Investment Adviser Regulation Post-Madoff: A Brave New World

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I. Introduction

An investment adviser is defined as any person that is in the business of providing investment advice regarding securities for a fee. Investment advisers, depending on various factors, can be registered and regulated on either the federal or state level. The need for rules and regulations on the federal level was recognized by Congress in 1935 and ultimately resulted in the enactment of the Investment Advisers Act of 1940 (“Advisers Act”). Since its enactment in 1940, the Advisers Act has undergone several fairly significant changes. The most recent significant amendments to the Advisers Act and the regulation of investment advisers were various provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

The Advisers Act can generally be divided into five substantive areas of regulation. These areas of regulation include: (1) investment adviser registration regulation.
quirements and related exemptions from registration, (2) an investment adviser’s disclosure obligations, (3) prohibited conduct and activities of investment advisers, (4) anti-fraud measures, and (5) the provision of an inspection and enforcement mechanism. Dodd-Frank changes each of these areas in varying degrees. One of the more significant changes relates to investment adviser registration and the elimination of a long-standing, and frequently used, exemption from registration referred to as the “private adviser exemption.” The elimination of this exemption will cause a large number of advisers that have historically been exempt from registration to now be registered (absent the availability of some other exemption) with the Securities and Exchange Commission (“SEC”). Dodd-Frank does offer some reprieve to the formerly unregistered private adviser by also creating several other exemptions including an exemption for: private advisers that have less than $150 million in assets under management, advisers who solely advise venture capital funds, certain foreign private advisers, and family offices. The ultimate usefulness of these “reprieves” to those advisers now facing the possibility of having to register, however, has yet to be determined.

Another change to investment adviser registration requirements relates to the determination of whether an adviser is eligible to register with a state or the SEC. Dodd-Frank effectively adjusts the balance of responsibility between the states and the SEC by increasing the minimum assets under management required for federal registration. Today, an investment adviser with $30 million in assets under management is required to register with the Commission. Under Dodd-Frank, that minimum is substantially increased to $100 million. As a result, certain investment advisers that have less than $100 million will be required to register with the states.

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7. See id. §§ 80b-3, 80b-4, 80b-6, 80b-7, 80b-9.
8. See infra notes 9–26 and accompanying text.
9. See id. § 403 (eliminating the “private adviser exemption” from 15 U.S.C § 80b-3(b)(3) (2006)).
12. See id. § 410.
13. Id.
15. Dodd-Frank Act § 410.
16. Section 410 of Dodd-Frank effectively raises the federal eligibility thresholds by prohibiting SEC registration unless the investment adviser has more than $100 million of assets under management, in which case the adviser is required to register with the SEC, unless an exemption is available. Id. If, however, the adviser has between $25 million and $100 million of assets under management and is not subject to registration and examination by its home state, then it is required to register with the SEC, notwithstanding that it fails to meet the $100 million threshold. 15 U.S.C. § 80(b)-3(a)(1) (2006), amended by Dodd-Frank Act § 410. In addition, if an adviser with between $25 million and $100 million of assets under management is otherwise required to register...
Dodd-Frank also attempts to resolve a long-standing debate regarding the conflicting standards of duty applicable to investment advisers under the Advisers Act and to broker-dealers under Securities Exchange Act of 1934 (the “Exchange Act”).17 Broker-dealers have often been viewed as a close relative of the investment adviser yet they are each subject to different standards of duty.18 While both may provide investment advice to customers,19 only investment advisers have a fundamental obligation as fiduciaries to act in the best interests of their customers.20 In the past, the SEC conducted studies regarding the investment advisory services offered by broker-dealers.21 Dodd-Frank attempts to put a long overdue end to this debate by granting the authority to the SEC to promulgate rules that would impose a “fiduciary duty” on broker-dealers when providing personalized investment advice to retail customers.22 Along with this rulemaking authority, the Commission was also required to conduct a study regarding the efficacy of a broker-dealer’s existing standard of care.23 The study concluded that a uniform fiduciary standard of care should be implemented for both investment advisers and broker-dealers when...
providing investment advice to retail customers. What this standard will inevitably look like and how it will impact broker-dealers and investment advisers is still a question.

