COUNTRY REPORT - UNITED STATES

Economic and Financial Background

This report focuses on developments in 2015 and the first half of 2016.

The US economy continued to grow in 2015 and the first half of 2016, though the pace of growth moderated as the period progressed. Real GDP which had grown at a 2.6 percent annual rate over 2013 and 2014, decelerated to a 1.9 annual rate in 2015, decelerating further to a 1.1 percent pace in the first half of 2016. Over the 18 month period, the economy was supported by consumer spending and investment in residential structures. Weighing against that was weakness in expenditures on equipment and nonresidential structures, which in turn reflected declines in the prices of oil and other commodities. Economic growth was particularly tepid in the fourth quarter of 2015 and the first quarter of 2016, averaging just 0.85 percent at an annual rate, as a stronger US dollar and weaker economic growth abroad weighed on factory output and exports. Net exports proved a drag on the economy in 2015, but that drag was eliminated in 2016 and economic growth rebounded to a 1.4 percent annual pace in the second quarter of 2016.

The moderate US economic growth from 2015:Q1 to 2016:Q2 was accompanied by solid gains in employment. The economy added 2.7 million jobs in 2015, and an additional 1 million jobs in the first half of 2016.[1] The labor force participation rate was about unchanged over the 18 month period. The unemployment rate declined from 5.6 percent in December 2014 to 5 percent in December 2015. The unemployment rate rested at 4.9 percent in June 2016, only slightly higher than its pre-financial crisis cyclical low point of 4.6 percent in 2006 and 2007.

Despite the declining unemployment rate, inflation remained in check. The consumer price index (CPI) rose just 0.7 percent in 2015, reflecting the sharp drop in oil prices. The core personal consumption expenditures (PCE) deflator, an index of prices (excluding food and energy) paid by consumers, rose at a 1.4 percent rate in 2015, down slightly from a 1.5 percent rate of increase in 2014. For the first half of 2016, core PCE inflation ticked up to a 2.0 percent annual rate.

In light of continuing US economic growth and an unemployment rate that had declined to about its pre-crisis level, many market participants expected the Federal Reserve to abandon a near-zero interest rate policy in order to begin restoring short-term interest rates to a more normal and sustainable level. However, with US inflation remaining subdued, economic growth weakening elsewhere in the world, and financial markets reacting sharply to incoming data, US monetary policy remained on hold throughout most of 2015. The Fed finally acted on December 16, 2015, raising short-term interest rates by 0.25 percent, the first tightening of US monetary policy since 2006. Many presumed that the Fed would continue to tighten monetary policy modestly in the first half of 2016. In the first quarter of 2016, however, with GDP growth weakening and financial markets remaining volatile, the Fed adopted a wait-and-see

[1] Based on US total nonfarm payrolls.

approach. Although incoming data suggested a pick-up in economic activity in 2016:Q2, the Fed stood pat at its June 14-15 meeting. Among other factors the Fed noted in its policy decision was that uncertainty surrounding the UK's upcoming vote on Brexit and its potential economic and financial market consequences.

Yields on long-term Treasury bonds fluctuated considerably from December 2014 to June 2016. The yield on 10-year Treasury bonds was 2.17 percent on December 31, 2014 but declined to 1.49 percent by June 30, 2016, a drop of 68 basis points. The decline, in part, reflected perceptions based on incoming data that US economic growth was not as robust in late 2015 and early 2016 as had been thought and investors' demands for the quality and liquidity of Treasuries in the face of uncertainty.

With oil prices dropping sharply in 2015, concerns increased about US energy-related companies. These concerns spilled over to the high-yield bond market, where many such companies had obtained financing. From December 2014 to December 2015, yields on high-yield bonds rose 205 basis points. The outlook for the high-yield market continued to deteriorate in early 2016, with yields on such bonds peaking at 10 percent in mid-February, an increase of 329 basis points over the level of December 31, 2014. From mid-February to June 30, 2016 conditions high-yield bond market conditions generally improved, and yields declined to 7.32 percent, although spiking temporarily following the UK's Brexit vote.

US stock markets fluctuated widely over the 18-month period, but on balance were about unchanged. The Dow Jones index, which stood at 17,823 on December 31, 2014, fell nearly 11 percent in late August 2015 in tandem with even sharper declines in other world stock markets, especially China. By late October 2015, the US stock market had fully recovered its losses, only to drop almost 10 percent in January 2016, once again over concerns about China's economy and as well as the melt-down in oil prices. By April 2016, US stock markets had recovered these losses. Like other world stock markets, US markets were tested following the UK's vote in late June 2016 to leave the European Union. For a few days following the Brexit vote, the Dow Jones index was down almost 900 points, only to recover that full amount in the last three trading days of June 2016 as market participants more fully digested the implications of Brexit.

Investors on net redeemed $77 billion from equity mutual funds in 2015. As in recent years, domestic equity funds (those focusing primarily on the US economy) again experienced outflows ($171 billion), while world equity funds (those investing primarily in stock markets outside the US or in a mix of US and non-US listed stocks) saw sizable inflows ($94 billion). These trends continued in the first half of 2016. Over the first six months of 2016, net new cash flow from domestic equity funds totaled -$79 billion, about on par with the pace of outflows over 2015. World equity funds again saw inflows, but the pace moderated substantially; in the first half of 2016, these funds experienced net new cash flow of just $12 billion, well off the pace of 2015. Concerns about the strength of economic growth in Europe and Asia, as well as uncertainty surrounding Brexit no doubt played a role.

The strong disparity of outflows from domestic funds versus inflows to world equity funds, a trend in place in the US for a number of years, reflects a number of factors. Among these are an apparent desire by US fund investors to diversify their holdings internationally, as well as to share in the higher long-term returns expected in developing economies. Also, there is an ongoing shift in the US from actively-managed domestic equity funds toward indexed domestic equity mutual funds and exchange traded funds (ETFs). For example, over the five years 2011-2015, domestic equity index funds received net new cash flow of $193 billion. Over the same five year period, net issuance of ETF shares totaled $954 billion, of which $439 billion was in domestic equity ETFs. Another related factor is that the US is seeing an ongoing shift from active management within funds to outside of funds, such as through fee-based programs that offer investors managed asset allocation strategies. These programs often provide an investor's primary asset allocation through a mix of index funds and/or ETFs.

Net new cash flow to bond mutual funds turned negative in 2015, as investors on net redeemed $26 billion. Outflows were concentrated in world and high-yield bond funds; these funds experienced outflows in most months in 2015, but outflows were strongest in December as concerns heightened about

high-yield bond issuers and also the economic outlook abroad. For 2015 as a whole, net new cash flows from world bond funds totaled -$24 billion; high-yield bond funds saw net new cash flows of -$37 billion. The slack in bond mutual funds may in part have been taken up by bond ETFs, which had net issuance of $55 billion for 2015, a record year.

Investors continued to value highly the liquidity and capital preservation money market funds provide, as evidenced by the relative stability of money market fund assets. Money market fund assets hovered throughout 2015 at about the $2.7 trillion level of the previous four years, finishing the year slightly above $2.7 trillion. In the first half of 2016, assets in money market fluctuated once again around the $2.7 trillion mark, but by June 2016 had dropped slightly below that level.

