

Written Statement of Stephen Brey
Staff Attorney for the State of Michigan Corporations, Securities, and Commercial Licensing
Bureau and Co-Chair of the NASAA Investment Adviser Section Regulatory Policy and Review
Project Group
March 2, 2023
U.S. Securities and Exchange Commission
Investor Advisory Committee
“Panel Discussion Regarding the Registered Investment Adviser Regulatory Framework”

Hello and good afternoon.

My name is Stephen Brey. I am a staff attorney with the State of Michigan Corporations, Securities, and Commercial Licensing Bureau. I am also co-chair of the Investment Adviser Regulatory Policy and Review Project Group of the North American Securities Administrators Association, commonly known as NASAA. I am grateful for the opportunity to speak with the SEC’s Investor Advisory Committee about how NASAA’s members protect investors through the regulation of investment advisers. My comments today reflect my own personal views and do not necessarily represent the official positions of NASAA, any NASAA member, or the State of Michigan.

I’ve been with Michigan’s Securities Division since 2013, and have been involved with the NASAA Investment Adviser Regulatory Policy and Review Project Group since 2016. I’ve had the opportunity to work with my counterparts not only in other states and the Canadian provinces, but also with staff from the SEC, FINRA, NASAA’s corporate office, members of industry, trade groups, and academia. All these stakeholders come to the table with different, but important perspectives that color the lens through which they see various issues facing the investment advisory industry and how it should be regulated. That said, each of them has approached the discussions in good faith and with a goal towards encouraging good business practices that ultimately protect the retail investors we all serve.

My goal today is to give the IAC an overview of NASAA and its investor protection mission. Relatedly, I will describe how that mission is advanced by regulating investment advisers at the state level and in so doing provide illustrative examples of the innumerable ways that NASAA helps its members oversee the firms and individuals within their regulatory purview.

NASAA and its Mission

NASAA was organized in 1919 and is the world’s oldest international organization devoted to investor protection. It is a voluntary association whose membership consists of the securities regulators in the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, as well as the 13 provincial and territorial securities regulators in Canada, and the securities regulator in Mexico. Over 300 volunteers from NASAA’s members participate on 54 committees and project groups organized by regulatory topic. They are supported by NASAA’s professional corporate office staff.

Through its board of directors, committees, sections, project groups, and corporate office staff, NASAA works to advocate for public policy that effectively regulates the securities industry and is in the best interests of retail investors, especially those who lack the expertise, experience, and resources to protect their own interests.

Relevant to today's discussion is NASAA's Investment Adviser Section. While other bodies within NASAA support related policy, NASAA's Investment Adviser Section leads NASAA's efforts related to the oversight of state-registered investment advisers and individual investment adviser representatives ("IARs").

NASAA Members' Regulated Population

State securities regulators register myriad manner of products, people, and firms. This includes many securities offerings, broker-dealers, broker-dealer agents, investment advisers, and IARs.

With respect to investment advisers, NASAA members share regulatory responsibility with the SEC. In general, small investment advisers (less than \$25 million of regulatory assets under management ("RAUM")) and mid-sized investment advisers (between \$25 million and \$100 million of RAUM) are registered with and primarily regulated by one or more state securities administrators. Conversely, large investment advisers (greater than \$100 million of RAUM) generally are registered with the SEC and are primarily subject to federal regulation instead of state regulation. In some cases, a small or mid-sized investment adviser may be permitted or required to register with the SEC instead of with one or more states and, in more limited circumstances, a small or mid-sized investment adviser may be registered with the SEC and one or more states. States can require notice filings and retain anti-fraud authority with respect to federal covered investment advisers. States also have authority to require the registration of most IARs doing business in the state regardless of whether an individual is employed by or associated with a state firm, or a federal-covered investment adviser.

Data published in NASAA's 2022 Investment Adviser Report shows that state-registered advisers had AUM of over \$400 billion dollarsⁱ across over 17,000 firms,ⁱⁱ while over 12,000 federal covered firmsⁱⁱⁱ notice-filed with the states in the prior year. For state-registered firms, the 2022 Investment Adviser Report showed that the overwhelming majority of state-registered firms are small shops, with 81% having two or fewer employees, 18% having 3-10 employees, and less than 1% having any more than that.^{iv} The advisers we oversee are overwhelmingly small businesses that provide advice to Main Street retail investors.

