Industry Trends – November 2018

Industry Statistics – Mutual Funds

Fund Category	Net Assets (in billions)		Percentage Change in Net Assets	Dollar Change in Net Assets (in billions)		
					Change Due to	
	Sept-18	June-18		Total Change	Net Cash Flows	Market
Stock	$10,874.7	$10,456.3	4.0%	$418.4	($72.5)	$490.9
Hybrid	$1,519.0	$1,495.8	1.6%	$23.2	($18.8)	$42.0
Taxable Bond	$3,486.0	$3,435.2	1.5%	$50.8	$37.1	$13.7
Municipal Bond	$680.0	$676.6	0.5%	$3.4	$4.8	($1.4)
Money Market	$2,863.6	$2,820.9	1.5%	$42.7	$33.9	$8.8
Total	$19,423.3	$18,884.8	2.9%	$538.5	($15.5)	$554.0

- **Stock** funds assets had an increase during the quarter of $418.4 billion. For the quarter ended September 30, 2018, market appreciation was $490.9 billion compared to an appreciation of $215.0 billion for the quarter ending June 30, 2018. Most, if not all of these gains have been eliminated in October. The net assets for stock funds increased from $10,456.3 billion as of June 30, 2018 to $10,874.7 billion at the end of September 2018.
- **Hybrid** fund assets increased from $1,495.8 billion as of June 30, 2018 to $1,519.0 billion as of September 30, 2018. This compares to a decrease of $2.1 billion in the second quarter of 2018. The increase was the result of market appreciation of $42.0 billion and net outflows of $18.8 billion.
- **Bond** funds had net inflows of $41.9 billion for the quarter ended September 30, 2018, compared to the previous quarter inflows of $24.0 billion. Assets for all bond funds increased $54.2 billion for the quarter ended September 30, 2018 which included, market appreciation of $12.3 billion.
- **Money market** funds had net inflows of $33.9 billion for the three months ended September 30, 2018, compared to the previous quarter inflows of $21.8 billion. Money market fund net assets, over for three-month period, increased from $2,820.9 billion as of June 30, 2018 to $2,863.6 billion as of September 30, 2018.

Source: Investment Company Institute website

REGULATORY UPDATE

SEC Adopts Changes to Regulation S-X

The SEC recently adopted amendments to certain financial statement disclosure requirements to conform them to U.S. Generally Accepted Accounting Principles ("GAAP") for investment companies. The amendments also incorporate a definition of extraordinary expenses into the fee table instructions in investment company registration.

The amendments to Rule 6-04.17 of Regulation S-X (balance sheet) omit the requirement to separately state the book basis components of net assets: accumulated undistributed investment income, accumulated undistributed net realized gains (losses), and net unrealized appreciation (depreciation) at the balance sheet date. Instead, consistent with GAAP, funds will be required to disclose total distributable earnings.[2]

The amendments to Rule 6-09 of Regulation S-X (statement of changes in net assets) omit the requirement to separately state the sources of distributions paid. Instead, consistent with GAAP, funds will be required to disclose the total amount of distributions paid, except that any tax return of capital must be separately disclosed.[3] The amendments also omit the requirement to parenthetically state the book basis amount of undistributed net investment income on the statement of changes in net assets.

In response to comments, the SEC omitted Rule 6-03(c)(1)(i) of Regulation S-X which permits consolidation only with subsidiaries that are investment companies. GAAP permits consolidation of investment company subsidiaries and consolidation of a controlling financial interest in an operating entity that provides services to the investment company.[4]

Currently the instructions to the prospectus fee table permit extraordinary expenses as defined under GAAP to be excluded from the total annual fund operating expenses included in the fee table. In January 2015, the FASB eliminated the concept of extraordinary items and the related definition from GAAP. The Commission has adopted amendments to Form N-1A, Form N-3, Form N-4, and Form N-6 that replace the outdated reference to GAAP with a definition of extraordinary expenses. That definition is consistent with the historical GAAP definition of extraordinary items.

The Commission also amended the instructions to the six-month expense example included in the shareholder report pursuant to Item 27(d) of Form N-1A. The amendment incorporates the same definition of extraordinary expenses.

