

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

November 24, 2014

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair White:

According to the Securities and Exchange Commission's (SEC) Budget Request for Fiscal Year 2016, "[t]here is an immediate and pressing need for significant additional resources to permit the SEC to increase its examination coverage of registered investment advisers so as better to protect investors and our markets." As you know, the SEC's examination coverage of investment advisers has dropped significantly in recent years.¹ This has prompted some market participants, lawmakers, and regulators to propose that Congress authorize the SEC to collect "user fees" from registered investment advisers to fund additional examinations. We agree that a greater portion of the more than 11,000 investment advisers currently registered with the SEC must be subject to regular and robust examinations to help ensure compliance with the Federal securities laws. We question, however, whether user fees are the best tool available to achieve this goal, and urge the SEC to pursue other more efficient and cost-effective alternatives.

Although the SEC's January 2011 staff study on "Enhancing Investment Adviser Examinations," mandated by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), explored user fees, among other options, as a potential source of funding to boost registered investment adviser examinations, the Study contains no analysis on the potential economic impact of user fees on such advisers and their customers. There is little doubt, however, that user fees will impose significant new costs on these firms and that the added costs will be passed along to their customers in the form of higher advisory fees. As you know, even a modest increase in advisory fees could

¹ See SEC Study on Enhancing Investment Adviser Examinations As Required by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Jan. 2011, ("SEC RIA Study"), <http://www.sec.gov/news/studies/2011/914studyfinal.pdf> (indicating that the number of SEC examinations fell from 1,521 in 2008 to 1,083 in 2010 while the number of SEC examiners devoted to registered investment adviser exams increased over that same period from 425 to 460).

significantly reduce long-term investment returns for millions of Americans who depend on this income to buy a home, pay for a child's education, or fund a secure retirement.² Moreover, user fees could have a disproportionate impact on small and mid-size registered investment advisers, which would make it more difficult for these firms to compete with their larger peers and reduce access to valuable advisory services for those less sophisticated investors who need it most.³ Increasing costs for small businesses and retail investors and curtailing access to investment advice will directly undermine the SEC's statutory mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

Authorizing the SEC to collect user fees will also result in the SEC adding hundreds of additional examiners and enforcement lawyers, with six-figure salaries, to its already large staff of more than 4,200 employees, to conduct investment adviser examinations and investigate potential wrongdoing. As one investment adviser consultancy firm has warned, "Any organization would struggle with such rapid hiring growth. It's possible that training may take longer than anticipated, proper talent may require more compensation, turnover may increase, and so forth. In other words, [user fees] may be more costly than initially projected regardless of the implementation details."⁴

Not only will hiring more examination and enforcement staff increase costs and add to an already bloated Federal bureaucracy at a time when millions of Americans are still looking for work, it will further distance the SEC from its traditional role as a disclosure agency.⁵ At the same time, it is unlikely that simply

² See SEC Office of Investor Education and Advocacy Investor Bulletin, "How Fees and Expenses Affect Your Investment Portfolio," http://www.sec.gov/investor/alerts/ib_fees_expenses.pdf ("Ongoing fees can also reduce the value of your investment portfolio. This is particularly true over time, because not only is your investment balance reduced by the fee, but you also lose any return you would have earned *on* that fee. *Over time, even ongoing fees that are small can have a big impact on your investment portfolio.*") (emphasis in original).

³ See RIA in a Box, "What is the cost of SEC Investment Adviser exam user fees to RIA firms?" Sept. 3, 2014 ("RIA in a Box Study"), <http://www.riainabox.com/blog/what-is-the-cost-of-sec-investment-adviser-exam-user-fees-to-ria-firms> ("The SEC sets a minimum annual firm fee regardless of [assets under management]: This is perhaps the greatest threat to small SEC-registered [investment advisor] firms. A minimum annual fee of \$20,000 per firm would equate to 2% of revenue for a typical \$100 million firm and would definitely be felt. This could also be particularly troublesome for mid-sized investments advisers with between \$25-\$100 million in [assets under management] in the state of New York that are required to be registered with the SEC.").

