JACKO LAW GROUP, PC
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Legal Risk Management Tip
May 2012

PROPOSED LEGISLATION COULD MEAN SRO OVERSIGHT FOR INVESTMENT ADVISERS

Introduction

On April 25, 2012, the House Financial Services Committee Chairman Spencer Bachus formally introduced legislation that would create one or more self-regulatory organizations ("SROs") and shift oversight of all registered investment advisers from the SEC and states to these SROs. Many fear, should the proposed bill become law, that FINRA would be a lead contender to serve as the new SRO.

Proposed Legislation

Under the Investment Advisers Act of 1940, the SEC has regulatory authority over investment advisers with over $100 million assets under management ("AUM"). Smaller advisers with less than $100 million AUM are regulated by the states. Due to the SEC's shrinking budget, examination of advisers has steadily decreased in recent years, which has caused lawmakers to have concerns, particularly in the wake of the Bernard Madoff fraud and other Ponzi schemes. Consequently, Bachus' proposed bill, referred to as the Investment Adviser Oversight Act of 2012, is designed to alleviate these budgetary and resource limitations and shift the regulatory responsibility to one or more SROs. As proposed, the legislation would also apply to state-registered advisers, forcing investment advisers at all levels to become members of a national SRO.

Although most advisers would be mandated to join a SRO under the legislation, the proposed bill does provide an exemption for certain types of investment advisers. An adviser would be exempt from joining an SRO if the investment adviser:

- Has one or more clients who is an investment company registered under the Investment Company Act of 1940; or
- Has 90 percent or more total AUM of which are attributable individually or in the aggregate to one or more of the following persons with which the investment adviser has entered into a written investment advisory agreement:
    - A client that is not 'in the United States'; or
    - A qualified purchaser as defined in the Investment Company Act of 1940; or
    - An issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940, but for section 3(c)(10), section 3(c)(11), section 3(c)(5)(C) or Rule 3a-7; or
    - A private fund; or

- A company that has elected to be a business development company pursuant to section 54 of the Investment Company Act; or
- An investment adviser registered under section 203 or that is regulated or required to be regulated as an investment adviser in a State in which it maintains its principal office and place of business; or
- A broker or dealer registered with the SEC; or
- An employee's securities company that has been granted an exemption under section 6(b) of the Investment Company Act of 1940.[1]

Even before the bill's introduction, the concept of an adviser SRO has sparked a fierce debate among lawmakers, investment professionals and various advocacy groups. Advisers and their advocates fear an SRO would be more costly and intrusive than the SEC, particularly if the SRO is FINRA, and would lack the expertise to enforce the fiduciary-duty standard under which investment advisers operate. Opponents also argue that a SRO would be twice as expensive as funding the SEC properly. Lawmakers, and several organizations representing broker-dealers, argue that the absence of SRO oversight gives investment advisers a significant advantage in the marketplace. The proponents argue investment advisers have an unfair advantage over broker-dealers, who are examined by FINRA every two years.

Conclusion

While the debate rages on, the House Financial Services Committee is expected to hold a hearing on the proposed bill in early June. It is anticipated the proposed legislation will pass in the Financial Services Committee but will run into obstacles at the Senate Banking Committee, making immediate passage of the bill highly unlikely. Nevertheless, this is an issue of top priority for many lawmakers and regulators and it could only be a matter of time before one form or another of the legislation becomes law. JLG will continue to monitor the progression of the proposed bill and the potential impact it may have on all investment advisers. For more information, please contact Eric M. Willens, Esq. at eric.willens@jackolg.com or (619) 298-2880.

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[1] SEC. 203B(b) H.R. 4624: Investment Adviser Oversight Act of 2012