UMB Fund Services

Industry Trends – November 2020

Industry Statistics – Mutual Funds

Fund Category	Net Assets (in billions) Sept-20	Net Assets (in billions) June-20	Percentage Change in Net Assets	Dollar Change in Net Assets (in billions) Total Change	Change Due to Net Cash Flows	Change Due to Market
Stock	$11,278.1	$10,609.4	6.3%	$668.7	($211.4)	$880.1
Hybrid	$1,503.7	$1,449.8	3.7%	$53.9	($12.7)	$66.6
Taxable Bond	$4,124.5	$3,911.1	5.5%	$213.4	$149.8	$63.6
Municipal Bond	$841.6	$805.7	4.5%	$35.9	$26.2	$9.7
Money Market	$4,404.2	$4,634.5	(5.0%)	($230.3)	($230.7)	$0.4
Total	$22,152.1	$21,410.5	3.5%	$741.6	($278.8)	$1,020.4

- Asset growth slowed in the third quarter with stock fund assets increasing during the quarter 6.3% or $668.7 billion, compared to the increase of $1,794.6 in the second quarter. For the quarter ended September 30, 2020, market appreciation was $880.1 billion compared to appreciation of $1,927.9 billion for the quarter ending June 30, 2020.

- Hybrid fund assets increased from $1,449.8 billion as of June 30, 2020 to $1,503.7 billion as of September 30, 2020. This compares to an increase of $145.4 billion in the second quarter of 2020. The increase was the result of market appreciation of $66.6 billion and net outflows of $12.7 billion.

- Bond funds had net inflows of $176.0 billion for the quarter ended September 2020, compared to the previous quarter inflows of $102.8 billion. Assets for all bond funds increased $249.3 billion for the quarter ended September 30, 2020 which included, market appreciation of $73.3 billion.

- Money market funds had net outflows of $230.7 billion for the three months ended September 30, 2020, compared to the previous quarter inflows of $295.1 billion. Money market fund net assets, over for the three-month period, decreased from $4,634.5 billion as of June 30, 2020 to $4,404.2 billion as of September 30, 2020.

Source: Investment Company Institute website

REGULATORY UPDATE

SEC Adopts Securities Offering Reform Rules for Certain Closed-End Investment Companies

The SEC recently adopted rules that modify the registration, communications, and offering processes for business development companies ("BDCs") and other closed-end investment companies under the Securities Act of 1933, as amended. The new rules allow these investment companies to use the securities offering rules that are already available to operating companies. They also extend to closed-end investment companies offering reforms currently available to operating company issuers by:

- expanding the definition of "well-known seasoned issuer" to allow these investment companies to qualify;
- streamlining the registration process for these investment companies, including the process for shelf registration;
- permitting these investment companies to satisfy their final prospectus delivery requirements by filing the prospectus with the Commission; and
- permitting additional communications by and about these investment companies during a registered public offering.

The amendments revise the current securities registration fee payment rules by requiring closed-end investment companies that operate as "interval funds" to pay securities registration fees using the same method as mutual funds and exchange-traded funds and extend the ability to use this payment method to issuers of certain continuously offered, exchange-traded products. Additionally, the SEC expanded the ability of certain registered closed-end funds or BDCs that conduct continuous offerings to make changes to their registration statements on an immediately effective basis or on an automatically effective basis a set period of time after filing. In addition, the SEC adopted structured data reporting requirements, including for filings on the form providing annual notice of securities sold pursuant to the rule under the Investment Company Act of 1940, as amended, that prescribes the method by which certain investment companies (including mutual funds) calculate and pay registration fees.

SEC Adopts Amendments to Modernize Shareholder Proposal Rule

In September, the SEC adopted amendments to the shareholder proposal rules in the Securities Exchange Act of 1934 in efforts to modernize the rules. The amendments are materially similar to the SEC's rules 2019 proposal previously reported on. The rules amend the ownership thresholds for proposal submissions and resubmissions and amends the role of representatives in the shareholder proposal process. The amendments also require that a shareholder proponent make available a representative to meet with the company and provide applicability within certain timeframes. The amendments apply to any shareholder proposal submitted for company meetings held on or after January 1, 2022.