⁴ RIA in a Box Study.

⁵ See Remarks by Commissioner Daniel M. Gallagher at the 2nd Annual Institute for Corporate Counsel, Dec. 6, 2013, <http://www.sec.gov/News/Speech/Detail/Speech/1370540462287#.VGN6vod0y30> ("The SEC is first and foremost a disclosure agency. With respect to corporate disclosure, our bedrock premise is that public companies should be required to disclose publicly and in a timely fashion the information a person would need in order to make

adding hundreds of new examiners will result in an immediate, material increase in the number of SEC examinations or the efficiency of such examinations; for example, publicly available data indicates that, on average, each *experienced and trained* SEC examiner conducts fewer than five investment adviser examinations per year out of a total pool of more than 11,000 registered investment adviser firms.⁶

In light of these and other concerns surrounding user fees, we urge you to reallocate existing SEC resources to immediately increase the amount of registered investment adviser examinations. For example, as we stated in our letter to you dated September 12, 2013, the SEC should redirect resources currently being used to protect “millionaire and billionaire” investors in private funds toward examinations of the many investment advisers who serve less sophisticated “mom and pop” investors. In addition, the SEC can shift more of its responsibility to examine broker-dealers to the Financial Industry Regulatory Authority (FINRA), which would allow additional, existing SEC resources to be reallocated to investment adviser examinations. As the SEC is responsible for overseeing FINRA, SEC staff would still have the primary responsibility to monitor the financial condition of broker-dealers as well as FINRA’s broker-dealer examination program

In addition, the SEC must consider creative solutions to solve the investment adviser examination deficiency, particularly those solutions that leverage the resources and expertise of the private sector. For example, your fellow Commissioner, Daniel Gallagher, recently suggested that the SEC could provide for “third-party” examiners of investment adviser firms.⁷ In 2011, the Association of Institutional Investors developed a “Common Audit Baseline,” which would “leverage the deep expertise and strengths of the audit profession, and provide a cost effective tool for regulators to efficiently support their oversight role without expending additional public monies.”

a rational and informed investment decision. On that foundation, our securities laws and the rules by which we administer them have been built.”).

⁶ See The Boston Consulting Group, *Investment Adviser Oversight: Economic Analysis of Options*, Dec. 2011, http://www.cfp.net/docs/public-policy/bcg_investment_adviser_oversight_economic_analysis.pdf?sfvrsn=2 (“Rate of exams per examiner per year is assumed to be 3.0, which is the current average number of IA exams conducted by an SEC examiner per year.”); SEC FY 2015 Congressional Budget Justification. See also SEC RIA Study (“The Staff acknowledges that important additional factors in the adequacy of the investment adviser examination program are the efficiency with which [the Office of Compliance Inspections and Examinations (OCIE)] conducts examinations, which depends on OCIE’s ability to identify compliance risks, its selection of examination candidates and the time it takes to conduct examinations, and the effectiveness of OCIE’s examinations in identifying compliance failures. OCIE’s efficiency also is affected by the amount of cooperation provided by advisers.”).

⁷ See Remarks by Commissioner Daniel M. Gallagher at the 46th Annual Rocky Mountain Securities Conference, May 9, 2014, <http://www.sec.gov/News/Speech/Detail/Speech/1370541779229#.VGN7H4d0y30>.

The SEC's willingness to solve its own problems rather than seek additional appropriations or the authority to impose new fees would be a welcome development. Please provide the Committee with written answers to the following questions by December 5, 2014:

1. Describe how the SEC plans to reallocate existing resources to increase registered investment adviser examinations;
2. Provide a timeline for the SEC to consider either a voluntary program, an order or a formal rule to permit third-parties to audit registered investment advisers; and
3. Provide the average of investment adviser examinations per SEC examiner across all offices and divisions for FY 2013 and FY 2014.

Thank you for your attention to this important matter.

Sincerely,



JEB HENSARLING
Chairman



SCOTT GARRETT
Chairman
Subcommittee on Capital Markets and
Government Sponsored Enterprises