The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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September 13, 2011

ICI Submits Statement for Record at Hearing on Investment Adviser and Broker-Dealer Regulatory Oversight

[25477]

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 56-11
INVESTMENT ADVISER MEMBERS No. 18-11
PENSION MEMBERS No. 51-11
SEC RULES MEMBERS No. 112-11 RE: ICI SUBMITS STATEMENT FOR RECORD AT HEARING ON INVESTMENT ADVISER AND BROKER-DEALER REGULATORY OVERSIGHT

On September 13, a subcommittee of the U.S. House of Representatives Committee on Financial Services held a hearing entitled "Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight." [1] Paul Schott Stevens, ICI's President and CEO, submitted a statement for the record in connection with the hearing. [2]

The statement describes ICI's positions on three issues: (1) the appropriate standard of care applicable to broker-dealers when providing personalized investment advice about securities to retail customers, which was the subject of the study mandated by Section 913 of the Dodd-Frank Act; (2) ways to provide enhanced examination resources for investment advisers, which was the subject of the study mandated by Section 914 of the Dodd-Frank Act; and (3) the need for improved product-neutral point-of-sale disclosure by financial intermediaries of all types.

Section 913 and Fiduciary Duties

The statement explains that ICI agrees with the basic recommendation in the 913 study that the SEC should establish a fiduciary standard for broker-dealers that provide personalized advice or recommendations about securities to retail customers. We also agree with the 913 study's recommended approach to implementation—namely, that the SEC would adopt rules establishing the new uniform fiduciary standard for advisers and broker-dealers as an "overlay" to supplement, and not supplant, the existing investment adviser and broker-dealer regimes. We support that approach because it would preserve

the strong fiduciary standard that applies to investment advisers, along with existing precedent, while applying the same high standard to both advisers and brokers when they are providing substantially similar services to retail clients.

The statement cautions that, in crafting those rules, the SEC must take care to apply the fiduciary standard to broker-dealers in a way that will not chill legitimate practices. [3] For example, the statement suggests that broker-dealers should be permitted, consistent with a fiduciary duty, to: maintain a commission-based business; limit the scope, nature, and anticipated duration of the relationship; sell proprietary investment products; offer the use of financial calculators or similar investment tools; execute unsolicited trades; service orphaned accounts; and engage in trading as principal.

The statement takes issue with suggestions in the 913 study that a person's receipt of transaction-based compensation (i.e., commissions) is a hallmark of broker-dealer activity, and that investment advisers receiving transaction-based compensation would need to consider whether they are obligated to register as broker-dealers under Section 15 of the Securities Exchange Act of 1934. We argue that as the standard of care for broker-dealers and advisers is harmonized, the label applied to the type of compensation they receive should no longer be relevant. Advisers and broker-dealers providing personalized investment advice or recommendations should equally be permitted to receive—and share—both asset-based fees and commissions.

The Future of Adviser Oversight

As a preliminary matter, the statement expresses ICI's belief that it is imperative that the SEC continue to serve as the primary regulator for investment advisers that advise registered funds, in light of the size and importance of these funds.

Recognizing that complexes of registered funds tend to have more frequent examinations than smaller advisory firms, we argue that efforts to reform the examination program should focus primarily on filling this gap in oversight.

With those principles in mind, the statement provides ICI's perspective on two of the main options recommended by the SEC staff in the 914 study, namely authorizing one or more self-regulatory organizations (SROs) to examine SEC-registered investment advisers, or requiring SEC-registered investment advisers to pay user fees to the SEC to fund the cost of their examinations.

SROs for Registered Investment Advisers. The statement expresses ICI's view that requiring registered funds and their affiliates to remain subject to SEC oversight, with other registered investment advisers to be overseen by an SRO, provides a reasonable way to fill the gap in oversight, while preserving the robust examination program the SEC currently follows for registered funds and their affiliates. The statement cautions that this option must be carefully designed to avoid duplicative regulation, and suggests that the following types of advisers remain subject to SEC oversight:

- Fund advisers and other institutional advisers [4] that already are subject to substantial SEC regulation, along with their affiliates; and
- Other SEC-registered investment advisers under common control with such an adviser.

Imposing User Fees on SEC-Registered Investment Advisers. The statement expresses ICI's

belief that requiring SEC-registered investment advisers to pay user fees to the SEC to fund the cost of their examinations also may be a viable option to address the SEC's resource concerns. We caution, however, that such a regime must distinguish between those entities that currently pay fees for their regulation and those that do not. For fund complexes, the calculation of assets under management should exclude assets managed in registered funds.

"Point-of-Sale" and Other Disclosure Initiatives Relating to Potential Intermediary Conflicts

Finally, the statement encourages the Subcommittee to consider the need for better product-neutral "point-of-sale" disclosure by both broker-dealers and investment advisers.

The statement reiterates our long-standing and consistent support for enhanced disclosure to help investors assess and evaluate a broker's recommendations. It also expresses our strong support for many of the current regulatory initiatives in this area, but questions those that single out mutual funds and other registered investment companies. The statement argues that from an investor perspective, the need for this type of disclosure is neither intermediary-specific nor product-specific. It is equally important for both broker-dealers and investment advisers, and equally important for all retail investment products—not just registered funds. We therefore urge Congress to continue to view broker disclosure as a critical need for retail investors across all products, and to discourage regulatory initiatives that would single out registered funds.

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endnotes

[1] The hearing was held by the Subcommittee on Capital Markets and Government Sponsored Enterprises, chaired by Congressman Scott Garrett (R-NJ).

[2] The statement is available at http://www.ici.org/pdf/11_house_fiduciary_stndrd_tmny.pdf.

[3] We reiterated this point later in the statement, when discussing the potential for regulatory conflict between the SEC fiduciary rulemaking and the Department of Labor (DOL) fiduciary rulemaking. After noting that it is important to understand that DOL and the SEC proceed from different statutory frameworks and that there are important differences in the obligations that attach to fiduciaries under each regime, the statement explains that, in both cases, ICI supports assuring that individual investors are protected by an appropriate legal duty when receiving personalized investment advice, as long as that duty is crafted such that it does not chill legitimate practices and investors do not lose access to the investment products and services that meet their needs. The statement says that, while the separate debates at DOL and the SEC need not pose a regulatory conflict, it is important that neither regulator act in a vacuum.

[4] The statement suggests that the types of institutional advisers that could remain subject to SEC examination might include those that advise private funds, ERISA plans,

collective trust funds, endowments, foundations, non-U.S. clients, and other institutional clients, if 90 percent or more of the assets under management of the registered investment adviser were attributable to such institutional clients.