Beginning in November 2015, certain funds and their investors began their final transitions to meet the Securities and Exchange Commission's (SEC) 2014 money market reforms, which must be fully implemented by October 14, 2016. This rule requires that prime and tax-exempt money market funds that are sold to institutional investors must price their shares and transact using a "floating" net asset value (NAV), rather than the stable $1.00 NAV that such funds had long maintained. Under the rule, all nongovernment money market funds (i.e., prime and tax-exempt funds, whether retail or institutional) can impose delays ("gates") or redemption fees on redeeming shareholders under limited situations. A fund is required to impose redemption fees if the fund's weekly liquid assets fall below 10 percent of its total assets, unless the fund's board decides a redemption fee is not in the fund's best interests. Institutional investors who prefer money market funds with stable $1.00 NAVs, and retail investors who want to avoid even the remote chance of redemption fees or gates, will have no choice but to invest in a government money market fund. Reflecting these considerations, according to weekly data, from January 7, 2015 to June 29, 2016, assets in prime and tax-exempt money market funds declined $475 billion, while assets of government money market funds rose $487 billion (more recent data indicate that the shift from prime and tax-exempt money market funds to government money market funds, when ultimately completed, will total more than $1 trillion).

Statistical Update on US Fund Activity

[Complete US fund industry statistical trends, updated monthly, are available on the ICI website at https://www.ici.org/research/stats. Comprehensive year-end information is available at http://www.icifactbook.org/.]

Open-Ended Mutual Funds

As of year-end 2015, total US mutual fund assets were $15.7 trillion, with 52.1% ($8.1 trillion) in equity funds, 17.6% ($2.8 trillion) in money market funds, 21.8% ($3.4 trillion) in bond funds, and 8.5% ($1.3 trillion) in hybrid funds.

The $15.7 trillion in total assets represents a decrease of $0.2 trillion or 1.4% below the level of year-end 2014. This change reflects a 2% ($166 billion) decrease in equity funds, a 1.1% ($30 billion) increase in money market funds, a 1.4% ($47 billion) decrease in bond funds, and a 2.9% ($40 billion) decrease in hybrid funds.

At the end of June 2016, total US mutual fund assets increased to $15.9 trillion, with 51.6% ($8.2 trillion) in equity funds, 16.9% ($2.7 trillion) in money market funds, 22.8% ($3.6 trillion) in bond funds, and 8.6% ($1.4 trillion) in hybrid funds.

The number of funds as of December 2015 was 8,117, up from 7,928 the year before. There were 8,115 funds as of June 2016.

From January 2015 to December 2015, net new cash flow to long-term funds was negative $123 billion, down from a positive $98 billion the previous year. New sales and exchange sales totaled $3.5

trillion, or 27% of total net assets at the end of December 2015. Redemptions and exchange redemptions of long-term funds were $3.6 trillion, or 28% of assets.

For the six-month period ending June 2016, net new cash flow to long-term funds was negative $23 billion. Over the same period, new sales and exchange sales of these funds totaled $1.8 trillion, while redemptions and exchange redemptions were $1.8 trillion.

ETFs

Total US ETF assets as of December 2015 were $2.1 trillion, with 84% ($1.76 trillion) in equity funds, and 16% ($344 billion) in bond and hybrid funds. This represents an increase of $126 billion or 6.4% over the $1.97 trillion of ETF assets in December 2014. Net issuance of ETF shares in 2015 was $231 billion, a decrease of $10 billion or 4% lower than the $241 billion of net issuance of ETF shares in 2014. The number of ETFs as of December 2015 was 1,595, up from 1,412 the year before.

As of June 2016, total US ETF assets were $2.23 trillion, with 82% ($1.82 trillion) in equity funds, and 18% ($406 billion) in bond and hybrid funds. Net issuance of ETF shares for the six-month period ending June 2016 was $65 billion. At the end of June 2016, there were 1,675 ETFs.

Closed-End Funds

Total US closed-end fund assets as of December 2015 were $261 billion, with 38% ($100 billion) in equity funds and 62% ($161 billion) in bond funds. This represents a decrease of $28 billion or 9.8% from the $289 billion of closed-end fund assets in December 2014. The number of closed-end funds as of December 2015 was 558, down from 568 the year before.

At the end of June 2016, total US closed-end fund assets were $266 billion, with 38% ($102 billion) in equity funds and 62% ($164 billion) in bond funds. There were 545 closed-end funds at the end of June 2016.

Trends in International Investments

As of December 2015, assets of international and global equity and bond mutual funds were $2.53 trillion, down 0.6% from $2.55 trillion in December 2014. These funds represented 20% of total long-term fund assets as of December 2015. There was a $70 billion net inflow to these funds in the twelve-month period ending December 2015, down from the previous year's inflow of $110 billion.

As of June 2016, total net assets of international and global equity and bond mutual funds were $2.54 trillion, representing 19% of total long-term fund assets. There was a $19 billion net outflow from these funds in the six-month period ending June 2016.

Assets of international and global equity ETFs were $475 billion in December 2015, up about 14% from $415 billion in December 2014. These funds represented 27% of total equity ETF assets in December 2015. As of June 2016, total assets of these funds were $465 billion, representing 25% of total equity ETF assets.

Assets of emerging market equity mutual funds and ETFs were $373 billion in December 2015, down 16% from $445 billion in December 2014. These funds represented 14.5% of total international and global equity fund assets, which were $2.58 trillion, as of December 2015. As of June 2016, total assets of these funds were $400 billion, representing 15.5% of total international and global equity fund assets, which were $2.58 trillion.

Assets of emerging market bond mutual funds were $45 billion in December 2015, down 24% from $59 billion in December 2014. These funds represented 10.4% of total international and global bond fund assets, which were $432 billion, as of December 2015. As of June 2016, total assets of these funds were $47 billion, representing 11.0% of total international and global bond fund assets, which were $425 billion.

Assets of global equity and bond closed-end funds were $47 billion in December 2015, down 11% from $53 billion in December 2014. These funds represented 18% of total equity and bond closed-end fund assets as of December 2015. As of June 2016, assets of international and global equity and bond closed-end funds were $47 billion, representing 18% of total equity and bond closed-end fund assets.

Regulatory and Self-Regulatory Developments

The following are some of the significant legal developments impacting investment companies registered under the Investment Company Act of 1940 ("US funds") during 2015 and the first half of 2016.

Dodd-Frank Implementation

In response to the financial crisis of the fall of 2008, the US Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") in July 2010. Since then, financial regulators continue to implement rulemakings mandated by the law.

