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Filed Electronically

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549

Re: *Study Under Section 914 of the Dodd-Frank Act on Enhancing Investment Adviser Examinations*

Dear Ms. Murphy:

Pickard and Djinis LLP[1] appreciates the opportunity to comment on the study regarding investment adviser examinations that the Commission is conducting pursuant to Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This provision directs the Commission to examine, among other things, whether designating one or more self-regulatory organizations (SROs) to augment the Commission's efforts in overseeing investment advisers would improve the frequency of investment adviser examinations. For the reasons set forth below, we believe that as the party that created the investment adviser regulatory regime, the Commission is in the best position to oversee that regime. We also believe that enforcement of the federal securities laws is a function most appropriately performed by a governmental body that is directly accountable to Congress and the public. Moreover, in our view, the costs of adding a layer of private oversight and enforcement for investment advisers would far outweigh any benefits that would be derived from such a move. The better alternative would be to ensure that the Commission has the resources it needs to operate an effective investment adviser oversight program.

The Commission Is the Best Party to Oversee the Investment Adviser Regulatory Regime

Roughly seventy years after the adoption of the Investment Advisers Act of 1940 (Advisers Act), the investment adviser industry has reached the point where virtually every aspect of an adviser's business is regulated. Existing laws and rules govern how an adviser: (i) attracts new

[1] Our firm specializes in securities regulation, with a particular focus on investment adviser and broker-dealer matters. Our investment adviser client base ranges from federally registered firms with billions of dollars of assets under management to state-regulated solo practitioners.

clients;[2] (ii) describes itself and its services to clients;[3] (iii) contracts with clients;[4] (iv) custodies client funds and securities;[5] (v) handles clients' confidential information;[6] (vi) trades clients' accounts;[7] (vii) votes clients' proxies;[8] and (viii) manages and discloses conflicts between its interests and those of its clients.[9] Each of these activities is further subject to the overarching fiduciary duties of care and loyalty that advisers owe to their clients.[10]

Federally registered advisers are also subject to extensive recordkeeping requirements;[11] and they are obliged to implement and enforce comprehensive compliance programs and codes of ethics.[12] Furthermore, the employees of federally registered advisers who deal primarily with a retail client base are subject to licensing and testing requirements similar to those that apply to employees of broker-dealers.[13] An additional regulatory regime is imposed on advisers to employee benefit plans,[14] and all the states but one maintain their own laws and rules for advisers

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[2] *See, e.g.* Advisers Act Rules 206(4)-1 (advertising), 206(4)-3 (paying for client referrals), and 206(4)-5 (pay to play).

[3] *See e.g.,* Advisers Act Rule 204-3 (brochure delivery requirement).

[4] *See, e.g.,* Advisers Act § 205 and Rule 205-3 (contract assignment and performance fees), and § 215(a) (voiding contracts that require clients to waive their rights).

[5] *See, e.g.,* Advisers Act Rule 206(4)-2.

[6] *See* Regulation S-P. *See also*, Advisers Act § 204A (insider trading).

[7] *See, e.g.,* Advisers Act § 206(3) and Rules 206(3)-1 and 206(3)-2 (principal trades and agency crosses).

[8] *See* Advisers Act Rule 206(4)-6.

[9] *See, e.g.,* Advisers Act Rules 204-3 (brochure rule), and 204A-1 (code of ethics).

[10] *See* Advisers Act § 206; *SEC v. Capital Gains Research Bureau, Inc., et al.*, 375 U.S. 180, 191-192 (1963).

[11] *See* Advisers Act Rule 204-2.

[12] *See* Advisers Act Rules 206(4)-7 and 204A-1, respectively.

[13] *See* Advisers Act Rule 203A-3.

[14] The Employee Retirement Income Security Act of 1974 (ERISA) and attendant Department of Labor rules impose strict controls on the management of covered employee benefit plan accounts.

who do not qualify for registration at the federal level.[15] The states also maintain extensive examination and enforcement programs.[16]

We respectfully submit that the best party to oversee this extensive body of regulation is the party that created it. With decades of experience interpreting the Advisers Act, the SEC is infinitely more knowledgeable about how investment advisers are supposed to behave than an SRO would be. Moreover, existing SROs take a rules-based approach to monitoring the conduct of their broker-dealer members, while the Advisers Act establishes a principles-based regulatory framework, which calls for a different type of oversight.

In addition to having superior expertise and more extensive experience in regulating investment advisers, the Commission also is more transparent and publicly accountable for its oversight activities than an SRO would be. Unlike government agencies, SROs are not subject to the Freedom of Information Act and other public records requirements. And although they engage in government-like law enforcement activities, SROs have long taken the position that they are not "state actors" and need not afford their members any of the due process protections regulated entities receive when they deal with governmental bodies. This being the case, we do not believe that it is appropriate to extend SROs' regulatory franchise to a new category of financial service providers.

The Costs of Imposing SRO Oversight on Investment Advisers Would Far Exceed the Benefits of Doing So

In FY 2009, the SEC examined approximately ten percent of the more than 11,000 registered investment advisers under its jurisdiction; twenty-two percent of the high-risk advisers were examined during this time period.[17] In addition to its examination activity, the Commission also engaged in extensive outreach activities targeted to areas identified as raising particular compliance risks.[18] The Commission accomplished all this without imposing any fees whatsoever

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[15] Although the focus of these comments is on the appropriate oversight of federally registered advisers, our comments equally support the proposition that the states are in the best position to oversee and enforce their own laws and rules, without interference by one or more SROs.

[16] *See* Letter from David Massey, NASAA President, to Elizabeth M. Murphy, SEC Secretary (November 22, 2010).

