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Bill may mean new self-regulatory agency for investment advisers

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By Joshua Horn

Oversight of investment advisers is coming to a head once again. On September 13, a Congressional financial services subcommittee will conduct hearings on oversight following the Securities and Exchange Commission's report that suggested a self-regulatory organization as an option for correcting the agency's failure to inspect investment advisers quicker than it has in the past. The call for this option, either a new self-regulatory entity or the Financial Industry Regulatory Authority, is a reaction to the SEC's inability to detect the Madoff Ponzi scheme.

The SEC has acknowledged its oversight deficiencies and that it lacks the resources to conduct examinations on a more robust basis. According to the SEC, it only examines 9 percent of investment advisers on an annual basis due to its lacks of resources. The current federal budgetary issues certainly suggest that Congress will not increase funding for the SEC to be the entity that will oversee investment advisers.

Leading up to these hearings, Congressman Spencer Bachus (R-AL), Chairman of the House Financial Services Committee, released proposed legislation that fixes on this option and provides for the establishment of a self-regulatory organization for investment advisers. Congressman Bachus' proposed legislation will address the fiduciary duty for investment advisers and oversight. Although the proposed legislation does not identify the self-regulators, like

broker-dealers, it calls for investment advisers to be members of the self-regulatory body. In addition, the bill provides for the possibility of establishing more than one regulatory entity. This entity or these entities would then report to the SEC.

At the time of the release of his bill, Bachus stated that he believed the self-regulatory route was the best way to oversee investment advisers. According to Bachus, the oversight that a self-regulatory body could conduct would help prevent future schemes like the one that Madoff perpetuated. Bachus went so far as to say that FINRA, through its regular examinations, would have prevented the Madoff Ponzi scheme. Congressman Bachus observed that FINRA regularly reviewed Madoff's broker-dealer business, but Madoff perpetrated the fraud through his investment advisory business.

Drawing FINRA into the picture, which could ultimately be the entity that oversees investment advisers, has sparked additional debate. Investment advisers contend that FINRA is not suited to oversee them because FINRA's oversight of broker-dealers focuses on the suitability standard, where investment advisers are subject to a fiduciary duty. To address this concern, FINRA has suggested that it would have two arms; one focused only on broker-dealers and the other on investment advisers. This way, FINRA could more adequately address issues unique to both.

Whatever the outcome of the hearings and Congressman Bachus' legislation, I am confident that the hearings will result in a further push for Congress to close the oversight gap between broker-dealers and investment advisers. The challenge will be for investment adviser compliance departments to be ready for heightened oversight that will surely be coming down the road.

(Joshua Horn is a partner and co-chair of the Securities Industry Practice at Fox Rothschild in Philadelphia).