Summary of Investment Adviser Oversight Act of 2012

On April 25, 2012, House Financial Services Committee Chairman Spencer Bachus (R-Ala.) introduced the "Investment Adviser Oversight Act of 2012," which would require all SEC and state-registered investment advisers to become members of an investment adviser "national investment adviser association" (self-regulatory organization or SRO). The bill is based on the 1938 law that led to the creation of NASD (now FINRA) and would grant broad rulemaking, inspection, and enforcement authority to any "national investment adviser association" that is approved by the SEC.

The bill mirrors the draft investment adviser SRO legislation that Bachus issued in September 2011 in many respects. However, the bill includes some significant changes, including expanding the type of advisers exempt from SRO membership requirements, requiring an SRO to conduct a cost-benefit analysis before adopting any new rules, and exempting state-registered investment advisers from SRO examination if the state in which they are based examines its advisers every four years.

Exemptions from IA SRO. The bill would exempt certain SEC-registered investment advisers with primarily institutional and very high net worth clients from being subject to an SRO. Specifically, the requirement to become a member of an SRO would not apply to (1) any investment adviser one or more of whose clients is a registered investment company; or (2) any investment adviser if 90% of its total assets under management are attributable to *one or more* of the following types of clients with which the adviser has a written investment advisory agreement:

- Qualified purchasers under the Investment Company Act (IC) (e.g., clients that in the aggregate own at least $5,000,000 in investments
- Private funds (hedge funds, private equity or venture capital funds) that rely on Section 3(c)(1) or 3(c)7 of the ICA
- Collective trust funds under Section 3(c)(11) of the ICA
- Charitable investment funds under Section 3(c)(10) of the ICA, or
- Certain other institutional clients, including mortgage REITs under Section 3(c)(5) of the ICA, issuers of asset-backed securities (Rule 3a-7 under the ICA), employee securities companies, business development companies, SEC-registered or state-registered investment advisers, SEC-registered broker-dealers, and certain clients not in the U.S.

Affiliated Advisers. In addition to the exemptions listed above, an investment adviser that is controlling, controlled by, or under common control with one or more advisers described above (affiliated advisers) would be excluded from SRO membership requirements if the excluded advisers and the affiliated advisers have combined assets under management 90% of more of which are attributable to one or more of the types of clients above, unless the SEC by order determines that the affiliated adviser is an "independent affiliate."

An “independent affiliate” is any affiliated adviser with “compliance programs, operations and businesses that are sufficiently independent” from those advisers exempted above such that membership by the affiliated adviser in an SRO is necessary for the protection of investors.

Rulemaking, Licensing, and Disciplinary Authority of IA SROs. Under the revised bill, the SRO rules must be designed to promote “business conduct standards” for its members consistent with their obligations to investors and must be consistent with the fiduciary standards applicable to investment advisers under the Advisers Act or state law, and do not unnecessarily duplicate, overlap or conflict with such laws. The rules must provide for periodic examinations of its members and their associated persons and “establish appropriate procedures to register persons associated with members, to require supervisory systems for members and their associated persons, and to discipline its members” and associated persons.

SRO Cost-Benefit Analysis in Rulemaking. Under the bill, the SRO would have authority to enforce the Advisers Act and rules thereunder and any rules of the SRO and would have to establish disciplinary procedures to do so. SRO rules would have to be approved by the SEC after notice and opportunity for comment and a cost-benefit analysis conducted by the SRO. The bill provides for notice-and-comment rulemaking under the Administrative Procedures Act in certain instances.

SEC Oversight of SRO. The SEC would have to conduct annual inspections of the SRO to ensure it complies with the Advisers Act and its rules and regulations.