic world where they keep talking about capital
 14 markets and developing their capital markets and at the same
 15 time the central banks are kind of nervous about it and
 16 don't like it and where they kind of want to keep things on
 17 the banking side. So there's an iteration that I think
 18 should happen.
 19 MS. FOX: So the SEC is a very active member of
 20 the FSB. We're at every single meeting. That's where the
 21 Chairman was yesterday. And one of our main goals or
 22 priorities in the coming year is to have more dialogue and
 23 engagement with central bankers and capital markets
 24 regulators to make sure that we -- I talked about kind of
 25 the two different lenses, to make sure that we understand

1 where each other is coming from. But what that means and
 2 how we can move forward together, especially in the FSB, as
 3 they start looking at the effects of reforms and closely
 4 looking at the asset management space.
 5 And also IOSCO is an active member on the FSB,
 6 too. So that gives another capital market lens. We also
 7 have bilateral meetings where the SEC talks to large central
 8 bankers, where we sit down for hours. Dalia has been
 9 engaged in those, where we say, this is how our market
 10 works, these are the new rules that we've put in place and
 11 go back and forth. So that's something that we're actively
 12 engaged on and is one of our priorities.
 13 MS. BLASS: One of the things I hope you got from
 14 the presentation, from Raquel, is the amount of resources
 15 actually from the Commission towards the international, you
 16 know, space. Not only the Office of International Affairs,
 17 which is an office, a full staff, Raquel, all her staff
 18 that's full time their job. But from our perspective in
 19 Investment Management, we also have an office the
 20 substantial amount of the Staff's time is dedicated toward
 21 international work. This is taking a tremendous amount of
 22 time and resources on our parts. And I think that's fair.
 23 I think you've seen from Alex's presentation and
 24 the presentations from, you know, Dan, Paul and Jason how
 25 much globalization is just part and parcel of the asset

1 management industry. And so I think it is fair that we are
 2 dedicating that amount of time and resources. It's a lot.
 3 And I think fair to say growing.
 4 MR. BERNARD: It's 3:27. I am going to suggest --
 5 MR. DRAEGER: I just have a question for Raquel
 6 and Dalia while you're here. You know, years ago I know the
 7 Commission did wonderful work in working with the Securities
 8 and Exchange Board of India, China, you know, just as their
 9 markets were really getting started. You were helping them,
 10 along with the World Bank and Agency for International
 11 Development, get their securities regulatory structures up
 12 and running.
 13 Is that type of work ongoing and to what extent?
 14 MS. FOX: So I am glad you asked that, because in
 15 my presentation today I really just focused on one part of
 16 the work we do. We really have four different things that
 17 we do in the Office of International Affairs, one of which
 18 is technical assistance, which we still do weekly. And we
 19 also reach out and go on extensive trips, where we help
 20 emerging markets and economies to get up to speed and we
 21 tell them what we do and try to help inform as they build
 22 their markets up.
 23 The other two aspects that I didn't mention, we
 24 also help with international enforcement cases, so we help
 25 our enforcement team here as well as regulators across the

1 globe when they're doing enforcement cases if they need
 2 resources from us. And we also help our OC team, so our
 3 securities examiners, as they go out to look at investment
 4 asset managers across the globe. So multifaceted in OIA.
 5 And we do that, of course, all with the help of many
 6 throughout the Commission.
 7 MR. BERNARD: So with that, I'm to call it. And I
 8 am going to ask if you would join me in thanking our
 9 panelists.
 10 (Applause.)
 11 MR. BERNARD: We do appreciate it. It was very
 12 insightful.
 13 So it's 3:30. We were due to finish at 3:15. But
 14 this was 15 minutes well spent.
 15 I am going to ask that we come back at 3:40, so we
 16 will have a 10-minute break instead of 15. And we'll have a
 17 wrap-up session. And I promise I will -- I don't have a
 18 gavel, but we'll, at 4:30 anybody that's got to run for
 19 transportation can run. We also have facilities if anybody
 20 wants to hang out and yack a little bit.
 21 (Recess.)
 22 DISCUSSION OF COMMITTEE: AGENDA ITEMS, NEXT STEPS, FUTURE
 23 MEETING TOPICS, AND SUBCOMMITTEES
 24 MR. BERNARD: First of all, it felt like a pretty
 25 good day to me. I hope you all agree. It has been

1 interesting. As I just said to Commissioner Roisman, it's
 2 an opportunity-rich environment, or target-rich environment.
 3 And again, I am grateful to all of our speakers.
 4 I think they did a terrific job. And also your active
 5 engagement along the way. I think the committee's
 6 engagement has been terrific. Not surprising to me but
 7 nevertheless terrific.
 8 So the way we're going to move forward is to
 9 identify issues on which to focus for work to be done by
 10 subcommittees. There will be sometimes when we just bring a
 11 panel back here. But often, it will be the subcommittee
 12 doing some work in phone calls, bringing back either a panel
 13 that they think would be useful for the whole group or
 14 coming back with just reporting out on their work.
 15 And my sense would be, and Dalia will guide me on
 16 this, over the course of a two-year stated life of this
 17 committee, we should be able to tackle a number of things.
 18 With that said, I personally don't think we should start
 19 with more than two, maybe three, get our feet wet. And some
 20 may take just a couple meetings, some may take longer. But
 21 when you finish one, you pick up another. And in the
 22 meantime, the discussion has led us to think about some new
 23 things that we ought to focus on. So that's sort of how I
 24 think of it. This will not be a one and done priority list
 25 by any stretch.