Systemic Risk Regulation - Financial Stability Oversight Council

In early 2015, the Financial Stability Oversight Council ("FSOC") issued a notice seeking comment on asset management products and activities. On March 25, ICI responded by providing data and analysis showing that US regulated funds and their managers do not pose risks to US financial stability. The letter stated that if FSOC's review of asset management identifies demonstrable risks related to regulated stock and bond funds, and the Council believes such risks require regulatory action, the SEC has the necessary expertise and regulatory authority to propose any enhancements it determines may be advisable. ICI explained there is no historical basis for FSOC's hypothesis that liquidity management practices and the mutualization of trading costs for funds incentivize fund investors to redeem heavily in the face of a market decline, potentially leading to additional downward pressure on markets. Empirical data demonstrates that mutual funds in aggregate experience only modest outflows in response to severe market downturns. The letter states that leverage could have implications for financial stability, however the regulatory burdens of the Investment Company Act limit investment companies' use of leverage. The regulated fund industry is well positioned to respond to operational risk that may arise from unanticipated business interruptions. Due to mutual funds' limited use of leverage, the agency nature of asset management, past orderly exit strategies, and the highly competitive nature, mutual funds are not susceptible to a disorderly failure. ICI's letter to FSOC is available at https://www.ici.org/pdf/15_ici_fsoc_ltr.pdf.

In late June 2016, the FSOC issued its 2016 annual report to Congress, which addresses significant financial market and regulatory developments, provides an assessment of those developments on the stability of the financial system, and identifies potential emerging threats to US financial stability. It also makes recommendations to enhance the integrity, efficiency, competitiveness, and stability of US financial markets, to promote market discipline, and to maintain investor confidence. The FSOC report begins with an executive summary and discussion of the FSOC's recommendations. It then provides an update of financial developments, including with respect to: US Treasuries, sovereign debt markets, foreign exchange, equities, commodities, wholesale funding markets, derivatives markets, nonbank financial companies, and investment funds (including the experience of Third Avenue Focused Credit Fund, a high-yield bond fund that suspended investor redemptions in December 2015). The report next reviews regulatory developments and FSOC activity since the 2015 annual report. Finally, it discusses potential emerging threats, including: cybersecurity, asset price declines and increasing volatility, risk taking in a low-yield environment, changes in financial market structure, financial innovation, and global economic and financial developments. The report is available at https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf

In April 2016, FSOC provided a public update on its review of possible financial stability risks in asset management. At an open meeting on April 18, FSOC discussed and unanimously approved the

issuance of a 27-page statement ("Statement") detailing the Council's views on such risks, as well as next steps, in the following areas: (1) liquidity and redemption; (2) leverage; (3) operational functions; (4) securities lending; and (5) resolvability and transition planning. The Statement focuses primarily on (1) liquidity and redemption risk, particularly with respect to mutual funds, and (2) leverage risk, particularly with respect to hedge funds. The Statement is available at https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf.

On July 18, 2016, ICI responded to FSOC's review of asset management products and activities and conclusions to date regarding liquidity and redemption risk in mutual funds. Among other things, the letter explains that FSOC has failed to substantiate its concerns regarding destabilizing redemptions from mutual funds and, indeed, faces high hurdles to do so. The letter includes two appendices: one examining the academic studies cited by FSOC in its April 2016 update, and the other analyzing events in the high-yield bond fund market (with a focus on the period from November 2015 to February 2016). It concludes by requesting that FSOC reconsider its conclusion about financial stability risks relating to liquidity and redemptions in mutual funds. ICI's letter to FSOC is available at https://www.ici.org/pdf/16_ici_fsoc_ltr.pdf.

Regulation of Derivatives Markets

More than six years after the passage of the Dodd-Frank Act in 2010, the reforms envisioned for the derivatives market regulatory framework largely have been implemented in the United States although the SEC remains further behind the Commodity Futures Trading Commission ("CFTC"). The new regulatory framework (1) imposes registration and regulation on market participants that engage in a significant amount of swap activities, called swap dealers and major swap participants; (2) requires reporting of swap transactions; and (3) imposes clearing and trade execution requirements on standardized derivative products.

Registration and Regulation of Swap Dealers and Major Swap Participants

CFTC rules governing the registration and regulation of swap dealers and major swap participants have been in effect since late 2012. The SEC continues to finalize its rules on the registration and regulation of security-based swap dealers and major security-based swap participants. During the past year, the agency adopted registration requirements, business conduct standards, and certain other regulations that will apply to these entities. Generally, regulated funds and their asset managers would not fall within the definition of swap dealers and major swap participants and the requirements on these entities would not apply directly to them. These rules, however, are important because they may impose obligations on regulated funds as counterparties to these regulated entities.

For example, the CFTC and the prudential regulators adopted margin requirements for uncleared swaps in late 2015, which are substantially similar to each other and consistent with the international standards that were adopted by IOSCO and Basel Committee on Banking Supervision. The rules require "covered swaps entities" ("CSEs")—a term that covers swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants—to engage in a bilateral exchange of margin with their counterparties (including regulated funds), when certain conditions are met. The rules establish minimum initial margin requirements, institute minimum transfer amounts, permit netting under certain circumstances, and set forth the eligible collateral that can be used for margin. CFTC-registered CSEs that do not have a prudential regulator must comply with the CFTC's rules, while CSEs subject to a prudential regulator's authority must comply with the rules of that regulator. The SEC also has proposed the capital and margin requirements for security-based swap dealers and major security-based swap participants, but the SEC's proposal departed significantly from those of other US regulators and the international standards. ICI has written a comment letter requesting that the agency issue a re-proposal harmonized with international standards and the CFTC's and prudential regulators' requirements (available at https://www.ici.org/pdf/28969.pdf). When the SEC adopts its margin rules for uncleared security-based swaps, those rules will apply to SEC-registered CSEs that do not have a prudential regulator.

In May 2016, the CFTC adopted a rule applying the CFTC's margin requirements for uncleared swaps to cross-border transactions. The rule applies the CFTC's margin requirements to all uncleared swaps of CFTC-registered CSEs in the United States and to uncleared swaps of certain CSEs outside the United States. The rule may have implications for non-US regulated funds because the definition of "US person" does not contain an exception for publicly offered non-US funds and those funds will have to analyze whether they are US persons under the rule, depending on their nexus to the US markets. In addition, the final rules provide eligible funds with "substituted compliance"—that is, the fund could comply with the margin requirements of a foreign jurisdiction—if the CFTC determines those requirements are comparable to the CFTC's.

Reporting Rules

The CFTC and SEC have both taken steps to further implement Dodd-Frank requirements for the reporting of swaps and security-based swaps, respectively. For swaps executed other than on a trading platform, the CFTC's reporting rules generally impose the reporting obligation on swap dealers. The CFTC, which has had an operational reporting regime since December 2012, adopted rules to clarify the application of their reporting requirements to cleared swaps. The SEC, which adopted security-based swap reporting rules in March 2015 but has not implemented those requirements yet, amended its rules to: (1) address a range of security-based swap reporting scenarios not covered by the existing rules; and (2) establish a compliance date for the security-based swap reporting regime.

The CFTC's and SEC's amendments to their reporting rules should have limited direct impact on ICI members because regulated funds have limited reporting obligations under these rules. The SEC's rules, unlike those of the CFTC, impose reporting obligations on both sides of a transaction, but one counterparty (typically a security-based swap dealer) will have substantially more obligations than the other (such as a regulated fund). In comment letters related to the implementation of security-based swap reporting requirements, ICI urged the SEC to ensure that trade repositories respect the limited application of security-based swap reporting rules to non-reporting sides (such as regulated funds) and do not seek to expand reporting requirements by imposing onerous obligations on funds through their rulebooks. ICI's comment letters are available at https://www.ici.org/pdf/29940.pdf and https://www.ici.org/pdf/30118.pdf.