Finally, the Commission amended its registration statement forms to omit required disclosures indicating that information about the fund may be reviewed and copied at the SEC's public reference room in Washington, DC.

SEC Adopts Inline XBRL for Tagged Data

The SEC recently adopted amendments to eXtenxible Business Reporting Language ("XBRL") requirements for operating companies and funds. The amendments that will become effective in phases, requires the use of Inline XBRL for financial statement information and risk/return summaries. The amendments are intended to improve the quality and accessibility of XBRL data. Inline XBRL involves embedding XBRL data directly into the filing so that the disclosure documents in both human-readable and machine-readable.

Funds that are currently required to submit risk/return summary information in XBRL will be required to transition to Inline XBRL on a phased-in basis. The amendments also do away with the 15 business day filing period for risk/return summary XBRL data so that the data will be available on a timelier basis.

Phase in:

- Fund groups with $1 billion or more as of the end of their most recent fiscal year will be required to comply two years after the effective date of the amendments.
- All other funds will be required to comply three years after the effective date of the amendments,

Additionally, the requirement for funds to post XBRL data on their websites will be eliminated upon the effective date of the amendments.

SEC Rejects Bitcoin ETF Proposals

On August 22, 2018, the SEC published three separate orders rejecting nine applications to list and trade various bitcoin ETFs submitted by ProShares, Direxion and GraniteShares. In the orders, the SEC stated that the proposals did not meet the burden to demonstrate consistency with the Securities and Exchange Act's requirement "that a national securities exchange's rules be designed to prevent fraudulent and manipulative acts and practices." The SEC's concern regarding fraud and manipulation in the proposed ETFs which would have invested in bitcoin futures echoed the justification for rejection of the Winklevoss ETF in July which would have traded physical bitcoin. The SEC noted that its "disapproval does not rest on an evaluation of whether bitcoin, or blockchain technology more generally, has utility or value as an innovation or investment." Additional proposals for bitcoin ETFs remain before the SEC, including a

VanEck SolidX Bitcoin Trust investing in physical bitcoin for which the SEC issued a notice in September requesting further comments.

SEC Withdraws Proxy Advisory Firm Related Letter

On September 13, 2018, the SEC's Division of Investment Management announced that it has withdrawn its letters issued in 2004 to Egan-Jones Proxy Services and Institutional Shareholder Services, Inc. regarding advisors' use of proxy firms. The SEC is expected to host a Roundtable on the Proxy Process in November 2018, which will allow it to hear from investors, issuers, and other market participants. In developing the agenda for the roundtable, the SEC has considered whether prior staff guidance regarding investment advisers' responsibilities of voting client proxies and retaining proxy advisory firms should be modified, rescinded or supplemented. The SEC's announcement also highlights that SEC guidance is nonbinding and does not create enforceable legal rights or obligations.

SEC Challenges Investment Adviser's Pricing of Cross Trades

The SEC announced a settlement with an investment adviser ("Adviser") for alleged mispricing of cross trades of fixed income, non-rated, thinly-traded municipal bonds. The SEC maintained that the method of pricing cross trades favored one party over the other, even though the Adviser owed the same fiduciary duty to both. The SEC further alleged that the Adviser failed to adopt and implement effective compliance policies governing the pricing of cross trades and to disclose the practice in its Form ADV and elsewhere.

The SEC claimed that from November 2011 through March 2016, the Adviser invested in non-rated, tax-exempt, thinly-traded municipal bonds. During this period of time, the Adviser allegedly arranged cross trades in these securities, representing both the buyer and the seller. The SEC claimed that the Adviser violated the Investment Advisers Act of 1940, as amended, by arranging the cross trades because the valuation method applied for pricing the trades favored one side over the other. The SEC asserted that the Adviser arranged cross trades that were executed at the month-end bid-side indicative quote supplied by the bonds' underwriter, with the sell-side party receiving an executed price at a small discount from that bid price. As a result, the Adviser's buy-side clients allegedly received favorable pricing.