1 The objective that we came to for today,
 2 recognizing that we were starting with a broad remit and
 3 we've got to narrow it down, was essentially to cover lots
 4 of information, trends and so forth in hopes of shaking out
 5 some issues for us to focus on, as opposed to -- I was
 6 certainly not going to come in as chair and say, hey, they
 7 called me chair so here are the three things we're going to
 8 do. I want to leverage the intellectual capital in this
 9 room.
 10 But given the amount of information we've taken on
 11 board, I also don't propose to do that in a 45-minute
 12 discussion among this group. I'd love for people to be able
 13 to go away, reflect on it a bit and so forth.
 14 What I would like to do -- I'm going to recommend
 15 -- actually, this was the way I hoped to proceed, is
 16 probably this evening, in fact, almost certainly this
 17 evening, I had in my notes shortly after we adjourn.
 18 Actually, I'm going to go up and hang out in the room. If
 19 anybody stays behind, I've got a train to Baltimore.
 20 But sometime tonight before I go to bed, I'm going
 21 to send all of you an email with a series of open-ended
 22 questions about today. Some around the content of -- the
 23 substance of what we discussed, some around process just so
 24 we can continuously improve. And also ask for what areas
 25 you think are worthy of further discussion and any

1 particular areas of interest to you. I'm hopeful everybody
 2 can reflect on that and maybe, just to keep us moving, by
 3 the end of this week -- or I guess this is a long weekend
 4 coming up, isn't it? Either end of this week or certainly
 5 early next week, respond to my email. You'll see the email
 6 tonight. And I'll take it on myself to distill that and so
 7 forth. And then meet with Dalia and team and then we'll
 8 circle back to you.
 9 So since we are not going to try and have a rapid
 10 prioritization, I thought now that we've spent a day
 11 together, we ought to do the around-the-table exercise. I'm
 12 not going to ask you for something funny about your
 13 childhood. What I was going to suggest is simply -- we can
 14 see your names. But introduce yourself, maybe your title if
 15 you want. But I'm more interested in functionally, what do
 16 you do? What's your area that you focus on?
 17 And then if you could offer -- and I have sort of
 18 no constraints on this -- any brief reaction from the day,
 19 whatever comes to your mind. It could be an observation, a
 20 question, a recommendation for us. Bearing in mind you're
 21 going to have a chance for more substantive feedback to me
 22 by email. But any quick reactions.
 23 I am going to yield to Mr. Bajkowski. You've
 24 heard enough from me, so you know who I am. So I'll just
 25 let you start, John, if you would.

1 MR. BAJKOWSKI: Sure, John Bajkowski. I represent
 2 individual investors. I'm with the American Association of
 3 Individual Investors. And my focus is on how to educate
 4 investors so they can make good decisions and reach their
 5 financial dreams.
 6 And a very interesting set of discussions today.
 7 And in many cases, there were pros and cons. Just as in the
 8 case of you want transparency, yet you have one group in the
 9 market who wants to perhaps not -- I won't say the word hide
 10 -- but the expense ratios don't cover asset management costs
 11 and individual investors look at the expense ratio. There
 12 is much confusion as far as what that holds. So there are
 13 different assets and different participants have different
 14 perspectives.
 15 The asset managements trend is for lower expense
 16 ratios. Yet when you talk about globalization and private
 17 equity, there is a trend there for higher expense ratios.
 18 So different parties have different needs. And I think the
 19 challenge is to figure out how to put it all together for
 20 all the different participants so that they get the
 21 disclosure that they need and want and it's understandable,
 22 and it's not buried amongst hundreds of pages of information
 23 that never gets read. So that was kind of my takeaway, I
 24 guess, from today's meeting.
 25 MR. BERNARD: Great. Michelle.

1 MS. BECK: I'm Michelle Beck. I'm the chief risk
2 officer of a retirement of TIAA. I came to TIAA through its
3 acquisition of Nuveen, so I used to be the risk officer on
4 the asset management side, so I've kind of been on now both
5 sides of that. And in my background, I've done portfolio
6 management of derivatives portfolios. So that's kind of the
7 -- makes it a little easier on that side of life for me. I
8 don't have to remember as much.

9 So today, one of the things that struck me today
10 is that we've actually come a long way from where folks were
11 sort of hawking stocks to people that are trying to retire.
12 And I think it is -- we're not all the way to an area of
13 maturation but asking instead what cash flow needs do you
14 have and what are the best products for that, which often
15 includes a lot of fixed income. You know, it's an awkward
16 period for the industry because we're kind of halfway done
17 on that. But it's a better place to be because stocks are
18 not the whole story on the way people need to invest. So I
19 liked that.

20 I think the other thread that came out of today
21 that, you know, we've been discussing and that will be
22 interesting is that choice and protection on illiquid assets
23 for investors. You know, what is the right balance there?
24 Because they may be part of that story of meeting those cash
25 flow outcomes. Maybe through intermediaries like pros or

1 maybe through individuals being able to participate, so an
2 interesting thread to follow.

3 MR. BERNARD: Great. Jane.

4 MS. CARTEN: Hi, I'm Jane Carten. I represent
5 Saturna Capital. I'm president and CEO there, as well as a
6 portfolio manager on one of our small ESG portfolios.