In the sections that follow, we provide a more depth analysis of Dodd-Frank’s impact on investment advisers particularly with respect to registration, disclosures, and the exemptions from registration. In addition, we will take a closer look at the broker-dealer fiduciary standard of care and examine the implications of an asset manager or private adviser being deemed “systemically important” as defined under Dodd-Frank.

II. Dodd-Frank Provisions Affecting Investment Advisers

A. Dodd-Frank and Investment Management

Dodd-Frank implemented sweeping changes to America’s financial regulatory regime. The law contains several amendments to the Advisers Act, many of which will significantly alter regulatory and disclosure requirements for investment advisers. This section summarizes these changes.

B. Elimination of the Private Adviser Exemption

Arguably, the most dramatic change to the oversight of investment advisers is the elimination of the private adviser exemption formerly found in Section 203(b)(3) of the Advisers Act. This exemption allowed an adviser to avoid registration with the SEC if the adviser had fewer than 15 clients during the preceding twelve months, did not hold itself out publicly as an investment adviser, and did not advise certain registered investment companies. This exemption was used by many private funds

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25. See infra Part II.A.—E.
26. See infra Part II.F & note 27 and accompanying text.
27. See, e.g., Damian Paletta & Aaron Lucchetti, Law Remakes U.S. Financial Landscape—Senate Passes Overhaul That Will Touch Most Americans; Bankers Gird for Fight Over Fine Print, WALL ST. J., July 16, 2010, at A1 (describing the Dodd-Frank Act as “touching every corner of finance” and “the biggest expansion of government power over banking and markets since the Depression”).
28. See generally Dodd-Frank Act, §§ 401–416 (amending regulatory and disclosure requirements under the Advisers Act).
29. Id. at § 403 (explaining that private advisors are eliminated from the exemption by inserting, “other than an investment adviser who acts as an investment adviser to any private fund,” immediately after “any investment advisor” in the Advisers Act).
to avoid SEC investment adviser registration.\textsuperscript{31} Based on SEC rules, private funds were permitted to count each fund advised by the investment adviser as a single client for purposes of determining how many clients the adviser had under Section 203(b)(3).\textsuperscript{32}

Although Dodd-Frank eliminates this exemption,\textsuperscript{33} it includes several new exemptions from investment adviser registration that are discussed below.

C. New Registration Exemptions

1. Private Advisers with Less than $150 Million Under Management

Dodd-Frank creates a new registration exemption for advisers that only manage private funds and have less than $150 million in aggregate assets under management in the United States.\textsuperscript{34} The term "private fund" includes any investment fund that is excepted from the definition of an investment company pursuant to either Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, which includes most U.S. hedge funds and private equity funds.\textsuperscript{35} Advisers eligible for the new exemption will still be subject to certain recordkeeping and reporting requirements which have yet to be finalized by the SEC.\textsuperscript{36}

\textsuperscript{31} See Jessica Natali, Trimming the Hedges is a Difficult Task: The SEC’s Attempt to Regulate Hedge Funds Falls Short of Expectations, 15 U. MIAMI BUS. L. REV. 113, 122 (2006–07) ("[H]edge fund advisors are permitted to manage up to 14 hedge funds without registering with the SEC, controlling the investments of an unlimited number of investors holding limited partnership interests in the various funds.").

\textsuperscript{32} See Dodd-Frank Act § 403 (replacing paragraph (3) of § 203(b) with "any investment adviser that is a foreign private adviser"). Under § 203(b)(3) of the Advisers Act, those excluded from being defined as clients of investment advisers included shareholders, partners, and business owners of business development companies as long as those individuals were clients separate of their respective roles. 15 U.S.C. § 80b–3(b)(3) (2006). See also Andrew J. Donohue, Director, Division of Investment Management, Speech by SEC Staff: Regulating Hedge Funds and Other Private Investment Pools, U.S. Securities & Exchange Commission (Feb. 19, 2010), http://www.sec.gov/news/speech/2010/spch021910ajd.htm (proposing that section 203(b)(3) of the Advisers Act was intended to exempt small advisors, but now it serves to exempt advisors who manage billions of dollars because of the ability to count a single fund as a client).

