Panel Discussion Regarding the Oversight of Investment Advisers:
Can Regulators Keep Up with Growth in the Industry

Meeting of the Securities and Exchange Commission
Investor Advisory Committee
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Thank you for the invitation to speak to the Investor Advisory Committee (IAC) today. My name is Micah Hauptman and I am the director of investor protection at the Consumer Federation of America (CFA). CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

The Problem:

CFA has long been concerned with the lack of adequate funding for investment adviser oversight, a problem that stretches back at least three decades and that we believe poses a significant risk to investors.[1] Over the years, CFA has been open to considering a variety of approaches to solve this resource problem.

The Commission's lack of resources necessary to keep pace with the increasing size, scope, and complexity of the investment adviser market has been well-documented. For example, Section 914 of the Dodd-Frank Act required that the Commission review and analyze the need for enhanced examination and enforcement resources for investment advisers. Published in 2011, the Commission staff documented a decline in the number and frequency of inspections of registered investment advisers and described new challenges the Commission would face as it would take on responsibility for registration and oversight of advisers to private funds.[2] The Commission staff found that, "the Commission likely will not have sufficient capacity in the near or long term to conduct effective examinations of registered investment advisers with adequate frequency."[3] The Commission Staff further observed that, "Even if the Commission is able to expand substantially the number of OCIE (now Division of Examinations or EXAMS) staff dedicated to

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[1] This problem began to emerge in the late 1980s at a time when both mutual funds and investment advisers serving retail clients were growing at an extremely rapid pace, and agency staffing to oversee these areas was growing slowly if at all. By the early 1990s, the problem had reached crisis proportions, with inspections so infrequent that a small adviser might reasonably expect to set up shop and reach retirement without ever seeing an SEC inspector.

[2] Study on Enhancing Investment Adviser Examinations As Required by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, January 2011, https://www.sec.gov/files/914studyfinal.pdf (hereinafter Section 914 Study). The 914 Study found that as the number of registered investment advisers and the assets managed by them had increased and the number of Examinations staff dedicated to examining registered investment advisers had decreased between 2004 and 2010, the number of examinations of registered investment advisers had decreased and the percentage of registered investment advisers examined each year had also decreased. While 18% of registered investment advisers were examined in 2004, only 9% of registered investment advisers were examined in 2010.28 At the rate that registered investment advisers were examined in 2010, the average registered adviser could expect to be examined less than once every 11 years, compared to approximately once every six years in 2004.

[3] *Id*.

inspecting registered investment advisers, based upon past experience and as discussed above, the number of [EXAMS] staff is unlikely to keep pace with the future growth among advisers."[4]

Indeed, since the Section 914 study was published, the number of registered investment advisers has grown significantly. While there were 11,888 advisers managing $38.3 trillion in 2010,[5] there are now more than 15,000 investment advisers managing approximately $125 trillion in assets; that's roughly a 26% increase in the number of advisers and a 326% increase in the amount of assets being managed.[6] In the last five years alone, the number of investment advisers has grown over 20 percent, with a more than 65 percent increase in assets managed by these firms.[7]

Further, as predicted, there has been significant growth in the number of advisers to private funds. Advisers to private funds now represent a significant portion of the investment adviser population. Currently, more than 5,500 advisers, totaling over 35% of all investment advisers, manage approximately 50,000 private funds with gross assets exceeding $21 trillion.[8] In the past five years alone, there has been an 80% increase in the gross assets of private funds, with retirement plans steadily contributing to this growth.[9]

Importantly, investment advisers provide asset management services to a significant number of retail investors. For example, in 2021, investment advisers provided asset management services to 50.7 million individual investors, the bulk of whom (86.4%) were non-high net worth individuals.[10] Dual registrants comprise a substantial portion of the advisory industry and