7 I think, for me, we have a little over \$4 billion
8 in assets under management, so it was a good reminder of
9 just how very tiny that is in the large scheme of things.
10 And I am thrilled to be able to participate and I thank all
11 of you for including me.

12 Some of the most interesting feedback or things
13 that I'll take and think about a lot were some of the things
14 from the earlier presentations, especially, just that
15 although robo advisers ended up with similar allocation
16 strategies and similar but not seemingly excellent returns.
17 And I'll definitely go back and research that a little bit
18 because it's interesting to me. And just the idea that
19 being full service to our investors is going to be
20 important, not just on the investment side but on insurance
21 and debt management as well. So that and the thinking about
22 the illiquidity of private equity in mutual funds and how --
23 how that can be put together with the fact that people are
24 wanting access to these companies before they have IPOed.
25 thank you.

1 MR. BERNARD: Great. Scot.

2 MR. DRAEGER: Thanks, Ed. First, very nice job
3 today leading this. So thank you for that.

4 MR. BERNARD: Thanks.

5 MR. DRAEGER: So I'm Scot Draeger. My
6 experiences are fairly broad. So I started my career here
7 at the Commission, which will forever be the best job I ever
8 had, and then was general counsel of a piece of Citigroup's
9 investment bank that was the back and middle office for the
10 mutual fund, private equity fund and hedge fund industries.
11 Practiced for 10 years privately, representing mostly fund
12 boards. And then now serve as president and general counsel
13 of an RIA that is about the same size as Jane's. So very
14 small in comparison.

15 I think I heard Alex say anything under 250
16 billion is now considered small.

17 MS. CARTEN: Look at all that opportunity we have.

18 MR. DRAEGER: So I think, you know, just to add a
19 little bit of levity to that, I think the last time I looked
20 at the IAA data, the average registrant RIA was somewhere
21 around a billion or so. So just to keep in perspective.

22 But today what I took from this is we have a fully
23 engaged group that has dedicated resources that are
24 substantial. And so there's an opportunity to do really
25 great work here.

1 I think the value proposition discussion was a
2 really wonderful one because I think, without question, we
3 all feel that from our clients, that the value proposition
4 of the value we add is changing and we're trying to get our
5 arms around that. And so trying to understand what we can
6 do as a group of industry leaders and regulatory leaders to
7 help investors have access to the tools that they want to
8 have access to, if we can do something to facilitate that, I
9 think we will have done good work.

10 I'm approaching this not from representing my
11 company or any particular interest but just trying to bring
12 experiences to bear to be of service.

13 MR. BERNARD: Great. Mike.

14 MR. DURBIN: Hi, Mike Durbin from Fidelity
15 Investments. I look after a line of business called
16 Fidelity Institutional, which is our clearing and custody
17 business, through which we're serving third party
18 intermediaries of all shape, size and form. We have a
19 capital markets business which includes a prime brokerage
20 offering as well as all the firm's securities lending,
21 securities financing activities. And then we have the asset
22 management distribution company.

23 Two things struck me from the day. Great day.
24 The first was the discussion in the middle panel about, you
25 know, sort of alternatives generally, private equity more

1 specifically. I think it would be -- if we're going to go
2 deep on this as a committee, I think it would be helpful to
3 narrow it a bit, because there is such a broad waterfront of
4 vehicles, expressions, asset classes, channels that we were
5 just noting one thing that we all conveniently avoided, I
6 think, is the notion of hedge funds. Which I'm not sure the
7 term was ever actually voiced, hedge funds and fund of
8 funds. There's probably something temporal around that. So
9 I think narrowing that, because it's such an important area,
10 might be helpful.

11 The second thing is, every panel, every
12 discussion, we touched on the disruptive power of
13 technology. Might be helpful to go a little deeper in some
14 of the use cases that are germane to the choice and
15 protection mandate, dual-hat mandate, you know, of the
16 Commission and the Division. Just as one example, there's
17 rentable technology now -- not from us, this is not an
18 advertisement. There's rentable technology now where,
19 mostly through startups but not exclusively, where you can
20 do index or strategy replication.

21 The bigger firms' role in that is we now can open
22 an account at zero minimum with zero commission and
23 fractional trading. So these are technologies going right
24 at the core of the collective vehicles, the mutual funds and
25 ETFs. And so I'm not saying we have to focus on that but

1 things that they face. They're probably similar to Jason's
2 but they'll be unique as women and minority-owned firms.
3 And I think it would be very interesting to hear their
4 perspective and the things that the SEC or we could do to
5 make sure they survive. So that would be my two cents.

6 MR. GREFF: Hi, my name is Paul Greff. I am the
7 chief investment officer for Ohio Public Employee Retirement
8 System. We manage about over \$100 billion in assets for our
9 members, the bulk of which is defined benefit. And our job
10 and staff is primarily to implement the board's asset
11 allocation and that's really, because we have a large
12 internal staff, we manage about 45 percent internally, is
13 always trying to figure out the optimization between active,
14 passive, external, internal. So a lot of what I was hearing
15 today really struck home, particularly the gentleman from
16 McKinsey talking about the trend in barbell. You know, here
17 I am thinking, you know, we're quite witty, but we're
18 tending to bring assets in house and reduce fees in those
19 asset classes that struggle to have active value and
20 reallocate that to those asset classes that add value net of
21 fees, whether the fees are large or not, such as, you know,
22 private equity and real estate. You know, we, like other
23 large pension plans, have large dollar amounts to allocate
24 to the private markets. So it's particularly of interest
25 and I think we have a good perspective when we discuss the

1 just representative of -- maybe go a little deeper when we
2 say disruptive technology, don't just say it and move on but
3 really go a little deeper, you know.