\textsuperscript{33} See Dodd-Frank Act § 403 (eliminating the private advisor exception of Section 203(b) of the Investment Advisers Act).

\textsuperscript{34} Id. § 408.

\textsuperscript{35} Id. at § 402(a)(29). See also Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. 77190–91 (proposed Dec. 10, 2010) (to be codified at 17 C.F.R. pt. 275) ("Private funds include hedge funds, private equity funds and other types of pooled investment vehicles that are excluded from the definition of ["investment company"][" under the Investment Company Act of 1940."]).

\textsuperscript{36} See Dodd-Frank Act § 408 (stating exempted investment advisors must keep records and make annual reports to the Commission to the extent deemed necessary to protect public interest or investors).
2. Venture Capital Advisers

Advisers who solely advise "venture capital funds" will also be exempt from registration requirements under the Advisers Act. Congress did not define "venture capital fund," instead directing the SEC to define the term within a year of Dodd-Frank's passage. In November 2010, the SEC proposed a detailed and relatively narrow definition that may make it difficult for advisers to take advantage of the exception, with a similarly limited grandfathering provision. The comment period for the proposed definition closed in late January 2011, and it is unknown whether the SEC will propose any amendments to the proposed definition. Notably, the SEC has currently proposed that exempt venture capital advisers still be required to comply with a variety of recordkeeping and reporting requirements.

3. Foreign Private Advisers

Dodd-Frank creates a category of investment adviser called "foreign private advisers," who are also exempt from registration requirements. A foreign private adviser is defined as: (1) having no place of business in the United States, (2) fewer than 15 (in total) U.S. clients and U.S. investors in private funds, (3) less than $25 million in assets under management.

37. See id. § 407 (stating that an investment advisor who only manages venture capital funds will not be subject to registration requirements).
38. See id. (indicating Congress allowed the SEC to determine the definition of "venture capital fund").
39. Id.
42. See Dodd-Frank Act § 407 (noting that even exempt advisers must still report to the Commission to the extent that public interest or the protection of investors requires); Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. at 77192 (proposed Dec. 10, 2010) (to be codified at 17 C.F.R. pt. 275) (explaining the advisers subject to the exemption may still have their books and records examined).
43. See Dodd-Frank Act §§ 402(a)(30) and 403 (defining "foreign private advisers" and adding foreign private advisers to Section 203(b)(3) of the Investment Advisers Act as exempt from registration).
lion under management from U.S. clients and U.S. investors in private funds, (4) does not hold itself out generally to the U.S. public as investment advisers, and (5) does not serve as an adviser to any registered investment company or business development company.44

For the purpose of counting clients under the new exemption, foreign advisers will have to “look through” their private funds and count each individual U.S. investor separately, as opposed to the former counting requirements which allowed advisers to count an entire fund as a single client.45 Foreign advisers qualifying for the exemption will not be subject to any reporting or recordkeeping requirements, in contrast to exempt private fund advisers and venture capital fund advisers.46

The rules proposed by the SEC regarding the foreign private adviser exemption would make the exemption broader than it would appear, for example, allowing a foreign adviser whose U.S. office provides advice solely to private funds and has aggregate assets under management in the U.S. of less than $150 million to rely on the $150 million private fund exception discussed above.47 However, the SEC proposed that these foreign advisers still be subject to certain recordkeeping and reporting requirements.48

4. Family Offices

A “family office” is excluded from the definition of “investment adviser” and is not subject to regulation under the Advisers Act.49 Dodd-Frank directs the SEC to define the term “family office,” and the SEC has proposed a definition which would

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44. Id.

45. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. at 77192 (proposed Dec. 10, 2010) (to be codified at 17 C.F.R. pt. 275) (explaining that an advisor will use facts and circumstances to determine the number of investors); Donohue, supra note 32 (describing how an entire fund could be counted as a single client).

