



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 [www.ici.org](http://www.ici.org)

October 25, 2010

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Study on Enhancing Investment Adviser Examinations under Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> is pleased to offer its views as the Securities and Exchange Commission considers the need for enhanced examination and enforcement resources for investment advisers, as required by the Section 914 of Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Institute members strongly support a vigilant and effective examination program for investment advisers. The trust that over 90 million investors place in registered investment companies is in no small part due to the rigorous regulatory regime under which these funds and their advisers operate.

We firmly believe that the SEC should have exclusive authority to oversee investment advisers. The oversight of an industry so intertwined with the financial interests of ordinary Americans should be conducted by an independent government agency directly accountable to Congress and the public. Further, a delegation of authority would be extremely disruptive to a longstanding and, by and large, effective system of regulation. Finally, we believe that the need for additional resources has largely been addressed by the Act, and independent recent developments at the Commission will help to focus those resources to further improve the examination and enforcement processes. Ultimately, we do not believe that delegating all or part of the SEC's authority to a self-regulatory organization ("SRO") would improve the regulatory oversight of investment advisers.

---

<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.51 trillion and serve over 90 million shareholders.

Moreover, delegation to an SRO would create a number of inefficiencies and inconsistencies in the regulatory and compliance environment. From a regulatory perspective, separating the SEC from an SRO with complete or partial oversight responsibilities over investment advisers would add new challenges to the communications and coordination between regulators. Carving out certain types of advisers for oversight by an SRO could lead to inconsistent standards across similar businesses; meanwhile, delegating oversight of certain business lines could cause advisers with diverse business to be overseen by two regulators, which would substantially increase those firms' compliance burdens and costs, without corresponding benefits.

For these reasons, we urge the Commission to retain its authority over these important functions. Our comments are discussed in more detail below.

*The SEC is the Right Agency to Oversee Investment Advisers*

The SEC is the most appropriate primary regulator for investment advisers, especially those that advise mutual funds. The SEC has been overseeing advisers since 1940 under the Investment Advisers Act, which sets out a principles-based approach specifically designed to regulate those entities providing advice. Advisers to mutual funds also must comply with the Investment Company Act of 1940 and its rules, which create a comprehensive framework regulating all aspects of the registered fund business. On top of these statutes and regulations, a robust body of formal and informal staff guidance has developed. While not immune from problems, this regulatory framework has proven to be extraordinarily successful in safeguarding investor interests while also allowing for the growth of a competitive and innovative industry. Transferring oversight responsibilities away from the SEC would result in a significant loss of institutional knowledge, experience, and continuity that has been developed over the last seventy years.

Moreover, we do not believe the SRO model is appropriate for oversight of the advisory industry. The principles-based system of adviser regulation, which is critically important to protect the fiduciary culture of the adviser industry, as well as the wide range of business models within the industry, is not readily transferable to a more prescriptive, rules-based model that works best in the SRO context. Further, the conflicts of interest inherent in industry self-regulation – or even the illusion of such conflicts – could harm the public perception of investment advisers. Finally, we do not believe that the cost of developing an adviser SRO (or building the capacity in an existing SRO, such as the Financial Services Regulatory Authority), much of which would likely be borne by advisers (in the form of member fees) and likely passed on to their clients, is an efficient use of resources.<sup>2</sup>

---

<sup>2</sup> In the event the SEC determines to outsource its oversight responsibilities over investment advisers to an SRO, we urge that the SRO have the structure and governance appropriate for adviser regulation. FINRA's governing body is not structured for this role. Its expertise is with the suitability standard formerly applicable to broker-dealers, not the higher fiduciary standard followed by investment advisers.

A far more efficient approach to enhancing the oversight of investment advisers would be to increase the SEC's resources and strengthen its qualitative abilities in this arena. In fact, the Commission's resources have already been substantially augmented as a result of the Act. Section 991 doubles the SEC's funding authorization during the next five years, and establishes a \$100 million reserve fund. At the same time, Section 410 significantly reduces the number of advisers that must register with the SEC, by raising the asset threshold for supervision by state securities regulators from \$25 million to \$100 million.<sup>3</sup> Together, these provisions will substantially enhance the resources available to the SEC to oversee registered investment advisers.

At the same time, recent developments at the Commission independent of the Act should improve the quality and rigor of the examination and enforcement process, and the Commission's ability to detect potential risks to investors more broadly. The Office of Compliance Inspections and Examinations has undergone significant reforms in the past two years, intended in part to focus greater attention on fraud detection. These reforms include recruiting examiners with specialized skills, increasing examiner expertise through training, and deploying significant resources to areas of high risk.<sup>4</sup> Going forward, OCIE "plans to significantly expand and enhance its oversight of registered advisers," including improving its risk assessment and surveillance methodologies and systems, and devoting "significant resources to conducting cause examinations arising out of tips and complaints alleging fraud or other abuse, as well as risk targeted and sweep examinations."<sup>5</sup>

Recent changes to the Division of Enforcement were also designed to strengthen the Division's ability to detect wrongdoing and enforce securities laws and regulations. Among other things, the Division has launched specialized units, including one focused on asset management; strengthened training for its staff; and established the Office of Market Intelligence, which is intended to ensure that the Division dedicates investigative resources to tips, complaints, or referrals presenting the greatest threat of investor harm.<sup>6</sup> More broadly, the establishment last year of the Division of Risk, Strategy,

---

<sup>3</sup> This will remove approximately 4,000 investment advisers from SEC oversight. See Investment Adviser Association and National Regulatory Services, *Evolution/Revolution 2010: A Profile of the Investment Advisory Profession* (Sept. 2010) at 14, available at <http://www.nrs-cmax.com/company/pdfs/NRS%20Evolution%20Revolution%202010%20White%20Paper.pdf>. We recognize that, under the Act, private fund advisers will be subject to the Commission's oversight. Many of these advisers, however, are already registered under the Investment Advisers Act. We believe that, even with the new registrants, the SEC will have far fewer registered advisers to examine.