SEC Adopts Revised Procedures for Review of Exemptive Order Applications

On July 6, 2020, the SEC adopted new procedures for the staff of the Division of Investment Management's use when reviewing applications for exemptive relief. These procedures provide for expedited review of certain applications mirroring applications that had been recently granted and also implement a timeline for applications that do not meet the requirements for expedited review.

The expedited review process is available to applications that are "substantially identical" to the terms (i.e., representations in an application that are material to the requested relief) and any other conditions set forth in recent precedents. Applicants for expedited review are not permitted to use portions of different prior applications as precedent and as a means of taking multiple, different applications as a means of combining precedents to support an application for expedited review. In order to qualify, the following conditions must be met:

- Two precedents must be referenced;
- The two precedents must be within the past three years;
- If there are more recent precedents than those chosen by the applicant, the applicant must explain why they didn't choose the more recent;
- The applicant must file a cover page which notes the request for expedited review, include the two prior precedents and submit marked copies comparing the application against the two prior precedents; and
- The applicant must certify that the application meets the requirements for expedited review and that the marked comparison copies are complete and accurate.

If the application meets requirements, the SEC will issue a notice of application no later than 45 days from the filing of the application. Amendments to the application may expend the length of time necessary for review.

For applications that do not meet the standards for accelerated review, the Staff has stated its position that action "should" be taken within sixty days of an initial filing or amendments. The Staff may also grant itself additional sixty-day extensions with notice to applicants.

The SEC did not adopt a provision that would have required publication of comments and responses although it did note that it would continue to consider requiring such publication in the future.

SEC Adopts New Proxy Voting Rules

In July, the SEC enacted long-awaited proxy voting rule reform, which was the result of a years-long effort to reform the proxy advisory industry. The process included requests for comments, surveying of investment advisers, and proxy voting-related SEC exam sweeps. The reform is comprised of both amendments to existing proxy voting rules and supplemental proxy voting guidance for investment advisers. The amendments to the proxy voting advice rules (1) codify that proxy voting advice constitutes a "solicitation" under the Securities Exchange Act of 1934 ("1934 Act"); (2) add disclosure and procedural requirements for proxy voting advisory firms wishing to avail themselves of certain exemptions in the 1934 Act; and (3) amend the proxy voting antifraud rule. As a result of the amendments, the SEC also updated its previously-released proxy voting guidance to investment advisers to incorporate new information based on the amendments. Proxy voting advisory firms affected by the amendments are expected to comply by December 1, 2021.

SEC Issues Statement on Form CRS Disclosures

As of June 30, 2020, broker-dealer and investment advisory firms began delivering their Form CRS relationship summaries to existing and prospective retail clients and customers. Staff Form CRS, which was adopted by the SEC in June 2019, is a brief relationship summary designed to help retail investors make informed choices regarding whether a brokerage or investment advisory relationship, as well as whether a particular firm, best suits the investor's particular needs and circumstances. The relationship summary was created with the intent of reducing investor confusion in the marketplace for brokerage and investment advisory services and assisting investors when they work with financial professionals. Firms must provide retail investors with a relationship summary containing plain English disclosures on the same topics under standardized headings in a prescribed order, allowing retail investors to compare different firms' services, fees, and other important information. Firms must also file their relationship summaries with the Commission and post the current relationship summary on the firm's public website, if the firm has one.

In July 2020, the SEC's Staff Standards of Conduct Implementation Committee announced that it had conducted a review of a cross section of firms to assess compliance with Form CRS requirements. The Committee noted that it had identified relationship summaries with simple and clear disclosures as well as examples of summaries that lack certain disclosures or could be clearer. The Committee will be sharing examples of best practices and feedback to firms. The Committee also plans to hold a roundtable in the near future to discuss its findings.

SEC Charges Financial Advisor with Fraud

On July 20, 2020, the SEC charged Michael Barry Carter, a Virginia-based former investment adviser and registered representative, with fraud for stealing millions of dollars from his clients. The SEC's complaint alleges Carter falsified internal documents to effect wire transfers from his brokerage customers' accounts to his personal accounts. Additionally, he sold securities owned by his clients without their authorization and directed the statements for these transactions to addresses he controlled. The SEC's complaint charges Carter with violations of the antifraud provisions of the Securities Exchange Act of 1934 and the Investment Act of 1940. The U.S. District Court of Maryland has announced criminal charges against Carter, to which he has pled guilty.

