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Recommendation of the Investor Advisory Committee Legislation to Fund Investment Adviser Examinations

Preliminary Observations:

- ® During Fiscal Year 2012, despite improved risk-based analysis to select examination candidates in its examination program, the SEC was able to conduct on-site examinations of only about eight percent of registered investment advisers. Over 40 percent of SEC-registered investment advisers have never been examined.¹ In practice, this equates to an approximately 13-14 year examination cycle for SEC registrants, and is simply inadequate to detect or credibly deter fraud.
- ® The IAC shares Chair White's concern that the resources available to the SEC's National Examination Program (NEP) are insufficient to permit the SEC to examine regulated entities and enforce compliance with the securities laws "in a way that investors deserve and expect." The IAC further shares Chair White's view that expanding the oversight of investment advisers and improving their regulation and compliance must be one of the SEC's "top priorities."
- ® The President's FY 2014 Budget request seeks appropriations that would permit the SEC to hire 250 additional examiners in FY 2014. Chair White has characterized this hiring as "vital" and as the first step in a "multi-year effort to increase coverage by [the SEC's] examination program."² However, Congress does not appear likely to fund this request. Indeed, the FY 2014 SEC budget approved by a House Appropriations Subcommittee on July 10, 2013 would provide the SEC with \$303 million less than the President's request.³ Such a funding level cannot support the necessary improvements to the SEC adviser examination and oversight programs without sacrificing other equally important Commission activities.
- ® Section 914 of the Dodd-Frank Act directed the SEC to study the options and costs of enhancing SEC-registered investment adviser oversight. In January 2011, the SEC released the findings of its study. The study's first recommendation was that Congress authorize the SEC to assess "user fees" on investment advisers it examines and that the revenue derived from such fees be used to fund additional adviser examinations.⁴

IAC Recommendation:

The Commission's registered investment adviser examination program faces significant capacity challenges in both the near-term and long-term. These challenges stem in part from the additional oversight the Commission must now conduct as a result of the Dodd-Frank Act including the registration of advisers to certain private funds. While states have successfully assumed oversight responsibility for a significant number of IAs formerly registered with the SEC, DFA's requirement that new adviser

¹ Testimony on SEC Budget by Chair Mary Jo White, U.S. Securities and Exchange Commission. Subcommittee on Financial Services and General Government, Committee on Appropriations, United States House of Representatives. May 7, 2013 <http://www.sec.gov/news/testimony/2013/ts050713mijw.htm>

² Testimony on SEC Budget by Chair Mary Jo White, U.S. Securities and Exchange Commission. Ibid. May 7, 2013.

³ U.S. House of Representatives. 113th Congress. "A bill making appropriations for financial services and general government for the fiscal year ending September 30, 2014, and other purposes." Full Committee Print. Accessible at: <http://appropriations.house.gov/uploadedfiles/bills-113hr-sc-ap-fy2014-fservices-subcommitteedraft.pdf>

⁴ Staff of the Division of Investment Management of the U.S. Securities and Exchange Commission, Study on Enhancing Investment Adviser Examinations (Jan. 19, 2011). Accessible at: <http://www.sec.gov/news/studies/2011/914studyfinal.pdf>

populations, such as advisers to private funds be registered w/ SEC, has prevented SEC from realizing any net reduction in oversight responsibilities. In order to meet these challenges, the SEC's adviser examination program requires a scalable source of funding that will permit the Commission to meet the new challenges it faces.

Recommendation

The SEC should request legislation from Congress that would authorize its Office of Compliance, Inspections, and Examinations (OCIE) to impose "user fees" on SEC-registered investment advisers, the revenue from which could be retained by the Commission to fund an enhanced investment adviser examination program including more frequent on-site examinations of SEC-registered advisers. As the Commission Staff Section 914 Study observes, user fees imposed upon registered investment advisers would provide scalable resources to support the Commission's examination of registered investment advisers. The fees collected from investment advisers would be available to the Commission without further appropriation, used solely to fund the Commission's investment adviser examination program, and set at a level designed to achieve an acceptable frequency of examinations. The IAC observes that legislation that would effectuate this policy has been introduced in the 113th Congress.⁵

Supporting Rationale: The user-fee legislation that has been introduced in the 113th Congress by Rep. Maxine Waters, H.R. 1627, the Investment Adviser Examination Improvement Act of 2013, enjoys support from many investment adviser industry associations. These organizations, which include the Investment Adviser Association, the Certified Financial Planners Board of Standards, the Financial Planners Association, and the National Association of Personal Financial Advisers, acknowledge the public policy imperative of improving adviser oversight, and have made clear in testimony and other public statement that they consider authorizing OCIE to collect "user fees" to be the optimal means for effectuating more frequent on-site examinations of federally registered advisers.^{6 7} Moreover, unlike alternative policies that might significantly increase the frequency with which SEC registered advisers are examined on a sustained basis, legislation that would authorize the imposition of "user fees" to augment the SEC's investment adviser examination resources has been considered and passed on a bipartisan basis by the House of Representatives twice in the past, during in the 102nd Congress in 1992,⁸ and the 103rd Congress in 1993.⁹

⁵ H.R. 1627, the Investment Adviser Examination Improvement Act of 2013.

⁶ Testimony of David G. Tittsworth, Executive Director of the Investment Adviser Association, before the House Committee on Financial Services. June 6, 2012 P. 10-11. Accessible at: <http://financialservices.house.gov/uploadedfiles/hhrg-112-ba-wstate-dtittsworth-20120606.pdf>

⁷ See House Committee on Financial Services Press Release, "Waters' Legislation Would Bolster Investment Adviser Examinations." April 19, 2013. Accessible at: <http://democrats.financialservices.house.gov/press/PRArticle.aspx?NewsID=1534>

⁸ On Sept. 22, 1992, during the 102nd Congress, the House of Representatives approved by a voice-vote H.R.5726, the "Investment Adviser Regulatory Enhancement and Disclosure Act of 1992."

⁹ On May 4, 1993, during the 103rd Congress, the House of Representatives approved by a voice-vote H.R.578, the "Investment Adviser Regulatory Enhancement and Disclosure Act of 1993."