



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

**Statement of the Investment Company Institute
Hearing on “H.R. 4624, the Investment Adviser Oversight Act of 2012”**

**Committee on Financial Services
United States House of Representatives**

June 6, 2012

The Investment Company Institute¹ is pleased to provide this written statement in connection with the hearing of the Committee on Financial Services on the oversight of investment advisers.

The fund industry has a significant interest in the subject of oversight of investment advisers. ICI and its members strongly support a vigilant and effective examination program for investment advisers. The trust that over 90 million investors place in registered funds is in no small part due to the rigorous regime under which funds and their advisers operate. We recognize, however, that the capacity limitations of the Securities and Exchange Commission (“SEC”) have prevented retail clients from benefitting to the same extent as fund investors from SEC oversight of investment advisers because registered fund complexes tend to have more frequent examinations than smaller advisory firms.² This bill is intended to address the differences in oversight and to strengthen the examination program for advisers to retail clients. The bill would authorize the creation of a self-regulatory organization (“SRO”) for advisers to retail clients, which was one of the primary options the SEC staff presented in a study last year to enhance adviser examinations as mandated by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).³

ICI supports the goal of meaningful oversight of all investment advisers. We also understand the need to address the difference between the examination of smaller, retail-facing advisers, which may not be inspected at regular intervals by SEC staff, and fund advisers, which are subject to more frequent and rigorous examinations and SEC oversight.⁴ This bill retains the SEC as the primary regulator for

¹ The Investment Company Institute is the national association of U.S.-registered investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs) (collectively, “registered funds”). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of registered funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

² See, e.g., United States Securities and Exchange Commission, *2010-2015 Strategic Plan*, at 13, available at www.sec.gov/about/secstratplan1015f.pdf (For its performance metrics, the SEC sets the target examination of registered investment companies at 15% each year compared to 9% for registered investment advisers).

³ Staff of the Division of Investment Management of the U.S. Securities and Exchange Commission, *Study on Enhancing Investment Adviser Examinations* (January 2011), available at www.sec.gov/news/studies/2011/914studyfinal.pdf (“914 Study”).

⁴ See *supra* note 2 and *infra* note 10.

investment advisers to registered funds and their affiliates while authorizing an SRO to provide greater oversight of advisers to retail clients.⁵ We believe that preserving the SEC as the primary regulator for advisers to registered funds is critical to avoid depriving fund investors of the benefits of continued and direct oversight of fund advisers by the SEC – the only regulator that can adequately oversee compliance both with the Investment Company Act of 1940 (“Investment Company Act”) and the Investment Advisers Act of 1940 (“Advisers Act”). We provide our views in more detail below.

I. The SEC Must Remain the Primary and Direct Regulator for Investment Advisers to Registered Funds

ICI strongly believes that the SEC must continue to be the primary regulator of investment advisers to registered funds because of the broad oversight the SEC provides to registered funds, their advisers and fund service providers. Because funds generally do not have employees and rely on third party service providers – primarily the fund’s investment adviser – to invest fund assets and carry out other business activities, the SEC’s continued examination and inspection of fund advisers is essential to provide appropriate oversight of registered funds. Investment advisers to registered funds, in addition to being regulated under the Advisers Act, must ensure funds’ compliance with the Investment Company Act and its rules, which – along with a robust body of formal and informal guidance from the SEC staff – create a comprehensive regulatory framework governing all aspects of the registered fund business. In plain terms, the SEC could not provide effective oversight of registered funds without examining the fund adviser, which is the most important service provider to a fund.⁶

Therefore, the provision in the bill preserving the SEC as the primary and direct regulator of advisers to funds is of paramount importance to meaningful oversight of registered funds.⁷ The failure to preserve this provision in the bill would result either in the SEC yielding examination authority over fund advisers to an SRO or in the duplication of examination functions by the SEC and the SRO. Neither outcome would serve the interest of funds and their shareholders.

A. Requiring SRO Membership Would Weaken or Result in Duplicative Regulation of Fund Advisers

⁵ In prior testimony to Congress, we have expressed concerns with delegation of SEC oversight of all registered investment advisers to one or more SROs. Statement for the Record of Paul Schott Stevens, President and CEO of the Investment Company Institute, Hearing on “Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight,” before the Subcomm. on Capital Markets and Government Sponsored Enterprises, United States House of Representatives (Sept. 13, 2011), available at www.ici.org/pdf/11_house_fiduciary_stndrd_tmny.pdf.

⁶ The SEC staff, in its examinations of registered fund complexes, typically reviews not only the registered funds, but all of their service providers, including advisers, principal underwriters, administrators and transfer agents.

⁷ Given the importance of registered funds, we believe it is appropriate that the exemption for advisers to registered funds is provided independently from the exemption for advisers with 90% assets under management attributable to institutional clients. The bill also provides that other institutional advisers that already are subject to substantial SEC regulation, along with their affiliates, remain under SEC oversight. The institutional advisers that would remain subject to SEC examination include those that advise private funds, ERISA plans, collective trust funds, endowments, foundations, non-U.S. clients, and other institutional clients.