Advisor Charged with Failing to Disclose Payments to Promote Services to Florida Educators

At the end of July, the SEC charged a Houston-based investment advisor, VALIC Financial Advisors, Inc. ("VFA"), with two charges for failing to disclose to teachers and other investors practices that generated millions of dollars in fees and other benefits to VFA.

VFA is a financial services vendor in nearly every school district in Florida. According to the SEC, VFA's parent company, The Variable Annuity Life Insurance Company ("VALIC"), made payments to an entity owned by the Florida teachers' unions in exchange for that entity's exclusive endorsement of VFA as its preferred financial services partner and the entity's agreement not to promote or endorse VFA's competitors. This practice allegedly took place for 13 years. In addition, VALIC also provided three full-time employees to serve as "member benefit coordinators" who deceptively presented themselves as employees of the entity owned by the teachers' unions. The "member benefit coordinators" promoted VALIC and VFA to Florida K-12 teachers and referred teachers to VFA for investment recommendations. The SEC found that the "member benefit coordinators" increased VFA's access to Florida K-12 teachers and that VFA did not disclose that the for-profit entity was paid to make VFA its preferred financial services provider. VFA and VALIC earned more that $30 million on the products it sold to Florida K-12 teachers during the period covered by the SEC's order.

In the second action, the SEC charged VFA for making misleading statements about, and failing to disclose, conflicts related to its receipt of millions of dollars of financial benefits from client mutual fund investments.

According to the SEC's order, VFA's wrap agreements with its clients provided that the advisory fee the client paid to VFA included the costs to execute securities transactions. The SEC found that VFA either directly invested or instructed its primary sub-adviser to select mutual fund investments for its clients that were part of VFA's broker's no-transaction fee program ("NTF Program") and therefore would not incur transactions fees that VFA would be responsible for paying. Generally, the funds available in the NTF Program we more expensive than other mutual funds available to VFA clients.

The SEC found that VFA's participation in the NTF Program generated financial benefits to VFA and that VFA failed to provide disclosures regarding these conflicts but also provided false and misleading disclosures about the conflicts. The SEC contends that VFA received both 12b-1 fees and revenue sharing from the clearing broker for investments in the NTF Program and clients with wrap agreements in which VFA was responsible for execution costs, VFA benefited by not having to pay transactions fees for investments in the NTF Program.

Without admitting or denying the SEC's findings, VFA consented to a cease and desist order, a censure and a civil penalty of $20 million. VFA further agreed to set advisory fees for all Florida K-12 teachers who currently participate in its advisory product in Florida's 403(b) and 457(b) retirement programs at its most favorable rates in the Florida K-12 market.

OCIE Issues "Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisors" Risk Alert

On August 12, 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Risk Alert addressing compliance risks and considerations for broker-dealers and investment advisers in the COVID-19 environment. The Risk Alert shares the OCIE'S observations and recommendations for the following categories:

- Protection of investors' assets;
- Supervision of personnel;
- Practices relating to fees, expenses, and financial transactions;
- Investment fraud;
- Business continuity;
- The protection of investor and other sensitive information.

The full risk alert is available at SEC.gov.

SEC Modernized Accredited Investor Definition

In August 2020, the SEC adopted amendments to the "accredited investor" definition to add new categories of investors that may qualify to participate in private capital markets. New categories accredited investors include the following:

- Individuals with Professional Certifications or Other Credentials: Persons with certain professional certifications, designations and/or credentials as designated from time to time by the SEC. Such credentials include Series 7, 65 and 85 licenses.
- Knowledgeable Employees of a Fund: With regard to investments in private funds, natural persons who are "knowledgeable employees" of the fund would be considered accredited investors with regard to investments in that fund.
- Limited Liability Companies and Certain Advisors: Clarification was provided that limited liability companies with $5 million and assets qualify. In addition, SEC- and state-registered advisers, exempt reporting advisers and rural business investment companies were added to the list of entities that qualify.
- Family Offices: Family office with at least $5 million in assets under management, and their "family clients" (as defined under the Investment Advisers Act).
- Spousal Equivalent: The term "spousal equivalent" was added to the accredited investor definition so that spouses may pool their finances for the purpose of qualifying as an accredited investor.