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[4] *Id*. Responding to the 914 Study, Commissioner Elisse Walter stated, "In simple terms, I believe that the Commission is not, and, unless significant changes are made, cannot fulfill its examination mandate with respect to investment advisers….And, that would be the case even if the Commission had the resources to double its examination frequency percentage, returning to the 2004 frequency level of 18%. Eighteen percent coverage annually is better than 9%, but still insufficient." We agree. Commissioner Elisse B. Walter, Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act), January 2011, https://www.sec.gov/news/speech/2011/spch011911ebw.pdf; *See also* Chairman Mary L. Schapiro, Testimony on "SEC Oversight," Before the Capital Markets and Government Sponsored Enterprises Subcommittee and Financial Institution and Consumer Credit Subcommittee of the U.S. House of Representatives Committee on Financial Services, April 25, 2012, https://www.sec.gov/news/testimony/2012-ts042512mls ("Without additional resources, the increasing complexity of registered firms and the disparity between the number of exam staff and the firms could compromise the effectiveness and credibility of the Commission's inspection and examination program.").

[5] Section 914 Study

[6] *See* 2023 Examination Priorities, Division of Examinations, U.S. Securities and Exchange Commission, https://www.sec.gov/files/2023-exam-priorities.pdf

[7] *See* Fiscal Year 2023 Congressional Budget Justification Annual Performance Plan, Fiscal Year 2021 Annual Performance Report, https://www.sec.gov/files/fy-2023-congressional-budget-justification-annual-performance-plan_final.pdf

[8] *See* 2023 Examination Priorities, Division of Examinations, U.S. Securities and Exchange Commission, https://www.sec.gov/files/2023-exam-priorities.pdf

[9] *Id*.

[10] Investment Adviser Association, Investment Adviser Industry Snapshot 2021, Evolution, Revolution, Reimagined, July 2021, https://investmentadviser.org/wp-content/uploads/2021/08/Investment_Adviser_Industry_Snapshot_2021.pdf. Generally, these are individuals with less than $1.1 million in assets under management with an adviser or a net worth of less than $2.2 million (excluding the value of a primary residence).

disproportionately serve the smallest retail clients, since most independent investment advisers require higher minimums.[11]

In addition, private funds are no longer being restricted to the wealthiest and most sophisticated investors on Wall Street. Rather, private funds and their advisers are increasingly targeting sales to retail investors.[12] As a result, private funds and the activities of the advisers who manage them have the potential to affect the investing outcomes of retail investors saving for retirement or their children's college education, to a much greater degree than ever before.[13]

While the most recent exam rate of 15% of investment advisers represents a meaningful improvement over the 9% exam rate in 2010, it is still unacceptably low in our view and insufficient to keep pace with the growth of the investment adviser market, complexity of business models and practices, the ever-increasing demands on Commission resources, and emerging and evolving risks to retail investors.[14] In short, the Commission continues to face significant resource challenges in providing a strong and effective examination program over registered investment adviser firms.

The Commission has repeatedly stressed the need for substantially more resources, including in its most recent Examination Priorities Report, stating, "Going forward, as the industry continues to grow and change, we believe increased examinations can only be achieved with significant investments in human capital and technology resources, as noted in our fiscal year 2021 priorities."[15] Moreover, in its most recent Congressional Budget Justification Annual Performance Plan, the Commission stated, "The [EXAMS] division remains significantly impacted by a rapidly evolving and growing industry. Additional resources are critical and

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[11] *See* Nicole Boyson, The worst of both worlds? Dual-registered investment advisers, Northeastern U. D'Amore-McKim School of Business Research Paper No. 3360537, December 1, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3360537.

[12] According to a June 2021 Pitchbook article, "Over the past few years, private equity firms have pursued the retail market aggressively." Adam Lewis, Opaque private equity is marketing to retail investors despite pushback, PITCHBOOK, June 2, 2021, https://pitchbook.com/news/articles/private-equity-marketing-to-retail-investors-despite-pushback. Large private equity firms have made no secret of the fact that the retail market is where the money is. For example, in a recent interview with Pensions & Investments, Apollo's Chief Client and Product Development Officer Stephanie Drescher stated that historically, Apollo was primarily focused on institutional investors and high net worth investors. The retail investor channel was "not a key piece of our strategy," Drescher said, "but it certainly is now." Arleen Jacobius, Firms eye the prize: wooing and winning retail investors, PENSIONS & INVESTMENTS, December 27, 2021, https://www.pionline.com/alternatives/alternative-managers-vying-retail-assets.