The SEC further alleged that the Adviser's compliance policies and procedures, as well as ADV disclosures, were inadequate. The Adviser's compliance procedures called for the Adviser to cross bonds at the bonds' "current market price – the last reported price – average of the bid and ask prices," which was later amended to "current market prices provided by the executing broker." Furthermore, the Adviser's valuation practice and its compliance policy were not consistent with the Adviser's Form ADV disclosure that stated that the Adviser has procedures

that require all cross transactions be made at an independent current market price. The SEC deemed the Adviser's compliance policies to be defective insofar as:

- The Adviser's portfolio manager (with potential conflicts of interest) had unsupervised discretion to challenge brokers' valuations;
- The Adviser did not have a valuation committee or other form of oversight over the basis of valuation challenges; and
- The Adviser failed to properly maintain documentation supporting the basis of its valuation challenges.

This action serves as a reminder to investment advisers to document the basis of their valuation methods, maintain adequate compliance policies (and follow them), and ensure consistent valuation practices, compliance policies and public disclosures.

Legg Mason Settles Foreign Bribery Case

At the end of August, Legg Mason disclosed settlements concerning an overseas bribery scheme. The settlements involved the SEC's enforcement unit as well as the U.S. Department of Justice which resulted in combined settlements of more than $71 million.

Both actions are based on the work of Permal Group, a fund of hedge funds group that Legg Mason acquired in 2015 and later merged into another subsidiary in 2016. The allegations involve Permal and Societe Generale and business that they won from state-owned companies in Libya using a Libyan middleman to bribe Libyan government officials in contravention of the Foreign Corrupt Practices Act. These settlements point out the need for financial services companies with a global presence to mitigate the risks of bribery and corruption which may be exacerbated when middlemen are involved.

SEC Issues Index Fund Bulletins

In early August, the SEC issued Investor bulletins addressing considerations when using traditional and smart-beta index funds.

The bulletin issued on traditional, market-cap weighted index funds emphasizes the price variability among the funds. The bulletin warns that not all index funds have lower costs than actively managed funds and that investors should understand the actual cost of any fund before making an investment.

The smart-beta bulletin includes quant funds and environmental, social and governance funds under the category of non-traditional index funds. The bulleting emphasized the distinction between these products and cap-weighted index funds, including lower market correlations,

more limited performance histories, more complicated investment strategies and usually higher expenses.

The bulletins come as retail investors continue to invest heavily in index funds and are intended to alert investors to expense variances among index funds.

SEC Levies Fine Against Hedge Fund for Inflated Values

The SEC recently levied a $10,000,000 fine against a hedge fund that included:

- Disgorging illicit profits totaling more than $4.7 million;
- Interest fees of $720,711 and
- A penalty of more than $4.7 million

The SEC also assessed personal liability against the firm's CFO including:

- A $100,000 enforcement fine; and
- A 12-month suspension from the securities industry

The SEC found that two hedge fund portfolio managers falsely inflated the value of securities held by their related funds, thereby falsely inflating returns, overstating the net asset value, resulting in $3.15 million in excess fees.

An SEC official's commentary: Advisory firms must create a culture of zero tolerance…. Supervisors must take reasonable measures necessary to detect and prevent securities-law related violations by their personnel.

Issues Remain as Firms Move Toward Implementation of Electronic Delivery

On June 4, 2018, the SEC adopted Rule 30e-3 under the Investment Company Act (the "Rule") which will allow certain registered investment companies ("Funds") with the ability to meet their shareholder report delivery requirements by making their reports and other related materials publicly available, free of charge, on a website, and sending fund shareholders a paper notice of the availability of such reports. The earliest date that notices may be used in lieu of paper reports is January 1, 2021. Existing Funds seeking to rely on the Rule as of that date must notify shareholders of the planned change in delivery method for a two-year period beginning at the start of 2019.

As Funds begin to notify shareholders that documents will begin to be delivered electronically, groups representing consumers and the paper industry are seeking to vacate the rule in federal court. These groups allege that the SEC failed to complete certain required steps as part of its

rulemaking process such as providing a proper explanation of the costs and benefits of the Rule and failed to respond to substantial concerns that commenters to the proposed rule had identified.

On August 3rd the SEC also issued guidance to smaller firms seeking to comply with the Rule. This written guidance lays out the conditions of the Rule, including that Funds must provide notice of any report being delivered electronically within 70 days of the final date of the period covered in the report. The guidance also reinforces that Funds must send printed reports for all Funds in a fund family if the investor requests paper copies for any fund in the fund family.

