



**U.S. Securities and Exchange Commission Investor Advisory Committee**

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

**Written Statement of Karen L. Barr, President & CEO  
Investment Adviser Association**

**March 2, 2023**

Thank you, Paul [Roye], and good afternoon, Chair Gensler, Commissioners Peirce, Crenshaw, Uyeda, and Lizárraga, members of the Investor Advisory Committee, and my fellow panelists. Thank you for inviting me to participate in this panel.

The Investment Adviser Association is a not-for-profit organization that has exclusively represented the interests of fiduciary investment adviser firms for more than eighty-five years.

Our members range from global asset managers to the medium- and small-sized firms that make up the core of our industry. Together, the IAA's members manage more than \$35 trillion in assets for a wide variety of clients, including individuals, trusts, investment companies, private funds, pension plans, state and local governments, endowments, foundations, and corporations. What they all have in common is that they are fiduciaries, that is, they have a special relationship of trust and confidence with their clients. Investment advisers provide a critically important service helping investors meet their life goals, including education, homeownership, and retirement. They are subject to the principles-based framework of the Advisers Act, which provides robust investor protection and a flexible, evergreen approach that has been adaptable to changes in the industry over the years.

The IAA strongly supports efforts to enhance Commission examinations of advisers and we appreciate the opportunity to speak to the Committee on this important topic.

I have been asked to provide the IAA's perspectives on the multifaceted issue of adviser oversight, which implicates Commission funding and appropriations, agency staffing for adviser examinations, and the recurring discussion of a self-regulatory organization (SRO) for our industry. This debate has also included the feasibility of outsourcing some portion of the Commission's oversight function through some form of third-party compliance assessments.

But first, I'm going to first spend a few minutes providing data on the advisory industry. The IAA publishes a Snapshot report every year doing a deep dive into the recent Form ADV data. We have been analyzing this data, together with NRS, for 20 years. The [link](#) is on our website as well as the underlying data files, and I encourage everyone to dig in.

I'm not going to go into all of these slides in detail in the interest of time. As a top line note, while investment advisory firms range from small local or regional firms to large global financial institutions with varying business models, the overwhelming majority of investment advisory firms are small businesses. Indeed, more than half of all federally registered advisers employ fewer than ten employees and more than 88 percent employ fewer than 50 non-clerical employees. Additionally, 88% of advisers manage less than \$5 billion in assets, with the majority managing between \$100 million and \$1 billion. These slides underscore that advisers are truly a Main Street profession.

As small businesses are the backbone of the fiduciary advisory community, we urge the Commission to recognize the unique challenges of smaller advisers and tailor regulation accordingly. Additionally, the IAA continues to urge policymakers to consider regulation holistically and take into account the cumulative impact of regulation on investment advisory firms of all sizes, and in particular on smaller advisers.

Since 2014, the number of Commission-registered advisers has grown from 10,985 to 14,806, representing a net increase of 34.8%. Additionally, aggregate assets under management for Commission-registered advisers has grown from \$61.6 trillion to \$128.4 trillion, which represents growth of 108.4%, although there is potentially significant double counting in this figure. Investment advisers now serve 64.7 million clients with almost 60% of advisers providing asset management services for individuals.

This growth in the number of advisers may be due to a number of factors, including state-registered advisers hitting the \$100 million threshold during the years of bull markets, the attractiveness of the business model, including open architecture, and the desire by clients for fiduciary advice and ongoing relationships. This is supported by the increase in the number of individual clients, the decrease in the number of brokerage firms and professionals licensed solely as registered representatives, and the number of firms initially registering with the SEC with less than \$100 million in assets.

At the same time, the Commission's examination rate of advisers increased from 10% in 2014 to between 15 and 16% in 2017 and has stayed relatively level as a percentage of registrants. We understand and appreciate that this increase is partially attributable to the Commission shifting more resources to investment adviser exams. The Commission has also attributed this increase to its ability to leverage data analysis to analyze and identify potentially problematic activities and firms. The staff has been able to successfully use this information to make risk-based decisions as to which firms to examine and how best to scope those examinations. While we would ideally see an increase in the examination rate, we are pleased that the Commission has been able to keep pace with the growth in the advisory industry and that the examination program today is strong.

