

# REPORT ON THE POTENTIAL IMPACT OF THE INVESTMENT ADVISER OVERSIGHT ACT OF 2012 ON SMALL ADVISERS

*By the Staff of the Massachusetts Securities Division  
May 31, 2012*

## Executive Summary

On April 24, 2012, a Bill was introduced in the Financial Services Committee (the “Committee”) of the United States House of Representatives entitled the “Investment Adviser Oversight Act of 2012” (the “Bill”). The Bill is currently scheduled for a hearing before the Committee in early June.

The Bill would authorize the Securities and Exchange Commission (“SEC”) to establish one or more self-regulatory organizations (“SROs”) to oversee investment advisers. As drafted, both state and SEC-registered investment advisers would generally be required to be a member of the SRO.

In order to understand the impact the Bill may have on state-registered advisers,<sup>1</sup> the Massachusetts Securities Division (the “Division”) of the Office of the Secretary of the Commonwealth William Francis Galvin conducted a survey of state-registered investment advisers. The survey was entitled “Survey Regarding the Investment Adviser Oversight Act of 2012” and was mailed to 649 state-registered advisers on Wednesday, May 16, 2012. A response (which could be sent anonymously) was requested within seven business days.<sup>2</sup>

The Division has received 353 returned surveys as of May 29, 2012. This represents 54.4% of all state-registered advisers located in Massachusetts. As described below in more detail, the survey responses represent firms of varying sizes and types, but generally are firms with one or two employees. 153 (43%) reported having gross revenues of less than \$50,000 annually.<sup>3</sup>

The advisers’ responses were very consistent in their opposition to the establishment of an SRO for investment advisers. Advisers believed an SRO would have a severe

---

<sup>1</sup> Studies have varied dramatically as to what the costs of an SRO would be. In the two most prominent studies, FINRA has estimated that the annual cost of an SRO would be approximately \$150 million per year and the Boston Consulting Group has estimated that cost at up to \$510 million per year. The cost of the SRO would be paid for by the members. FINRA has also estimated that 14,500 advisers would be required to be members of the SRO. Based on these estimates, the *average* annual cost to each member firm would be between \$10,345 and \$35,172 per year. We anticipate a small investment adviser’s membership fee might be lower than the average annual fee. In any event, however, any increase is likely to be a large percentage increase over the current \$300 an investment adviser pays in annual registration fees to Massachusetts.

<sup>2</sup> Each survey that was mailed contained a distinct document control number to control for potential duplicative responses.

<sup>3</sup> All percentages related to specific questions are based upon the number of responses to the specific question. See **Exhibit 1** for a list of specific question response rates.

impact on their business and would make them less likely to retain existing or hire new staff members. 146 of 353 (41%) advisers volunteered additional information in the optional comment section suggesting that they would be forced out of business if the Bill passes in its current form.

### Key Findings

Small investment advisers are consistently and overwhelmingly opposed to the establishment of an SRO because of the financial impacts such a bill would have on their small business. 98% of survey respondents indicated that passage of a bill that required them to become an SRO member and pay membership fees would have a financial impact on their ability to run their firm. 241 (69%) advisers characterized the financial impact to be “Severe” and the highest on the survey’s 1-9 scale. Advisers also indicated that they would be less likely to hire more personnel (81%) and may be forced to conduct layoffs (55%) given the additional costs the adviser would incur as a result of an SRO membership. Most significantly, approximately 146 of 353 (41%) advisers volunteered additional information in the optional comment section suggesting that they would be forced out of business if the Bill passes in its current form. A copy of the results of the survey is attached as **Exhibit 1** to this report.

### Massachusetts Small Investment Advisers – Who Are They?

The advisers who responded to the survey generally reflect the demographic of the typical Massachusetts-registered investment adviser. 279 (79%) advisers reported having assets under management less than \$30 million. 153 (43%) advisers reported gross revenue from advisory services of less than \$50,000.00 per year. 95% (337) of firms have fewer than five employees, and 80% (277) reported having only one person providing investment advice to clients.

All survey respondents are registered as investment advisers and located in Massachusetts. Such registrants currently pay an annual registration fee of \$300 per year.