[13] This is due to the fact that the accredited investor definition is based on income and net worth thresholds that were instituted in 1982 and have not kept pace with inflation.

[14] By way of comparison, the Commission and FINRA examined 44 percent of all registered broker-dealers. To the extent financial professionals view this difference in regulatory oversight as meaningful such that it decreases the risk of enforcement if the firm engages in misconduct, it could create incentives for market participants, particularly dual registrants, to engage in regulatory arbitrage by providing services to investors through their advisory firm. *See* Fiscal Year 2023 Congressional Budget Justification Annual Performance Plan, Fiscal Year 2021 Annual Performance Report, https://www.sec.gov/files/fy-2023-congressional-budget-justification-annual-performance-plan_final.pdf

[15] *See* 2023 Examination Priorities, Division of Examinations, U.S. Securities and Exchange Commission, https://www.sec.gov/files/2023-exam-priorities.pdf

necessary to help EXAMS address the ongoing disparity between the number of exam staff and the size of the SEC-regulated community."[16]

The EXAMS staff's workload includes both its core work and responding to evolving risks in the market. Risk alerts that EXAMS has issued in recent years on a range of issues paint a picture of the many evolving risks EXAMS is tracking. The Risk Alerts also suggest a need to examine investment advisory firms much more comprehensively and rigorously to ensure firms are complying with their regulatory obligations, including:

- Examinations Focused on the New Investment Adviser Marketing Rule;[17]
- Observations from Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identify Theft under Regulation S-ID;[18]
- Investment Adviser MNPI Compliance Issues;[19]
- Observations from Examinations of Private Fund Advisers;[20]
- Observations: Investment Advisers' Fee Calculations;[21]
- Observations from Examinations of Advisers that Provide Electronic Investment Advice;[22]
- Observations Regarding Fixed Income Principal and Cross Trades by Investment Advisers from An Examination Initiative;[23]
- Observations from Examinations of Investment Advisers Managing Client Accounts That Participate In Wrap Fee Programs;[24]
- Review of ESG Investing;[25]
- OCIE Observations: Investment Adviser Compliance Programs;[26]

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[16] Fiscal Year 2023 Congressional Budget Justification Annual Performance Plan, Fiscal Year 2021 Annual Performance Report, https://www.sec.gov/files/fy-2023-congressional-budget-justification-annual-performance-plan_final.pdf

[17] Risk Alert, Division of Examinations, Examinations Focused on the New Investment Adviser Marketing Rule, September 19, 2022, https://www.sec.gov/files/exams-risk-alert-marketing-rule.pdf

[18] Risk Alert, Division of Examinations, Observations from Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identify Theft under Regulation S-ID, December 5, 2022, https://www.sec.gov/files/risk-alert-reg-s-id-120522.pdf

[19] Risk Alert, Division of Examinations, Investment Adviser MNPI Compliance Issues April 26, 2022 https://www.sec.gov/files/code-ethics-risk-alert.pdf

[20] Risk Alert, Division of Examinations, Observations from Examinations of Private Fund Advisers, January 27, 2022, https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf

[21] Risk Alert, Division of Examinations, Observations: Investment Advisers' Fee Calculations, November 10, 2021, https://www.sec.gov/files/exams-risk-alert-fee-calculations.pdf

[22] Risk Alert, Division of Examinations, Observations from Examinations of Advisers that Provide Electronic Investment Advice, November 9, 2021, https://www.sec.gov/files/exams-eia-risk-alert.pdf

[23] Risk Alert, Division of Examinations, Observations Regarding Fixed Income Principal and Cross Trades by Investment Advisers from An Examination Initiative, July 21, 2021, https://www.sec.gov/files/fixed-income-principal-and-cross-trades-risk-alert.pdf

[24] Risk Alert, Division of Examinations, Observations from Examinations of Investment Advisers Managing Client Accounts That Participate In Wrap Fee Programs, July 21, 2021, https://www.sec.gov/files/wrap-fee-programs-risk-alert_0.pdf