4 MR. BERNARD: That was on the short list of issues
5 we considered for today. So that's a point well made.

6 MR. DURBIN: Thank you.

7 MR. GARCIA: I'm Gilbert Garcia. And I always
8 enjoy, you know, dialogue like this. And ultimately, you
9 know, we have an incredible opportunity to do a lot of good
10 here. And I think keeping focused on the North Star is such
11 an important thing. And, you know, I got in the bond
12 business in 1983 at Salomon Brothers. And so I've been in
13 the bond business ever since. And I'm very sensitive to,
14 you know, small firms. I'm an entrepreneur. We're 15
15 billion, which I'm glad to know is bigger than the one
16 billion average but again way below 200 billion. And I also
17 see the North Star in someone like Jason because, you know,
18 we've got to be sensitive to these smaller firms, these
19 entrepreneurial firms. And of course one of the types of
20 firms that is so disproportionately represented in some of
21 the larger dialogue are women and minority-owned firms.

22 And so I have a keen interest in that because I
23 think it's important if they survive and participate in the
24 American dream. And so I would welcome the opportunity to
25 have a panel or something that talks about some of the

1 private/public aspect. And, you know, when we talk about
2 giving access to retail which I'm all -- you know, you would
3 think that, from a nonpartisan view, is the right way. But
4 from a selfish view could really impact our returns and our
5 ability and leverage to negotiate terms that we feel are
6 important.

7 You know, I think I can bring some perspective, at
8 least for the large pension plans, you know, who have dollar
9 amounts to put in this area and assumed rate of return that
10 are very difficult to hit if you don't include the
11 alternative asset classes.

12 MR. HALL: I'm Rich Hall. I'm the deputy chief
13 investment officer at UTIMCO, which is the investment
14 management company that manages the endowment assets for the
15 University of Texas and Texas A&M Systems. Deputy CIO means
16 I do everything the CEO doesn't want to do.

17 Our mandate is to, you know, create a perpetual
18 entity that can provide or maintain the purchasing power of
19 a \$50 billion endowment and have that available to future
20 generations of Texans to support scholarship and other
21 research endeavors.

22 I think two things struck my mind today or caught
23 my ear today. One, I didn't realize the impact of MiFID,
24 particularly on small investment managers. And the thought
25 for me is that supporting smaller firms or individuals who

1 are high talent and spinning out and creating their own
2 businesses has been one of the biggest alpha drivers for us
3 because these people are good enough that they actually can
4 spin out and create their own firms. And so if there are
5 structural disadvantages in place or put in place, that
6 would be detrimental to us in our mission.

7 The second thing is to think about the impact on
8 private markets of retail inclusion and how that works.
9 Kind of have three voices in my head arguing for different
10 perspectives. One is as an individual, I would love to have
11 access. As a shareholder of these companies, I'd love to
12 see them grow. And certainly retail access has long been --
13 I think, John, you can comment on this more, but the Holy
14 Grail of some of the private asset managers as they've grown
15 because they see this as a huge AUM opportunity to tap into.
16 And then thirdly, as an investor in the funds, you know, I
17 think my observation broadly is that many firms need to cap
18 their fund sizes in order to retain the level of returns
19 that they've achieved to date. So I don't think there's a
20 clean answer there but probably something worth delving
21 into.

22 MS. HATHI: Hi, everyone. Neesha Hathi. I am the
23 chief digital officer at Charles Schwab and Company. I have
24 been there actually it will be 16 years next month and have
25 had a lot of different roles. The chief digital officer

1 role is one that was created a couple years ago after I
2 spent a few years in retail and many years in our adviser
3 services business where we serve registered independent
4 advisers. And the role really is around managing all of our
5 client-facing technology, so all the technology that
6 supports our retail clients as well as our RIA clients. And
7 I also lead our robo adviser business which was talked a lot
8 about today.

9 First of all, it's really great to be here and
10 hear all the perspectives. We participate in so many
11 different, little parts of the industry, so it's great to
12 hear all that's going on that's, you know, different than
13 what we are thinking about.

14 A couple things that stood out to me, one is just
15 that the public/private market conversation. I was just
16 talking to somebody about this. It was interesting that,
17 you know, there's a -- we also tend to worry a lot about the
18 retail investor and how we protect that retail investor.
19 And it was interesting to me that we didn't talk about are
20 there incentives that you can create to get more of these
21 companies to go public sooner. We talked more about how do
22 you get to the private market. And so just it would be
23 great to leverage the public market structure and get more
24 companies to actually go earlier, if there was an
25 opportunity to figure out how to create an incentive to do

1 that.

2 A second thing that stood out to me was just the
3 ESG conversation and theme that kind of went through a
4 number of topics today. And, you know, especially in our
5 Schwab Intelligent Portfolios, our robo advice business, we
6 have not pursued ESG at this point. And one of the reasons
7 for that is because of this definition problem that I think
8 we see. If I think of what it means to me versus what I
9 think it probably means to each person in this room, it
10 means something a little bit different. And so I think
11 figuring out how we define that or decide not to define it
12 and let folks customize it in a way that feels appropriate
13 in some sort of framework is something that I think would
14 not only help from a regulatory perspective and make sure
15 that we're, you know, not greenwashing -- I had never heard
16 that term -- but greenwashing, but also provide customized
17 solutions the way clients want them to be for themselves,
18 given the own values and beliefs that they have. So,
19 anyway, those are things that stood out.

