

## Highlights From SEC's Asset Management Conference

On May 19, 2023, the SEC assembled a host of industry participants and academics for an inaugural conference to discuss emerging trends in asset management. Topics included:

- Corporate governance and civic democracy
- Private funds, investor protections, and industry concentrations
- Investment complexity and outsourced services
- Retail investors, fund trends, and investment innovation

The esteemed panelists highlighted the complexity of these issues and why there is no clear-cut, simple path forward as the SEC continues deliberations on a record number of proposed rules.

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### Opening Remarks

SEC Chair Gary Gensler's [introductory remarks](#) cited several data points on the growth in the asset management sector:

- Registered investment advisers (RIAs) manage more than \$110 trillion in assets across more than 50 million clients
- SEC-registered investment fund balances have grown to more than \$30 trillion in more than 16,000 funds
- The private fund industry has grown to \$25 trillion<sup>1</sup> in gross assets, which is now larger than the \$23 trillion<sup>2</sup> in the commercial banking sector
- Since 2017, the number of exchange-traded funds (ETFs) has grown by more than 50% to roughly 3,000 funds and assets of approximately \$7 trillion

Gensler also highlighted three emerging trends and the related, recently issued proposals:

- The use of third-party service providers by investment advisers. See "[New Outsourcing Rules for Investment Advisers?](#)"
- The use of qualified custodians. See "[Expansion of Adviser's Safeguarding & Custody Rules?](#)"
- The evolving challenges regarding cybersecurity and protecting customer information. See "[New Cyber Rules Proposed for Investment Funds & Advisers.](#)"

### Corporate Governance & Civic Democracy

The panelists primarily discussed corporate governance of asset managers as it relates to how they vote proxy shares on behalf of their fund's investments. This is relevant because the three largest asset managers (BlackRock, Vanguard, and

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<sup>1</sup> Based on Form ADV filings through March 31, 2023. Represents the sum of RIA gross asset value and Exempt Reporting Adviser gross asset value, less estimated overlap.

<sup>2</sup> See Federal Reserve, "Assets and Liabilities of Commercial Banks in the United States" (May 12, 2023), available on the [Federal Reserve site](#). Total assets of approximately \$22.9 trillion (Table 2, Line 33).

State Street) own 26% of the S&P 500 based on their fund's investments. Individual investors directly own about 25% of shares in publicly traded companies. Historically, public company shareholders have been "rationally apathetic," *i.e.*, most either did not vote or followed management's recommendations, on the assumption that company directors were better informed about a corporation's best interests.<sup>3</sup> Shareholders have recently begun voting against management in larger numbers and are demanding more engagement on certain topics, most notably on environmental, social, and governance (ESG) issues.

The panelists agreed that most asset owners are not clear about their objectives or may have multiple objectives in investing, *e.g.*, better returns, improved risk management, and/or influence on societal issues. For pension and retirement plans, the asset "owner" is not clear; is it the retirement plan or the plan's covered employees' wishes that should be considered for proxy voting? This ownership conundrum also is true for sovereign and endowment funds.

On ESG issues, the panelists cited the imprecision of current language/definitions and challenges around fund naming conventions. In many cases, the portfolio of an ESG fund may differ from a non-ESG fund by a single stock. Empirical and academic research is mixed if ESG-labeled funds outperform or lag non-ESG funds. The panelists generally agreed that individual state anti-ESG legislation undermines strong national regulation.

Recent statistics on ESG proxy proposals include:

1. At Fortune 250 companies, there were 221 ESG-related resolutions submitted for consideration in the first half of 2022, up from 128 in all of 2021.<sup>4</sup>
2. Nearly 40% of large cap public companies faced a shareholder vote on ESG issues in the second half of 2022.<sup>5</sup>
3. At all companies, the number of climate-related shareholder proposals more than doubled from 2021 to 2022.<sup>6</sup>

The panelists generally agreed that European solutions may not be a viable path forward either due to difference in underlying market size or market structure. For example, panelist Carsten Stendevad, currently with Bridgewater but previously the CEO of Denmark's national pension plan, discussed the reasons the European use of exit pricing or swing pricing to protect investors from dilution would not work in U.S. markets (see "[Funds Face New Liquidity & Swing-Pricing Requirements](#)").