### Small Advisers Believe that SRO Costs Would Adversely Affect Their Business

Advisers who responded to the survey generally believed that the costs associated with becoming an SRO member would affect their business financially. Respondents indicated that establishment of an SRO would make the firm less likely to hire new employees, less likely to retain existing employees, less likely to remain an independent investment adviser (as opposed to joining a larger firm to save on regulatory costs), and, in many cases, would force the firm out of business completely.

Respondents almost unanimously indicated that passage of the Bill would have a significant to severe financial impact on their business, primarily because of the additional membership costs associated with an SRO. 98% of advisers indicated that passage of the Bill would have at least some financial impact on their business. 241 (69%) advisers characterized the financial impact as “Severe” and the highest on the survey’s 1-9 scale.

Small advisers also consistently indicated that passage would limit their ability to retain or hire employees. 286 (81%) advisers indicated that they would be less likely to hire new employees as a result of passage of the Bill. Only 28 (8%) indicated they would be more likely to hire employees. Some of those advisers more likely to hire new employees stated that they would hire individuals in order to address additional regulatory requirements and would shift resources away from client services to accomplish this. Small advisers also indicated that they would be less likely to retain existing employees if required to be members of an SRO; 103 (55%) advisers that had at least two employees indicated they would be less likely to retain one or more of them, resulting in job losses in Massachusetts.

### Effects on Adviser Independence

Most advisers responding to the survey have no affiliation with a larger broker-dealer or investment adviser and remain independent small businesses. 77% of advisers (266) who responded to the survey indicated that they would be less likely to continue operating as an independent investment adviser if required to become an SRO member. 85% of advisers (291) indicated that if required to become an SRO member, they would be less likely to remain operating as the owner of a smaller investment adviser firm. Based upon clarifying adviser comments written on the surveys, we believe the comments about not remaining independent were driven heavily by the fact that most advisers found the membership fees to be too costly for a small investment adviser to absorb.

### Other Comments

The survey invited any additional comments the survey respondent wished to include. Many small advisers wrote lengthy descriptions of their business and how passage of the Bill would affect them – totaling over fifty pages. Investment advisers' comments varied significantly, and ranged from detailing the potential increases in costs to clients, the lack of need for an SRO, and a description of their practices. Most significantly, 146 (41%) advisers volunteered additional information in the optional comment section suggesting that they would be forced out of business if the Bill passes in its current form. A small sample of the hundreds of comments the Securities Division received in response to the survey is attached as **Exhibit 2** to this report.

### Conclusions

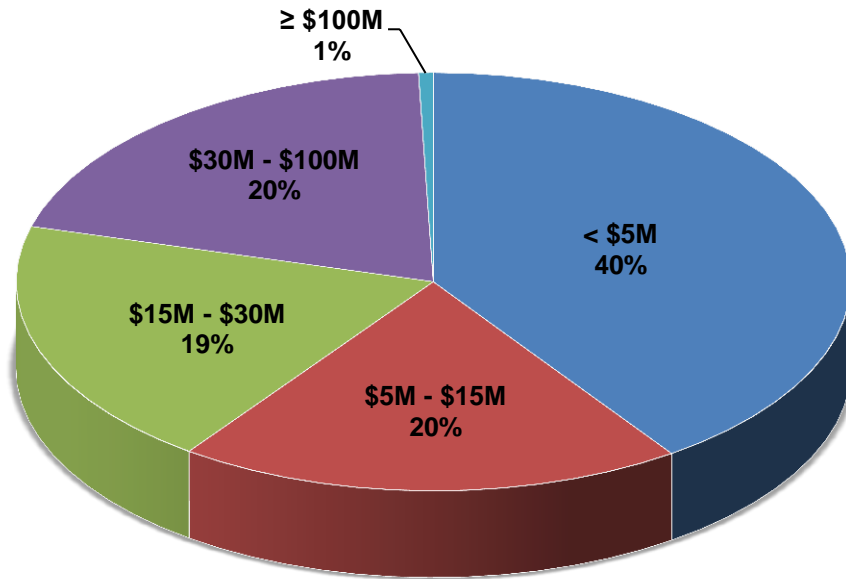
241 (69%) advisers characterized the financial impact as "Severe" and the highest on the survey's 1-9 scale. Advisers also indicated that they would be less likely to hire more personnel (81%) and may be forced to conduct layoffs (55%) given the additional costs the adviser would incur as a result of SRO membership. Most significantly, approximately 146 (41%) advisers volunteered additional information in the optional comment section suggesting that they would be forced out of business if the Bill passes in its current form.

