

Executive Summary
SRO Discussion Draft
“Investment Adviser Oversight Act of 2011”¹

I. Background

- a. Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), passed by the 111th Congress, required the Securities and Exchange Commission (“SEC” or “Commission”) to review and report back to Congress on the frequency of its exam cycle for federally registered investment advisors (“RIAs”).² The report reviewed the SEC’s oversight program over the last five years and whether one or more self-regulatory organizations (“SROs”) should be created to improve the frequency of exams.³
- b. The five-member Commission was unable to reach consensus on the staff recommendations. SEC staff thus recommended Congress consider three options to strengthen the Commission’s examination program.⁴
 - i. **Self-Funding** -- Authorize the Commission to impose user fees on SEC-registered investment advisers (RIAs or IAs).
 - ii. **SRO** -- Authorize one or more SROs, under SEC oversight, to examine all SEC-registered IAs.
 - iii. **Limited SRO** – Authorize FINRA to examine dual registrants, i.e., investment advisers of dually registered broker-dealers, for compliance with the Investment Advisers Act of 1940 (’40 Act).

II. Short Title and Bill Status.

- a. Title: “Investment Adviser Oversight Act of 2011.”

¹ See draft bill at http://financialservices.house.gov/UploadedFiles/BACHUS_017_xml.pdf (September 2011).

² See Sec. 914, “Study on Enhancing Investment Adviser Examinations,” Dodd-Frank Wall Street Reform and Consumer Protection Act, <http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf>, at 455.

³ See Staff of the Division of Investment Management of the U.S. Securities and Exchange Commission, “Study on Enhancing Investment Advisers Examinations,” January 2011, at <http://www.sec.gov/news/studies/2011/914studyfinal.pdf>.

⁴ Please see the fi360 executive summary of the SEC’s study for additional details at http://www.fi360.com/main/pdf/SROstudy_executivesummary_012011.pdf (January 2011).

- b. Bill status: The draft bill and SEC report were scheduled to be reviewed by the House Subcommittee on Capital Markets and Government Sponsored Enterprises on September 13, 2011. A witness panel of financial and consumer trade groups, state securities regulators, and a prospective SRO for investment advisers, the Financial Services Industry Regulatory Authority (“FINRA”), were also invited to comment on the bill’s provisions.

Rep. Spencer Bachus, R-Ala., chairman of the House Committee on Financial Services, is expected to introduce an SRO bill containing many of the same provisions in the near future.

III. Scope of RIA Registration.

State and federal RIAs would be required to maintain membership with a registered national investment adviser association (SRO) unless otherwise exempt. Dually registered broker-dealer/RIAs would not be exempt.

- a. Exemptions. Any adviser with 90 percent or more of the firm’s assets under management attributable to one or more of the following types of clients would not be subject to SRO registration:
- i. Investment companies (mutual fund advisors)
 - ii. Non-U.S. persons
 - iii. Clients that in aggregate own at least \$25 million in investments
 - iv. Various religious, education or charitable entities
 - v. Stock pension plans and collective trusts
 - vi. Private equity funds
 - vii. Venture capital funds
 - viii. An RIA that is controlled by another RIA registered with the SRO where the compliance programs are closely integrated
 - ix. Any other adviser or class of adviser that the Commission may exempt by rule or regulation

IV. SRO Criteria.⁵

- a. More than one SRO could be registered with the Commission. However, the SEC would first determine that each applicant:
 - i. is organized so that it has the “capacity” to enforce compliance with its rules and regulations; and
 - ii. its rules meet the following criteria:
 1. assure a “fair representation” on its board of directors of the public and the investment adviser industry (the latter individuals must not be associated with an RIA or BD firm);
 2. are designed to prevent fraudulent acts and to protect investors;
 3. are necessary and consistent with the Act and the fiduciary standards applicable to investment advisers under the Advisers Act or similar state law, and do not duplicate, overlap or conflict with those laws;
 4. do not pose “any burden on the business of investment advisers” or their ability to compete in the marketplace;
 5. provide for periodic exams of its members (RIAs), and to coordinate these with the Commission and the States;
 6. provide for equitable allocation of dues and other operating expenses;
 7. provide for issuance of an annual financial report to the SEC and Congress;
 8. establish criteria for investment advisers to become members; and
 9. establish disciplinary procedures for violations of the rules and regulations.
- b. No SRO rules would take effect until a minimum of one year after the date of enactment, unless the SEC determines otherwise.

V. SEC Procedure for Reviewing SRO Applications.

Upon the filing of an application by a prospective SRO:

- a. The SEC would publish notice and “afford interested persons an opportunity to submit written data, views and arguments.”

⁵ We would note that much of the language in the draft bill summarized in the remainder of this document mimics the language for SROs for broker-dealers set forth in the Securities Exchange Act of 1934.

- b. Within 90 days the SEC would either grant the application or initiate proceedings to determine whether registration should be denied.
- c. Proceedings for denial would include
 - i. Notice of the grounds for denial and opportunity for hearing and a final decision within 180 days.
 - ii. The SEC could extend the proceedings for up to 90 days if it finds good cause.

VI. Procedure for SRO Rule Approvals or Changes by the SEC.

- a. Each SRO would file rules of the association with the Commission, including an opportunity for "interested persons" to submit written data, etc., regarding the proposal.
- b. Generally within 35 days of publication, the SEC would approve the proposed rule or institute proceedings for disapproval.
- c. Proceedings would conclude within 180 days, with an extension of another 60 days if the Commission finds good cause for the delay.
- d. The Commission would be required to consider in its review of the proposed rule consistency with the requirements of the Act and the rules applicable to SROs registered thereunder.
- e. The Commission would also summarily approve a rule change without delay if "such action is necessary for the protection of investors or the safeguarding of securities or funds."
- f. Rule proposals would be published for public comment by the SEC, along with a statement by the Commission citing the basis for amending the rules.

VII. SRO Disciplinary Procedures.

- a. In any proceeding to discipline an RIA or associated person, the SRO would be required to include a statement citing the activity and rule violation, including the sanction and reason for it, notify the party, and give that person an opportunity to defend against such charges.
- b. The SRO could summarily
 - i. suspend a member or associated person that has been expelled or expended by another SRO,
 - ii. suspend a member or associated person in serious financial or operational difficulty, or

- iii. limit or prohibit a person's advisory services if the SRO determines the person does not meet its qualifications.
- c. The Commission could stay a summary action on its own or upon application by an aggrieved person.
- d. The SRO would file notice with the SEC of all final disciplinary sanctions. A person could file for a review of the sanction with the Commission within 30 days of such notice. The Commission has the authority to cancel, reduce or revoke the sanction upon review.

VIII. Denial of SRO Membership.

- a. The Commission would follow certain procedures for reviewing a denial of membership in the SRO, or the barring of any person associated therewith.

IX. SRO Compliance.

- a. Each SRO would be required to comply with the provisions of the Advisers Act, the rules of the SEC, and its own rules. The Commission would conduct a regular inspection of the SRO annually to ensure compliance.
- b. The SEC could suspend, censure or revoke the registration of an SRO, or place limitations on its activities upon a finding that it has violated or is unable to comply with this Act or related rules.
- c. Officers and Directors of the SRO could also be removed or censured by the Commission after notice and opportunity for hearing regarding willful violations of this Act or any related rules.