The panelists universally cautioned against overregulation that might result in reduced investor choices or limit access to asset management services.

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<sup>3</sup> "From Apathy to Activism: The Emergence, Impact, and Future of Shareholder Activism as the New Corporate Governance Norm," bu.edu, 2019.

<sup>4</sup> "ESG-Related Shareholder Proposals – Takeaways From the First Half of 2022," orrick.com, July 25, 2022.

<sup>5</sup> Ibid.

<sup>6</sup> "The Corporate Proxy Ballot Takes Center Stage for ESG," forbes.com, November 10, 2022.

**Panelists:**

*Dalia O. Blass, Former Head of External Affairs, BlackRock*

*Carsten Stendevad, Co-CIO for Sustainability, Bridgewater Associates*

*Lisa M. Fairfax, Presidential Professor, University of Pennsylvania Carey Law School*

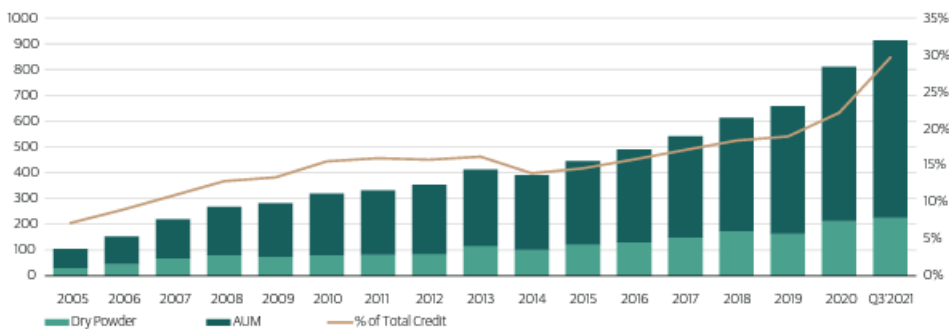
## Private Funds, Investor Protections, & Industry Concentrations

Professor Cathy Hwang addressed corporate governance. Many of her insights mirrored earlier speakers and her comments are included above. Professor Elisabeth de Fontenay discussed two topics: private credit funds and the regulatory protections between private fund managers and investors.

### Private Credit Funds

Private credit funds are beginning to replace commercial banks for middle market financing. Forbes reports that private credit investing has grown 25% over the last two decades, and in 2021, private debt investing stood at \$1.2 trillion.<sup>7</sup> De Fontenay highlighted some benefits of private credit funds. The different business cycle of banks versus credit funds means that while banks may be pulling back on lending due to current economic uncertainties, credit funds are sitting on “dry powder” that can still be deployed. Credit funds are closed-end and, therefore, not as susceptible to deposit runs as capital is contractually locked in for longer time frames. De Fontenay was concerned that in the recent age of low interest rates, capital was chasing companies and may have been propping up marginal businesses. In a rising interest rate environment, there may be a wave of restructurings or bankruptcies coming. She also pointed to a lack of disclosure in this shadow banking sector, especially around leverage.

EXHIBIT 2: US Private Credit Market / % of Total Credit Market



Source: Preqin, Credit Suisse, As of September 30, 2021; Total credit market defined as the aggregate of the high yield bond, senior loan, and private credit markets. Senior loans refers to broadly syndicated loans.

<sup>7</sup> “Private Credit Investing: Current Opportunities and Risks,” forbes.com, March 30, 2023

## Private Funds Investor Protections

De Fontenay then offered her insights on investor protections in the private fund space. Currently, private funds are governed contractually by the limited partnership agreements, side letters, and management agreements because investment in private funds is limited to sophisticated accredited investors. In February 2022, the SEC issued a proposal that would significantly expand the regulation of private fund advisers, including:

- Require SEC-registered private fund advisers to give investors a quarterly statement with details on fund performance, fees, and expenses
- Require registered private fund advisers to get an annual audit for each private fund
- Require registered private fund advisers to obtain and distribute to investors a fairness opinion for adviser-led secondary transactions, along with a written summary of certain material business relationships between the adviser and the opinion provider
- Prohibit all private fund advisers, including those that are not registered, from certain activities and practices

See [“SEC Proposes Extensive Private Fund Reforms.”](#)

As an alternative to regulation, De Fontenay suggested simply requiring disclosure of all fund documents (properly redacted) could be sufficient to level the playing field and facilitate greater standardization, similar to what has happened in the venture capital space. She disapproved of allowing retail investors to participate in the private fund space primarily because it is not clear if private fund returns beat public market investing and, secondly, due to the lack of diversification and liquidity.

