IMpact: An investment management podcast series

Episode 2: Evolving landscape of investment management regulations

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Reese Blair: *Hello, everyone. I'm Reese Blair, your host of IMpact, the new investment management podcast series from Deloitte. IMpact brings you hot takes and fresh perspectives from top experts in the industry. Whether we're discussing issues like regulation, recession, or resiliency, we'll take a deep dive into the latest news, trends, and challenges facing investment management professionals. So, tune in, learn something new, and walk away with insights that will help you make an impact on the IM industry and the world around you.*

Reese Blair: I want to say welcome back, *IMpact* series podcast listeners. We are thrilled to have you joining us for our second episode in this series. Today, we really want to spend time unpacking a topic that's truly top of mind for our investment management leaders, and that is the regulatory environment. Now, over the past few years, regulation has been coming out of the Securities and Exchange Commission, or the SEC, at such a rapid pace that firms are asking themselves, "How do we stay afloat through this wave of change?" Joining us to dive into this topic is Jason Nagler, senior director of the Investment Company Institute. Jason, welcome, we're so thankful to have you with us today.

Jason Nagler: Yeah, thanks, Reese. I'm super excited to be here. I started my career at Deloitte, and I'm really happy to be back on the podcast with you.

Reese Blair: That's exciting, Jason, so good to have you with us. I consider myself a lifelong learner, Jason, and from our initial conversations getting ready for this interview, I was so engaged learning from your perspective and insights into our industry. And I'm really excited, quite honestly, that we have the opportunity to share that knowledge with our listeners today. And as always, I'm eager to learn something new. In fact, I've been asking our guests to share either a book they're currently reading or one of their all-time favorites. So, before we jump into today's topic, I'm curious: What book has really made an impact on you that you'd be willing to share with our listeners?

Jason Nagler: Yeah, no, happy to do that, Reese. So, I'm a huge fan of Michael Lewis, and I'm sure many of the listeners are familiar with *The Big Short*, *Liar's Poker*, *Moneyball*. I love one of his first books after *Liar's Poker*, *The New New Thing*, and that's a book about a Silicon Valley entrepreneur named Jim Clark. He was the first person to start up three $1 billion market-cap public companies. And they follow Jim Clark through this book and his journey on starting these new companies, and he is constantly seeking this new, new thing. And the book really delves into the struggle between his technical brilliance and constantly trying to find innovation and move forward. And as he starts these companies, he tends to get pushed out—kind of like Steve Jobs did at Apple—and they bring in more business generalists to move his companies forward, and then he keeps on starting new companies. And so, I find that really interesting. I think that happens every day in our industry—that kind of struggle between the technical and the business generalist and the visionary thinking. And I think it applies to what we do every day to move our industry and business forward but, at the same time, being mindful of the ever-evolving regulatory landscape, especially in financial services and investment management.

Reese Blair: Jason, that is fantastic. Look, there's always so much insight provided by Lewis and any writing, any of his books. In fact, I want to say he even has a podcast. Great recommendation, thank you for sharing that with our listeners. Hey, before we dive deeper into the regulatory environment and the topic for today, I really want to set the stage for our listeners. Now, we talked about you being a senior director at the Investment Company Institute, and we also talked about you having your background at Deloitte. So, maybe, could you just share a little bit about your background in general, the journey that you've had thus far with your career? And then maybe we'll pivot to talking about the Investment Company Institute's role in the industry as well as its relationship with the SEC.

Jason Nagler: Yeah, happy to do that. So, as you mentioned, I started my career at Deloitte, and I was in the Boston office for Deloitte auditing a lot of mutual funds and private equity clients that were there, also audited some small technology clients. And after a few years, one of my clients suggested moving over to being the preparer of financial statements and overseeing fund administration. And so, I did that at GMO, that's a Jeremy Grantham shop in Boston. And then headed to PIMCO in New York City where I did something very similar, and I was a deputy treasurer of their funds. So, really interacted a lot with the audit firms and our front office kind of figuring out how to account for difficult-to-value instruments and all those kind of things that go along with fund administration oversight. And after I had all that experience, this role came up in Washington, DC. And this is a much different role than what I've done in my career. In my career, I was focused on the operations of mutual funds, cutting NAVs, ensuring the accounting was accurate, protecting shareholders, all the things that you do. But this is a role that's really much more focused on policy. And so, the ICI, we're the trade association for the regulated investment companies industry. Our members include mutual funds, ETFs, closed-ended funds. The ICI's global, so we represent our members in the US, but also who offer products in Europe and around the world for UCITs [undertakings for collectible investment in transferable securities] and other types of products like that. Interestingly enough, the ICI's been around since 1940, and so the laws and regulations that govern mutual funds come from the Investment Company Act of 1940. And at that time, the SEC believed it would be helpful to have a trade association representing the industry as they developed the regulatory framework for mutual funds. So, the ICI's been around for 83 years, and we take seriously the use of mutual funds for the over 100 million shareholders there are in America, including the many retirees and savers who are in 401(K) plans all over the world. So it's a really important responsibility, and we take it seriously, and we want to protect investors and also represent our members very well.