46. See Dodd-Frank Act § 407 (required venture fund advisors to maintain records); Id. § 408 (requiring exempt private fund advisors to maintain records); Changes to the U.S. Investment Advisers Act Affecting Non-U.S. Private Fund Advisers with Compliance Deadline of July 21, 2011, REED SMITH (Feb.10, 2011), http://www.reedsmith.com/publications/search_publications.cfm?widCall1=customWidgets.content_view_1&cit_id=30407 (explaining foreign private advisers currently have no registration or reporting requirements); see generally, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. at 77190–77227 (discussing the foreign private advisers exemption under Dodd-Frank).

47. See generally Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. at 77190–77227 (discussing the foreign private advisers exemption and the $150 million private fund exception under Dodd-Frank).

48. Id. (“We are proposing a new rule, rule 204–4, to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.”).

49. See Dodd-Frank Act § 409 (adding “family office” to the investment adviser exemption).
require a “family office” to (1) have no clients other than “family clients,” (2) be wholly owned and controlled by family members, and (3) not hold itself out to the public as an investment adviser. “Family clients” would include family members and certain entities connected to family members.

D. State vs. Federal Registration

Dodd-Frank reallocated the balance of regulatory responsibility between state and federal securities authorities. Currently, investment advisers with $30 million or more under management are generally required to register with the SEC, while those with $25 to $30 million may elect to register with the SEC or applicable state regulatory authorities. Under Dodd-Frank, an investment adviser would be prohibited from registering with the SEC if it has between $25 million and $100 million and is required to register, and registration subjects it to examination, in its home state, unless the adviser would be required to register with 15 or more states or advises a registered investment company. Essentially, the bar to registration has been raised to $100 million in assets under management. Investment advisers with between $25 and $100 million are generally subject to state regulation.

E. Expanded Recordkeeping and Disclosure Requirements

Dodd-Frank gives the SEC authority to create wide-ranging recordkeeping and disclosure requirements for certain investment advisers. The SEC has proposed a va-
riety of rules pursuant to its authority, one of which would amend the existing Form ADV to require registered advisers to private funds to disclose increased information about their funds. This information would include the fund’s value, the types of investors in the fund, and information about other individuals associated with the fund. Registered private advisers would also have to fill out a new form called Form PF, which would require the disclosure of certain ‘census-type’ information about their funds and assets. The SEC has proposed a new rule and form to implement this Dodd-Frank mandate. The proposal is far-reaching and includes disclosures regarding information that usually is considered confidential and proprietary by private funds. The information will, among other things, permit regulatory agencies to determine risk to the U.S. financial system.

Advisers qualifying for either the venture capital or private fund adviser exemptions would also be subject to disclosure requirements under Form ADV. These unregistered advisers would be required to disclose, among other things, basic identifying information, form of organization, other business activities, disciplinary history, financial industry affiliations, and control persons.

F. Broker-Dealer Fiduciary Study

Dodd-Frank directs the SEC to study the effectiveness of existing legal or regulatory standards of care for brokers, dealers and investment advisers. The same study must also examine whether there are legal or regulatory gaps or shortcomings in existing standards of care for the protection of customers. The SEC conducted the study and released its findings in late January 2010, recommending a uniform fiduciary standard of care for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. It is not yet

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59. Id. at 77,064–66.
61. Id. at 8068.
62. Id. at 8071.
63. See id. at 8069–70 (describing how information collected on the Form PF will provide important information regarding operations and strategies of private funds).
65. Id. at 77,063.
66. See Dodd-Frank Act § 913(b).
67. Id.
68. See SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, supra note 24 at ii.
clear if or when the SEC will propose a rule implementing the recommended uniform fiduciary standard.69

III. VARIOUS ASPECTS OF THE DODD-FRANK ACT THAT IMPACT THE INVESTMENT MANAGEMENT INDUSTRY

A. Registration

1. Hedge Fund Managers

The elimination of the private adviser exemption will cause various private fund advisers to register with the SEC and be subject to regulatory and disclosure standards.70 This will be a major shift for the private fund industry and the SEC. Historically, private funds and their advisers have been exempt from most securities registration, regulatory, and disclosure requirements.71 In the same vein, the SEC has not had to examine or otherwise supervise private funds and their advisers.72