20 MR. JIVRAJ: Thanks, Adeel Jivraj. I am an audit
21 partner with Ernst and Young, specializing in the audits of
22 mutual funds and private equity funds and hedge funds. I
23 also had the privilege and honor of serving on the Staff
24 many, many years ago as an assistant chief accountant within
25 the Division of Investment Management.

1 A lot of things stuck out. You know you had a
2 good day when you walk away learning something new with new
3 insights and new perspectives, and that certainly was -- was
4 today. Certainly the conversation of private and public
5 securities and how pension endowment funds have the ability
6 to invest in private securities where 401(k) plans are
7 limited in that and how that could be hurting the investor
8 and how it potentially could allow access with the right
9 protections around certain outcomes.

10 So I am certainly looking forward to serving with
11 all of you and honored to be on the committee.

12 MR. LUDT: Good afternoon. I'm Ryan Ludt. I have
13 spent the last 25 years of my career at Vanguard, the first
14 20 years or so of that in the portfolio management and
15 trading space on the equity side of things and then the last
16 handful of years running our ETF capital markets business.
17 Which means we work in the marketplace, looking after the
18 health of our ETFs, trading volumes, spreads, working with
19 regulators and the exchanges to help our ETFs and help
20 investors in the marketplace thinking about trading in
21 liquidity.

22 So again, echoing a lot of the previous comments,
23 certainly happy to be here and very happy to be part of this
24 and looking forward to future conversations and helping.

25 The two themes I think that stood out to me were

1 the use of technology and really where that leverage comes
2 from. And that to me seems like it's beneficial from the
3 asset management side of things and from the client side of
4 things, as well. And, you know, I myself and our firm have
5 been thinking about what does that look like and how can we
6 continue to leverage technology to improve outcomes?

7 And I think that also probably feeds into the
8 second point and this is this idea of ESG and thinking about
9 what does ESG look like, how do we think about definitions
10 of that? But probably equally important is there probably
11 are no two definitions of ESG that are the same for anybody.
12 And so as you think about some of the comments around mass
13 customization and the capabilities that would be needed to
14 really feel good about that, I think, you know, that's where
15 those two topics of ESG and technology will pull together.

16 MS. MCGEE: Hi, I'm Susan McGee. I'm an attorney
17 by profession and spent my career in an asset management
18 business at a small fund complex. Interfaced with Jane
19 quite a bit. And in my new role, I'm on a few boards for
20 Goldman Sachs, so it's a very different world for me.

21 And what is interesting about the small funds is
22 when new regulations, new requirements are imposed on small
23 funds, small funds have to be creative. They don't have a
24 lot of resources. And that's what I have noticed at
25 Goldman, something comes out and they have the money to go

1 Morningstar Research Services. Thank you very much for
2 letting me be a part of this committee. I look forward to
3 what it's going to do.

4 At Morningstar Research Services, essentially, I
5 work with our analysts there, more than 120 globally.
6 They're engaged in conducting qualitative research on
7 managed investments, which typically take the form of mutual
8 funds, ETFs and their equivalents abroad, culminating in a
9 rating that we assign that's known as the analyst's rating,
10 and then also responsible for coordinating any thought
11 leadership, perspective setting, context setting research
12 that our team streams out into the market to help investors
13 to make more informed choices, we hope, as well as
14 overseeing our other ratings methodologies, a few of which
15 were referenced during the course of presentations today.

16 In terms of takeaways for me, thank you for a very
17 informative day. I really enjoyed each one of the
18 presentations that was made. I think that probably one of
19 the things that was especially, I guess, resonant for me was
20 the changing nature of the relationship between asset
21 manager and client. I think the way we would have defined
22 that relationship, that we would have measured the efficacy
23 of that relationship, what success meant, is going to
24 change, as we can tell, very meaningfully, if it hasn't
25 already, over the course of the next five to 10 years. And

1 to buy, to hire. And so I do think it's important to listen
2 to small funds.

3 What I guess the two things that stuck out to me
4 today was -- and I had not heard this before, was that the
5 trend -- and several presenters brought this up -- the trend
6 is going to be that investors are looking for outcomes. And
7 if you kind of think about that and take it to a logical
8 conclusion, that's going to change -- that will be very
9 disruptive to a lot of asset managers that are not full
10 service, to private banks, et cetera. It's like, is the
11 world moving to a family office environment? So that's
12 something for me to think about.

13 But I think the one thing that is most important
14 was the globalization issue. And, you know, we're here
15 talking about how can we make the U.S. environment better,
16 so we have some -- you know, some control over that future.
17 But with the globalization, we don't. And I'm just really
18 curious -- I didn't get to speak with Raquel that much --
19 but how do you have -- how do you interact and how do you
20 have any kind of influence, particularly on regulators that
21 could care less about the U.S., you know, these days? So
22 it's a tricky environment. So I think it's a very difficult
23 environment, but I think it's critical. So that kind of
24 piqued my interest today.