Based upon the consistent survey responses, it appears that advisers believe that establishment of an SRO to oversee state-registered advisers would have an adverse

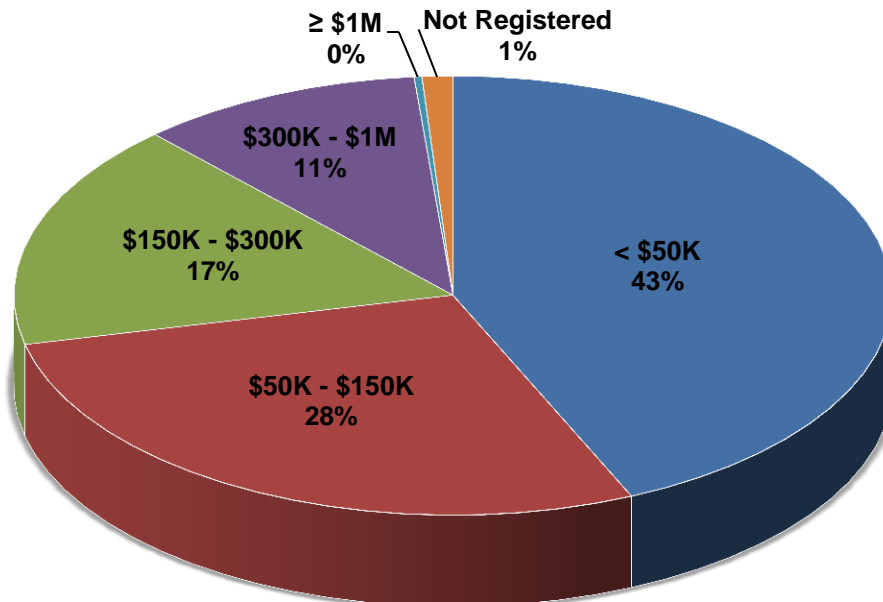
financial effect on the ability of these firms to conduct their business operations due to the added costs of membership and compliance.

# EXHIBIT 1: SURVEY RESULTS

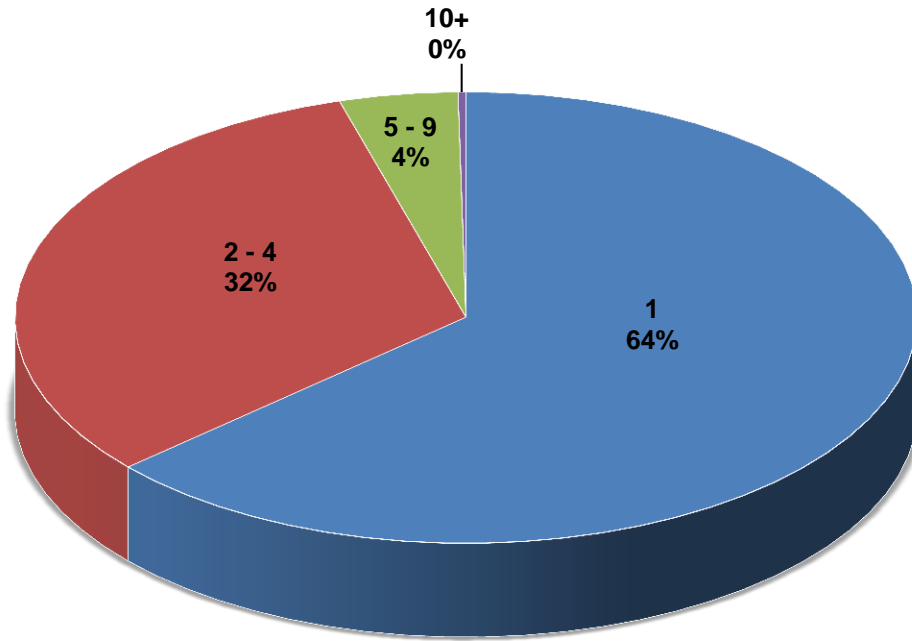
## 1. Responding Firms' Current Levels of Assets Under Management