The SEC also has two requests for public comment outstanding. First, the SEC seeks comment on additional ways to improve fund information disclosures, such as modernizing the design, delivery and content of fund information. Next, the SEC seeks comment on the framework for certain processing fees that broker-dealers and other intermediaries charge for delivering shareholder reports and other materials to investors. The Investment Company Institute recently sent out a notice reminding its members that at the time the SEC adopted the Rule, the SEC also approved the New York Stock Exchange's (the "NYSE") proposal that under the Rule the NYSE's notice and access fee would not be charged for any account with respect to which a Fund pays a "preference management fee" in connection with a distribution of Fund reports.

SEC Proposes Amendments to the Whistleblower Program

In a June 28, 2018 Press Release, the SEC announced it voted to propose amendments to the rules governing its whistleblower program. The proposed rules would provide the SEC with additional tools to ensure whistleblowers are rewarded for their efforts, increase efficiencies in the claim review process, and clarify the requirements for anti-retaliation protection. SEC Chairman Jay Clayton noted that the proposed rules are intended to help strengthen the program by appropriately and expeditiously rewarding those who provide information that leads to successful enforcement actions. The public comment period will be open for 60 days following publication in the Federal Register.

Recent CFTC Enforcement Actions

The now fully represented Commodities Futures Trading Commission issued a slew of enforcement orders in four broad areas:

- Fraud and manipulation
- Recordkeeping and supervision
- Reporting
- Registration

It is too early to tell what these actions indicate about the new Commission's enforcement direction. In a number of these cases, the determinations make direct reference to cooperation. This may assist in understanding how the Commission is viewing its recently established cooperation policy. In some orders they are merely acknowledging cooperation while, at other times, explicitly stating that the cooperation affected the penalty amount. In the latter references, however, there is no clear indication of just how much the cooperation affected the actual findings.

California Passes Far-Reaching Consumer Privacy Law

In June 2018, California enacted the California Consumer Privacy Act of 2018 ("CCPA"), a sweeping privacy law that grants California residents new rights. Under the CCPA, covered businesses are required to provide consumers with notice, access and deletion rights with respect to certain personal information as well as allowing consumers to opt-out of sale of their personal information. Though not as broad, the CCPA takes certain cues from the European Union's General Data Protection Regulation which took effect earlier in the year. Consumer rights under the CCPA include, among others:

- **The Right to Know** – when requested by a consumer, covered businesses must disclose (i) what personal information a business has collected, (ii) the purpose for which their personal information is collected, and (iii) whether their personal information has been sold or disclosed, and to whom.
- **The Right to Opt Out** – a consumer has the right, at any time, to direct a business that sells information to third parties not so sell the consumer's personal information.
- **The Right to Request Deletion** – a consumer has the right to request that a covered business delete any personal information which the business has collected about the consumer.
- **The Right to Equal Service** – even in the event that a consumer exercises his/her privacy rights under the CCPA, that consumer has the right to equal service and price from the covered business.

Personal Information. "Personal information" is defined broadly under the CCPA to include not only identifiers (e.g., name, address social security number), but also such information as geolocation, biometric information, internet browsing history, employment and educational data, shopping habits, etc.

Covered Businesses. Businesses covered by the CCPA include for-profit businesses that do business in California and (i) have annual gross revenues over $25 million, (ii) receive or disclose personal information of 50,000 or more California residents, or (iii) derive 50 percent or more of annual revenues from selling consumers' personal information.

Fines and Actions. Once effective, the CCPA allows for the enforcement of steep fines of between $100-$750 per record for a breach or unauthorized release of personal data resulting from a covered business's violation of its duty to implement and maintain reasonable security procedures and practices. Intentional violations of the CCPA's privacy provisions may carry penalties of up to $7,500 per violation. The CCPA also creates a private right of action for data breaches, subject to certain notification requirements.

Effective Date and Exemptions. In October, the California legislature delayed the enforcement date of the CCPA so that it is currently set to take effect July 1, 2020. Subsequent amendments to the CCPA also provide exemptions for businesses that are already subject to, and operating in compliance with, federal privacy laws, such as the Gramm-Leach Bliley Act ("GLBA"). Businesses covered by rules promulgated under GLBA (e.g., Reg S-P) should carefully assess the applicability the exemptions.