FINRA's 2022 Industry Snapshot shows that there were 307,590 individuals registered as both IARs and broker-dealer agents, along with 77,468 individuals registered solely as IARs.^v That's over 385,000 individuals registered with the states as IARs.^{vi}

How do the states oversee the firms and individuals within their purview, and what tools does NASAA provide to help facilitate that oversight?

The NASAA Examination Module, Also Known As NEMO

NASAA members carry out examinations of state-registered investment advisers to assess adviser compliance with state regulatory requirements. The issues addressed with state-registered advisers on exams are fairly consistent across jurisdictions thanks to NASAA's efforts to encourage uniformity among its members.

For 37 NASAA members, examinations are efficiently and effectively conducted using the NASAA Examination Module (NEMO) system.^{vii} NEMO is a web-based software application available for use by state securities examiners to conduct examinations of investment advisers and broker-dealers in their jurisdictions.^{viii} NEMO allows an examiner to create an examination in the application, prompts the examiner on topics that should be addressed during the examination, identifies important questions that should be asked of the adviser, and allows for the submission of responses from the adviser directly into the system. Jurisdictions that use NEMO can securely store their own examination data on the system according to their own state privacy and record retention laws, and it is not accessible by other regulators. That said, NEMO also allows for the anonymized collection of high-level examination data across the participating jurisdictions. NASAA's Investment Adviser Section relies on that high-level data to track trends and to inform its policy proposals.

Simply put, NEMO streamlines the examination process from start to finish for jurisdictions that elect to use it. The simplification of the examination process allows states to effectively oversee more advisers in less time.^{ix}

The Use of Data to Protect Investors and Foster Regulatory Compliance

NEMO is more than just a step-by-step guide to help examiners cover important bases on an examination. Since the examiner can enter the data directly into the system, NEMO is able to effectively gather anonymized high-level data for NASAA's coordinated examination program. Coordinated examinations generally take place every other year, with one underway now. Since the 2023 coordinated examination is ongoing, the data from 2021 is the most recent available. The 2021 coordinated examination was summarized in a report available on the NASAA website, and is linked to my written statement.^x NEMO makes it more efficient for NASAA members to identify trends before they become problems, and to address regulatory gaps that may emerge in the review of the data collected across jurisdictions. This efficiency inures to the benefit of retail investors and the industry alike.

The 2021 coordinated examination findings identified common deficiencies among the group of firms examined by the states. The most common examination deficiencies included registration problems, books and records inadequacies, contract issues, problematic advertising, misleading fee disclosures, custody of client funds or securities, financial disclosure problems, among others.^{xi}

The ability to gather relevant data from the regulators with boots on the ground puts NASAA in a better position to propose and advocate for effective policy solutions to address the issues facing investment advisers, IARs, and the retail investors that they serve.

Policy Support for NASAA Members

NASAA and the Investment Adviser Section can use the feedback to advocate policy that protects retail investors. Examples of policy proposals derived from effective data collection include the development of model rules for states to adopt and implement at home. Recent examples in the investment adviser space include the adoption of a model rule requiring written compliance and supervision policies and procedures,^{xii} a new IAR continuing education requirement,^{xiii} and a proposed qualification examination validity extension program to work in tandem with the IAR continuing (IAR CE) education program.^{xiv}

The policies and procedures model rule lays out specific written policies that investment advisers must adopt, implement, and enforce.^{xv}

The data collected consistently showed that advisers had deficiencies that could be prevented in the future through properly tailored policies and procedures. The policies and procedures model rule includes a compliance grid created by members of NASAA's Investment Adviser Section that is intended to be a starting point for advisers to consider what common topics may apply to their own practices.^{xvi} These tools help to inform investment advisers of the activities they should address in their policies and procedures, and to minimize the risk of a deficiency that could lead to investor harm. Everybody benefits when effective policies and procedures reduce risks to Main Street investors.

In the same way that an educated investor is more likely to make rational and informed investment decisions, an educated investment professional is more likely to provide better services to the investing public. The IAR Continuing Education program adopted by the NASAA membership in November of 2020 will help investment advisers to better serve their clients.^{xvii} The model rule, when adopted by jurisdictions, requires twelve hours of continuing education credit for IARs who are registered in the jurisdiction.^{xviii} This requirement applies to all registered IARs, whether they work for a state-registered or federal covered firm.

