

MEMORANDUM

January 19, 2011

To: File No. DF Title IX - Enhancing Investment Adviser Examinations Study

From: Vanessa Countryman, Office of Commissioner Kathleen L. Casey
Saurabh Shah, Office of Commissioner Troy A. Paredes

Re: ICI and FINRA Views on the Concept of an SRO for Investment Advisers
to Retail Investors

On January 13, 2011, Vanessa Countryman, Counsel to Commissioner Kathleen L. Casey and Saurabh Shah, Counsel to Commissioner Troy A. Paredes, met with Paul S. Stevens, President and CEO of the Investment Company Institute and Richard G. Ketchum, Chairman and CEO of FINRA. The participants discussed the views of ICI and FINRA on the concept of an SRO for investment advisers to retail investors.

Mr. Stevens submitted the attached memorandum in connection with the discussion.

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ICI Views on the Concept of an SRO for Advisers to Retail Investors

The ICI is on record as opposing the concept of an SRO for investment advisers.¹ While we strongly support effective oversight of all segments of the adviser oversight, we believe the SEC is the best agency to fulfill this obligation. We recognize, however, that current budget constraints may prevent the SEC from doing so. In the absence of an ability to address these constraints in another way, the ICI would not oppose an SRO for advisers structured as follows.

To ensure effective oversight of all investment advisers, certain oversight gaps should be addressed:

- Current regulatory resources make it difficult to provide a comparable level of oversight for all segments of the investment adviser industry. Certain segments, such as mutual fund advisers, are already subject to substantial SEC oversight, while many other segments of advisers, particularly advisers who do not have a substantial institutional business, are not.
- This latter segment includes many advisers who are technically under SEC supervision, but, due to SEC resource constraints are unlikely to be effectively supervised by that agency's examination program.
- A proposal should ensure that:
 - All segments of the adviser industry are subject to effective oversight;
 - Mutual fund advisers, and other institutional advisers and their affiliates that operate under common systems, who are already subject to substantial SEC oversight, remain under SEC oversight; and
 - Any SRO that is established does not result in duplicative regulation.

Implementing concepts:

- At a high level, responsibility for investment adviser oversight could be divided between the SEC and an SRO, with the SEC focusing on mutual fund advisers and advisers to large institutions (whether or not they also may have some retail advisory services within their enterprise) and the SRO focusing on other advisers, particularly retail advisers.
- Based on the forgoing intent, the definition of the required membership of the SRO would exclude the following:
 - Mutual fund advisers
 - Advisers to large institutional clients defined as:
 - An adviser "substantially all" of whose assets under management are from "institutional clients."
 - "Substantially all" means 90% or more of assets under management.

¹ See Letter to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, from Karrie McMillan, General Counsel, Investment Company Institute, dated Oct. 25, 2010.

- “Institutional clients” means mutual funds, ERISA clients, collective funds, endowments, foundations, any non-U.S. accounts and other clients that have \$25 million or more in investments (*e.g.*, qualified purchasers).
 - Other registered advisers under common control with the forgoing, assuming the outcome is reasonable. For example, these might include firms that operate as a substantially integrated business. Factors could include:
 - Whether the entity would be subject to duplicative examination by the SEC and the SRO in the same business line / entity.
 - Whether the entity shares a compliance program with another regulated entity that is governed by 38a-1 of the ICA or 206(4)-7 of the IAA, or common trading desks.
- Consistent with the view that every adviser should be subject to supervision by either the SEC or an SRO for advisers, but not both, the rules should afford a mechanism whereby registered advisers are directed to supervision and oversight by one regulator or the other. These provisions would provide a mechanism to allocate supervisory responsibilities between them based on the forgoing SRO membership requirements. Once this is determined, a registered adviser would have the ability to apply for supervision by the other regulator depending on particular facts and circumstances which may include organizational structure, business plans or other considerations.
- An SRO would include oversight by the SEC so that rules and interpretations of the Investment Advisers Act would continue to be governed by the SEC through notice and comment rulemaking and the ability of the SEC to issue interpretive guidance under the Act.