For investors that do not meet these criteria, the SEC maintained the income and net worth tests for individuals to qualify as accredited investors.

In addition to the changes to those qualifying as accredited investors, the SEC also expanded the definition of "qualified institutional buyer" in Rule 144A to include limited liability companies and rural business investment companies if they meet the $100 million in securities owned and invested definition. Also added were any institutional investors that are accredited investors but not otherwise qualifying as a qualified institutional buyer provided they satisfy the $100 million invested threshold.

SEC Proposed Amendments to Form 13F

The SEC recently proposed amendments to Form 13F to alter the reporting threshold requirements for institutional investment managers. Form 13F was originally adopted by the SEC in 1975 and requires investment managers with over $100 million in assets under management to file portfolio data on Form 13F. The proposal raises the Form 13F reporting threshold from $100 million to $3.5 billion which accounts for the market value growth of equity securities since 1975. Other changes in the SEC's proposal include an automatic SEC staff review of the Form 13F reporting threshold every five years and the removal of the option to omit small position holdings from Form 13F. The request for comments on the proposal closed in September 2020.

SEC Issues Proposal on Modernizing Fund Reporting

On August 5, the SEC proposed comprehensive modifications to the mutual fund and exchange-traded fund disclosure framework. The proposed disclosure framework would feature concise shareholder reports that would highlight information that is particularly important to investors to assess and monitor their fund investments.

The proposal would:

- require streamlined reports to shareholders that would include, among other things, fund expenses, performance, illustrations of holdings, and material fund changes;
- significantly revise the content of these items to better align disclosures with developments in the markets and investor expectations;
- encourage funds to use graphic or text features—such as tables, bullet lists, and question-and-answer formats—to promote effective communication; and
- promote a layered and comprehensive disclosure framework by continuing to make available online traditional shareholder reports that is currently required but may be less relevant to retail shareholders generally.

The proposed framework would provide an alternative approach to keeping investors informed about their ongoing fund investments. Instead of receiving both prospectus updates and shareholder reports, which today can be lengthy and complex, existing investors would receive the streamlined shareholder report. The SEC believes that this would provide investors with concise information to effectively assess and monitor their fund investments. Information currently required in shareholder reports that is not included in the streamlined shareholder report would be available online, delivered free of charge upon request, and filed on a semi-annual basis with the SEC.

In addition, the proposal would amend prospectus disclosure requirements to provide more consistent information regarding fees, expenses, and principal risks. To improve fee- and expense-related information more broadly, the proposal would also amend investment company advertising rules to promote more transparent and balanced statements about investment costs. The proposed advertising rule amendments would affect all registered investment companies and business development companies.

Key features include:

- a new summary shareholder report that contains:
  - Revised expense example
  - Management discussion of fund performance
  - Graphical representation of holdings
  - Material fund changes
  - Link to additional information
- Website requirements
  - Traditional GAAP financial statements
  - Financial highlights table
  - Proxy results
  - Advisory contract renewal
  - Board/officer compensation
- Corresponding changes would be made to:
  - Changes to N-CSR
  - Prospectus amendments
  - Eliminates delivery requirements in the new Rule 30e-3

The SEC published a three-page sample of the annual report and a table comparing current annual/semi-annual shareholder reports. That sample can be found at:

https://www.sec.gov/image/tailoredshareholderreports

A public comment period will begin for 60 days following publication in the Federal Register.

Issues with Edgar System Prompts SEC to Issue Proposal for New Rule Regulation S-T

With all funds now reporting on Form N-Port and recent N-PX Filings, the EDGAR filing system has experienced month-end delays in handling the number of filings. As a result, the SEC issued a proposal for new proposed Rule 15 of Regulation S-T. Rule 15 would allow the SEC to take steps to promote the reliability and integrity of the EDGAR system. Among the elements are:

- Allow filers to request the SEC to adjust a filing date when the filing is delayed due to technical difficulties beyond the filer's control.
- Allow the SEC to remove from EDGAR an entire submission or document if it contains executable code.
- Allows the SEC to prevent submissions that prove to be a cybersecurity threat or to correct system or staff errors.
- Allow the SEC to take actions administratively that promote the reliability of the system.