Clearing Requirements

CFTC rules presently require clearing of certain standardized interest rate and index credit default swaps. In early February, the CFTC reached an agreement with EU regulators for the mutual recognition of central counterparties ("CCPs") under CFTC and EU rules. The agreements allows CFTC-registered US CCPs to operate in the EU and to satisfy certain EU requirements by complying with comparable US rules. Similarly, EU CCPs are permitted to operate in the US while complying with EU regulations that are comparable to US law.

The SEC continues its efforts to finalize other derivatives reforms, including rules establishing standards for covered clearing agencies. In March 2014, the SEC proposed standards for the operation and governance of registered clearing agencies that meet the definition of a "covered clearing agency" (such as clearing agencies that provide central counterparty services for security-based swaps). We submitted a comment letter expressing significant and serious concerns with the SEC's policies and procedures approach for the requirements on segregation and portability. Specifically, with respect to the protection of cleared security-based swaps collateral posted by customers, ICI urged the SEC to propose to require clearing agencies to provide the protection provided by the model adopted by the CFTC for cleared swaps collateral. ICI's comment letter is available at https://www.ici.org/pdf/29907.pdf

Volcker Rule

On June 1, 2015, ICI sent a letter to the US Federal Reserve Board urging that it and other US regulators take immediate action to clarify the treatment of US registered investment companies and similarly regulated non-US funds under the final regulations implementing the Volcker Rule. Specifically,

the letter requests that (1) the Federal Reserve promptly provide a sufficient (multi-year) seeding period for existing regulated funds and make clear that, going forward, a multi-year seeding period will be equally available for newly-formed regulated funds, and (2) the regulators issue public guidance to clarify that regulated funds that are "foreign public funds" under the Final Rule will not be treated as banking entities. The letter is available at https://www.iciglobal.org/pdf/29066.pdf.

On June 12, 2015, the Federal Reserve and other regulators issued guidance in the form of a "Frequently Asked Question" regarding the application of the Final Rule to foreign public funds. The FAQ provides that a foreign public fund ("FPF") will not be treated as a banking entity in its own right or have its activities attributed to its banking entity sponsor if: (1) the fund satisfies the conditions for the FPF exclusion; (2) the fund and its sponsor comply with applicable limitations in the relevant foreign jurisdiction; and (3) the sponsor does not own, control or hold with power to vote 25 percent or more of the fund's shares "after the seeding period." The text of the FAQ is available at http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#14. The regulators have not provided additional guidance or clarification with respect to the allowable seeding period for a regulated fund, nor have they indicated whether such guidance will or will not be issued in the future.

Regulation of Funds' Use of Derivatives

In December 2015, the SEC proposed an updated and more comprehensive approach to regulating US regulated funds' use of derivatives and certain similar instruments ("senior securities") under the Investment Company Act of 1940. The proposal seeks to ensure that funds: are not unduly speculative and have sufficient assets to meet payment obligations under those instruments. The proposal would permit a fund to enter into derivatives, financial commitment transactions (e.g., reverse repurchase agreements, short sale borrowings, or similar borrowing agreements), and other senior securities, if it complies with the conditions of a proposed exemptive rule having three main conditions: (i) portfolio limits – a fund must limit its notional exposure from senior securities to a 150% exposure-based limit or, if it meets a value-at-risk test that determines whether the fund's use of derivatives reduces the portfolio's overall expected risk, a 300% risk-based portfolio limit; (ii) asset segregation – a fund must segregate an amount of assets (generally cash and cash equivalents) on the books of the fund to enable the fund to meet its obligations under derivatives and financial commitment transactions; and (iii) risk management program – a fund must establish a formal derivatives risk management program if a fund engages in more than a limited use of derivatives or uses certain complex derivatives.

ICI filed comments on the proposal supporting the SEC's goals, while urging the SEC to preserve the benefits of derivatives as a portfolio management tool and recommending significant revisions to the proposal. ICI suggested the SEC to focus on its proposed requirements for segregating assets and a derivatives risk management program, with certain modifications, because these would achieve the Commission's goals without hamstringing funds through unnecessary portfolio limits. ICI argued that limiting derivatives positions based on notional amounts was flawed, because this method overstates a fund's obligation and the true economic risks of a derivatives transaction. ICI explained that the proposed limits could force hundreds of funds either to liquidate, adopt different product structures, or radically transform their strategies. If the SEC did adopt portfolio limits, however, ICI said the SEC should adjust gross notional exposure based on the relative risk of the derivative's underlying reference asset. ICI also contended that the proposed requirement that funds generally segregate cash and cash equivalents could force funds to hold cash at an increased cost to fund shareholders and/or to hold assets that do not correspond to the fund's investment objective and strategy. ICI's comment letter is available at https://www.ici.org/pdf/16_ici_sec_derivatives_ltr.pdf.

ICI filed two supplemental comment letters in July and September 2016. The first supplemental letter recommended a standardized schedule to adjust gross notional exposure for risk (available at https://www.ici.org/pdf/30089.pdf). The second supplemental letter recommended revisions to the SEC's proposed value-at-risk test to permit funds that constrain expected risk to use a higher portfolio limit (available at https://www.ici.org/pdf/30277.pdf).

Money Market Funds

By October 14, 2016, the money market fund industry must fully implement the 2014 money market fund reforms passed by the SEC, cementing major changes for investors and fund complexes.

The 2014 SEC rules largely centered around two principal reforms. The first reform requires prime institutional and tax-exempt institutional money market funds to price and transact in their shares using "floating" net asset values (NAVs). The new rules also require funds to calculate their NAVs to four decimal places. (For a fund with a NAV of $1.00, that means calculating the NAV to one-hundredth of a penny—i.e., $1.0000.) Government money market funds (money market funds that invests at least 99.5 percent of their total assets in cash, government securities, and/or repurchase agreements that are collateralized by cash or government securities) and retail money market funds (money market funds that have policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons) may continue to seek to maintain a stable NAV using amortized cost valuation and/or penny rounding.

The second principal reform will enable, and in certain cases require, all nongovernment money market funds (i.e., all prime and tax-exempt funds, whether institutional or retail) to impose barriers on redemptions (so-called liquidity fees and gates) during extraordinary circumstances, subject to determinations by a money market fund's board of directors. Specifically, the new rules give a money market fund's board the flexibility to impose liquidity fees of up to 2 percent, redemption gates (a delay in processing redemptions for up to 10 business days), or both if the fund's weekly liquid assets have dropped below 30 percent of its total assets. If a fund's weekly liquid assets fall below 10 percent of its total assets, the SEC rules require the fund to charge redeeming investors a fee of 1 percent of their redemption, unless the fund's board determines either that no fee, or a lower or higher fee (not to exceed 2 percent), would be in the best interests of the fund.

