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NASAA

November 22, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC Study on Enhancing Investment Adviser Examinations under Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. ("NASAA") appreciates the opportunity to comment on the study required by Section 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Act"), which requires the Securities and Exchange Commission ("Commission") to review and analyze the need for enhanced examination and enforcement resources for investment advisers through the designation of one or more self-regulatory organizations ("SROs"). NASAA fully appreciates Congressional desire to examine and improve regulatory effectiveness especially in the wake of recent financial turmoil. However, NASAA firmly believes that when it comes to the important subject of investment adviser regulation, there is no regime superior to the governmental collaboration between the states and the Commission.

As my colleagues and I expressed during our meeting with Commission staff on November 4, the states have a proven track record in the area of investment adviser regulation. Further, NASAA is confident that state securities regulators will continue to marshal the examination and enforcement resources necessary to effectively regulate the Investment Adviser population subject to their oversight. While state investment adviser examination programs and resources are documented in significant detail in the comprehensive report that NASAA previously provided the Commission in support of the Act's Section 913 study[1], some significant findings from that report include:

- States employ more than 400 experienced employees dedicated to the licensing and examination function, including field examiners, auditors, accountants, and attorneys. More than half of the states that reported qualitative staffing data indicate an average

1 *Available at* http://www.sec.gov/comments/4-606/4606-2789.pdf

staff experience exceeding ten years, with a heavy concentration of personnel in the five- to fourteen-year range.

- State investment adviser examination totals have progressively increased each year for the past five years resulting in a 20 percent increase in the total number performed this year-to-date as compared to 2006. As of August 2010, states had already completed 2,463 on-site examinations of investment adviser registrants.
- The majority of state routine (non-cause) investment adviser examinations are performed on a formal cyclical basis. All states that adhere to a formal cycle audit their entire investment adviser registrant populations in six years or less. Half of the states complete the examinations on three-year-or-less cycles.

Similarly, the Commission should be given the examination and enforcement resources it needs to frequently and comprehensively examine the activities of investment advisers subject to its oversight. As the total number of investment adviser registrants subject to Commission oversight will soon be reduced by approximately 4,000 firms (approximately a 36 percent decrease), previous concerns expressed by Commissioners and other commentators prior to the Act regarding examination resources should be allayed.[2] Moreover, to the extent the Commission requires additions to or reassignments of resources to perform investment adviser examinations, Section 991 of the Act authorizes a $1 billion increase in the Commission's budget over the course of the next four years, enabling the Commission to augment and redistribute its resources as needed in the future.

The issue of examining firms registered as both investment advisers and broker-dealers poses no problems to government regulators. Both the states and the Commission have authority to examine these entities regardless of their registration status. In addition, SEC Division Directors, in recent testimony before Congress[3], noted the Commission's Office of Compliance Inspections and Examinations has already instituted several significant measures to integrate the activities of the broker-dealer and investment adviser examination programs.

In light of the anticipated increase in budget and resources for the Commission and the concurrent decrease in investment adviser firms that will be registered with the Commission, the question of designating one or more SROs over investment advisers to improve the frequency of Commission examinations is not yet ripe for consideration.

However, should the Commission introduce the question of an SRO for investment advisers, NASAA would urge the Commission to conclude that investment adviser regulation is a governmental function that should not be outsourced to a private, third-party organization that

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2 NASAA recognizes that Commission resources are constrained at the moment in order to meet all of the deadlines imposed by the Act and that fewer examinations will take place this year as a result. It does not follow, however, as suggested by others, that the Commission should be expected to examine only nine percent of registered investment advisers in the future. With significantly fewer investment advisers and increased staffing and budgets moving forward, NASAA is confident that the Commission will have the capacity to adjust its program to allow timely and thorough examination of investment advisers.

3 See Testimony by Robert Khuzami, Director, Division of Enforcement, and Carlo di Florio, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Sept. 22, 2010, available at http://www.sec.gov/news/testimony/2010/ts092210rk-cd.htm.

does not have expertise or experience with investment adviser regulation. Securities regulation in general and investment adviser regulation in particular is best left with governmental regulators that are transparent and directly accountable to the investing public. One can readily conclude that the designation of an SRO for the oversight of investment advisers, with its attendant direct and indirect costs, its opaque structure and attendant lack of accountability and transparency, would outweigh any perceived benefits to the investing public.

The chief concerns the states have with the designation of an SRO for the oversight of investment advisers are the collaboration, transparency, accountability, and conflict issues that have always been inherent to the SRO model. While industry SROs had historically worked as a partner with the Commission and the states (creating what was referred to as the "three-legged stool" of regulation), this model recently changed based on an over-broad construction of the "government actor doctrine". To avoid a classification as a "government actor", the relevant SRO has restricted the release of information to the government and has affirmatively taken the position that it is prohibited from active collaboration with governmental regulators, including the governmental entity responsible for its oversight. As such, previous synergies with the SRO have been lost, and it has become increasingly difficult for the governmental regulators to meaningfully control oversight or investigations over registrants subject to the current SRO model.

Collaboration issues aside, the regulatory work performed by SROs lacks transparency. Although SROs have been performing governmental functions for decades, they are not subject to similar Freedom Of Information Act (FOIA) and public records requirements as are the Commission and state securities regulators. Even where there is public disclosure by SROs regarding members, as in the case of BrokerCheck, the SRO has placed limitations and filters on regulatory records that far exceed FOIA provisions. The end result is that vital information is withheld from the investing public. Without greater transparency, investors cannot obtain the information they need to make informed decisions.

Finally, the current SRO model raises accountability and conflict concerns. Even where there is an independent Board of Directors, SROs remain organizations built on the premise of self-rule and are, as a matter of first principle, accountable to their members rather than the investing public. Ultimately, no matter how many safeguards are instituted, an SRO has substantial conflicts of interest that governmental regulators do not. This is particularly true in situations where industry and investor interests conflict, as in the case of mandatory pre-dispute arbitration clauses and the disclosure or expungement of historical settlements, judgments, and investor claims. Ultimately, SROs simply cannot match the accountability of government regulators, nor the proximity and familiarity of state regulators, in particular, when considering investor protection and regulatory thoroughness.

At a time when securities regulators must strengthen their regulatory resolve and contribute to investor confidence, the strongest signal that the Commission can send to Congress and to the investing public is to soundly reject the notion that it cannot effectively regulate the investment adviser firms subject to its oversight. Accepting full responsibility for these functions is not always easy, particularly in economic climates such as these, but it is a role the Commission and states have proudly accepted and served for decades. Investors should expect and deserve no less in the years to come.

In sum, NASAA urges the Commission to join me and my fellow state securities regulators in reaffirming our commitment to investors by retaining full jurisdiction over investment adviser registrants. If there is anything that NASAA or the states can do to assist the Commission as we continue to meet this challenge, please do not hesitate to ask.

NASAA appreciates this opportunity to comment and to contribute to the study, and looks forward to working with the Commission in the future.

Should you have any questions regarding these comments, please contact the undersigned or Rex Staples, NASAA's General Counsel at rs@nassa.org.

Yours,

David Massey
NASAA President
North Carolina Deputy Securities Administrator

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
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