Franklin Fined for Violating Fund of Funds Rule

The SEC ordered Franklin Templeton to pay a $325,000 penalty for violating a regulation designed to monitor the investment of funds in other funds and putting its own interests ahead of its shareholders. The court order highlighted that Franklin did not initially reimburse the funds for the losses or disclose this to its internal board, contrary to its own policies. The SEC maintained that Franklin failed to implement pre-trade screening process. Franklin fully reimbursed the allocation funds, with interest, for its losses in December 2018.

There is an SEC limitation on funds investing more than 10% of their assets in other unaffiliated funds. In the event the fund exceeds the 10% limitation, the investment advisor to the fund must ensure that it and its affiliates do not own more than 3% of the shares of the underlying fund.

From December 2014 through November 2015, Franklin Advisers purchased shares of three ETFs for three of its allocation funds and eight retirement target-date funds resulting in ownership of more than 10% of each affiliated fund in at least one of the ETFs. Additionally, Franklin Advisers also exceeded the 3% ownership limit of the shares of the underlying fund. When the issues were discovered, the firm attempted to resolve them by reducing positions in the ETFs. Two of the ETFs posted gains while one ETF had realized losses.

The SEC found further that Ontario-based Franklin Templeton Investment Corp. acquired shares of an ETF for six Quotential Funds in the amount of between 64.59% and 90.65% of the ETF between February 2015 and September 2016. This subsidiary also asked the ETF's investment manager to reduce management fees in exchange for an increased investment in the ETF. In a separate mater, five Quotential Funds acquired up to 29% of the shares of another ETF.

In addition to the penalty, the SEC told Franklin and its affiliates not to violate these applicable limitations in the future.

CFTC Reviewing Fund Disclosure

The Commodity Futures Trading Commission ("CFTC") is reviewing commodity-based fund disclosures as a result of market volatility, especially in the energy sector. The CFTC stated that they have seen situations where the fund strategy may have changed but not the disclosure. Comments were addressed to the risk disclosure of funds.

OCIE Issues Risk Alert on Ransomware

In July 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Cybersecurity Risk Alert highlighting recent reports of "orchestrated phishing and other campaigns designed to penetrate financial institution networks to, among other objectives, access internal resources and deploy ransomware." OCIE noted an increase in the sophistication of ransomware attacks on SEC registrants, including investment advisers and investment companies. Under a ransomware attack, malware is designed to provide unauthorized access to an institution's systems while denying the institution's access to the systems until a ransom is paid. OCIE encourages firms to monitor cybersecurity alerts published by the Department of Homeland Security Cybersecurity and Infrastructure Security Agency on ransomware attacks (www.cisa.gov). In addition, OCIE stressed the need for firms to take appropriate steps to mitigate the risk of ransomware attacks, including:

- **Incident response and resiliency policies, procedures and plans.** Assess, test and periodically update incident response policies and procedures, including contingency and disaster recovery plans.
- **Operational resiliency.** Determine which systems can be restored during an attack so that services can continue.
- **Awareness and training programs.** Provide cybersecurity and resiliency training to equip employees with information concerning cyber risks and to heighten awareness of the threat of cyber-attacks.
- **Vulnerability scanning and patch management.** Implement proactive vulnerability and patch management programs that are conducted frequently across a firm's technology environment.
- **Access management.** Manage user access to systems including limiting access, use of strong passwords, use of multi-factor authentication, and immediate revocation of system access for former employees and contractors.
- **Perimeter security.** Implement perimeter security capabilities to inspect and control network traffic and prevent harmful traffic. Such capabilities would include firewalls, intrusion detection systems, email security and web proxy systems with content filtering.

OCIE Issues Risk Alert on Credential Stuffing

In September 2020, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Risk Alert highlighting the increased use of "credential stuffing" cyber-attacks on SEC registered investment advisers and broker-dealers. Credential stuffing is an automated attack where attackers obtain usernames, email addresses and corresponding passwords from the dark web and then use automated scripts to try the usernames and passwords on other websites to attempt to gain access to accounts.