Capital Markets Reforms

Shortening the US settlement Cycle

On September 28, 2016, the SEC proposed a rule amendment to expedite the process for settling securities transactions. Currently, the standard settlement cycle for most US broker-dealer securities transactions is three business days, known as T+3. The proposal would shorten the settlement cycle to two days, or T+2. The proposed amendment is designed to enhance efficiency and reduce risk, consistent with a multi-stakeholder process underway to move to a shortened settlement cycle.

The SEC will seek public comment on the proposed amendment to Rule 15c6-1(a) of the Securities Exchange Act of 1934 for 60 days. It will then review the comments and determine whether to adopt the proposed amendment to Rule 15c6-1(a) as a final rule.

Market Volatility

On December 2015, the staff of the SEC released a research note containing empirical data and other information to help assess the operation of the US equity markets under the stressed conditions of August 24, 2015. Among other things, the note provides an overview of trading on August 24. 2015, compares trading in a large dataset of corporate stocks and exchange-traded products ("ETPs") on August 24 with trading during previous control periods, describes the opening processes at the primary listing exchanges, considers the operation of the National Market System Plan to Address Extraordinary Market Volatility (commonly known as the Limit Up-Limit Down Plan), and examines the widely varying nature of trading in ETPs on August 24. The note does not recommend any rulemaking or other initiatives to address the market volatility on August 24, but the material in the note may foster discussion about potential refinements to equity market structure. The SEC staff is continuing to examine a number of issues related to trading on August 24, including the factors that may have been associated with volatility

in ETPs and other securities, the effect of short sale restrictions, the opening process on primary listing exchanges, the reopening process following Limit Up-Limit Down halts, the operation of the Limit Up-Limit Down Plan, and the operation of market-wide circuit breakers. Research Note on Equity Market Volatility on August 24, 2015" (December 2015), available at https://www.sec.gov/marketstructure/research/equity_market_volatility.pdf.

Exchange-Traded Funds

ICI has worked with the securities exchanges to determine if volatility has increased in general and to identify any causes or contributing factors. The exchanges have indicated that there is no evidence that ETFs have contributed to, or caused an increase in, volatility. Comments by SEC officials on preliminary research conducted by the Division of Trading and Markets also indicate that there is no evidence of ETFs contributing to market volatility, at least in any significant manner. These findings are consistent with ICI research examining trading conducted during the recent volatile periods in the securities markets, which illustrates that recent high volatility is a global phenomenon driven by macroeconomic developments. On July 21, 2105, the SEC approved a NASDAQ rule change allowing exchange-traded managed fund shares to trade; according to a regulatory notice available at https://www.sec.gov/rules/sro/nasdaq/2015/34-75499.pdf.

Generic Listing Standards for ETFs

On March 4, 2015, the SEC published for comment the NYSE Arca, Inc.'s proposal to adopt "generic listing standards" for actively managed ETFs. The SEC has approved rules for many exchanges, including NYSE Arca, allowing index-based ETFs that meet certain generic listing requirements to be listed without obtaining SEC approval on an individual fund basis. The proposed rules similarly would provide uniform listing criteria for actively managed ETFs. In response, ICI filed a comment letter that strongly supports efforts to add certainty and uniformity to the ETF listing process. The letter also encourages the SEC to revisit the ETF rule first proposed in 2008 that would allow most ETFs to begin operating without obtaining from the SEC individual exemptive orders under the Investment Company Act of 1940. ICI's comment letter is available at https://www.ici.org/pdf/28875.pdf

Decimalization Pilot Program

On May 6, 2015, the SEC approved the national market system plan to implement tick size pilot program, which is available at http://www.sec.gov/rules/sro/nms/2015/34-74892.pdf. The tick size pilot will begin by October 3, 2016. It includes stocks of companies with $3 billion or less in market capitalization, an average daily trading volume of one million shares or less, and a volume weighted average price of at least $2.00 for every trading day. The pilot will last for two years, and market participants will be required to collect data to ensure the impact of the pilot can be properly studied.

Alternative Trading Systems

On February 25, 2016, ICI submitted a comment letter in response to a proposal by the SEC to amend the regulatory requirements applicable to alternative trading systems ("ATSs"). The proposed amendments would apply primarily to ATSs that offer trading in stocks listed on a national securities exchange ("NMS Stock ATSs"). The proposal aims to provide investors, other market participants, and the Commission with more information about the operation of NMS Stock ATSs. The proposal would require each of these trading systems to make detailed public disclosures on newly-proposed Form ATS-N about its operation and the activities of its broker-dealer operator and its affiliates. ICI's comment letter supports the SEC's proposal to require all NMS Stock ATSs to make standardized and comprehensive disclosures on new Form ATS-N and is available at https://www.ici.org/pdf/29733.pdf

Consolidated Audit Trail

On April 27, 2016, the SEC proposed a national market system ("NMS") plan to create a consolidated audit trail ("CAT") designed to allow regulators to track all trading activity in the US equity and options markets. The proposed NMS plan details the methods by which self-regulatory organizations ("SROs") and their members (i.e., broker-dealers) would record and report information to the CAT. The proposed NMS plan also sets forth information about how the central processor for the CAT would maintain data accuracy, integrity, and security.

Rule 613 of Regulation NMS requires the SROs to submit jointly an NMS plan to create, implement, and maintain a CAT that would capture—in a single, consolidated location—customer and order event information for equity and options orders from the time of order entry through routing, cancellation, modification, or execution. The CAT required by the rule would enhance the information available to the SEC by, among other things, improving the SEC's ability to track an order as it is routed through broker-dealers and trading centers and linking executed orders to subaccount allocations. The rule outlines a framework for the CAT, including the minimum data elements the SEC believes are necessary to create an effective CAT, but grants the SROs broad discretion to supply details of the CAT through an NMS plan.

ICI submitted a comment letter in July supporting the proposal, ICI's comment letter is available at https://www.ici.org/pdf/30042.pdf.

Anti-Money Laundering Developments

On May 16, 2016, the Financial Crimes Enforcement Network ("FinCEN") issued final rules to strengthen and clarify customer due diligence ("CDD") requirements under the Bank Secrecy Act ("BSA") for banks; broker-dealers; mutual funds; and futures commission merchants and introducing brokers in commodities. Available at www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf. The final rules require financial institutions (including mutual funds) ("FIs") to identify beneficial owners of "legal entity customers." FinCEN explains that this rule "will assist law enforcement in financial investigations, help prevent evasion of targeted financial sanctions, improve the ability of financial institutions to assess risk, facilitate tax compliance, and advance US compliance with international standards and commitments." The rules also make explicit FIs' obligations with respect to (i) understanding the nature and purpose of customer relationships, and (ii) conducting ongoing monitoring and updating customer information. The compliance date is May 11, 2018. In its comment letter to FinCEN's proposal, ICI supported FinCEN's objective of protecting the US financial system form money laundering and terrorist financing activities. ICI's letter is available at https://www.ici.org/pdf/29461.pdf.