Second Circuit Joins Others in Holding that SLUSA Precludes State Law Best Execution Claims

Brokerage firms seeking to avoid litigating best execution claims based on violation of state laws received another boost as the Second Circuit joined the Seventh, Eighth and Ninth Circuits in finding that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") precludes state law claims based on a brokerage firm's alleged violation of its duty of best execution when routing customer trades. SLUSA precludes plaintiffs from filing in federal or state court, a covered class action based on state law claims alleging that defendants made a misrepresentation or omission or employed a manipulative or deceptive device in connection with the purchase or sale of a covered security.

In Rayner v. E*Trade Fin. Corp., plaintiff filed a putative class action asserting various claims based on the claim that E*Trade routed orders to trading venues that provided E*Trade with the largest rebates based on order flow instead of ensuring that E*Trade's clients purchased and sold securities at optimal price and volume. Although plaintiff clearly filed a state law claim, plaintiff argued that SLUSA should not preclude the alleged state law claims because the complaint did not allege fraud and such fraud was not in connection with the purchase or sale of a covered security. While on its face the complaint may have not alleged fraud, the Second Circuit emphasized "substance over form" in reviewing the complaint to find that fraud had been alleged in connection with the purchase and sales of securities.

New Pricing Trends: Negative Fees and Direct Indexing

In August, Fidelity launched two index funds with no advisory, 12b-1 or administrative fees. Fidelity's strategy is to draw in new clients to whom the firm could later pitch different products. In any event, industry analysts do not expect the trend to stop at zero fees but rather anticipate negative fee funds to be launched at some point.

Another pricing strategy is direct indexing or allowing investors to assemble their own portfolios of securities in separate accounts. Industry analysts expect direct indexing to be popular in taxable accounts and it is not expected to impact the ETF market. Another advantage of this strategy is that investors can vote proxies as they please.

S&P 500 Global Industry Classification Standard Reorganized

For the first time in 19 years, Standard & Poor's implemented a reorganization of the Global Industry Classification Standard ("GICS") within the S&P 500 index effective on September 24, 2018. The biggest change resulting from the GICS reorganization is the expansion and renaming of the Telecommunications sector to "Communication Services." The new Communications Services sector includes (i) traditional telecommunications companies such as AT&T and Verizon, (ii) media companies such as Disney and Comcast, and (iii) large internet-based companies such as Facebook, Alphabet and Netflix. The reorganization increased the weighting of the new sector from 2% to over 10% of the index. Sectors experiencing the largest corresponding declines in weighting were Technology and Consumer Discretionary.

Broker-Dealer to Repay Clients $1.37 Million

Per a recent Financial Industry Regulatory Authority ("FINRA") order, a Pennsylvania-based broker-dealer (the "Firm") will repay $1.37 million to over 2,700 of its clients for overcharging mutual fund fees over a period of seven years. Between January 1, 2011 and June 27, 2018, the Firm failed to identify and apply available sales charge waivers to eligible retirement accounts and charitable organizations. FINRA states that the Firm relied on its advisors to determine eligibility but failed to maintain adequate written supervisory procedures to assist them in making the determinations.

The Firm has neither admitted nor denied the findings.

Liquidity Rule Implementation Update

On June 28, 2018, a divided SEC made significant changes to the reporting and public disclosure requirements that were adopted in 2016 as part of a package of comprehensive liquidity risk management reforms for open-end funds. The key changes were:

- Replaced the original Form N-PORT public classification reporting requirement with a new narrative shareholder report disclosure about the operation and effectiveness of fund liquidity risk management programs.
- Elimination of Form N-PORT aggregate liquidity classification reporting. Under the Amendments, Form N-PORT will not require funds to publicly report aggregated portfolio level liquidity classification information, as would have been required by the Form as originally adopted in 2016.
- Optional multiple classification reporting for a single position
- Disclosure of cash and cash equivalents on Form N-PORT

In a recent survey completed by ACA Compliance Group found the following:

- 72% of respondents indicated that the investment adviser, through a committee structure, will be designated as the program administrator.
- 50% of respondents indicated that their Boards will be aware of the liquidity risk management program that is required to be in place by December 1, for large funds, but will not approve until the full plan is in place by June of 2019. 31% indicated that the Boards will provide a two-step approval.
- 70% indicated that the advisor and/or sub-advisors will be responsible for liquidity classification designation
- 62% indicated that they will classify the liquidity of holdings monthly. 24% indicated that they will classify holdings daily.
- Most respondents indicated that they will utilize third party vendors or a combination of vendors to initially determine classifications. 18% said that they will build in-house capabilities.
- 44% have not determined a highly liquid minimum. 44% will set a level of 50% or greater.