Private funds historically have been reticent to disclose much information about their investment philosophy and investors.73 After Dodd-Frank, many private fund advisers will be required to, among other things, register with the SEC, complete Form ADV (which is a public document), complete Form PF (which is not a public document), maintain a code of ethics, institute compliance programs, and maintain certain books and records.74

2. Non-U.S. Investment Advisers

After Dodd-Frank, many non-U.S. investment advisers will have to consider if they will be subject to investment adviser registration with the SEC if they have U.S.

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69. See Jessica Holtzer, SEC Study Lifts Bar for Brokers, WALL ST. J., Jan. 24, 2011, at C4 (indicating opposition to the uniform fiduciary standard, which may impede implementation efforts).

70. See Rules Implementing Amendments to the Investment Advisers Act of 1940, 75 Fed. Reg. at 77,053. As discussed earlier, Dodd-Frank exempts private fund advisers managing less than $150 million from registration. See supra text accompanying notes 34–36.

71. See id. at 77,053 (“Title IV repeals the ‘private advisor exemption’ contained in section 203(b)(3) of the Advisers Act under which advisers, including those to many hedge funds, private equity funds and venture capital funds, had relied in order to avoid registration under the Act and our oversight.”).

72. Id.

73. See Steve Eder, Global Finance: Managing Money, In ‘Plain English’—Disclosing Fees, Histories in Clear Prose; 'Try Personal Pronouns,' SEC Advises, WALL ST. J., Mar. 14, 2011, at C3 (discussing the dramatic impact of new disclosure requirements on private funds, such as hedge funds, who have never registered with the SEC).

clients or have U.S. investors in private funds managed by the adviser.\textsuperscript{75} Prior to Dodd-Frank, many non-U.S. advisers addressed U.S. registration obligations by complying with the private adviser exemption or various SEC staff interpretations. After Dodd-Frank, many non-U.S. advisers will have to subject themselves to increased U.S. regulation or limit their services to non-U.S. persons.\textsuperscript{76}

B. State v. Federal Registration

The new registration requirements outlined in Dodd-Frank will reallocate the registration and regulation of investment advisers between the SEC and the various states.\textsuperscript{77} As outlined above, the criteria to qualify for SEC registration were changed by Dodd-Frank and Congress did not provide a grandfather provision for advisers currently registered with the SEC who will no longer meet the new registration criteria under Dodd-Frank.\textsuperscript{78} These investment advisers will have to deregister with the SEC and determine if they will be required to register in one or more states.\textsuperscript{79} This is a significant change for these investment advisers as they will have to review the laws of each state where the adviser is physically located or has clients.\textsuperscript{80} Each state will have its own registration requirements and rules and regulations.\textsuperscript{81} While the SEC has attempted to mitigate this problem by permitting federal registration for advisers who must register with 15 or more states, many advisers may not qualify for the exemption and, in any event, will be required to review various state laws to determine if they will be required to register in those states and maintain a system to track when the adviser expands into a new state.\textsuperscript{82}


\textsuperscript{77} See supra text accompanying notes 12–16.

\textsuperscript{78} See Rules Implementing Amendments to the Investment Advisers Act of 1940, 75 Fed. Reg. at 77,053.

\textsuperscript{79} Id. (“This provision will require a significant number of advisers currently registered with the Commission to withdraw their registrations with the Commission and to switch to registration with one or more State securities authorities.”).

\textsuperscript{80} Id. at 77,060–61.

\textsuperscript{81} Id. at 77,060 & n.98, 77,061 & nn.109–10 (discussing the state requirements for investment advisers to register and for states to report to the Commission if advisers in the state will no longer be subject to examination).