Proxy Voting Developments

In January 2015, ICI and the Independent Directors Council ("IDC") released a *Report on Funds' Use of Proxy Advisory Firms*. The report serves as a tool to assist fund advisers and boards in evaluating recent guidance from the SEC staff on proxy voting, available at http://www.sec.gov/interps/legal/cfslb20.htm. In a question-and-answer format, the report focuses on three broad topics: (1) the use of proxy advisory firm services generally; (2) board oversight of proxy advisory firms; and (3) fund advisor oversight and due diligence of proxy advisory firms. The report is available at https://www.ici.org/pdf/pub_15_proxy_advisory_firms.pdf.

Fund Advertising

On May 18, 2015, FINRA proposed amendments to Rules 2210, 2213, and 2214 to reduce the filing obligations imposed on FINRA members' retail communications. On May 22, FINRA issued additional questions and answers relating to Rule 2210 as a means of providing additional interpretive guidance to its members. ICI submitted a comment letter on July 2, 2015, supporting the proposal because, if adopted, the proposal should reduce burdens on FINRA member firms related to the filing of

registered investment company advertisements and sales literature, without an attendant reduction in investor protection. Additionally ICI recommended enhancements on the proposal to: (1) clarify that a firm may rely on the proposed FINRA filing exclusion for shareholder reports if the firm files them in compliance with applicable SEC requirements; (2) expand the filing exclusion to include updates to narrative information in SEC filings and investment-related commentary; and (3) eliminate the current filing requirement for closed-end funds and codify a set of clear disclosure standards tailored to funds' retail communications. The comment letter is available at https://www.ici.org/pdf/29140.pdf.

On June 9, 2016, FINRA filed with the SEC proposed amendments to FINRA Rules 2210, 2213, and 2214. www.sec.gov/rules/sro/finra/2016/34-78026.pdf. On July 6, 2016, ICI filed a comment letter and strongly supported the proposal, which if adopted should reduce burdens on FINRA member firms related to the filing of registered investment company advertisements and sales literature. ICI's comment letter is available at https://www.ici.org/pdf/30016.pdf.

Liquidity Management

In September 2015, the SEC proposed liquidity risk management rules for mutual funds and open-end ETFs. SEC Chair White first discussed this liquidity initiative as part of a broader package of reforms intended to enhance and strengthen the SEC's regulation of the asset management industry in December 2014. The proposal aims to promote effective liquidity risk management among funds, and reduce the risk that funds will be unable to meet redemptions, or else will meet redemptions in ways that dilute interests of fund shareholders. At least a couple of findings and trends have motivated the SEC to act. First, SEC staff engaged in industry outreach on this topic, and found variations in the nature of and resources devoted to funds' liquidity risk management programs. The SEC believes the proposal will improve overall industry-wide liquidity risk management practices. Second, the SEC notes the growth in the US fund industry in general, and in fixed income and alternative funds employing more complex investment strategies in particular. Further, the SEC notes that over twenty years have passed since it last provided guidance regarding the liquidity of open-end funds. The clear implication is that a renewed focus on liquidity management is timely and appropriate.

Specifically, the proposal would: (1) require funds to establish liquidity risk management programs; (2) permit, but not require, funds (except money market funds and ETFs) to use swing pricing for calculating their share prices; and (3) require funds to provide additional disclosures about redemptions, swing pricing (if applicable), and liquidity on Form N-1A, proposed Form N-PORT, and proposed Form N-CEN. ICI and IDC submitted four comment letters in response. The ICI letters generally supported requiring funds to adopt liquidity risk management programs, and most disclosure aspects of the proposal; opposed the six-bucket asset classification scheme and related reporting requirements and provided an alternative; opposed the three-day liquid asset minimum and provided an alternative; and recognized the advantages and disadvantages of swing pricing, and addressed the operational and other hurdles that presently impede funds from adopting it.

ICI and IDC's comment letters are available at https://www.ici.org/pdf/16_ici_sec_lrm_rule_comment.pdf., https://www.ici.org/pdf/16_ici_sec_lrm_dera_comment.pdf., https://www.ici.org/pdf/16_idc_sec_lrm_comment.pdf., https://www.ici.org/pdf/16_ici_sec_lrm_overview_comment.pdf.

Pension and Retirement Plan Developments

Fiduciary Investment Advice

In April 2016, the Department of Labor ("DOL") published a final rule revising the definition of who is a fiduciary as a result of providing investment advice under ERISA. Like the proposal published in April 2015, the final rule treats as fiduciary advice a much broader range of situations than under current guidance, including many interactions with individual retirement account owners, and would impose a

best interest standard of conduct on these interactions. The consequences of becoming a fiduciary under ERISA include restrictions on how a financial services professional can be paid for providing services to a plan. ICI filed four comment letters in July 2015 in response to DOL's rule proposal package. The letters are available at https://www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf, https://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf, https://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf,and https://www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf.

As an overarching theme, the letters state that ICI and its members support the principle underlying the proposal—that a financial adviser should always act in the best interests of its clients—but warn that the current rule proposal will limit investors' access to needed financial information and could ultimately raise retirement savings and investing costs. The letters offer constructive ideas toward developing a workable fiduciary standard rule. The final rule goes into effect on April 10, 2017 (certain provisions are not required until January 1, 2018).

State Run Retirement Proposals

Generally, the US retirement system is based on federal laws that preempt state laws. However, in recent years, a number of states have put forward proposals to provide retirement plans for private-sector workers employed in the state. Many of these proposals would require employers in the state to automatically enroll their employees into an individual retirement account. As of October 2016, California, Illinois, Oregon, Connecticut and Maryland all have enacted legislation authorizing the creation of state-run mandatory auto-IRA programs and are in various stages of implementation.

In November 2015, the DOL proposed a regulatory safe harbor from ERISA coverage for mandatory payroll-deduction IRA programs established and maintained by state governments for private-sector workers. In August 2016, DOL finalized this proposal. The safe harbor, largely unchanged from the 2015 proposal, provides that these state programs will not be subject to ERISA as long as they meet certain conditions. Now that DOL has finalized this safe harbor, states will be able to move forward with their program designs. Concurrent with the final safe harbor rule, DOL proposed an extension of the safe harbor for municipalities or other political subdivisions (besides state governments) who want to offer retirement programs for private-sector workers. Under the proposal, eligible cities and counties (*i.e.*, those with populations at least as large as the least populous state and not located in a state that establishes a state-wide retirement savings program for private-sector workers) generally would be subject to the same conditions applicable to state-run programs under the safe harbor. ICI submitted a comment letters in response to the November 2015 proposal and the August 2016 proposal to expand the safe harbor to municipalities. The letters are available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB71/00062.pdf and https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB76/00016.pdf. While noting ICI's strong support for efforts to promote retirement security for American workers, our comment letters express concern that the policies espoused by the proposal have the potential to harm the voluntary system for retirement savings that is working to help millions of American private-sector workers achieve retirement security. In this respect, our letters note concerns that the Department's approach would do away with the protections of ERISA for state-administered workplace savings programs, nullify ERISA preemption in the face of precisely the kind of conflicting state laws that necessitated the preemption doctrine in the first place, and grant states the ability to use tools not otherwise available to private-sector employers and retirement plan providers today.