The twelve credits are divided into two six-credit components: the Ethics and Professional Responsibility Requirement and the Products and Practice Requirement.^{xix} To avoid duplicative continuing educational requirements, the Products and Practice Requirement can be satisfied by complying with FINRA's CE requirements for agents of FINRA-member broker-dealers.^{xx} Similarly, continuing education taken by individuals to maintain a credential that qualifies for a qualification examination waiver may also qualify for IAR CE credits under certain circumstances.^{xxi}

Credits taken above the annual requirement do not carry forward from year-to-year.^{xxii} An IAR who fails to complete twelve hours in a reporting period is eligible to re-register, but will re-register in a status of “CE inactive” as a means of reminding the individual, notifying their firm, and letting the public know.^{xxiii} If the IAR fails to make up the credits from the first reporting period and to complete all required credits in the second reporting period (a total of 24 credits across two years), then the IAR will not be eligible to renew their registration at the close of the second year, and be unable to conduct business.^{xxiv} IARs are responsible for ensuring that the continuing education that they complete is reported, and they are able to do so through FINRA’s FinPro system.

As of today, eleven jurisdictions^{xxv} have adopted the model rule, and others have proposed it. NASAA maintains an information center on its website listing the jurisdictions with IAR CE requirements and a resource page with updated FAQs and other relevant information. IARs are one of the few categories of financial professionals who, until implementation of IAR CE by a jurisdiction, have no continuing education requirements to maintain their registered status. Broker-dealer agents, mortgage brokers, insurance salespeople, accountants and other financial professionals are all required to perform some level of continuing education to keep up on trends in their industries and to maintain licensure.

With IAR CE, NASAA members have a tool to ensure that IARs maintain their knowledge of ethics, regulatory requirements, products, and practices within the securities industry. Enhanced knowledge of these important matters among IARs will benefit retail investors too.

NASAA has also proposed a model rule to extend validity of an IAR’s qualification examination when not employed by or associated with an investment adviser. Presently, when an individual is not employed as an IAR with a firm, their examination validity expires two years after they leave their employment. While not yet adopted by NASAA or any member jurisdiction, the rule proposal would allow an IAR to maintain the validity of their examination for up to five years so long as they are eligible for enrollment, they enroll in the program, and they comply with continuing education requirements imposed by the IAR CE rule. If adopted by NASAA and in NASAA-member jurisdictions, the model rule would align IAR qualification examination validity rules with FINRA’s new Maintaining Qualifications Program (MQP) for broker-dealer agents, as well as a recently adopted NASAA model rule^{xxvi} that mirrors FINRA’s MQP for broker-dealer agent examination requirements imposed by NASAA members that adopt the rule.

The flexibility created by the rule would permit industry professionals to step away from work without jeopardizing their qualifications, and without having a negative impact on the important investor protection policies advocated by NASAA and its members.

Michigan

My home state of Michigan has taken advantage of the tools created by NASAA that I have described here today. Our examiners use the NEMO examination tool to conduct, record, and store examination data, including for NASAA’s coordinated examinations. Currently, Michigan

examiners use a hybrid approach to conduct examinations, performing some on-site, and some remotely. The tools provided by NASAA makes Michigan's examinations more efficient and effective.

The most common deficiencies found in Michigan include many of the same ones cited in the 2021 coordinated examinations, with registration failures^{xxvii} being a common recurring issue. Michigan examiners routinely uncover a number of investment advisers each January that failed to renew their registrations, but continued to collect fees for the advice they provided. These registration violations are often resolved through the issuance of deficiency letters when advisers promptly correct their registration failures and notify clients of the unregistered activity. In some cases, however, remediation is not swift, disclosures to clients are lacking, and the initiation of regulatory proceedings becomes necessary.

Michigan has also adopted many of the model rules produced by NASAA's various project groups. The most recent Michigan rule adoptions involve investment advisers. In 2022, Michigan adopted both the Investment Adviser Policies and Procedures Rule and the IAR CE rule,^{xxviii} with 2023 being the first calendar year that IARs in Michigan will be required to take continuing education courses. We look forward to the investor protection benefits that these rule adoptions will provide.