25 MR. PTAK: Hi, I'm Jeffrey Ptak. I'm from

1 with that, there are attendant implications that I would
2 imagine we as a subcommittee and, of course, the Commission
3 would have to consider. What does it mean to protect an
4 investor? What does it mean to help to ensure that they're
5 informed about how it is they're defining success in the
6 relationship that they've entered into with the asset
7 manager or wealth manager or other provider that's helping
8 them to achieve their goals? And I think the way that they
9 would answer that question going forward will be a bit
10 different than the way they might have answered it in the
11 past where, perhaps, there was a rating that would denote
12 their level of success, there would be excess return, alpha
13 and other financial measure. That might not work for them
14 going forward. And so, obviously, we have to adapt.

15 I would say the other quick takeaway for me, and I
16 won't belabor it because it's already been discussed, public
17 versus private. You know, and giving retail access to
18 privates, I think it's a very, very interesting issue. But,
19 you know, I happen to look at the success of things like
20 target date funds and I guess I come away with a slightly
21 different conclusion. I feel like those have been, by many
22 measures, a runaway success for investors. And I don't feel
23 like they've been deprived by not having access to privates
24 within those structures. And I do worry about some of the
25 implications of them having access to illiquids within

1 there, given the fact that it is sort of a mass market
2 investment option that's available to so many members of the
3 investing public. But I also look forward to learning more
4 and perhaps it will change my view.

5 MR. SIRRI: My name is Erik Sirri. I'm a college
6 finance professor. I teach at Babson College. I'm also a
7 trustee of some mutual funds -- and ETFs. And I did a
8 couple stints here at the SEC.

9 I think that the things that struck me today, I
10 guess I would say there were two. One was the emphasis on
11 outcomes. I guess I was a little bit surprised to hear
12 that. It seemed like it was more than marketing for some of
13 them. It's hard for me to see how that gets generated
14 absent some kind of a principal contract or a principal
15 guarantee, whether an insurance company or otherwise. But
16 nonetheless, I thought that was -- you know, a couple people
17 mentioned that and that was interesting.

18 With regard to the public/private, I thought, you
19 know, it's an important topic. It's comprehensively within
20 the SEC's mandate. It triggers investor protection. But it
21 also triggers capital formation. So you've got both sides
22 of that mandate coming in there.

23 But it's, you know, such a complicated problem. I
24 mean, we didn't even start to break down the pieces. It was
25 an introduction. But set aside the format, do investors --

1 face on the New York Stock Exchange, where we are the
2 designated market maker for about 35 to 40 percent of the
3 names on the New York Stock Exchange. And so we focus on
4 the very liquid markets.

5 We've seen the evolution or revolution on that
6 side of the market as more products become electronically
7 traded with transparent price discovery. You know, equities
8 for a long time, futures some of them, now nearly all of
9 them. And, you know, we think that transparency and price
10 discovery are kind of the keys to people making effective
11 and accurate investment decisions.

12 So two things that -- one that came up and one
13 that maybe didn't come up. The public/private thing was
14 interesting for us, which might sound counterintuitive. But
15 I think we believe that there is -- you've got to
16 distinguish private from very early stage to -- particularly
17 when you talk about companies -- to sort of the pre-IPO
18 stage and when is it appropriate for retail investors to
19 have access might be a question of life cycle and also
20 incentives for that company to go private at some point in
21 the near future. The reciprocity to that is perhaps having
22 nonaccredited investors or lower level of investor having
23 access to companies then.

24 So I think we've heard a lot about private/public,
25 but I think it's trying to find some guardrails and limits

1 would investors reasonably guarantee, just from the economic
2 exposure -- set aside how they get at the exposure -- if
3 they had it in their portfolio. If it's an efficient asset,
4 you know, an incremental amount should help them. And then
5 even if it would help them, are the frictions that it would
6 take to adequately getting it in the portfolio, do you eat
7 up the incremental return? I don't know. You know, that's
8 a tough thing.

9 You could see like the monitoring of that, maybe
10 it doesn't even occur at the product level. Maybe it occurs
11 at the level outside the product, like at the adviser level.
12 Or maybe it takes a whole new product. Maybe it's not an
13 open-end mutual fund. Maybe it's something else or
14 something with a different set of exemptions around it. I
15 don't know. But it seems to me that was a pretty important
16 set of issues. So I am looking forward to seeing what we do
17 with that.

18 MR. SUBRAMANIAM: Hi. Rama Subramaniam, echoing
19 everyone's comments. Thanks to the SEC and Ed for the
20 organization. A lot of information. I definitely learned a
21 lot.

22 I am from GTS Asset Management. GTS Asset
23 Management is part of the wider GTS Group. We are probably
24 better known as a participant in the very liquid markets as
25 a market maker, primarily in U.S. equities, with a public

1 around that beyond people getting some access through target
2 date funds or mutual funds. So I think focusing on trying
3 to narrow the scope of that, of finding something meaningful
4 to do in that space, I would definitely love to be a part
5 of.

6 The other thing we didn't talk about, we talked a
7 lot about fees. We didn't talk about the cost of trading,
8 impact on liquidity for, you know, a lot of the funds,
9 right? There's been the growth of passive funds, there's
10 been less trading, particularly for, again, U.S. equities.
11 You see a rush of trading at the end of the day. And, you
12 know, I'm not sure it's a topic if you sort of focus on
13 costs to the investor. On the one hand, we see a lot of
14 liquidity when markets are fine. But that liquidity seems
15 to disappear very quickly as soon as there's some
16 turbulence. And so with more and more electronic trading
17 and technology being thrown at trading and a lot of trading
18 being automated, what is the impact for the Main Street
19 investor is something that didn't come up. And I just
20 wonder whether -- you know, we talk about fees, but we don't
21 talk about the impact of electronic trading on investors'
22 returns and investors' costs.