We also commend Commission staff for their work publishing examination priorities and risk alerts and providing guidance to educate advisers. The transparency and guidance are very helpful as advisers continually develop, assess, and enhance their compliance programs. To increase their value to advisers, we recommend that the Division of Examinations issue Risk Alerts with examination observations about best practices that distinguish between larger and smaller firms as well as among different business models.

## Commission Funding

The IAA strongly believes the best way to enhance oversight of investment advisers is to ensure that the Commission has adequate resources, and that the agency continues to improve its examination program. Examinations are inherently a government function.

The Commission has more than eight decades of experience regulating and overseeing the investment advisory profession. Moreover, the Commission is directly accountable to Congress and the public with regard to its budget and performance. The IAA believes that the Commission – an experienced and accountable governmental regulator – continues to be in the best position to provide oversight of the advisory profession and should retain its primacy in investment adviser regulation.

The IAA has consistently supported the Commission’s efforts to strengthen its examination program for investment advisers. Adequate resources for, and a commitment to, an effective Commission examination program for investment advisers must be a high priority for policy makers and for the Commission. Over the last five years, the Commission has focused on enhancing and restructuring its enforcement and examination functions. Most recently, the Commission has elevated the Office of Compliance Inspections and Examinations into a Division of Exams.

The Commission has implemented a more risk-focused examination program to enhance compliance at advisory firms, inform the financial industry about potentially risky practices and methods to effectively address them, and provide information for Commission enforcement investigations, where appropriate. The program continually collects and analyzes a wide variety of data about investment advisers using quantitative techniques. The Division also uses tips, complaints and referrals and surprise custody audits to help determine which advisers to examine and the scope of the exams. Thus, the exam coverage rate is not based on random selection; it is risk-based, which ensures that advisers that pose the highest risk are being examined the most frequently.

The IAA has a long history of supporting efforts to increase the frequency of investment adviser examinations. However, it is important to recognize that the coverage statistic is only part of the equation. Examinations must be effective, substantive, risk-targeted, and conducted by examiners who understand both relevant regulations and the nature of the businesses being examined. The quality of examinations is as important as the number.

We appreciate the observation in the Exams Division’s 2023 priorities that “as the industry continues to grow and change, [the Division] believe[s] increased examinations can only be achieved with significant investments in human capital and technology resources.” To this point, the Commission received an 8% increase to its budget under the latest government funding deal, which equates to an additional \$2.15 billion. We would urge the Commission to allocate adequate resources to the Exams Division to increase adviser oversight. We will continue to support sufficient funding for this purpose.

## Alternatives

Several alternatives to enhance adviser oversight have been previously discussed. But, in our view, none of these alternatives would be an adequate substitute for the Commission’s expertise, experience, and

accountability. Alternatives to governmental oversight should only be considered if it were clearly determined that Commission funding cannot be adequate to sustain an effective examination program.

In considering legislation and/or rulemaking to enhance investment adviser examinations, the Commission should consider the costs and benefits of the various alternatives, especially the impact they will have on small advisers. I will provide our perspective on some of those alternatives today, including creation of an SRO for advisers, the assessment of user fees, third-party examinations, and raising the AUM threshold for Commission registration.

### SRO

The IAA strongly opposes the creation of an adviser SRO. Specifically, we have consistently voiced our objections to extending FINRA's examination or rulemaking authority to advisers.

We are not aware of any analysis or empirical data demonstrating that the costs associated with the creation of an SRO would be outweighed by the benefits. To the contrary, there is compelling evidence that the costs of outsourcing regulation and oversight of thousands of investment advisers to an SRO would be far greater than the comparable costs of enhancing the Commission's inspection program. For example, appropriate government oversight is required in any SRO structure and thus requires dedication of significant government resources. Commission resources would still be required to oversee the operations of any SRO by conducting oversight examinations of the SRO, considering appeals from sanctions imposed by the SRO, and approving SRO fee and rule changes.

In addition to costs, the substantial drawbacks to an SRO significantly outweigh any potential benefits. These drawbacks include minimal transparency and accountability, insufficient oversight by the Commission and Congress, conflicts of interest, and the lack of meaningful due process protections and cost-benefit analysis restraints. An SRO would not have the expertise or experience to examine investment advisers. Rather, the SEC's examination team is the most qualified and competent to do so. Further, outsourced oversight to an SRO or other third party could lead to fragmentation and inconsistency of interpretation and application of the law.