As the liquidity rule program compliance dates approach, uncertainty remains in the industry regarding how best to navigate its many elements. The survey makes it clear that no one-size-fits-all approach exists for attaining compliance.

ACCOUNTING UPDATE

PCAOB Provides Updates on Auditor Reporting

On August 23, 2018, the PCAOB provided supplemental information to PCAOB Release No. 2017-001, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards. This guidance was originally published on June 1, 2017 in conjunction with the adoption of PCAOB Auditing Standard AS 3101. Release 2017-001 and AS 3101 require changes to the auditor's report, to clarify the auditors' role and responsibilities, provide additional information about the auditor and make the report easier to read.

Specifically, the updates focus on:

- Providing aid to the auditor in applying the concepts in the original release, such as determining auditor tenure. If there is uncertainty of the tenure of the audit firm, the auditor should state as much in its report and provide the earliest year in which the auditor has knowledge it served as such.
- Further standardizing the reporting model by specifying placement and providing examples of disclosures. Also providing guidance in situations where auditors decide to include voluntary disclosures of information currently required to be disclosed in Form AP, Auditor Reporting of Certain Audit Participants.

The update recognizes that there are certain explanatory paragraphs such as going concern considerations, material changes in accounting principles, and corrections of material misstatements that are required to be presented with an appropriate title immediately following the opinion paragraph. However, to the extent that an explanatory or emphasis paragraph is needed pertaining to other considerations, there is no guidance on placement, and the auditor should use its judgement in placement and appropriately title the section.

FASB Modifies Fair Value Measurement Disclosure

The Financial Accounting Standards Board recently released an update that modifies fair value measurement disclosures required by Topic 820. The ASU eliminates, modifies, and adds disclosure requirements for fair value measurements.

The following disclosure requirements were removed from Topic 820:

- The amount of and reasons for transfers between Levels 1 and 2 of the fair value hierarchy;
- The policy for timing of transfers between levels;
- The valuation process for Level 3 fair value measurements;[4] and

- For nonpublic entities, the changes in unrealized gains and losses for the period included in earnings (or changes in net assets) for recurring Level 3 fair value measurements held at the end of the reporting period.

The following disclosure requirements were modified in Topic 820:

- For investments measured at net asset value in reliance on the practical expedient,[5] disclosure of the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse are required only if the investee has communicated the timing or announced the timing publicly;
- The measurement uncertainty disclosure required for investments categorized in Level 3 of the fair value hierarchy is intended to communicate information about the uncertainty as of the reporting date. The Board clarified that the disclosure relates to significant unobservable inputs at the measurement date, and does not relate to their possible future changes; and
- In lieu of a roll forward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3, and purchases and issues of Level 3 assets and liabilities.

The ASU adds the following new disclosure requirements for Level 3 fair value measurements. These disclosures, however, are not required for non-public entities.

- The range and weighted average of significant unobservable inputs used. The reporting entity should disclose how it calculated the weighted average (e.g., weighted by relative fair value). For certain unobservable inputs, a reporting entity may disclose other quantitative information, such as the median or arithmetic average, in lieu of the weighted average, if such information would be a more reasonable method to reflect the distribution of unobservable inputs; and
- Changes in unrealized gains and losses for the period included in other comprehensive income.

The amendments in the ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt any removed or modified disclosures immediately and delay adoption of the additional disclosures until their effective date.

As to materiality, the recently adopted amendments to Chapter 3 of Concepts Statement No. 8 indicate that the omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. According to the Board the recently adopted definition is consistent with that used by the SEC, PCAOB, and AICPA.