[25] Risk Alert, Division of Examinations, Review of ESG Investing, April 9, 2021, https://www.sec.gov/files/esg-risk-alert.pdf

[26] Risk Alert, OCIE Observations: Investment Adviser Compliance Programs, November 19, 2020, https://www.sec.gov/files/Risk%20Alert%20IA%20Compliance%20Programs_0.pdf

- Observations from OCIE's Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices;[27]
- Observations from Examinations of Investment Advisers Managing Private Funds;[28]
- Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest;[29] and
- Compliance Issues Related to Best Execution by Investment Advisers.[30]

In addition to focusing on the above risks, in our view, EXAMS should be examining comprehensively for investment advisers' use of forced arbitration clauses. Following the lead of the brokerage industry, investment advisers now regularly include forced pre-dispute arbitration clauses in their account agreements. However, unlike brokerage firms, which, pursuant to FINRA rules, must include FINRA Dispute Resolution Services as an available forum, investment advisers are not subject to any similar requirements. Often, these firms designate privately run dispute resolution forums such as the American Arbitration Association or JAMS in their arbitration clauses. These forums are far more expensive than the FINRA forum and require the investor to make a sizable deposit to proceed with their claims.

Presently, there is no public information about investment adviser arbitrations. Investment advisers do not uniformly disclose their arbitration clauses. In addition to not uniformly disclosing the use of a pre-dispute arbitration clause, investment advisers do not uniformly disclose investor complaints or their outcome. Therefore, it is virtually impossible to know how many investor complaints have been made against an an investment adviser, whether the complaint resulted in an arbitration, and the outcome of the arbitration including whether any arbitration award has been paid. As a result, there is no clear picture on whether investors doing business with investment advisers actually have access to justice.[31]

Similarly, EXAMS should be examining comprehensively for investment advisers' use of hedge clauses. A hedge clause is a provision added to an investment advisory contract or agreement which purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser provided by state or federal law. The Commission has stated that, while a hedge clause may be appropriate for an institutional client, "there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with those antifraud provisions…. Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the antifraud provisions,

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[27] Risk Alert, OCIE, Observations from OCIE's Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices November 9, 2020, https://www.sec.gov/files/Risk%20Alert%20-%20Multi-Branch%20Risk%20Alert.pdf

[28] Risk Alert, OCIE, Observations from Examinations of Investment Advisers Managing Private Funds, June 23, 2020, https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[29] Risk Alert, OCIE, Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest, July 23, 2019, https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Supervision%20Initiative.pdf

[30] Risk Alert, OCIE, Compliance Issues Related to Best Execution by Investment Advisers, July 11, 2018, https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf

[31] *See* Group Letter to Chair Gensler, May 17, 2022, https://consumerfed.org/wp-content/uploads/2022/05/Groups-urge-SEC-to-Investigate-Registered-Investment-Advisers-Use-of-Forced-Arbitration-Clauses-5.17.22.pdf

even where the agreement otherwise specifies that the client may continue to retain its non-waivable rights."[32] And yet, we understand firms continue to use these clauses.[33]

Clearly, despite what some may contend, the fact that investment advisers are fiduciaries to their clients is not a guarantee that they will comply with the law in all respects. On the contrary, investment advisers must be regularly, comprehensively, and vigorously examined and advisory misconduct must be zealously enforced in order to ensure that investment advisers comply with the law. As several of the Risk Alerts above make clear, this includes examination and enforcement of the fiduciary duty to ensure that investors receive the best interest advice they need and deserve and that advisory conflicts of interest are not allowed to taint advice.

Potential Solutions:

The Section 914 Study found that, "The Commission's examination program requires a source of funding that is adequate to permit the Commission to meet the new challenges it faces and sufficiently stable to prevent adviser examination resources from periodically being outstripped by growth in the number of registered investment advisers."[34] The Study addressed the question of how best to ensure that adequate resources are devoted to oversight of investment advisers. It outlined three options for Congress to consider adopting to address "capacity constraints" concerning examinations and discussed the pros and cons of these approaches:

- imposing user fees on SEC-registered investment advisers to fund their examinations by SEC inspection staff;
- authorizing one or more self-regulatory organizations (SROs) to examine, subject to SEC oversight, all SEC-registered investment advisers; or
- authorizing FINRA to examine dual registrants for compliance with the Advisers Act.