23 MR. SUYDAM: Hi, John Suydam at Apollo Management.
24 My background is on the legal side. I'm the chief legal
25 officer at Apollo. So I work with the legal, compliance and

1 tax structuring teams at Apollo. I've been involved in the
2 private equity and private markets my whole career, 30, 32
3 years.

4 I thought today was extremely informative. There
5 were a lot of things that we covered, some of which are very
6 connected and, frankly, it just raised a lot of questions,
7 the things I heard of additional things I'd like to learn
8 more about. Even, you know, the talk about fees and the way
9 in which research costs are being paid for may be pulling
10 back the amount of research that's available, which I
11 believe indexation and other things that have been going on
12 within the public markets are already pulling back the
13 availability of research. And if we see a trend line of
14 8,000 public companies going down to 4,000 and you've got
15 small and middle market companies right now with no dollars
16 going to research them, is that a trend that's going to
17 continue? And, you know, the trend we're seeing will get
18 exacerbated which then impacts a lot of the other things we
19 were talking about between public markets, private markets.

20 So I think there was a lot to learn today and I
21 think it's far more interconnected than we even think
22 looking at it initially.

23 MR. TIBERGIEN: Yes, I'm Mark Tibergien, I run the
24 RIA custody business at BNY Mellon Pershing. I am also
25 senior leader in BNY Mellon, which has about 35 trillion of

1 assets under custody globally. And we are a systemically
2 important financial institution, which was referenced
3 earlier. So everything that was talked about will keep me
4 up tonight. So thank you for that.

5 So I -- yeah, I'm trying to keep it local and
6 manageable to the points that you're talking about that are
7 things that would be interesting to address. And if I
8 connect some of the dots, probably in addition to everything
9 else that was said, one thing that jumped out at me early
10 was the issue around age demographics. The question that
11 comes up is how, as a business, do we become relevant not
12 just to clients but also to talent? How do we become a
13 business that anybody even cares about? Because, obviously,
14 we have reputational damage and other issues that we have to
15 look at.

16 But I thought that one of the quirky things that
17 came out is that we seem to have difficulty defining who
18 that end person is. Are they an investor? Are they a
19 consumer? Are they a client? Are they a customer? And all
20 of this makes a difference in how we ultimately look at the
21 market. And so I think that this question of being relevant
22 to the next generation of end users or end customers really
23 becomes critical.

24 The second thing that jumped out at me is clearly
25 we are a business that has gone from being investment

1 forward to planning forward to experience forward today.
2 Yet we're still linked to the old model of pricing. This is
3 the only profession where the clients pay for the value they
4 bring rather than the value the provider brings. And it
5 would be like my doctor charging me by the pound; I would be
6 overpaying every time.

7 No comments. Nobody has to add to that.
8 (Laughter.)

9 MR. TIBERGIEN: So the issue is around cost and
10 pricing and profitability within this business. Because
11 clearly, there is an element of disfunction in the economics
12 of the enterprise. And I'm not sure that as a business,
13 we're transforming fast enough in a way that other
14 industries have been hit by disruption. And that's
15 something that I would take a look at.

16 MR. WERMERS: Russ Wermers. I am a professor of
17 finance at the University of Maryland. And, first of all, I
18 would like to commend Ed, you and Dalia and the remainder,
19 Christian and so on, for assembling such a great blue ribbon
20 panel of committee members. I am honored to be a part of
21 this.

22 So background on myself, I have been an academic
23 for 25 years now, focusing on research on public asset
24 managers, mutual funds, generally. More recently, I have
25 been doing some work and become more interested in private

1 -- private equity funds and have done some work on that
2 recently.

3 That said, I think I have a lot to learn from the
4 other committee members and I learned a lot today from the
5 speakers. The speakers were really great, too, in terms of
6 the things that I don't, you know, see in my ivory tower or
7 research. So I'm looking forward very much to continuing
8 learning from this and hopefully perhaps bringing some of my
9 own expertise into the committee.

10 Beyond that, I guess, so I've done -- I do some
11 consulting in the asset management industry. I think most
12 relevant to my outside academic experience is that I've been
13 a frequent expert witness for ERISA cases, lawsuits against
14 the defined contribution plans. So I am intimately familiar
15 with Gartenburg factors, with the litigation risk and the
16 economics of the defined contribution plans and why they are
17 being pushed toward a certain way of doing things.

18 That said, I think I am -- I was really, before
19 coming into this meeting, I was interested in private
20 investments by public funds. I think there are a lot of
21 barriers to this. And then I heard about private
22 investments in target date funds. So, Jeff, you articulated
23 some concerns. I think it's a great topic to think about
24 though. I'm not sure how I feel about this. But there is
25 some resonance of that with me.

1 And then I think, like Mark, I think it's great if
2 we -- we talked a little bit about structure of fees. Not
3 nearly enough, though. I think this is one thing that needs
4 to be confronted by especially active managers, is how to
5 risk share. In other words, incentive-based fees or at
6 least partly incentive-based fees. Why isn't this evolving
7 in the industry? Perhaps there are great reasons for this.
8 But it seems like a natural way for active managers to, you
9 know, win back their clients if they're worthy of such.