The professor cited increasing regulation as a barrier to entry for smaller funds and one of the causes for increasing industry concentration. She cautioned the SEC to consider the cost of newly proposed regulation, especially for smaller fund managers.

### *Panelists:*

*Elisabeth de Fontenay, Professor of Law, Duke University*

*Cathy Hwang, Barron F. Black Research Professor of Law, University of Virginia*

## Investment Complexity & Outsourced Services

### Should Index Providers Be Regulated as Advisors?

Professor Adriana Robertson first addressed the role of specialized index providers and if they meet the definition of a subadvisor that should be subject to SEC oversight. She highlighted the investment advisor definition in the *Investment Advisers Act of 1940*:

*“Any person who, for compensation, engages in the business of advising others, either directly or indirectly or through publications of writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, of who, for compensation and as part of regular business, issues or promulgates analysis or reports concerning securities*

*... but does not include the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation.”*

The Supreme Court ruled in the 1985 Lowe case that the publisher’s exclusion depends on whether the advice is general or personalized to the client. While a general S&P 500 index would likely fall under this exclusion, the development of highly specialized and bespoke indexes likely are more personalized in nature and should be regulated or formally exempted.

Robertson also highlighted the “closet activeness” of passive funds, noting that many indexed ETFs and open-end mutual funds are very active based on conventional measures. Research has shown that more active index funds and ETFs usually have a worse performance compared to less active funds.

## ESG Ratings

Robertson concluded her remarks with the complex role of ESG ratings. Criticisms leveled against the ESG rating industry include:

- Methodologies that differ across providers
- ESG ratings have low correlation across providers
- Methodologies change over time

Additional work is needed to determine whether this is a real problem.

Professor Dirk Zetzsche discussed multi-tiered service chain in the asset management sector and advocated for regulation of new digital finance platforms.

### *Panelists:*

*Adriana Z. Robertson, Donald N. Pritzker Professor of Business Law, University of Chicago School of Law*

*Professor Dirk Zetzsche, ADA Chair in Financial Law, University of Luxembourg*

## Retail Investors, Fund Trends, & Investment Innovation

The session began with insights into and challenges facing the ETF industry. A report by Oliver Wyman notes that as of the end of December 2022, total ETF assets under management have reached \$6.7 trillion, at a rate almost three times faster than traditional mutual funds.<sup>8</sup> Panelist Eric Balchunas was bullish on the continued growth in ETFs due to their passive, cheap, and simple nature.

<sup>8</sup> “The Renaissance of ETFs – Exchange-traded Funds Are Fueling Marking Opportunities,” oliverwyman.com, 2023

Panelist Anne Robinson highlighted innovation at Vanguard. Retail investors demand a simple, clear platform for financial planning. As advisers move from traditional brick-and-mortar offices, regulations may need to be refreshed. Information delivery mechanisms that predate the computer also need to be updated.

Professor Urska Velikonja brought the conversation back to pass-through voting issues and who retail investors are and what they want. Retail investors vote for equity shares they own directly 30% of the time. Voting increases when firms send out paper ballots. Retail investors also typically support management in their voting. Retail investors not happy with a firm's performance or management usually will sell their shares.

*Panelists:*

*Eric Balchunas, Senior ETF Analyst, Bloomberg Intelligence*

*Anne E. Robinson, General Counsel and Corporate Secretary, The Vanguard Group, Inc.*

*Urska Velikonja, Anne Fleming Research Professor, Georgetown University Law Center*

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## Contributor

**Anne Coughlan**

Director

[anne.coughlan@forvis.com](mailto:anne.coughlan@forvis.com)