Successful attacks can result in bad actors gaining access to customer accounts and firms' systems, creating the risk of both financial loss and the loss of confidential information, such as personally identifiable information or user login credentials, which the actors can then sell on the dark web or use in further credential stuffing attacks.

OCIE encourages firms to review their Regulation S-P and Regulation S-ID policies and programs to address the growing threat of credential stuffing. In particular, firms may consider implementing a number of practices to help protect client accounts, including:

- Updating password policies and procedures.
- Use of Multi-Factor Authentication ("MFA").
- Deployment of Completely Automated Public Turing test to tell Computers and Humans Apart ("CAPTCHA").
- Implementation of controls to detect and prevent credential stuffing attacks.
- Monitoring the dark web for user credentials.

Valuation Update

Deloitte issued their 18th Fair Valuation Survey. The survey highlights a few trends that Deloitte sees:

The industry is experience unprecedented challenges during the early days of the pandemic, including extreme volatility and market illiquidity. More than 81% of survey participants reported experiencing difficulties including:

- 65% questioned security prices from primary sources.
- 58% experienced delays due to price challenges or review.
- 41% identified decrease effectiveness of foreign fair value factors.
- 30% identified market transactions that were determined to be disorderly and not reflective of fair value.

Despite these factors, fund groups continued to strike and publish NAVs throughout the pandemic often due to funds adopting real-time adjustments such as:

- Adapting materiality thresholds and/or flexible price tolerances and investigating daily prices differences.
- Changed procedures or responsibility for the pricing process or challenge process.
- Receiving support from directors/trustees via special meetings.

Other key findings:

- More than half (61%) of participants indicated that the valuation format for private equity stated that models are not standard and may be unique to each investment.
- In the last 12 months, 31% changed their primary source for certain fixed income securities
- 63% reported using bid pricing when valuing fixed income securities.
- 62% indicated that they hold some private equities.
- 36% indicated they had performed a site visit of third-party pricing vendors through virtual means.

Complete Survey can be found at:

https://www2.deloitte.com/us/en/pages/financial-services/articles/annual-fair-valuation-survey.html

ICI Submits Comment Letter on SEC Proposed New Rule on Fair Valuation

Last quarter, the SEC proposed rule 2a-5 that would modify the requirements for determining the fair value of a fund's investments. The Proposed Rule is intended to provide a consistent framework and standard of baseline practices for fair value. During this quarter, the Investment Company institute filed their comment letter. Major areas addressed were:

- Separate out "evaluated" prices obtained from a third-party pricing vendor. Evaluated prices are used for trillions of dollars in fixed income securities. Today those securities are reflected in financial statements as a level 2 holding. The proposal would, for valuation purposes, require those to be fair valued and the ICI feels that would distract the Board from necessary involvement on trolley fair valued securities.
- Modify the frequency, timing and content of information that is provided to the board.
- Allow for more principle based fair value determination that would allow for flexibility for addressing the differences in some investments and changes in some investments over their life cycle.
- Allow for more attention spent on the process of price challenges then specific criteria

The SEC has not responded to the numerous comment letters received.

ICI Releases 2020 Investment Company Fact Book

The *2020 Investment Company Fact Book*—the 60th edition of ICI's research publication—offers extensive data and insight on funds and fund investors. This year's *Fact Book* is more than 300 pages and contains nearly 200 charts and tables. The *Fact Book* has shifted away from marketing to financial analysis and has expanded to keep pace with industry growth and developments. This year's book contains additional information on the worldwide fund industry, ETFs, closed-end funds, characteristics and behavior of fund investors, and the market for retirement-related products.

The full Fact Book can be found at: https://www.icifactbook.org/

TAX UPDATE

Regulatory

IRS Issues Final Regulations on Section 163(j) Limitation on Interest Expense Deduction

The U.S. Department of the Treasury and the Internal Revenue Service issued final regulations regarding the limitation on the deduction for interest expense in internal revenue code ("IRC") section 163(j) as amended in 2017 by the commonly referred to Tax Cuts and Jobs Act ("TCJA"). The amended 163(j) limits the deduction for net business interest expense to 30 percent of a taxpayer's adjusted taxable income ("ATI"). Business interest expense is any interest paid or accrued on indebtedness allocable to a trade or business and does not include investment interest.