According to the Study:

User fees:

- User fees imposed upon registered investment advisers would provide scalable resources to support the Commission's examination of registered investment advisers.
- User fees also could provide resources that would permit Examinations to improve the effectiveness of its examinations through long-term strategic planning that could allow Examinations to better utilize both technology and its workforce.
- Stable resources could provide the adviser examination program increased flexibility to react to developing and emerging risks associated with investment advisers, and to direct staffing and strategic responses that may help address critical areas or issues.

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[32] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248, June 5, 2019, https://www.sec.gov/rules/interp/2019/ia-5248.pdf;

[33] *See* In the Matter of Comprehensive Capital Management, Inc., January 11, 2022, https://www.sec.gov/litigation/admin/2022/ia-5943.pdf; 2023 Examination Priorities, Division of Examinations, U.S. Securities and Exchange Commission, https://www.sec.gov/files/2023-exam-priorities.pdf ("Lastly, examinations will review whether firms have customer or client agreements that purport to inappropriately waive or limit their standard of conduct, such as through the use of hedge clauses.").

[34] Section 914 Study

- Imposing user fees to adequately fund the examination program may be a less expensive option than an SRO, although the Staff has not evaluated the potential start-up or operational costs of an SRO.
- Retaining exclusive responsibility of Examinations to conduct investment adviser examinations (funded by user fees) may avoid certain inefficiencies associated with delegation to one or more SROs.
- The user fee approach would also leverage SEC examination staff with substantial experience and expertise in the oversight of investment advisers that is closely integrated with legal and policy staff that support their activities.
- Imposing user fees would avoid the difficult scope of authority, membership, governance, and funding issues raised by an SRO.
- User fees would avoid the need for the Commission to use resources to staff an expanded SRO examination program.
- User fees also would shift the cost of regulation to the advisers themselves. Registered investment advisers currently bear little of the cost of their regulatory oversight as compared to other groups of participants in the financial services markets.

SRO(s):

- Congress could, alternatively, authorize one or more SROs for registered investment advisers in order to provide scalable resources to support the Commission's examination of registered investment advisers.
- An SRO would not, however, free the Commission to use all resources currently dedicated to adviser examinations to pursue other matters. Commission resources would still be required to oversee the operations of any SRO by, depending upon the scope of the SRO's authority, conducting oversight examinations of the SRO, considering appeals from sanctions imposed by the SRO, and approving SRO fee and rule changes. Substantial resources of both Examinations and the Commission's Division of Trading and Markets are currently employed to oversee the activities of FINRA.
- The design and implementation of one or more investment adviser SROs would require resolution of a number of important issues regarding the number, scope of authority, membership, governance, and funding of the SRO or SROs. These issues are complicated by the diversity of the investment adviser industry, strong opposition among investment advisers, investment company and accounting trade associations, state regulators and investor advocates to any SRO, and tensions about the prospect of FINRA, which has expressed an interest in becoming an SRO for investment advisers.
- Multiple SROs could focus expertise and better accommodate industry diversity, but also could more likely lead to SRO "capture" by the discrete industry group from which SRO staff are drawn and to which they may return after their service. Even a single SRO, because it is not only funded by the industry it oversees, but also may include industry representatives in its governance structure or otherwise have a different relationship with industry than an independent government regulatory agency, could possibly have enhanced susceptibility to industry capture.
- Multiple SROs also could lead to regulatory arbitrage, as SROs seek to attract members by offering a more accommodating regulatory and oversight program or by charging lower fees leading to inadequate funding for regulatory programs. Multiple SROs also could be more costly than a single SRO because they would be less likely than a single

SRO to achieve economies of scale. Moreover, different SROs would likely, over time, develop different approaches to applying the Advisers Act and their own rules to similar activities. Prevention of these consequences would require vigorous oversight by the Commission. Adequate oversight would require Commission resources, and multiple SROs would require a corresponding greater amount of resources.