\textsuperscript{82} Id. at 77,053–54, 77,059–60, 77,074.
C. Disclosure

On an annual basis, private fund advisers that are required to be registered with the SEC will also be required to file the newly created Form PF.\footnote{See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 8068, 8,071, 8,078 (Feb. 11, 2011) (to be codified at 17 C.F.R. pt. 275).} The Form PF requests “basic” information from all private fund advisers including identifying information, assets under management, and the amount of assets attributable to certain types of funds.\footnote{Id. at 8,079.} In addition, private fund advisers that manage hedge funds will be required to provide additional information regarding, for example, investment strategies, counterparty exposure and trading and clearing mechanisms.\footnote{Id. at 8,078.} The required frequency of reporting and updating depends on the size of the private fund adviser and the types of funds being managed.\footnote{Id. at 8,071–72, 8,075, 8,078.} Private fund advisers who have less than $1 billion in assets under management would be required to file Form PF annually.\footnote{See id. at 8075 (proposing three types of Large Private Fund Advisers including advisers who manage hedge funds of at least $1 billion, advisers managing a liquidity fund of at least $1 billion, and advisers managing private equity funds of at least $1 billion).} On the other hand, large private fund advisers—\textit{i.e.}, those with at least $1 billion in assets under management—would be required to file Form PF quarterly and provide more detailed information.\footnote{Id. at 8,077.} This $1 billion threshold will apply to advisers of hedge funds and private equity funds.\footnote{Id. at 8,077–78.}

Advisers that only provide advice to private funds and have less than $150 million in assets under management and advisers that solely provide advice to venture capital funds, that are not required to register with the Commission, will not be required to file the Form PF.\footnote{Id. at 8,071–72, 8,075, 8,078.} Such advisers would, however, be subject to separate certain reporting requirements on the Form ADV as “exempt reporting advisers.”\footnote{Id. at 8,077.} Foreign private advisers that are exempt from registration, on the other hand,
would not be required to file Form PF and will not need to comply with the Form ADV reporting requirements.92

Ultimately, the changes effected by Dodd-Frank are likely to materially increase the costs of compliance and may cause certain investment advisers, such as non-U.S. advisers, to decline to manage the assets of U.S. investors. The increased costs associated with implementing Dodd-Frank will likely be passed on to the investors.

D. Broker-Dealers v. Investment Advisers

As a result of the study mandated by Dodd-Frank to analyze the effectiveness of existing legal and regulatory standards of care applicable to brokers-dealers and investment advisers, the SEC staff recommended the adoption of a uniform federal fiduciary standard for brokers and advisers similar to that currently applied to investment advisers.93 Broker-dealers will be held to a fiduciary standard no less stringent than the existing fiduciary standard for investment advisers under Sections 206(1) and 206(2) Advisers Act.94 The staff recommends that the Commission should exercise its rulemaking authority to require broker-dealers and investment advisers to act in the best interest of their customers without regard to financial or other interests of the broker-dealer or investment adviser.95 The standard will apply “expressly and uniformly to both broker-dealers and investment advisers, when providing [personalized] investment advice about securities to retail customers.”96

Broker-dealers have historically not been viewed as “fiduciaries.”97 Investment advisers, however, are “fiduciaries” and, as a result, have an obligation to act in the

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92. See Press Release, supra note 52 (reporting that the Commission may impose reporting requirements on “exempt reporting advisers,” but not on foreign advisers that are exempt from registration).
93. See SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, supra note 24 at 107–08.
94. Id. The Supreme Court has construed Advisers Act Section 206(1) and (2) as establishing a federal fiduciary standard governing the conduct of advisers. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963) (concluding that the Investment Advisers Act of 1940 reflects Congress’ recognition that relationships with investment advisers are fiduciary in nature); see also Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979) (noting that Section 206 establishes a fiduciary relationship standard). The adviser’s fiduciary duty is enforceable under Advisers Act Sections 206(1) and (2), which prohibit an adviser from “employ[ing] any device, scheme, or artifice to defraud any client or prospective client” and from “engage[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” 15 U.S.C § 80b-6(1)–(2) (2006).
95. SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, supra note 24, at 108–09.
96. Id. at 108.
97. See id. at 106 (noting that investment advisers have traditionally not been viewed as fiduciaries under federal securities law). Yet, a broker-dealer has owed a fiduciary duty if the broker-dealer exercised control or discretion over customer assets or if a duty of trust and confidence arose between the broker-dealer and the customer. Id. at 54.
best interests of their customers.\textsuperscript{98} Broker-dealers have relied on an exemption from the definition of “investment adviser” that requires any advice provided by the broker-dealer to be incidental to the broker-dealer’s business and precludes the broker-dealer from receiving “special compensation.”\textsuperscript{99} While broker-dealers are subject to a number of duties, including among other things a duty of fair dealing and best execution, these duties do not rise to the same level as the “fiduciary” standards currently imposed on investment advisers.\textsuperscript{100}