Reese Blair: Wow, well, Jason, that is fantastic. Thank you for sharing that. Eighty-three years—that is incredible! Really helps to have that color as background for our discussion today. And so, I appreciate you not only sharing a little bit about you, but also about the work that you're doing with the ICI and what the ICI is all about, why they exist, and the role they have. I think we're probably at that point where we can dive into our conversation, and I'd be curious to start with how would you describe the current SEC rulemaking landscape, and how would you say it's probably changed over the past couple of years?

Jason Nagler: So, I'd say the pace of regulation has increased substantially over the last couple of years, and new rules and proposals are rolling out the fastest they've probably ever been—we feel like two to three times the previous SEC regime. To us, there appears to be a shift in the approach to rulemaking being more solution focused in search of a problem as opposed to focusing on an existing problem to really drive regulation and what those rules are trying to solve. We get the sense, and it seems like academia's been more involved in writing regulation as well, which [has] created an interesting intersection with industry leaders and participants. Sometimes, because of that, some of the feedback from the industry and folks who have been around for a long time, who are very interested in protecting investors and concerned about their well-being—that insight is taken a little less seriously maybe than it has been in the past. And so, it's a little different and how the SEC is coming up with rules and some of the partnership that maybe previously has been there with the industry.

Reese Blair: Got it. Well, I mean, it's pretty clear that the regulatory landscape has certainly shifted over the past few years when it comes to the approach and pace of rulemaking. So, maybe with that in mind, Jason, what sort of changes have you seen among the interaction of industry associations and organizations with both the SEC and industry participants?

Jason Nagler: There's still a very good and healthy dialogue, though, I would say. And we continue to meet at all levels with the SEC and the SEC staff. In my role at the ICI, we continue to engage with the staff regularly on accounting-related topics that may require an interpretive discussion to ensure the industry is applying those rules in a way that the staff would expect, and of course, in a fair way and transparent to shareholders. And then I would say, in terms of the industry participants and ICI's members, that relationship has always been very strong. I think investment company shops have to make an active decision to be a member at the ICI, but I would say that that relationship is stronger than ever. Just given the industry rallying around certain recent proposals, maybe that some of the leaders of those organizations or members (more of the rank-and-file members) feel like aren't as well thought out or not as backed by evidence and data, such as some of the recent proposals like swing pricing liquidity or the vendor oversight proposal.

Reese Blair: Yeah, no, Jason, listen, I absolutely agree. I've certainly seen it from my clients. Industry leaders, participants, everybody's been extremely engaged and absolutely aware of all the regulation that's been coming down the pike. And I'd say that's probably been picking up in recent years. So [I] certainly agree with you there. Hearing a lot of chatter in the industry more and more about how folks are maybe looking at that pace of change and regulation that's coming down the pike. And so, I'd like to maybe go a little bit deeper. Maybe we can touch on some tangible examples. I think our listeners would certainly appreciate some real-life examples of things that are either being discussed actively or that have sort of come up recently. I think that would be really timely and accretive here. So which regulations, maybe, that rolled out that continue to impact and challenge industry leaders? When you take a step back and think about what are some of those topics that just keep coming up I'm curious to get your take on that. And then maybe on the flip side, where have some of these regulations actually been beneficial to the industry? I'd love to get your take as well on that.

Jason Nagler: That's a really good question. I would say, I mean, first recent rulemaking that comes to mind is 2a-5. And 2a-5 has to do with valuation, and it applies to registered investment companies, so mutual funds and business development companies. And it continues to be a topic of conversation for industry professionals since it was initially required kind of middle of 2022.

And as I noted, the rule sets requirements for determining fair value and good faith, and allows the board to choose a designee that's responsible for determining fair value for the fund. There's additional responsibilities placed on boards, and there's been a shift in roles and dialogue in order to maintain compliance. There's also a delicate balance to consider here where boards will want to try to stay engaged and continue to oversee the investment adviser as valuation designee without being too involved or hands-on. I think it's important to note a lot of this work was getting done before 2a-5, but 2a-5 really sketches out a framework that funds need to follow much more closely now. And while the board's still ultimately responsible for fair valuation under the '40 Act, rule 2a-5 proves that the board can fulfill its obligations through its active oversight of the valuation designee, which is typically that investment adviser fund for performance and compliance with the other requirements of 2a-5.