- Crafting exclusions for certain types of investment advisers could be difficult in practice because many investment advisers have diverse client bases and business lines. Moreover, exclusions could provide opportunities for regulatory arbitrage.
- Given the diversity in the investment advisory industry, an appropriate governance structure is important to prevent one business model from dominating the SRO or the SRO from providing a competitive advantage to particular business models.
- Operation of an investment adviser SRO would involve substantial costs that would be funded largely by membership fees paid by investment advisers, which may be resistant to the fees.

Authorize FINRA to examine dual registrants for compliance with the Advisers Act:

- While only about five percent of investment advisers registered under the Advisers Act are broker-dealers and thus members of FINRA, almost all of the largest retail broker-dealers are also registered as investment advisers. These dual registrants have a substantial portion of retail advisory clients and employ a significant number of investment adviser representatives.
- Authorization of FINRA to enforce the Advisers Act would free existing Commission resources spent examining dual registrants to be re-directed to other investment advisers.
- It would partially address the inefficiencies that result from subjecting a dual registrant to two separate examinations, one by FINRA and the other by Examinations.
- It would permit a single regulator (FINRA, subject to existing SEC oversight), having obtained a more holistic view of dual registrants' client activities and compliance environment, to conduct a more effective examination of a dual registrant. Such examinations also could be more cost efficient.
- The Commission staff may lose experience examining these large retail advisers, and may not gain important information about their activities.
- There would be a risk that, over time, different and inconsistent approaches to applying the Advisers Act to dual registrants and other advisers could develop. The Commission would have to exercise vigilant oversight to prevent this from occurring.

As stated above, CFA has been open to a variety of approaches to solve this resource problem. The goal should be to determine which approach has the potential to deliver the highest quality of oversight at a reasonable cost to the investment adviser community and the investors who will ultimately bear those costs.

As a matter of principle, CFA believes in funding government adequately to fulfill the functions it is mandated to perform, rather than farming out those responsibilities to private entities. We see no reason why Congress should not adopt that approach in this case, since adequate funding for investment adviser oversight could be provided either through the normal appropriations process or through special user fees at no additional cost to taxpayers. Moreover, representatives of the investment adviser community have indicated their willingness to pay user fees to fund

more robust SEC oversight. For the reasons stated in the Study, we believe the user-fee approach outlined in the Section 914 Study offers the most optimal option for funding enhanced inspections in a way that promotes investor protection while minimizing added costs to industry. The IAC has agreed, recommending in 2013 that the Commission request legislation from Congress that would authorize its EXAMS Division (then OCIE) to impose "user fees" on SEC-registered investment advisers.[35]

In the past, CFA has categorically opposed delegating investment adviser oversight to an SRO, particularly if that SRO were given rule-making authority. However, after having spent decades arguing for various approaches to increase SEC resources for investment adviser oversight with nothing to show for our efforts, we were forced to reassess our opposition to the SRO approach. Specifically, we concluded that a *properly designed* SRO proposal could be an improvement over the status quo. Too often, however, the SRO approach is presented as an easy solution by individuals who have not adequately confronted the many thorny issues it presents. The SEC study does an excellent job, in our view, of laying out the issues that would need to be addressed if Congress were to pursue this approach.

The third approach that the 914 Study considered was to authorize FINRA to examine dual registrants for compliance with the Advisers Act. To the extent that brokerage and investment advisory firms and financial professionals offer commercially indistinguishable services to the same customers and the regulatory frameworks for broker-dealers and investment advisers have converged,[36] there is a certain logical appeal to this approach. Moreover, to the extent such an approach would offer efficiencies given that FINRA may already be examining the broker-dealer side of the firm, it may make sense to also examine the investment adviser. In addition, since dual registrants comprise a substantial portion of the advisory industry and disproportionately serve the smallest retail clients, authorizing FINRA to examine dual registrants could ensure greater coverage of firms that provide services to retail investors who need protections the most. For example, a recent study of dual registrants found evidence that these advisers engage in conflicts of interest, have high fees, and provide their clients with poor investment performance, implying that these advisers are not serving their clients' best interests.[37]

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[35] Recommendation of the Investor Advisory Committee Legislation to Fund Investment Adviser Examinations, November 22, 2013, https://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-examinations-recommendation-2013.pdf ("The fees collected from investment advisers would be available to the Commission without further appropriation, used solely to fund the Commission's investment adviser examination program, and set at a level designed to achieve an acceptable frequency of examinations.").