Requiring fund advisers to be members of an SRO could result in the SEC deferring its oversight responsibilities to an SRO, which would detract from the SEC's ability to obtain a complete picture of the fund and its service providers and to assess potential risks. Because funds are operated by their service providers, only looking at the fund and not its adviser would provide the SEC with a very limited picture of the fund's activities and would make it extremely difficult, if not impossible, for the SEC to exercise effectively its regulatory responsibilities. To ensure that the regulatory framework continues to remain robust, the SEC's examination staff and its rulemaking staff must have a close working relationship that facilitates the application of existing rules and the development of new or different ones. The SEC benefits from having its examination staff "on the ground" and reporting back on potential concerns or rulemaking suggestions, while SEC examiners benefit from the guidance of the rulemaking staff and knowledge of its policies and objectives.⁸ Imposing another regulator would weaken the oversight of the fund industry, which could have adverse consequences for fund shareholders.

On the other hand, if advisers to registered funds are subject to both SEC and SRO oversight, registered funds and their shareholders would be significantly harmed by the imposition of duplicative examinations that will only result in additional costs without any corresponding benefits. We understand that membership fees for an SRO may be significant based on studies by other organizations.⁹ This extra cost would ultimately be borne by fund shareholders. In addition, funds and their advisers could face conflicting regulations by the SEC and the SRO or struggle with regulatory hodgepodge – where the SRO pursues its perceived regulatory mandate without regard to the implications of divergent standards. Managing these regulatory conflicts also will result in compliance costs that would be passed on to fund shareholders.

B. Costs of Duplicative Regulation Cannot be Justified by Any Potential Benefits

The additional costs cannot be justified or outweighed by any potential benefit of imposing an additional regulator on fund advisers. As discussed above, because the SEC's examination of funds would be ineffective without inspections of their advisers, any oversight by an SRO of fund advisers would be inherently duplicative. Given that the bill is intended to address a gap in oversight – the lack of effective oversight of retail advisers – requiring duplicative inspections of fund advisers would not address any perceived supervisory need. Moreover, given that the SEC has allocated its limited resources to examining registered funds in recognition of the importance of funds, there would be little or no benefits to the additional costs that would be imposed by SRO membership. In fact, in fiscal year 2011, registered funds were examined by the SEC 62% more often than registered investment advisers.¹⁰

⁸ Indeed, Section 965 of the Dodd-Frank Act requires compliance examiners to be placed in the Divisions of Investment Management and Trading and Markets, likely to further facilitate this important relationship.

⁹ The Boston Consulting Group, *Investment Adviser Oversight: Economic Analysis of Options* (Dec. 2011) (The study estimates an average cost of over \$50,000 per investment adviser for membership in an SRO.)

¹⁰ See United States Securities and Exchange Commission, *FY 2011 Performance and Accountability Report*, at 40, available at www.sec.gov/about/secpar/secpar2011.pdf#performancesummary (For fiscal year 2011, 13% of the registered investment companies were examined versus 8% of registered investment advisers); 914 Study, *supra* note 2 at 22-23 ("From 1998 to 2003, large mutual fund complexes were examined once every five years. By 2005, these funds were scheduled for examination once every two to three years."); United States Securities and Exchange Commission, *2004-2009 Strategic Plan*, at 32, available at www.sec.gov/about/secstratplan0409.pdf ("The SEC will fully implement a risk-based methodology

C. The SEC Has Proven to be an Effective Regulator of Funds and Their Advisers

We strongly encourage Congress, in attempting to provide more effective oversight of smaller advisory firms, not to affect negatively the SEC's comprehensive regulatory framework and oversight of registered funds and their advisers. This robust regime has served fund investors well for many years. While not immune from problems, this regulatory framework has proven to be extraordinarily successful for the last 70 years in safeguarding the interests of investors while allowing the industry to grow, innovate, and be competitive in a global marketplace. Today, the fund industry serves more than 90 million shareholders and has more than \$13 trillion in assets, including \$4.7 trillion of retirement assets invested in mutual funds.¹¹ Maintaining the SEC as the primary and direct regulator for fund advisers (regardless of whether these advisers also advise other clients) permits a single regulator to ensure compliance with both the Investment Company Act and the Investment Advisers Act in a consistent and thoughtful manner.¹² This approach ensures the highest level of protection for funds and their shareholders, which must be preserved in light of the size and importance of these funds in helping millions of Americans meet their long-term financial goals.

II. The SEC Must Remain the Primary and Direct Regulator for Investment Advisers Under Common Control with Investment Advisers to Registered Funds

Similarly, the SEC must remain the primary regulator for advisers that are affiliated with fund advisers, an approach which is incorporated into the bill. ICI believes that this approach would ensure consistent regulation of advisers under common control and would avoid inconsistencies that would result if commonly controlled advisers were subject to examination by two different regulators. For example, advisory complexes often have common compliance policies, procedures and personnel and may use one trading desk for all their affiliates' trading activity. Having advisers potentially subject to different interpretations of the adequacy of the procedures or operations of their trading desks, for example, likely would create confusion and the potential for inadvertent compliance violations.

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We appreciate the opportunity to share our views with the Committee on enhancing oversight of investment advisers to retail clients, and we look forward to working with Congress in addressing these important issues in a manner that maximizes protections for the millions of American investors who rely on registered funds to achieve their investing goals.

for selecting and setting examination and inspection cycles for investment advisers and funds. Larger or higher risk entities will be examined more frequently to ensure that the agency quickly identifies problems before they affect large pools of savings.”).

¹¹ See *ICI 2012 Investment Company Fact Book*, 52nd Edition, available at www.ici.org/pdf/2012_factbook.pdf.

¹² Having an SRO examine the non-fund advisory business of such fund advisers would be inefficient and would raise the same concerns as discussed below with respect to advisers that are affiliated with fund advisers.