Reese Blair: Got it, no, that makes a lot of sense. Wonder if you can maybe unpack what that interaction between the management and the board? I mean, 2a-5, we're hearing a lot of chatter around what that looks like is, individuals sort of try to redefine that relationship in some ways and try to maybe think about what oversight really means. I mean, there were a lot of requirements that came out in conjunction with that rule, things that challenged maybe how you determine fair value, how do you determine some things readily available? I mean, there's a lot of things that I know some practitioners struggle with. So, curious to get anything that you thought or have heard to be particularly important to management in the board, specifically around 2a-5?

Jason Nagler: Yeah, I would just say it's an ongoing dialogue. I think there's requirements in the rule, but I think there's opportunities to continue to fine-tune all of that, and that's what we've heard. As managers have gone and spoken with the boards and funds have presented this information for the first time, there's opportunities to continue to fine-tune. I think on the board side, they need to establish a robust oversight process to review and evaluate the fair value, determinations made by that investment adviser. The board should evaluate the expertise of the resources available within the fund company to make those fair value determinations. And this includes looking at the qualification of the individuals involved in that process and the availability of the necessary tools and data. I think one area that we've heard quite a bit around is conflicts of interest. And the board should be vigilant in identifying and managing conflicts of interest that may come up in the fair value process. This includes assessing potential conflicts of interest within the fund company, between the funds and its service providers, or affiliates, entities involved in valuations. And that's particularly important when it comes to more private investments where there's outside party giving them a fair value. So, I mean, there's a lot of stuff that boards and management are doing under the rule that's required. But getting that balance right, the transparency right, what does that process look like on an ongoing basis to evaluate the fund service providers that they use to do valuation—that's going to continue to evolve, I think, as the industry gets through a couple of additional cycles of this rule.

Reese Blair: Yeah, no, that makes a lot of sense. And for me, Jason, it's always interesting to break down the impact of new regulation. I can't say I've always had a seat in the room when some of the stuff's being discussed, so I always find it fascinating to learn about what some of the impacts are on businesses that—you mentioned it—"balance" right there. There are certainly benefits to some of this regulation, and there are also challenges along the way. And we've certainly seen our fair share of commentary coming from both sides of the argument, things that have been enhanced and increased as a result of this. And this regulation that's coming down the pike and some of the challenges along the way. I tell you one of those challenges that we've been hearing about, and it's actually picking up on one of our previous conversations around really seeing businesses focus on cost-cutting measures, maybe reevaluating some of the operations that they currently undertake and maybe figuring out how to do more with less. And so, when you think about the adoption of new regulation, how do you think firms can manage costs while trying to drive efficiencies?

Jason Nagler: I mean, that's a great question. I would say all new regulation is going to have monetary costs associated with its implementation. That's just a fact. You're going to have new and existing processes, you're going to have to create new things to meet the requirements of those new standards. There's always going to be a cost with human capital as firms look to allocate resources and the need to onboard and train and retrain, and unfortunately, retain professionals with the responsibility of maintaining compliance with any kind of new regulation. As we continue to see regulation rolling out at such a fast pace, there's a challenge faced by leaders to not only ensure they're meeting the standards, but to do it in a way that's cost-effective and efficient. And I would say that [in] the asset management space, fees continue to go down and businesses continue to try to get more efficient. Obviously, there's new technology to help with all of that. And so, I would say, while the new regulation can typically be seen as costly, leaders do have an opportunity to flip some of that narrative in certain cases. It's not going to be all cases, but in certain cases. And as this regulation rolls out—unfortunately, it is probably at a record pace—but there's an opportunity to reevaluate current processes, look for ways to deploy new technology and legacy processes, and definitely look to ways to streamline. That doesn't mean there's not an enormous amount of cost and effort upfront to comply with any new regulation, but occasionally, the amount of work needed to be undertaken can lead to legacy process improvement. And I think that's really important for firms to do. They need to take a scalpel to all of this new regulation, look at their processes, look at new tools, because data is so powerful these days—and some of the technology is just so good—and maybe flip the narrative to the extent that they can.

Reese Blair: That actually is a great segue into our next topic, Jason, as you mentioned. We've touched on a lot of the current changes to the regulation environment. We've touched on its impact to the investment management industry. I think if we switch gears a little bit and look to the future—because I think we've had a rear view focus up to this point—what areas of the business would you say listeners should expect to see regulation focus on in the next, I don't know, six to 12 months or so?

