

KITCES IAR ETHICS CE DAY

What's Happening In Washington

The Current Policy Landscape For Investment Advisers



Karen L. Barr
President & CEO
Investment Adviser Association



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The Hill Landscape



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Hill Landscape

- Political Backdrop
- SEC Funding/Budget
 - House Republican Appropriations Bill
 - House policy riders would block SEC implementation of several rulemakings
 - Potential year-end omnibus agreement
- House SEC Oversight Hearings

Hill Landscape

- Legislation to Ease Burden on Small Businesses, including RIAs
 - H.R. 2792 (Small Entity Update Act)
 - IAA strongly supports this bill
- Legislation to Expand Accredited Investor Eligibility
 - Eligibility currently set by net worth and income thresholds
 - H. R. 2797 would direct SEC to establish an exam as a new pathway
 - H.R. 2799, IAA-supported, would accord eligibility to clients being advised by RIAs, as fiduciaries

Hill Landscape

- ESG Legislation
 - House Financial Services Committee ESG Working Group
 - Numerous bills introduced in the House that would block SEC rulemaking on ESG and affect proxy voting.
 - State legislation
- Tax Policy
 - Potential tax extenders package
 - Deduction of advisory fees
 - 20 percent pass through deduction

Hill Landscape

- Retirement
 - Secure Act 2.0 technical corrections
 - Secure Act. 3.0?
- E-delivery
- Cybersecurity/data privacy legislation
- Financial Exploitation Prevention Act
- Other developments

The Regulatory Landscape

Policy Themes

- Changes to principles-based regulation of advisers
- Impact of regulation on smaller advisers
- Cumulative impact and interconnectedness of new and existing regulation
- Sustainable investing
- Scrutiny of private funds
- Changes to how markets work from a buy-side perspective

Regulatory Tsunami

- Custody/Safeguarding
- Cybersecurity
- Outsourcing
- Regulation S-P
- Predictive Analytics
- ESG/Sustainable Investing
- Private Funds
- And much more...

Custody/Safeguarding Proposal

- Cover all assets, including crypto, art, real estate, commodities
- Eliminate authorized trading exception and cover discretionary authority to trade
- Privately offered securities subject to new obligations
- Require advisers to enter into contracts with clients' custodians with specific terms and obtain reasonable assurances on a wide range of requirements
- Impose additional detailed recordkeeping requirements

Custody/Safeguarding – Concerns

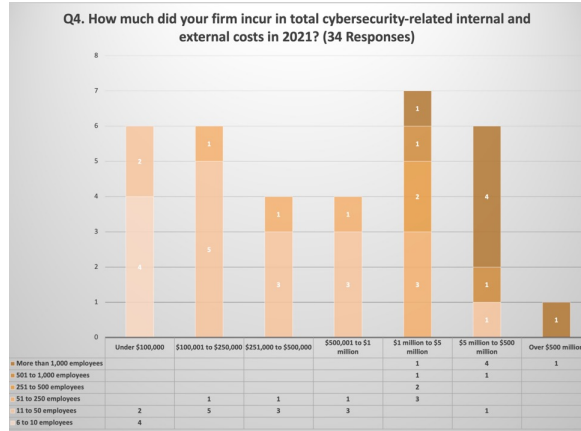
- Expansion of concept of “custody” to include virtually all advisers
- Unrealistic requirements to enter into written agreements with custodians that custodians likely wouldn’t agree to
- Interposing advisers in client-custodian relationship
- Use of Advisers Act for backdoor regulation of custodians
- No analysis that discretionary trading presents meaningful risks
- Significant burden on smaller advisers

Cybersecurity Proposal

- Report “significant” cyber incidents to SEC within 48 hours
- Have policies and procedures to address cyber risks at advisers and service providers, conduct annual reviews to assess effectiveness, document review
- Disclose cyber risk and incidents that occurred in past two years in Form ADV
- Maintain certain cyber-related books and records

Cybersecurity – Concerns

- Policies and procedures are important and already required under compliance program rule
- 48 hour reporting to SEC would impede advisers' efforts to respond
- Public disclosures could provide roadmap to threat actors
- IAA requested exclusion for smaller advisers from SEC reporting
- IAA Member survey shows SEC severely underestimates costs



"How much did your firm incur in total cybersecurity-related internal and external costs in 2021?"

34 responses

Outsourcing Proposal

- New prescriptive minimum due diligence requirements before engaging service providers, including service provider subcontractors
- Specific monitoring requirements
- New recordkeeping requirements
- Form ADV disclosure of covered functions and service providers
- Oversight of third-party recordkeeping

Outsourcing – Concerns

- If adopted as proposed, rule would result in sea change in vendor oversight processes
- Proposed rule unnecessary – advisers' fiduciary duty extends to outsourcing
- Concern that this is anti-fraud rule – huge costs for minor violations

Outsourcing Rule – Impacts to RIAs

- Required to jump through hoops to retain, or maintain, service providers
- Need to obtain reasonable assurances regarding compliance from vendors
- Must disclose sensitive information on Form ADV
- Will incur significant cost and operational burden – especially for smaller firms and service providers
- May have difficulty retaining qualified personnel, especially if forced to in-source services