Target Date Funds

In response to the market declines in late 2008 and concern that investors in target date funds were not always aware of the equity allocations in such funds, in 2010, both the SEC and the DOL issued proposals related to TDFs (and reopened comment periods in the Spring of 2012). As of October 2016, neither agency has yet finalized its proposal. ICI materials on target date funds (including the above-

mentioned comment letters) can be found at the ICI Target Retirement Date Funds Resource Center at http://www.ici.org/trdf.

Lifetime Income

With the gradual shift from defined benefit pension plans to defined contribution plans as the primary retirement plan offered by private-sector employers, policymakers are focused on how to assist workers in spending down their retirement assets over their lifetimes. Data showing the prevalence of lump sum distributions from defined contribution plan accounts has caused concern among some that participants are not making optimal use of their savings. Since most defined contribution plans are not required to offer annuities or other lifetime income options, proposals have centered on requiring plans to offer these types of distribution forms or how to otherwise encourage employers to make them available, and how to encourage greater utilization of annuities by participants.

In discussions with policymakers, ICI emphasizes the tradeoffs inherent in various distribution options currently available to plan participants and IRA owners. Individual retirees have different circumstances and needs (although many already hold a significant portion of assets in annuity-equivalent form, including Social Security), and there is no one-size-fits-all approach to managing assets during retirement. ICI continues to urge the government to recognize the validity of both annuity and non-annuity approaches and that education and advice for the distribution phase are critically important.

Stemming from these policy discussions, in May 2013, the DOL released a draft proposal to require lifetime income illustrations on quarterly benefit statements for DC plan participants. The draft proposal would require benefit statements to include annuity-based illustrations of a participant's current account balance and projected account balance at retirement age, in terms of both a single life annuity and joint and survivor annuity for married participants. ICI's comment letter is available at http://www.ici.org/pdf/27446.pdf. The DOL was expected to publish a proposed regulation following up on its draft proposal in late 2015; however, this project no longer appears on its short-term regulatory agenda.

401(k) Retirement Saving Plans – Fee Disclosure

In February 2012, the DOL released a final rule under section 408(b)(2) of ERISA requiring retirement plan service providers to furnish information on fees to employers. The final rule, which became effective July 1, 2012, applies to those providing recordkeeping and brokerage services to 401(k) plans, requires record-keepers to serve as conduits of information about the investments used in 401(k) plans and requires record-keepers to disclose an estimate of the cost to the plan of record-keeping services. Record-keepers may fulfill their disclosure obligations by providing employers with the investment issuer's current disclosure materials, such as prospectuses. DOL expressed concern over the complexity and volume of the disclosure materials provided to employers and in March 2014 proposed a rule amending the final 408(b)(2) rule to require retirement plan service providers who meet their disclosure obligations by use of multiple or lengthy documents to furnish a guide to assist employers in reviewing the disclosures. At the same time, DOL announced that it would begin conducting a series of focus groups to explore current practices and effects of the final disclosure rule and gather information about the need for a guide to help employers navigate and understand the disclosures. In separate comment letters to the DOL, (available at http://www.ici.org/pdf/28119.pdf and http://www.ici.org/pdf/28179.pdf) ICI commented critically on both the methodology to be used in the focus groups and the substance of the proposed rule. ICI further urged the DOL to withdraw the proposed rule and reissue it after first publishing a Request for Information to determine what, if any, difficulties employers may be encountering in connection with the receipt of the disclosure, as well as cost-effective solutions to address those specific problems. As of October 2016, DOL has yet to finalize the proposed rule.

International Tax Developments

Foreign Account Tax Compliance Act ("FATCA")

Progress continues in reducing the burdens imposed by the Foreign Account Tax Compliance Act ("FATCA") on financial institutions and their investors. Congress enacted FATCA in 2010 to address concerns that certain US persons were holding assets through foreign financial institutions to evade their US tax obligations. The considerable effort by ICI, ICI Global, and others to seek FATCA implementation rules that accommodate the many unique aspects of fund investing has yielded positive results.

The US government's extensive effort to expand the intergovernmental agreement ("IGA") network is another important step towards reducing FATCAs burdens. 113 countries are now covered by IGAs. IGAs greatly simplify FATCA compliance for local financial institutions.

"Global FATCA" or the "CRS"

The G20-supported/OECD-crafted Common Reporting Standard ("CRS") – the global version of FATCA – is based largely on FATCA's Model 1 IGA (which provides reciprocal exchange of financial account information). The similarities between FATCA and the CRS reduce the burdens imposed on financial institutions, and their customers, compared to if the CRS been an entirely new regime.

Additional guidance was issued this year by the OECD clarifying how the CRS will be applied to funds. Importantly, for US funds, an FAQ clarifies that "controlling persons" of US funds (and any other funds organized in "non-participating jurisdictions") need not provide a taxpayer identification number ("TIN"). The OECD also is working on guidance clarifying that funds organized as trusts need not treat every fund investor as a controlling person whose name, birthdate, and TIN must be provided. Finally, the OECD placed on its website "model" CRS self-certification forms that were developed by the OECD business advisory group chaired by ICI Global; these model forms will benefit customers that interact with different types of financial institutions (e.g., funds, banks, brokers, insurance companies) located in different countries.

104 countries have agreed to implement the CRS for collecting and exchanging automatically financial account information; 54 countries have agreed to implementation by 2017, with most of the rest implementing the CRS by 2018.

It is important that the regimes be designed so that their tax compliance benefits exceed the costs imposed on business and that the OECD's Treaty Relief and Compliance Enhancement ("TRACE") initiative be implemented jointly with the CRS. Joint implementation of TRACE and the CRS would provide for the possibility that the burdens on business associated with implementing the CRS might be accompanied by the benefits TRACE provides to investors seeking to claim relief under income tax treaties.

Base Erosion and Profit Shifting ("BEPS")

ICI and ICI Global are actively participating in the OECD's BEPS consultation, which primarily targets the cross-border activities of multinational entities. The final BEPS Reports, approved by the G20 in October 2015, addressed fully most of our concerns on fund treaty eligibility, tax nexus for funds and advisers, dispute resolution, and profit allocation. In June 2016, we submitted detailed comments to the OECD on how the BEPS agreements will be incorporated into a multilateral instrument (MLI) that countries can sign to update simultaneously their treaties with like-minded countries. Specifically, we urged country-specific guidance, to be published on the OECD website, regarding how each country believes its funds should be treated for treaty eligibility purposes.

Recently, we have become active in attempts in Europe to "gold plate" various BEPS initiatives by going beyond what was agreed by at OECD and by the G20. Specifically, we have raised concerns with proposals that taxpayers, such as fund managers, disclose to the general public certain information that would be provided to governments in the BEPS Action 13 "country-by-country reports." This information, in many situations, is otherwise not disclosed publicly. Moreover, in most cases, the information would be insufficient to provide the general public with an understanding of whether a company is "paying its fair share" of tax in each country; instead, it likely would produce only misunderstandings.

US Tax Developments

The Congress passed the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") at the end of the year, which retroactively made permanent several key tax provisions that had expired at the end of 2014. The Path Act included several tax extenders of interest to the industry.