The 2022 Investment Adviser Report showed that Michigan had more than 423 state-registered investment adviser firms in 2021,^{xxix} and that number is up to 581 as of February 21, 2023. This growth trend in the investment adviser space necessitates collaborative regulatory responses among the states and with the SEC. NASAA and its members will continue collaborating with each other and the SEC to advocate for and effectuate public policy that protects investors.

Conclusion

NASAA provides resources and information to its members to facilitate the effective regulation of investment advisers and IARs. These tools allow NASAA and its membership to gather relevant and important information and data to inform advocacy and policy proposals in support of NASAA's investor protection mission. The data-driven policy proposals championed by NASAA encourage better practices by investment advisers, and ensure access to fiduciary-quality advice for Main Street investors.

I encourage the SEC and its staff to continue communicating and collaborating with NASAA and its members on important policy initiatives affecting our shared regulated population. Changes to investment adviser rules and forms, like amendments to Form ADV, affect every investment adviser, regardless of size. Continuing to openly communicate and respectfully share our perspectives will inure to the benefit of all investment advisers – federal and state – and to the retail investors we all serve.

ⁱ 2022 NASAA Investment Adviser Section Report, available online at: <https://www.nasaa.org/wp-content/uploads/2022/06/2022-IA-Section-Report-FINAL-updated-05192022.pdf>.

ⁱⁱ *Id.*

iii *Id.* at 3.

iv *Id.* at 5.

v FINRA 2022 Industry Snapshot, available online at: <https://www.finra.org/rules-guidance/guidance/reports-studies/2022-industry-snapshot/representative-data>.

vi *Id.*

vii NASAA Updates Exam Resources for State Securities Examiners (November 13, 2019), available at: <https://www.nasaa.org/53161/nasaa-upgrades-exam-resource-for-state-securities-examiners/>.

viii *Id.*

ix In the same way that NASAA helps states conduct examinations, it also collaborates with the SEC to ensure a unified registration platform for the investment advisory industry. State and federal covered advisers and their representatives use the same system, the IARD, to compile and submit registration materials. NASAA's CRD/IARD Steering Committee works with the SEC and FINRA on system operations and enhancements.

x 2021 Coordinated Investment Adviser Examination Data, available online at: <https://www.nasaa.org/wp-content/uploads/2021/09/2021-Coordinated-IA-Exams-Public-Final-9-10-21.pdf>.

xi *Id.* at 4.

xii NASAA Model Rule for Investment Adviser Written Policies and Procedures Under the Uniform Securities Acts of 1956 and 2002 (November 24, 2020), available online at: <https://www.nasaa.org/wp-content/uploads/2020/07/NASAA-IA-PandP-Model-Rule-and-Sample-Compliance-Grid.pdf>

xiii NASAA Model Rule on Investment Adviser Continuing Education (Model Rule 2002-411(h) or 1956-204(b)(6)-CE) (November 24, 2020), available online at: <https://www.nasaa.org/wp-content/uploads/2020/10/NASAA-IAR-CE-Model-Rule.pdf>.

xiv Request for Public Comment on a Proposed NASAA Model Rule for an Investment Adviser Representative Examination Validity Extension Program Under the 1956 and 2002 Uniform Securities Acts (December 2, 2022), available online at: <https://www.nasaa.org/wp-content/uploads/2022/12/NASAA-Request-for-Public-Comment-re-IAR-Exam-Validity-Model-Rule-12-2-2022.pdf>.

xv *Supra*, note xii.

xvi *Id.*

xvii *Supra*, note xiii.

xviii *Id.*

xix *Id.*

xx *Id.*

xxi *Id.*

xxii *Id.*

xxiii *Id.*

xxiv *Id.*

xxv IAR CE Member Adoption (accessed February 8, 2023), available at: <https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-representative-continuing-education/member-adoption/>.

xxvi NASAA Model Rule: Examination Requirements for Broker-Dealer Agents (Adopted September 18, 2022), available online at: <https://www.nasaa.org/wp-content/uploads/2022/09/NASAA-Model-Rule-Examination-Requirements-for-Broker-Dealer-Agents-9-18-2022.pdf>.

xxvii *Supra*, note ix.

xxviii Mich. Admin. R. 451.4.21, available online at: https://www.michigan.gov/lara/-/media/Project/Websites/lara/cscl/NonImages_new/Securities/MUSA_Rules_Eff_2162022.pdf?rev=06808390e4104108b77a5d0f1ed6c2be.

xxix *Supra*, note i, at 2.