Reporting of Restricted Cash

ASU 2016-18 is now effective for fiscal years beginning after 12/15/17. The amendment requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update do not provide a definition of restricted cash or restricted cash equivalents. The new guidance requires a reconciliation of the totals in the statements of cash flow when cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one-line item on the balance sheet. These amounts will no longer be provided as cash flow activities.

Any amounts deemed as restricted will now be encompassed in the beginning and ending 'Cash, cash equivalents, and restricted Cash' totals and will no longer be shown as a change in balance/payable/receivable in the reconciliation of operating or financing activities.

TAX UPDATE

House approves Tax Reform 2.0 Legislation

The U.S. House of Representatives, Ways and Means Committee Chairman Kevin Brady, released a two-page document titled, House GOP Listening Session Framework, Tax Reform 2.0, on July 24, 2018, that proposed building on the growing successes of the Tax Cuts and Jobs Act in three main ways: by protecting middle-class and small business tax cuts, promoting family savings and spurring new business innovation. On September 10, 2018, Chairman Brady released the legislative text of three bills that make up Tax Reform 2.0: H.R. 6756 – American Innovation Act of 2018, H.R. 6757 – Family Savings Act of 2018 and H.R. 6760 – Protecting Family and Small Business Tax Cuts Act of 2018 and on September 13, 2018, the bills were approved by the House Ways and Means Committee. The full House on September 27, 2018, approve H.R. 6756, The American Innovation Act of 2018 and H.R. 6757, the Family Savings Act of 2018, and, on September 28, 2018 approved H.R. 6760, the Protecting Family and Small Business Tax Cuts Act of 2018.

President Trump signs Strengthening Retirement Security in America executive order

The President of the United States, Donald Trump, signed an executive order on August 31, 2018, setting forth that it shall be the policy of the Federal Government to expand access to workplace retirement plans for American workers and that Federal agencies should revise or eliminate rules and regulations that impose unnecessary costs and burdens on businesses, especially small businesses, and that hinder formation of workplace retirement plans.

Expanding access to multiple employer plans (MEPs), under which employees of different private-sector employers may participate in a single retirement plan, and reducing the number and complexity of employee benefit plan notices and disclosures currently required, the executive order indicated that it shall be the policy of the Federal Government to address these problems and promote retirement security for America workers.

The executive order directed the Secretary of Labor to examine policies that would: (1) clarify and expand the circumstances under which United States employers, especially small and mid-sized businesses may sponsor or adopt a MEP as a workplace retirement option for their employees, subject to appropriate safeguards; and (2) increase retirement security for part-time workers, sole proprietors, working owners, and other entrepreneurial workers with non-traditional employer-employee relationships by expanding their access to workplace retirement plans, including MEPs.

The executive order also directed the Secretary of Labor, in consultation with the Secretary of the Treasury, to complete a review of actions that could be taken through regulation or guidance, or both, to make retirement plan disclosures required under ERISA and the Internal Revenue Code of 1986 more understandable and useful for participants and beneficiaries, with also reducing the costs and burdens that impose on employers and other plan fiduciaries responsible for their production and distribution.

The executive order directed the Secretary of the Treasury to consider proposing amendments to regulation or other guidance, consistent with applicable law and the policy set forth in the order, regarding the circumstances under which a MEP may satisfy the tax qualification requirements set forth in the Internal Revenue Code of 1986, including the consequence if one or more employers that sponsored or adopted the plan fails to take one or more actions necessary to meet those requirements.

The executive order also directed the Secretary of the Treasury to examine the life expectancy and distribution period tables in the regulations on required minimum distribution from retirement plans (67 Fed. Reg. 18988) and determine whether they should be updated to reflect current mortality data and whether such updates should be made annually or on another periodic basis.

IRS Approves 401(k) Arrangement Allowing Employer to Contribute "Match" Based on Student Loan Repayments

The Internal Revenue Service (IRS) issued on August 17, 2018, Private Letter Ruling (PLR) 201833012, whereby the Taxpayer requested a ruling under Internal Revenue Code Section 401(k). The Taxpayer sponsors a defined contribution plan (Plan) with a IRC section 401(k) cash or deferred arrangement feature that is intended to qualify for tax-favored treatment under IRC section 401(a).