10 So I think most of everything else has already
11 been discussed so I will stop there.

12 MR. SAVAGE: Thanks, Ed. I'm Joe Savage. I'm a
13 vice president in the Office of Regulatory Analysis at
14 FINRA. I'm a nonvoting member of the committee.

15 I just want to echo Russ, it's a real honor to be
16 a part of this group, a lot of really smart folks from a lot
17 of different backgrounds and I feel really lucky to be part
18 of this group.

19 I really learned a lot today from the
20 presentations. You know, at FINRA, we don't regulate
21 investment advisers or investment companies. But we do sort
22 of overlap with the asset management world in a number of
23 ways. We are the entity that primarily looks at ads for
24 mutual funds and variable insurance products. You know, we
25 go into a lot of jurisdictional questions which I'm involved

1 with about where does our jurisdiction end and where does
2 the state or the SEC's jurisdiction over advisers begin.

3 You know, in terms of things I'm involved with,
4 I'm working a lot on Reg BI these days and also I'm sort of
5 the primary guy behind this rule set for capital acquisition
6 brokers which are smaller sort of boutique investment
7 banking firms that either are consultants to capital raising
8 or they're finders or placement agents for institutional
9 investors. So I'm interested a lot in the private placement
10 side.

11 The other thing that really struck me was the
12 first presentation from Mike and Ben about information and
13 how much that's changing the industry and it really made me
14 think about, you know, whether we're heading toward
15 something where there's going to -- at least at the retail
16 level, there's going to be algorithms that will determine
17 our financial needs based on, you know, what stores we shop
18 at online and how many cat videos we watch and, you know,
19 it's a little scary. I think Commissioner Peirce mentioned
20 that as well. And so that's something that really struck
21 me.

22 MR. GLASS: Alex Glass. I have been the Indiana
23 Securities Commissioner since July 2015. Basically, the
24 securities division, there's, at a high level, three main
25 functions. There's investor education, registration of

1 securities products and the individuals who sell those
2 securities products, and then enforcement if people get in
3 trouble. But really, as a state regulator, our key aspect
4 of what we do is investor protection.

5 So based on a lot of the discussions today, my red
6 flag of regulator -- my regulator red flag went up. You
7 know, particularly when we're talking about access to
8 private markets. That's obviously something, you know, when
9 we're talking about protecting Hoosiers, that always makes
10 me very uncomfortable. Another thing, something we see
11 quite a bit, is just disclosure issues. So when Jason was
12 talking about who's paying for the research, I in the future
13 see an enforcement action where somebody is not properly
14 disclosing to investors who is actually paying for the
15 research.

16 So very, very interesting conversations today. As
17 everybody said, I'm happy to be part of the group.

18 Another thing I recently took on this year is I am
19 the chair of the IA section for NASAA. So learned a lot of
20 that, hearing a lot of other conversations that I think
21 we'll be able to contribute and be a good part of this
22 group.

23 MR. BERNARD: As I was very familiar with the
24 material -- not all the material they were going to present,
25 but certainly who the presenters were from the work we did

1 preparing, I also had the good fortune to have a phone
2 conversation with each of you, most of you back in October.

3 My observation would be simply that Dalia and her
4 team did a superb job building a really remarkable committee
5 that spans across the industry, universally, with
6 experienced, senior folks. And I'm -- particularly as your
7 chair, I'm greatly relieved to have this much intellectual
8 capital surrounding us and look forward to working with all
9 of you on -- so far, I haven't seen any topics on the list
10 that aren't a little bit vexing. But we'll sort it out.

11 Is there anything you want to say in closing?

12 MS. BLASS: I just want to thank you all. Hearing
13 you go around the table, a lot of the issues you raised I
14 actually have asterisks, notes all over them. So a lot of
15 this stuff is the same thing on my mind.

16 It's really, really good to hear both agreement on
17 issues that we need to be taken up, but also different
18 perspectives on the same issues. I really look forward to
19 the work of this committee, your engagement, and hopefully
20 the recommendations that you give us. So I am very, very
21 grateful for your time.

22 I found the presentations fascinating. I will
23 echo those of you who said that you learned something today.
24 I learned more than something; I learned quite a lot and I
25 think my staff did, as well.

1 So I has a notepad that's full, which says
 2 something, because I usually do not take notes because I
 3 can't read my handwriting that well. So it was really,
 4 really very informative and I really look forward to working
 5 with the committee.
 6 MR. BERNARD: I'm going to call that a win. So
 7 we're done. Anyone who's got to run, by all means do so.
 8 The Staff have moved some -- all those treats that
 9 disappeared, that was to sort of encourage us to move along.
 10 No, they moved them back up to nine, where we had lunch. So
 11 anyone who would like to stay, hang out for a bit, please
 12 feel free to do so. But by no means feel obliged to. We
 13 know that you've had a full day. Most of you had to travel
 14 a long way. But if you've got time until your airplane,
 15 come on up and hang out with us for a little bit.
 16 Thanks, all. And you'll get an email from me
 17 tonight and then you'll hear about next steps.
 18 (Whereupon, at 4:31 p.m., the committee meeting
 19 was adjourned.)
 20 * * * * *
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 25

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