[36] *See* Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors, March 30, 2022, https://www.sec.gov/tm/iabd-staff-bulletin ("Both Regulation Best Interest ("Reg BI") for broker-dealers and the fiduciary standard for investment advisers under the Investment Advisers Act (the "IA fiduciary standard") are drawn from key fiduciary principles that include an obligation to act in the retail investor's best interest and not to place their own interests ahead of the investor's interest. Although the specific application of Reg BI and the IA fiduciary standard may differ in some respects and be triggered at different times, in the staff's view, they generally yield substantially similar results in terms of the ultimate responsibilities owed to retail investors.").

[37] *See* Nicole Boyson, The worst of both worlds? Dual-registered investment advisers, Northeastern U. D'Amore-McKim School of Business Research Paper No. 3360537, December 1, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3360537 ("Despite the surprise win by the Financial Planning Association in 2007 requiring brokerage firms wishing to charge asset-based fees to dual register as fiduciaries, the increase in fiduciary assets was not accompanied by a reduction in conflicts of interest, a reduction in fees, nor an increase in retail client welfare. In fact, the welfare of dual registered retail RIA clients may even be worse than the

While authorizing FINRA to examine dual registrants for compliance with the Advisers Act could ensure greater coverage of firms that serve the smallest retail clients, it's not clear however that investors would be better off. For example, would FINRA's examinations result in better outcomes than the outcomes that result from the Commission's examinations? Recently the Commission has brought many high profile, innovative cases against dual registrants.[38] Would these kinds of cases continue be brought? Would they be referred to the Commission by FINRA or brought by the Commission based on its own inspection? These questions are difficult to answer. As the Section 914 Study stated, the Commission staff may lose experience examining these retail advisers, and may not gain important information about their activities, which may result in certain cases not being brought.

In addition, as the 914 Study makes clear, there would be a risk that, over time, different and inconsistent approaches to applying the Advisers Act to dual registrants and other advisers could develop. The Commission would have to exercise vigilant oversight to prevent this from occurring. In the end, it's not clear the costs and time associated with this oversight would be worth the benefits. Nor is it clear that it would add to efficiencies at the Commission such that the Commission could meaningfully expand examination coverage of other advisers. Still, this is an idea worth considering.

Finally, while not discussed in the Section 914 Study, another solution that has been suggested would be to require advisers to hire third-party consultants to conduct SEC-like examinations. To the extent certain third-party audits focus their efforts on objective measurements, for example asset verification, it may be beneficial to have third parties engage in such audits, subject to appropriate oversight by the Commission. However, to the extent third party audits focus their efforts on subjective measurements that require judgment, it would raise the risk that third party auditors may be subject to conflicts of interest, given the fact that these auditors would likely be selected and paid by the firm being audited. Therefore, whether third party audits of investment advisers would actually be worth the costs and risks remains an open question.

Conclusion:
More frequent examinations of advisers would allow the Commission to detect misconduct earlier, which may help to limit client losses; it would also provide stronger deterrence of advisory misconduct. In order to achieve these goals, the Commission needs adequate funding for investment adviser oversight and Congress must provide the Commission with that additional funding.

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welfare of their retail brokerage clients, since dual registrants invest retail RIA clients in the same underperforming revenue-sharing mutual funds as brokerage clients, but charge their retail RIA clients higher fees (2.2% per year on average compared to the typical 1% annual commission of a load (C Share) mutual fund).").

[38] SEC, Press Release, SEC Share Class Initiative Returning More Than $125 Million to Investors, March 11, 2019, https://www.sec.gov/news/press-release/2019-28