The Taxpayer proposes to amend the Plan to offer a student loan benefit program under the Plan (the program), under which the Taxpayer would make an employer nonelective contribution on behalf of an employee conditioned on that employee making student loan repayments (SLR nonelective contribution). The program is voluntary – an employee must elect to enroll, and once enrolled, may opt out of enrollment on a prospective basis. If an employee participates in the program, the employee would still be eligible to make elective contributions to the plan but would not be eligible to receive regular matching contributions with respect to those elective contribution while the employee participates in the program. Such an employee would be eligible to receive SLR nonelective contributions and true-up matching contributions, as appropriate, described in the PLR. All employees eligible to participate in the

Plan will be eligible to participate in the program. If an employee initially enrolls in the program but later opts out of enrollment, then the employee will resume eligibility for regular matching contributions.

Under the program, if an employee makes a student loan repayment during a pay period equal to at least 2% of the employee's eligible compensation for the pay period, then the Taxpayer will make an SLR nonelective contribution as soon as practicable after the end of the year equal to 5% of the employee's eligible compensation for that pay period. The SLR nonelective contribution is made without regard to whether the employee makes any elective contribution throughout the year. If the employee does not make a student loan repayment for a pay period equal to at least 2% of the employee's eligible compensation but does make an elective contribution during that pay period equal to at least 2% of the eligible compensation for that pay period, then the Taxpayer will make a matching contribution as soon as practicable after the end of the plan year equal to 5% of the employee's eligible compensation for that pay period. (true-up matching contribution). In order to receive either the SLR nonelective contribution or the true-up matching contribution, the employee would need to be employed with the Taxpayer on the last day of the plan year. Both SLR nonelective contributions and true-up matching contributions will be subject to the same vesting schedule as regular matching contributions.

The IRS concluded that the Taxpayer's proposal to amend the Plan to provide SLR nonelective contributions under the program will not violate the contingent benefit prohibition of section 401(k).

IRS Publishes Updated Safe Harbor 402(f) Notices for Eligible Rollover Distributions

The Internal Revenue Service (IRS) issued Notice 2018-74, that modifies the two safe harbor explanations in earlier Notices, that may be used to satisfy the requirement that certain information be provided to recipients of eligible rollover distributions. The safe harbor explanations as modified by Notice 2018-74 take into consideration certain legislative changes and recent guidance, including changes related to qualified plan loan offsets and guidance issued on self-certification of eligibility for a waiver of the deadline for completing a rollover and include other clarifying changes.

2018 Year-End Reporting Layouts and Target Delivery Dates

The Investment Company Institute ("ICI") released their calendar 2018 year-end reporting layouts and target delivery dates. The Primary Layout has been designed to track the IRS Form 1099-DIV. The Secondary Layout provides a means for regulated investment companies ("RICs") to use to report various additional tax related items. The NRA Layout provides a means for reporting information on IRS Form 1042-S. The 2018 Primary Layout has been updated to account for Form 1099-DIV's new Box 5, Section 199A Dividends. The 2018 Secondary Layout has minor, non-substantive, updates. The 2018 NRA Layout is identical to the 2017 NRA Layout.

Funds are encouraged to provide their year-end tax information to brokers and banks as soon as it is available. The target dates for delivering year-end tax information to brokers and banks will be as follows: Primary Layout - Tuesday, January 15, 2019; Secondary Layout – Tuesday, January 22, 2019; and NRA Layout – Tuesday, February 5, 2019.

Investment Company Institute's 2018 Tax & Accounting Conference – Tax-Related Panels and Topics

The ICI's 2018 Tax & Accounting Conference included several financial, regulatory and tax related panels discussing various issues and topics.

The International Tax Issues Affecting Funds and Their Investors panel included discussion topics related to Specific Country Issues, EU Reclaims, Organisation for Economic Co-Operation and Development - Treaty Relief and Compliance Enhancement (OECD -TRACE), EU Code of Conduct Withholding and Brexit.

The International Tax Issues Affecting Management Companies panel included discussion topics related to Implications of the 2017 Tax Law Changes, Recent Activity in the European Union (EU) and Global Changes on the Horizon.

The Domestic US Tax Update for Funds and Management Companies panel included discussion topics related to Issues Arising from 2017 Tax Reform Legislation, South Dakota v. Wayfair – Implications for Management Companies, Qualified Investment Income Update, and Callable Bond Premium.