In addition to the uniform standard, the staff also identified other areas of regulation where “harmonization” should be considered. Currently, investment advisers and broker-dealers are required to comply with different rules and regulations in a number of different areas that address the same or similar functions.\textsuperscript{101} Recognizing this, the staff, for example, recommended the issuance of consistent rules and/or guidance regarding marketing and advertising communications for both investment advisers and broker-dealers.\textsuperscript{102} In addition, the staff recommended the harmonization of rules regarding the use of finders or solicitors, customer remedies, supervisory requirements, books and records, firm registration procedures, and licensing and continuing education requirements.\textsuperscript{103} By harmonizing these areas, advisers and broker-dealers that perform similar functions will be subject to similar regulations.\textsuperscript{104}

While the Study makes strides to create fiduciary standards and to harmonize certain rules and regulations applicable to investment advisers and broker-dealers,\textsuperscript{105} there is still a long way to go before any new fiduciary standard is finalized. The completion of the study is merely one step in what could be a long process to finalize rules and regulations regarding uniform standards and harmonized rules and

\begin{footnotes}
\item[98] See id. at 106 (explaining that the investment advisers’ fiduciary duty of loyalty requires the advisers to act in the best interests of clients).
\item[99] See 15 U.S.C. § 80b-2(a)(11) (2006) (stating an investment adviser does not include “any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor”); see also SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, supra note 24, at 15–16 (noting the exclusion available to broker-dealers requires the elements of “solely incidental” services and no “special compensation”).
\item[100] See SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, supra note 24, at 54, 66, 69, 106 (recognizing broker-dealers’ duties include a duty of fair dealing, a fiduciary duty under some circumstances, a duty to disclose in certain situations, a duty to charge fair prices, and a duty to seek to obtain best execution of customer orders).
\item[101] Id. at viii–ix.
\item[102] Id. at 130–32.
\item[103] Id. at 129–39.
\item[104] See id. at 129–39.
\item[105] Id. at 107–08, 129–39 (outlining and recommending harmonization between investment advisers and broker-dealers in standards of care, conduct and several other areas).
\end{footnotes}
regulations for broker-dealers and investment advisers. As a result, the ultimate impact on broker-dealers and investment advisers is still for the most part unknown.

E. Self Regulatory Organization for Investment Advisers

Dodd-Frank also required the Commission to undertake a study to analyze the need for enhanced investment adviser examinations.106 One option raised in the Commission’s study is the creation of a self-regulatory agency (“SRO”) to oversee the activities of investment advisers.107 Today, unlike investment advisers, broker-dealers are subject to the oversight of various SROs such as the Financial Industry Regulatory Authority (“FINRA”).108 The concept of an SRO for investment advisers has been debated for several years and the Commission used the Study to continue the dialogue of an investment adviser SRO, to allocate SRO responsibility to the Financial Industry Regulatory Authority (“FINRA”), or impose user fees on the industry to pay for their oversight by the SEC’s Office of Compliance Inspections and Examinations.109

The Commission’s study also touched on a broad range of additional issues that are important to investment advisers and broker-dealers, including principal trading activities of broker-dealers once they are subject to a fiduciary standard and harmonization of broker-dealer and investment adviser regulation (e.g., record-keeping, use of finders/solicitors, and licensing of individuals).

