The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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Diverse Investment Advisers Act

[32227]

February 21, 2020 TO: ICI Members
Investment Company Directors SUBJECTS: Advisory Contract Renewal
Compliance
Disclosure
Fund Governance
Investment Advisers RE: Diverse Investment Advisers Act

We want to inform you about proposed legislation known as the Diverse Investment Advisers Act (DIAA). It has not been officially introduced but is a high priority for House Financial Services Committee (HFSC) Chairwoman Maxine Waters. We expect her Committee to formally consider the legislation soon. In its current iteration, DIAA would require SEC registrants, including registered investment companies, "contracting for the services of an investment adviser" to utilize a version of the Rooney Rule[*] and to publish a request for proposal (RFP) inviting "diverse investment advisers" to submit a proposal. A diverse investment adviser is defined as a firm that is 51 percent women, minority, or veteran owned.

The RIC or other SEC registrant issuing the RFP must interview at least one qualified diverse investment adviser or certify to the SEC that no such applicant responded to the RFP. Issuers of securities are similarly covered by the draft legislation. DIAA subjects SEC registrants and issuers to robust reporting requirements about diversity contracting practices to the SEC and, for investment advisers, on Form ADV.

Currently, the draft bill applies to RICs when contracting for unaffiliated sub-advisers when shareholder approval is not required. We understand the draft bill does not apply when a fund is renewing an existing investment adviser contract during its annual section 15 process. (*See* bill analysis.)

The draft legislation was first considered during a June 25 HFSC hearing entitled "Diverse Asset Managers – Challenges, Solutions, and Opportunities for Inclusion." (*See* hearing memo.) The hearing focused on the first of five legislative discussion drafts intended to increase the use of diverse asset managers by institutional investors. (Early versions referenced asset managers, while recent versions reference investment advisers.) The hearing was collegial and focused on institutional investors that typically issue RFPs, such as pension funds, endowments, and foundations.

Evidence was presented that diverse firms represent 8.6 percent of all asset managers but

manage only 1.1 percent of AUM. This shortfall was discussed along with statements and testimony that diverse firms are as "good or better" than industry counterparts and that such firms represent 25 percent of the top quartile of fund performance. Witnesses and members of Congress discussed potential reasons for this underrepresentation, including lack of diversity policies, the smaller size of these firms, and unconscious bias.

The Committee also focused on solutions to enhance utilization of diverse firms, and consensus developed around the idea of instituting a Rooney Rule process when institutional investors and issuers let an RFP.

ICI reviewed the initial draft bill discussed and released at the hearing and discovered it applied to RICs and would implicate the contract process between a RIC and all its advisers under section 15 of the Investment Company Act of 1940. As drafted, every mutual fund could be "contracting for the services of an asset manager" when conducting its annual contract renewal, and thus subject to the Rooney Rule. ICI engaged the HFSC immediately, noting that there had been no discussion at the hearing about applying the bill to RICs. We acknowledged the value of diversity and inclusion and the intent behind the legislation but explained our business model and why putting fund contracts, including renewals, out to bid was inappropriate.

We learned the initial draft bill was not intended to broadly capture RICs but the HFSC declined to remove RICs entirely from the bill's purview. Through engagement with ICI and key members, the Committee agreed that a mutual fund should not have to put out to bid its annual contract renewal with an affiliated adviser. But, the Committee ultimately determined that a sub-adviser contract is a rough equivalent to an RFP—since a third party is being hired to manage the fund's assets—and should therefore be subject to the Rooney Rule. They further acknowledged the business distinction between an affiliated and unaffiliated sub-adviser. Accordingly, the current discussion draft includes an exclusion for section 15 contracts generally but applies to contracts for unaffiliated sub-advisers when shareholder approval is not required.

We recognize that this bill if enacted into law would significantly impact some ICI members. ICI staff have extensively discussed the proposed legislation with the Executive Committee and the Board of Governors at their recent meetings and with other member firms. The Executive Committee determined at its January meeting that ICI should not oppose the legislation in its current form.

The media has not yet focused on this issue and no bill has been officially introduced, but this will likely change as we expect the HFSC to formally consider the legislation soon, perhaps in March. The bill is likely to pass out of Committee and maybe the House, but its future is uncertain in the Senate. While ICI does not oppose the current discussion draft, we will continue to engage with key public policymakers and stakeholders in the private sector. The bill impacts a significant group of SEC registrants and issuers beyond the RICs that ICI represents. We encourage you to review the bill to discern its impact on your firm and consider engaging with other parties that may be interested in this matter. The HFSC would like to hear from ICI members, especially about the process and procedures you utilize to select sub-advisers. We will apprise you of further developments.

Susan Olson
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Chief Government Affairs Officer

endnotes

[*] Adopted in 2003, the Rooney Rule is a National Football League policy requiring every team with a head coaching vacancy to interview at least one or more diverse candidates. The Rooney Rule was expanded in 2009 to include general manager jobs and equivalent front office positions. The Rooney Rule is named after Dan Rooney, the late former Pittsburgh Steelers owner and chairman of the league's diversity committee.

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