Regulation S-P Proposals

- Require incident response programs in policies and procedures
- Require breach notification to clients within 30 days if sensitive information was or reasonably likely to have been accessed
- Require advisers to enter into written contract with their service providers, requiring providers to take certain measures and notify advisers within 48 hours of becoming aware of breach
- Broad definition of “customer information”
- New recordkeeping requirements

Regulation S-P – Concerns

- Incident response program is appropriate requirement
- Concerns with scope of coverage and whether public disclosure would provide a roadmap to threat actors
- Concerns with another requirement to enter into specific contractual terms with service providers
- Advocating for uniform breach notification requirements across federal and state agencies

Predictive Analytics

- Conflicts of interest associated with use of predictive analytics by investment advisers and brokers
- Identify and eliminate or neutralize the effect of conflicts associated with using covered technologies in investor interactions
- Written policies and procedures
- Definition of covered technologies extremely broad –
Analytical, technical or computational functions, algorithms, models, correlation matrices, or similar methods or processes
That optimize for, predict, guide, forecast, or direct investment-related behaviors or outcomes

Private Fund Advisers – Proposals

- Private Fund Adviser Proposal – prohibitions, quarterly statements on fees and expenses and performance, annual audit, GP-led secondaries
- All advisers – written annual compliance review
- Changes to Private Fund Reporting – SEC Form PF and SEC/CFTC Joint Proposal

Private Fund Advisers – Concerns

- Significant departure from principles-based framework
- SEC should not dictate contractual provisions among private parties
- SEC should take internal controls approach rather than prohibiting specific provisions
- Retroactive application unfair and burdensome
- Quarterly reporting requirements overly complex

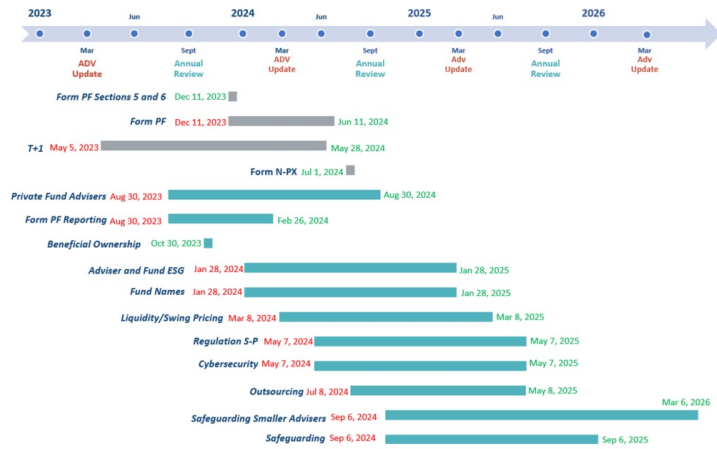
Sustainable Investing/ESG

- SEC proposal to require RIAs to make disclosures regarding their ESG practices
- DOL issued rule that permits consideration of ESG factors in investment selection if in best interest of client

Cumulative Impact Of Regulation

- SEC should review its rulemaking agenda holistically
- Undertake assessment of cumulative costs, burdens, and other implications
- Address how these rules would affect smaller advisers and consider alternatives
- Seek public feedback on a comprehensive implementation timeline and staggered implementation dates for all proposals

SEC Proposed Implementation Timeline For Adviser Rulemakings



***This graph illustrates a timeline for implementing the Adviser Proposals based on the IAA's reasonable assumptions regarding the effective dates and the compliance dates being proposed by the Commission for each proposal.*

Wait, There's More?!



What Else To Expect – Scrutiny

- SEC Examinations & Enforcement
- Investor Advisory Committee Recommendations on Oversight of Advisers
 - Third party exams?
- Focus on Fiduciary Interpretation, Reg BI, and SEC staff bulletins on aspects of these duties
- Marketing Rule Implementation
- Mandatory Arbitration

What Else To Expect – Retirement Policy

- DOL focus on advice provided to retirement investors, rollover recommendations
- Changes to exemptions for prohibited transactions

What Else To Expect – Rulemaking

- FTC proposal on non-competes
- Beneficial Ownership Reporting

What Else To Expect – Trading

- T+1: Shortening the securities transaction settlement cycle
Effective May 28, 2024
- Equity Market Structure (Order Competition, Tick Sizes, Disclosure) and Broker-Dealer Best Execution (retail orders, all securities)

What Else To Expect – AML

- Legislation that would have imposed AML on advisers dropped last year (IAA had opposed)
- Instead, Congress included “report language” encouraging Treasury/FinCEN to update and finalize its 2015 proposal for RIA AML
- IAA educating FinCEN on advisers and low risk presented

Contact Us!

202.293.4222

iaalegalteam@investmentadviser.org

iaaservices@investmentadviser.org

www.investmentadviser.org

Thank You

As the leading organization for fiduciary investment advisers, the IAA advances the interests of member firms by providing powerful advocacy, essential expertise and personalized support.