The PATH Act made permanent the section 871(k) flow-through provisions, which provide more equitable US withholding tax treatment for distributions of interest and short-term capital gains to foreign shareholders. Section 871(k) permits US funds to designate certain distributed amounts to foreign shareholders as interest-related dividends and short-term capital gain dividends that are exempt from US withholding tax. The PATH Act made section 871(k)'s permanence effective for taxable years beginning after December 31, 2014.The PATH Act also made permanent the provisions of section 897(h) regarding a RIC's qualified investment entity treatment under the Foreign Investment in Real Property Tax Act ("FIRPTA"), effective as of January 1, 2015. It also permanently extended the exception from subpart F income for active financing income. The Congress continued to focus on tax reform through 2015 and into 2016, though no significant legislation was passed. Various legislative proposals were introduced in the House of Representatives and the Senate that would reform corporate taxation and the taxation of derivatives. In preparation for the upcoming elections, both political parties and their presidential candidates have proposed extensive changes to the tax code, including modifications to the taxation of individuals, capital gains, and domestic and international operations of corporations.

To help facilitate the new money market fund reforms, the Internal Revenue Service and the Treasury Department provided guidance on several related tax issues. In May 2016, the IRS provided an alternate diversification requirement for variable insurance product funds that become government money market funds, alleviating concerns that such funds would not be able to satisfy the existing tax requirements. The IRS also issued guidance addressing the tax treatment of adviser contributions made to money market funds in preparation for compliance with the new money market fund rules. In July, the IRS and the Treasury Department finalized the regulations on use of a simplified method of tax accounting, called the NAV Method, by investors in floating NAV money market funds.

Accounting and Auditing Developments

Financial Accounting Standards Board ("FASB")

In February 2015, ICI filed a comment letter on a FASB proposal addressing disclosure of portfolio holdings in investment company financial statements. The proposal would require investment companies regulated under the Investment Company Act of 1940 to disclose information about investments held by investee funds whose fair value exceeds five percent of the of the reporting investment company's net assets. In particular, if the reporting investment company's proportional share of any investment owned by any individual investee fund exceeds five percent of the reporting investment company's net assets at the report date, then each such investment must be named and categorized, consistent with the schedule of investments disclosure requirements. ICI's comment letter argued that there would be little benefit associated with the proposal where the investee fund is a regulated investment company because the investee fund's holdings must be publicly disclosed four times per year and they are readily accessible on the SEC's and the fund sponsor's websites. The letter recommends that the proposal apply only to investments in investment companies that are not regulated investment companies. The comment letter is available at https://www.ici.org/pdf/28742.pdf. In August 2015 the FASB withdrew the proposal.

Public Company Accounting Oversight Board ("PCAOB")

In December 2015, the PCAOB adopted rules requiring disclosure of the name of the audit engagement partner for each financial statement audit. According to the PCAOB, the name of the engagement partner would be useful to investors and other financial statement users. In its original proposal the PCAOB would have required the name of the engagement partner to appear in the auditor's

report. ICI's comment letter expressed concern that the proposal could impair the ability of investment companies and other issuers to access capital markets on a timely basis. For example, if the engagement partner left the audit firm after completion of the audit and prior to the annual update of the fund's registration statement, then the auditor would not be able to consent to being named as an expert in the fund's registration statement and the fund could not offer its shares. To avoid this outcome, the Institute's comment letter recommended that if the Board proceeds with the proposal, that it require disclosure of the engagement partner outside the auditor's report. The comment letter is available at https://www.ici.org/pdf/27919.pdf. Consistent with ICI's recommendations, the final rules adopted by the PCAOB require disclosure of the engagement partner on PCAOB Form AP, which will be publicly available and searchable on the PCAOB's website.

In May 2016, the PCAOB reproposed a 2014 proposal that would require auditor's reports to describe "critical audit matters" which are matters involving especially challenging, subjective or complex auditor judgment. The proposal would require the auditor's report to identify the critical audit matter, describe the principal considerations that led the auditor to determine that the matter is a critical audit matter, describe how it was addressed in the audit, and refer to the relevant financial statement accounts and disclosures. The 2016 proposal would also require the auditor's report to disclose the auditor's tenure. According to the PCAOB, the changes to the auditor's report will better inform investors and others that rely on auditor reports. Consistent with recommendations submitted by ICI in its comment letter on the 2014 proposal, the 2016 proposal excludes SEC registered investment companies from critical audit matter reporting. The ICI comment letter on the proposal supports the exclusion of investment companies from critical audit matter reporting and recommends that auditor tenure be disclosed in PCAOB Form AP, rather than the auditor's report. The comment letter is available at https://www.ici.org/pdf/30147.pdf.

Securities and Exchange Commission

In May 2015, the SEC issued a proposal that would expand and modernize reporting requirements for registered investment companies. The SEC proposed: (1) new Form N-PORT, which would require funds to report monthly information about their portfolio holdings and certain risk metrics in a structured data format; (2) new Form N-CEN, which would require funds to report certain census-type information to the SEC in a structured data format and would replace Form N-SAR; and (3) amendments to Regulation S-X, which governs the form and content of financial statements filed with the SEC. The amendments to Regulation S-X are focused on improving disclosure relating to investments in derivatives; and (4) new rule 30e-3, which would permit but not require funds to fulfill shareholder report delivery requirements by making shareholder reports available on a website. ICI filed a comment letter on August 11, 2015 generally supporting the proposals but also recommended that the SEC modify and improve the proposals in some significant ways. The comment letter is available at https://www.ici.org/pdf/15_ici_sec_reporting_modernization_ltr.pdf.

In June 2015 the SEC issued a concept release seeking public comment on whether there would be benefit from requiring additional disclosure from audit committees about how they execute their existing audit oversight responsibilities. The release asks whether new disclosures would better inform investment and proxy voting decisions about whether to ratify the selection of the auditor or re-elect members of the audit committee. Closed-end investment companies are currently required to provide disclosure about the audit committee's oversight of the financial statement audit. Open-end funds, however, are not currently required to provide such disclosure. In its comment letter on the concept release the Independent Directors Council expressed the view that such additional disclosures would not benefit closed-end fund investors. IDC further argued that such disclosures should not be required for open-end funds. The comment letter is available at https://www.idc.org/pdf/29328.pdf.

In June 2016 the SEC issued no-action relief that allows funds to rely on audits of their financial statements where the auditor was not independent due to a violation of the "loan rule," under specified circumstances. The SEC's auditor independence rules indicate that where an auditor obtains a loan from an entity, and that entity owns more than ten percent of an audit client's equity securities, then the auditor

is not independent with respect to the audit client or any of its affiliates. The no-action relief expires after 18 months and the SEC is expected to consider amendments to the loan rule during that time.

SEC Consideration of International Financial Reporting Standards

In May 2015, the SEC's Chief Accountant indicated that there is virtually no support for having the SEC mandate IFRS for all issuers and that there is little support for having the SEC provide filers with an option to use IFRS. The Chief Accountant indicated that there is continued support for convergence between US GAAP and IFRS. It appears highly unlikely that the SEC will require US issuers to adopt IFRS.