The final regulations confirm that IRC section 163(j) applies to regulated investment companies ("RIC"s). The final regulations clarify that ATI is a RIC's taxable income without any adjustment made under IRC section 852(b)(2) to compute investment company taxable income. Therefore, the 30 percent limitation is applied before the RIC's dividend paid deduction ("DPD"). The regulations do require an increase to ATI by the amount of the dividends received deduction ("DRD") calculated under IRC section 243.

The final regulations are effective 60 days after publication of the final regulations in the Federal Register.

Proposed Regulations Permitting RICs to Pay Section 163(j) Interest Dividends

The U.S. Department of the Treasury and the Internal Revenue Service released proposed regulations under which a regulated investment company ("RIC") that earns business interest income may pay internal revenue code ("IRC") "section 163(j) interest dividends" that corporate shareholders may treat as interest income for purposes of IRC section 163(j). The proposed regulations would provide a RIC's corporate shareholder with interest income instead of ordinary dividend income that potentially would increase the amount of interest expense that the shareholder could deduct under IRC 163(j) as amended in 2017 by the commonly referred to Tax Cuts and Jobs Act (TCJA). The amended 163(j) limits the deduction for net business interest expense to 30 percent of a taxpayer's adjusted taxable income (ATI).

Section 163(j) dividends are defined in the proposed regulations as any dividend, or part of a dividend, that is reported by the RIC as a section 163(j) interest dividend in a written statement provided to its shareholders. The proposed regulations limit the amount of section 163(j) interest dividends that a RIC may report, to the excess of the RIC's business interest expense for the taxable year over the total of the RIC's business interest expense for taxable year plus other deductions that are properly allocable to the RIC's business interest income.

The proposed regulations would apply to taxable year beginning on or after the date that is 60 days after the final regulations are published in the Federal Register. Taxpayers may choose to apply the rules in the proposed regulations, however, for taxable years beginning after December 31, 2017, and before the effective date of the final regulations, as long as taxpayers and their related parties apply the rules consistently.

IRS Approves Temporary Use of E-Signatures for Certain Tax Forms

The Internal Revenue Service ("IRS"), as part of their response to the COVID-19 pandemic, is implementing a temporary deviation with the issuance of a memorandum dated August 27, 2020, that allows taxpayers and representatives to use electronic or digital signatures when signing certain forms, including Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies, that currently require a handwritten signature. The IRS indicates in a footnote that electronic and digital signatures appear in many forms when printed and may be created by many different technologies. No specific technology is required for this purpose during this temporary deviation.

The IRS memorandum is effective for the forms indicated in the memorandum that are signed and postmarked beginning on or after August 28, 2020 through December 31, 2020.

Other

2020 ICI Reporting Layouts and Target Delivery Dates

The Investment Company Institute ("ICI") released their calendar 2020 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 ("RIC"s) to use to report various additional tax related items. The NRA Layout provides a means for reporting information reported on IRS Form 1042-S.

The 2020 Primary, Secondary, and NRA layouts have been updated to no longer require that entries be listed in CISIP order.

In 2018, the Primary Layout had been updated to account for Form 1099-DIV's new Box 5, "Section 199A dividends". Last year, the 2019 Primary Layout had been updated to include a breakout of the Section 199A amounts to conform with the qualified dividend reporting format. The 2019 Primary Layout had also been updated to specify that Box 1b, "Qualified dividends", of the Form 1099-DIV, may be eligible for reduced capital gains rates subject to the shareholder level holding period requirement.

In 2019 the Secondary Layout had been updated to include a new "Section 163(j)-Related Interest Dividend" column. This column is to be utilized with Treasury issuing guidance permitting RICs to pass through interest income to corporate shareholders for purposes of determining such corporations' interest expense limitation under Section 163(j).

The 2020 NRA Layout is identical to the 2019 NRA Layout.

The target dates for delivering year-end tax information to brokers and banks will be as follows: Primary Layout - Tuesday, January 19, 2021; Secondary Layout – Tuesday, January 26, 2021; and NRA Layout – Tuesday, February 2, 2021. Funds are encouraged to provide their year-end tax information to brokers and banks as soon as it is available.