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Obama Financial Reform in the Securities Market

Introduction

On June 17th, President Barrack Obama released his Financial Regulatory Reform Plan ("Plan"). The Plan is a comprehensive framework of proposed rules, regulations, reports, committees and oversight councils. Although much of the Plan looks to create more regulations for the banking industry, a few key points address increasing regulatory oversight for the securities world.

Importantly, the Plan's focus sets the foundation for what the Securities and Exchange Commission ("SEC") and Congress should do. Some of the key provisions to the Plan include: the call for advisers of private funds to register with the SEC, the unionization of the SEC and Commodity Futures Trading Commission ("CFTC"), and harmonization of broker-dealer ("BD") and investment adviser ("IA") regulations.

Hedge Fund Regulation

Under the proposed Plan, the President advises for the following to occur:

> All advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) whose assets under management exceed some modest threshold should register with the SEC under the Investment Advisers Act. The advisers should also be required to report information on the funds they manage that is sufficient to assess whether any fund poses a threat to financial stability.[1]

This proposal is similar to other proposals calling for hedge fund adviser registration, such as the Private Fund Investment Advisers Registration Act of 2009 and the Hedge Fund Transparency Act of 2009. For more information, please review JLG's May 2009 Risk Management Tip entitled Hedge Fund Regulation: Further Proposals, which can be found at http://www.jackolg.com/CM/Custom/News-Room.asp.

SEC/CFTC Unionization

The idea of regulating futures and securities is the same for both the SEC and the CFTC. They aim to protect investors, ensure market integrity and promote price transparency. Many of the differences that have distinguished the two regulatory bodies are no longer needed. In particular, the Plan cites that "the growth of derivatives markets and the introduction of new derivative instruments have highlighted the need for addressing gaps and inconsistencies in the regulation of these products by the CFTC and SEC."[2]

The Plan calls for a joint report by the CFTC and SEC to address the conflicts, gaps, and any issues between the agencies and the markets they regulate, and possible resolutions and/or reasons those conflicts or gaps exist.[3] While the Plan does not call for the two agencies to begin a consolidation process at this time, the idea to merge the two agencies is not new. In fact, Secretary of the Treasury, Timothy Geithner made it clear that there have been talks about CFTC/SEC consolidation, and applauded the joint report efforts. Based on JLG's analysis, we believe that one of the primary hurdles for any merger at this time is the fact that the oversight committees of each agency (the House Agriculture Committee and the House Committee on Financial Services) are both steadfast in retaining their supervisory authority over their respective agencies.[4]

BD/IA Regulation Harmonization

Another facet to the President's Reform Plan calls for a very basic goal: to "[e]stablish a fiduciary duty for broker-dealers offering investment advice and harmonize the regulation of investment advisers and broker-dealers."[5] Many broker-dealers, and particularly those that offer investment advice as part of their services, may argue that they already owe a fiduciary duty to their clients. However, the Securities Exchange Act of 1934 and its associated rules do not specifically impose this duty.

BD/IA harmonization has been widely discussed for years within the securities industry. In a May 2009 speech, SEC Commissioner Elisse Walter outlined the history, current framework, problems, and potential solutions for integration of the industry. Walter suggests that to begin, "Congress should throw both statutes (Securities and Exchange Act of 1934 and Investment Advisers Act of 1940) on the floor, select what is best in each, and cover any holes through which the floor boards show. In doing so, Congress should look at every aspect of a financial professional's business, from the moment of its inception until its dissolution."[6] It remains to be seen whether Congress will embrace this approach

Conclusion

While the three proposals outlined above are still in the early stages of conception and their future remains unknown, one thing is certain – change is coming. As the proposals evolve, it is imperative for members of the securities industry to comment on the proposed regulations and to proactively adapt to those rules which become promulgated.

JLG will continue to monitor and report on the issues contained herein, as well as any evolution of new regulatory developments that may impact broker-dealers, investment advisers, hedge funds and other private funds.

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[1] www.ustreas.gov, June 17, 2009. Financial Regulatory Reform: A New Foundation at 37. July 1, 2009, (http://www.financialstability.gov/docs/regs/FinalReport_web.pdf)
[2] Id. at 49.
[3] Id. at 50.
[4] www.risknews.net, Peter Madigan, June 18, 2009. "U.S. Treasury would support future SEC/CFTC merger, hints Geithner." July 1, 2009, (http://www.risknews.net/public/showPage.html?page=863230).
[5] Financial Regulatory Reform at 71.

[6] Elisse Walter. Mutual Fund Directors Forum Ninth Annual Policy Conference
Ritz Carlton Hotel, Washington D.C., May 5, 2009. "Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization?" July 1, 2009, (http://www.sec.gov/news/speech/2009/spch050509ebw.htm)