<sup>4</sup> See Examinations by the Securities and Exchange Commission, Office of Compliance Inspections and Examinations, February 2010, available at: <http://www.sec.gov/about/offices/ocie/ocieoverview.pdf>; Testimony by Robert Khuzami, Director, Division of Enforcement, and Carlo di Florio, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Sept. 22, 2010, available at <http://www.sec.gov/news/testimony/2010/ts092210rk-cd.htm>.

<sup>5</sup> See *SEC FY 2011 Congressional Justification In Brief* (Feb. 2010) at 46.

<sup>6</sup> See Testimony, *supra* note 4.

and Financial Innovation was intended “to enhance [the Commission’s] capabilities and help identify developing risks and trends in the financial markets.”<sup>7</sup>

These recent developments should dramatically improve the SEC’s ability to oversee investment advisers. At a minimum, the Commission should not delegate its oversight authority until the full effect of these reforms has been assessed.

*Delegation to an SRO Would Create Inefficiencies and Inconsistencies*

Delegation of investment adviser oversight to an SRO would create a number of inefficiencies and inconsistencies in the regulatory and compliance environment. Separating the SEC from an SRO with complete or partial oversight responsibilities over investment advisers would add new challenges to the communications and coordination between regulators, decrease the efficiency and consistency of oversight, and create substantial compliance burdens and costs for advisers. These challenges would exist regardless of the demarcation of delegated authority.

For example, delegation of rulemaking and examination authority to an SRO would divorce current and future regulation of investment advisers from a seventy year history with a regulator that understands the advisory business, coupled with the fundamental nature of principles-based regulation. As noted above, SROs are typically more capable in a strict rules-based environment. Absent a shift to a rules-based framework, which is neither necessary nor appropriate for investment advisers,<sup>8</sup> the transfer of authority and institutional knowledge would require immense coordination between the Commission and the SRO, as well as ongoing oversight by the SEC. Even so, advisers would need, for a period of time, to work with rulemaking and examination staffs that do not understand their business or regulatory framework.

Delegating solely the adviser examination function would alleviate some of these concerns, but would raise a number of others. Separating a rulemaking body from its examination arm would inhibit both application of existing rules and development of new ones. The SEC would lose the benefit of having its own examination staff “on the ground” and reporting back on potential concerns or rulemaking suggestions, while the SRO examiners would lack the benefit of internal knowledge of the rulemaking staff’s considerations and goals.<sup>9</sup> Such an approach would have a particularly detrimental effect on the quality of examination of mutual fund complexes. Fund examinations typically include a review of all of the fund’s service providers – advisers, principal underwriters, administrators, and

---

<sup>7</sup> See SEC Announces New Division of Risk, Strategy, and Financial Innovation, SEC Press Release (Sept. 19, 2009).

<sup>8</sup> While a fair amount of criticism has been leveled at the SEC’s examination process in the wake of recent scandals, it has not to our knowledge been suggested that the regulatory framework governing investment advisers is at fault or in need of overhaul.

<sup>9</sup> Indeed, Section 965 of the Act requires compliance examiners to be placed in the Divisions of Investment Management and Trading and Markets, likely for this very reason.

transfer agents. Separating out the fund's adviser for examination by an SRO would eliminate this holistic approach to fund regulation, and likely create regulatory gaps.

Nor can we recommend the delegation of examination responsibility for only certain types of advisers, such as dually registered broker-dealers and investment advisers or affiliated broker-dealers and investment advisers, as suggested by Section 914 of the Act, or for certain business lines within an adviser. Delegating oversight of certain advisers to an SRO could create conflicting standards for advisers who are essentially in the same line of business. For example, advisers that are affiliated with broker-dealers or are dually registered could have different examiners, and ultimately be held to different standards, than those to which independent, standalone investment advisers are held. This approach would run contrary to current efforts towards regulatory harmonization, a goal the ICI strongly supports.<sup>10</sup>

Carving out certain business lines for SRO oversight, meanwhile, would create substantial compliance burdens and costs, as well as inconsistencies. For example, if the SEC continued to examine mutual funds, but delegated examinations of other adviser functions, many advisers would be overseen by two regulators, potentially with different compliance and recordkeeping requirements and standards. This approach would be particularly problematic for advisers with parallel or similar businesses, such as mutual funds and separately managed accounts or private funds, which may share common personnel, trading desks, and other services. Even if both regulators maintained similar regulations and guidelines, it is inevitable that interpretations and execution of guidelines would vary.

\* \* \* \*

---

<sup>10</sup> See, e.g., Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated Aug. 30, 2010, available at <http://www.sec.gov/comments/4-606/4606-2570.pdf>.

Ms. Elizabeth M. Murphy

October 26, 2010

Page 6 of 6

For all of these reasons, we believe the SEC is the right regulator to oversee investment advisers. We urge the Commission not to outsource this important function to an SRO that will not have the Commission's expertise. If you have any questions about our comments or would like any additional information, please contact me at (202) 326-5815, or Mara Shreck at (202) 326-5923.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

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

Andrew J. Donohue, Director  
Division of Investment Management

Robert W. Cook, Director  
Division of Trading and Markets