F. Systemically Important

Dodd-Frank created the Financial Stability Oversight Council (“Council”) that, among other things, will be responsible for determining if certain non-banking financial institutions should be considered systemically important to the U.S. financial market and, therefore, should be subject to additional regulation by the Federal Reserve.110 In determining what companies should be categorized as systemically important:

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107. See SEC, STUDY ON ENHANCING INVESTMENT ADVISER EXAMINATIONS, supra note 24, at 29–30 (2011), available at http://www.sec.gov/news/studies/2011/914studyfinal.pdf (“Congress could, alternatively, authorize one or more SROs for registered investment advisers in order to provide scalable resources to support the Commission’s examination of registered investment advisers.”).

108. See id. at 1, 4, 29–31.

109. Id. at 39.

important, the Council will evaluate a set of factors that analyze the interdependence and interaction of the company with the financial market.\textsuperscript{111} Ultimately, the Council aims to determine what companies pose a threat to the financial health of the U.S. based on, among other things, the company’s size, scope, and the interrelatedness of the company’s business with the financial stability of the country.\textsuperscript{112}

Asset managers and private funds could, depending on their size and business, be determined to be systemically important by the Council and, thereby, become subject to the increased regulatory oversight by the Federal Reserve.\textsuperscript{113} The designation of a company as systemically important by the Council would subject the company to heightened regulations, which may include, among other things, minimum leverage capital requirements as well as limits on leverage, disclosure of the company’s credit exposure, stress tests, liquidity requirements and risk-management requirements.\textsuperscript{114}

1. Municipal Advisers

Dodd-Frank also created a new category of regulated entity called “municipal advisers.”\textsuperscript{115} The Commission has issued rules governing the registration and regulation of municipal advisers.\textsuperscript{116} The new municipal adviser category will encompass a broad range of persons that previously provided unregulated advice to municipal issuers and solicited business for such advisers.\textsuperscript{117} Banks, lawyers, board members, investment advisers, and many other persons who provide advice to municipalities might be subject to various aspects of this new regulatory regime.

\textsuperscript{111} Id. § 804(a)(2) (listing the factors the Council shall take into consideration including the aggregate monetary value of transactions carried out, the aggregate exposure of the financial market utility or financial institution, the relationship, interdependencies, or other interactions of the financial market utility with other financial market utilities, the effect that the failure of the financial market utility would have on critical markets, financial institutions, and any other factors the Council deems appropriate).

\textsuperscript{112} See id. § 113 (a)(1) (stating the Council may determine a non-bank financial company is subject to supervision by the Board of Governors based on the nature, scope, size, scale, concentration, interconnected, or mix of activities pose a threat to the financial stability of the United States).

\textsuperscript{113} Id. §§ 112(a)(2)(K), 113(a)(1).

\textsuperscript{114} Id. § 115(b).

\textsuperscript{115} Id. § 975.

\textsuperscript{116} Temporary Registration of Municipal Advisors, Exchange Act Release No. 34-62824, (Sept. 1, 2010).

2. Derivatives

Dodd-Frank also drastically impacted the regulation of over-the-counter derivatives. This previously unregulated market now is subject to new product registration and central clearing requirements. In addition, traders in these instruments may be subject to new registration requirements. Development of new rules governing this market are being drafted by the Commission and CFTC. Investment advisers need to remain aware of developments in this area.

IV. Conclusion

While Dodd-Frank offers some of the most sweeping regulatory changes to the U.S. financial industry since the 1940’s, the ultimate impact on the financial industry is still largely unknown. Many of the regulations promulgated under Dodd-Frank require the Commission to undertake additional studies and issue rules. As a result, while Dodd-Frank is certain to have an impact, and in some ways already has, the full extent of that impact and the resulting improvements may not be known for some time.

118. See Title VII of the Dodd-Frank Act.
120. See Damian Paletta & Aaron Lucchetti, supra note 27 and accompanying text.
121. See Elisse B. Walter, Commissioner, Sec. Exch. Comm’n., Remarks Before the 43rd Annual Securities Regulation Seminar (Oct. 29, 2010), http://www.sec.gov/news/speech/2010/spch102910ebw.htm (highlighting that the Dodd-Frank Act required more than 100 rulemakings and more than 20 studies by the SEC).