An SRO would also disproportionately affect small businesses, imposing additional costs on their limited resources, subjecting them to an additional layer of regulation as well as inspection and enforcement authority by a potentially conflicted private regulator.

### User Fees

A second alternative to direct funding of the examination program is to augment the current program through the imposition of user fees. While the IAA strongly believes that Congress should provide adequate funding for this critical oversight function, in the absence of such funding, we have supported the assessment of an appropriate user fee on advisers dedicated to increased examinations. Because user fees would keep the exam function within the Commission and be used solely to bolster that program, it is a far better option than creation of an SRO. In fact, in addition to the IAA, this alternative approach to an SRO has been endorsed previously by consumer advocates and the Investor Advisory Committee.

User fees are already an important source of funding for inspections and examinations of other financial institutions and regulated entities by many federal agencies, including the Comptroller of the Currency.

User fees can be a smart, efficient use of funds. If need be, allowing the Commission to charge user fees would empower it to build on the expertise and infrastructure it has already established in examining advisers.

User fees would also better enable the Commission to improve the effectiveness of its examinations through long-term strategic planning that would better use modern technology and its workforce. A stable source of funding would permit use of technology-based solutions that can take years to develop and implement. Stable and scalable resources would also provide the examination program with increased flexibility to react to emerging risks and better target staffing and strategic resources as appropriate.

As we have stated in the past, any legislation to authorize user fees should include provisions that: (1) specifically preclude any investment adviser SRO if such fees are imposed; (2) clarify that such user fees will be dedicated to an increased level of investment adviser examinations (instead of simply being used as substitute funding for the existing level of examinations); and (3) set forth specific Commission reporting requirements and review of any such user fees by Congress and the public. Any user fee imposed on advisers would need to be apportioned appropriately as to not have a disparate impact on smaller firms, considering factors such as the adviser's number of employees and AUM.

#### Third-Party Exams

Other ways to augment the Commission's own investment adviser examination program, including third-party examinations, have also been discussed in the past. In our view, however, third-party exams have significant potential disadvantages as compared with Commission examinations.

The Commission would have to address several serious concerns about the standards, scope, and frequency of any such third-party reviews; the confidentiality of any work product generated; the qualification process for third parties; and the ability of the Commission to oversee the third parties. We also have significant concerns regarding the costs that could be imposed on advisers, particularly smaller advisers.

As an initial matter, the Commission could consider assessing the types of voluntary third-party reviews that investment advisory firms currently employ. These include financial audits, internal control reports by third parties, compliance reviews by third parties, mock audits, and internal audits. Before engaging in any rulemaking that would require Commission-registered advisory firms to undertake an examination or other review by a third party, the Commission should evaluate what practices are already undertaken, how such practices are utilized, the types of third parties retained, and the costs involved, especially costs for smaller advisers.

Should the Commission move forward despite these concerns, we submit that any use of third-party exams to supplement the Commission's exams should be targeted and limited in scope to areas – like verification of assets – in which a third-party might have expertise, and narrowly tailored to achieve specific objectives.

As noted previously, the IAA believes that the Commission – an experienced and accountable governmental regulator – continues to be in the best position to provide oversight of the advisory profession and should retain its primacy in investment adviser regulation.

### Changing AUM Threshold

The IAA is aware that there have been calls from time to time to again increase the AUM threshold for Commission registration, similar to the Dodd-Frank Act provision that raised the minimum asset level at which RIAs are subject to oversight by the Commission from \$25 million under management to \$100 million. This removed about 2,100 firms from Commission oversight and assigned them to agencies in states where they did business.

The IAA has not taken a position on raising the threshold again, but believe that, prior to any action taken on this issue, the Commission should work with state regulators and NASAA to assess the states' capability and willingness to oversee another inflow of advisers.

### Conclusion

The IAA is committed to supporting the Commission's efforts to obtain adequate funding through the appropriations process. We strongly believe that examinations are a government function. The IAA continues to encourage the Commission to consider ways in which it can increase the frequency and quality of investment adviser examinations under its current allocation of resources and any future allocated resources. We look forward to continuing to work with this Committee, the Commission, and its staff on this important issue.