Jason Nagler: I mean, I'd say there's a proliferation of new technology just being used across the investment management industry, it changes the way business is done, the way portfolios are managed. You're living in a box if you don't know what ChatGPT is and start having played with generative AI. And things like AI and algorithms are being adopted in all parts of the organization. I'd say that data and the way you manage data, I think, is going to change. I think data tools are just so powerful these days and so integrated into business processes. Because of that data, I think sales, legal, operations, portfolio management—all of those things are going to change. And I think because of that, we'll see regulation in that space. I think we'll see regulation for AI around user agreements. I think we'll continue to see regulation around access controls. We've already seen the British regulator looking at funds and looking at rules for generative AI and investment manager oversight of those algorithms.

Reese Blair: Got it, very helpful. Well, Jason, we touched on technology, we touched on the role that automation will have in the workplace when looking at the concept of the future of work, and it's really clear that technology will have a significant impact. And so, it's only natural that regulation will follow closely behind as it becomes such an integral part of our industry. Is there anything that excites you or terrifies you about the proliferation of technology?

Jason Nagler: I think I'm very excited about it. I think technology gives industry leaders an opportunity to make their employees' lives better. I think a lot of the technology that's been rolling out in the past couple of years will automate away some of the tasks that historically were done by certain people in their organizations. I think that's an opportunity to polish up your skill sets and provide employees training and understanding how technology works, and in some cases, just learning how to prompt AI and you just do a better job. I think, ultimately, that technology should lead to better outcomes for investors, a more efficient business with hopefully lower fund fee costs, and all those things that come along with what's happened in the asset management industry over the last 83 years for funds. I think costs continue to go down for investors, which is a great thing. And things like technology drive that, and that's what we're here for, right? We're here to deliver returns for shareholders in the right ways, and technology—we need to watch what we're implementing. I mean, I'd be remiss to tell you, I hear Elon Musk and his fear of AI. But at the same time, it seems like there's a lot of very brilliant people helping us with the implementation, who will continue to partner with the financial services industry and the investment company industry to make the industry operate more efficiently and better, ultimately, for our shareholders. So, I'm excited about it. I'm cautiously optimistic is what I would say, but I do think there's some great opportunities.

Reese Blair: Thank you for sharing that, Jason. I was hoping you would say you were excited because I'm certainly excited! So I'm glad we're aligned there.

Jason Nagler: So, I think, we should expect to see something similar coming across all the various global regulators, including the SEC, in the coming years.

Reese Blair: No, that's fascinating, and it's interesting that you mention the British regulators. How often would you say you engage with regulators across the pond, around the world? Do you often compare and contrast what's happening here in the US with what's happening globally?

Jason Nagler: Yes, as I mentioned, ICI, we do have a global arm. We are focused on US-based asset managers who have operations in other parts of the world. I would say that the more these regulators stay aligned in what they're trying to do, the lower cost for members and the less confusion for shareholders when rules are different. And to a lot of our listeners, the difference between US GAAP and IFRS—there's differences there. And so, we look at what's happening globally, we advocate for these standards to look similar just because I think that helps all of these global businesses deliver the things that they need to do, like reporting or compliance with all of these rules, in a more streamlined way. I think these regulators talk to each other, and there's the super regulators like the IOSCOs of the world that push a lot of this stuff down. But I don't think all the jurisdictions adopt according to those suggestions or those standards. I know the SEC doesn't. And so, we keep our finger on the pulse of definitely all the major regulators globally where funds are offered, for sure.

Reese Blair: Hey, Jason, I just want to thank you, honestly, for your time today. Your perspective on the regulatory environment is really appreciated. And I know our listeners are going to walk away with a lot of fantastic insight. That's really the purpose of this podcast: to just provide insights to our listeners, let them have impact with that insight. I've always said knowledge is not power, it's the use of knowledge where you have power. And I think you've provided some very, very profound insights during this talk today, in this conversation today. Look, as we close out, Jason, again, I have to say thank you, thank you. I know you're busy. I know you have a lot going on. There's a lot of things that are keeping you busy, from a regulatory perspective. But again, appreciate you carving out some time to speak to us today. We've had such an insightful conversation. Again, appreciate all the perspective that you had to bring to the table. I know I've personally learned a lot. I told you upfront, I'm a lifelong learner, and so I am absolutely full. And thank you for just providing so many wonderful insights. I think it's probably safe to say our listeners are as well. So, I think they got a lot out of today's podcast. So, here at the *IMpact* podcast, we like to say that we could either spend time or invest time. And Jason, we've absolutely invested our time well today, so thank you for joining *IMpact*. Until the next time…

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