[17] SEC, *FY 2011 Congressional Justification in Brief* at 20. During FY 2010, the number of federally registered advisers rose slightly and the overall percentage of examined advisers declined slightly. Investment Adviser Association and National Regulatory Services, *Evolution Revolution 2010 -- A Profile of the Investment Adviser Profession* at 2; SEC, *FY 2010 Performance and Accountability Report*, (November 15, 2010) at 27. The Information regarding the percentage of high-risk advisers examined in 2010 is not yet available. *Id.*

[18] *Id.* at 43-44; *FY 2011 Congressional Justification in Brief* at 17-18. These activities include a national seminar, regional seminars, interactive broadcast seminars and compliance alerts. *See* www.sec.gov/info/iaicccoutreach.htm.

on the investment advisers it regulates. By contrast, in 2009, FINRA collected almost $ 390 million in regulatory fees from the fewer than 4700 broker-dealers under its jurisdiction.[19]

Industry members and regulators have expressed concern over the costs of an investment adviser SRO for years. For example, at the Roundtable on Investment Adviser Regulatory Issues that the Commission's Division of Investment Management hosted in 2000, an Executive Vice President of the NASD had this to say about the issue:

> A real downside to an SRO or to establishing one, is the enormous cost, which I think would be a real disincentive to having an SRO. . . . I don't think one can overstate what it would cost, not only to start up an organization like this but the cost to the membership of providing [it].[20]

Reducing the costs imposed directly on advisers and indirectly on their clients as a result of duplicative regulation was a primary factor that motivated Congress to pass the National Securities Markets Improvement Act of 1996 (NSMIA).[21] Interposing a layer of SRO oversight between advisers and the Commission would obliterate one of NSMIA's most substantial achievements.

While the costs of designating one or more SROs for investment advisers are clear the benefits are less so. In analyzing the question of benefits, we submit that the number of adviser examinations that an SRO could conduct is less important than the quality of those examinations. SROs' lack of familiarity with the extensive regulatory regime imposed on advisers raises serious concerns about such organizations' ability to oversee the implementation of that regime effectively. Moreover, as the Madoff and Stanford scandals show, SRO examinations can be ineffective even where the activities being examined are squarely within the purview of the organization's jurisdiction and expertise.[22]

As to this last point, the suggestion has been made that the NASD/FINRA's failure to uncover the massive fraud perpetrated by Bernard L. Madoff Investment Securities LLC was attributable to the fact that the SRO lacked jurisdiction over investment advisers. However, at all times, Madoff Securities was a registered broker-dealer whose defrauded clients maintained discretionary, commission-only brokerage accounts at the firm. There was no separate advisory

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[19] *See* FINRA 2009 Annual Report at 2-3 (2010).

[20] Div. Inv. Mgmt., SEC, *Transcript of the SEC Roundtable on Investment Adviser Regulatory Issues*, *available at* www.sec.gov/divisions/investment/roundtable/iadvrndt.htm (May 23, 2000).

[21] Pub. L. No. 104-290, 110 Stat. 3416; S. Rep. No. 104-293 at 2-4 (1996).

[22] *See* FINRA, *Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes* (2009). This report identifies a number of red flags the NASD/FINRA missed in examining each of these broker-dealers.

business and Madoff Securities did not register as an investment adviser until 2006, after which time he continued to be subject to the Exchange Act and SRO rules.

The defrauded Madoff clients gave Madoff Securities custody and trading authority over their assets, and they received account statements and trade confirmations purportedly showing trading by the broker-dealer in and for the benefit of their accounts. These activities implicated a host of Exchange Act rules, including 15c3-3 (customer protection/custody of securities); 10b-10 (trade confirmations); and 17a-3 and 4 (books and records). These activities also implicated a host of NASD/FINRA Rules, including 2120 (use of manipulative, deceptive or other fraudulent devices); 2230 (confirmations); 2340 (customer statements); 2330 (customers' securities or funds); and 2510 (discretionary accounts). There is no question that the NASD/FINRA had both the authority and responsibility to investigate Madoff's fraudulent conduct.

While the SEC's examination program has not been beyond reproach, we submit that dollar for dollar, it is far more efficient and effective than its privately run counterpart. We do not believe the benefits derived from SRO oversight of investment advisers would justify the costs thereof.

The Better Alternative

Instead of imposing a duplicative layer of very expensive and arguably ineffective private regulation on federally registered investment advisers (more than half of whom have 5 or fewer non-clerical employees),[23] a far better approach would be to ensure that the Commission has adequate resources to oversee the Advisers Act regulatory regime. Congress has already taken important steps in this direction. The Dodd-Frank Act doubles the level of the Commission's authorization over the next five years, and permits it to establish a $ 100 million reserve fund.[24] This legislation also reallocates responsibility for overseeing mid-sized investment advisers between the Commission and the states.[25] As a result of this reallocation, approximately 4100 advisers are expected to switch from federal to state registration this year,[26] thus freeing up Commission resources for oversight of larger advisers. Should these measures prove insufficient, we urge the Commission to seek authority from Congress to impose user fees on registered advisers as necessary to support an effective investment adviser oversight program.

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[23] *Evolution Revolution 2010*, *supra* note 17, at 10. This report also indicates that more than 90 percent of federally registered advisers have 50 or fewer such employees. *Id.*

[24] Dodd-Frank Act, § 991.

[25] Dodd-Frank Act § 410; Advisers Act § 203A.

[26] "Rules Implementing Amendments to the Investment Advisers Act of 1940," SEC Release No. IA-3110 (November 19, 2010) at 9.

We appreciate the opportunity to comment on this important study. Please contact the undersigned if you need further information on any of the matters discussed in this letter.

Respectfully submitted,

Mari-Anne Pisarri

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
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