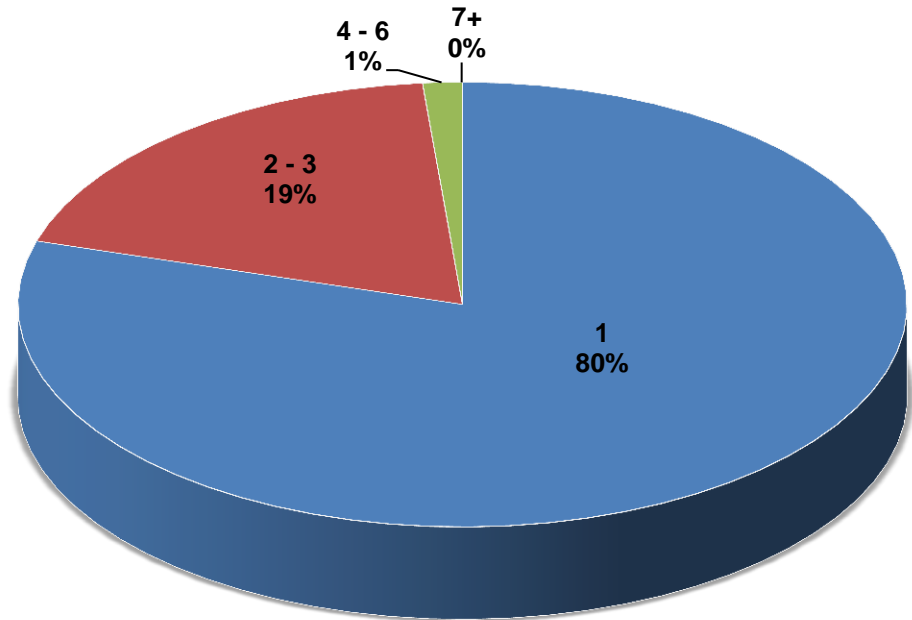
## 2. Responding Firms' Gross Incomes from Advisory Services in Last Fiscal Year



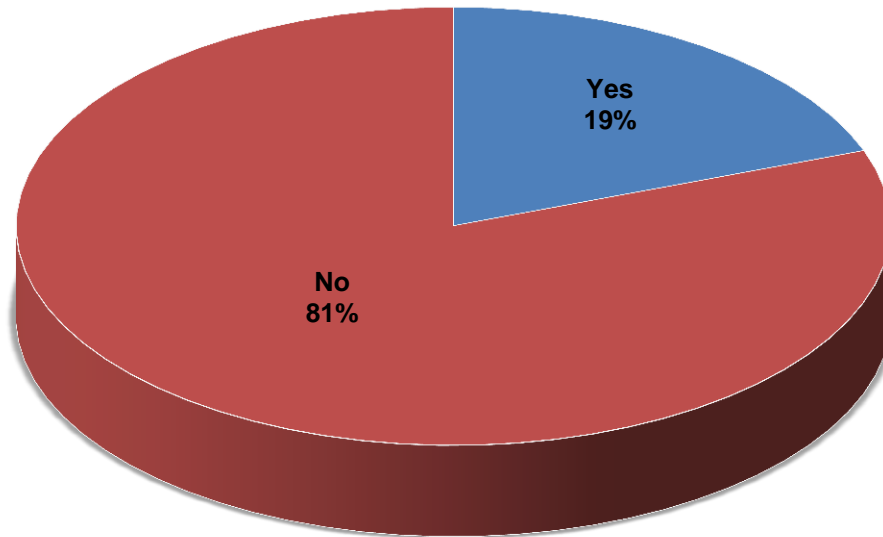
### 3. Responding Firms' Current Employees



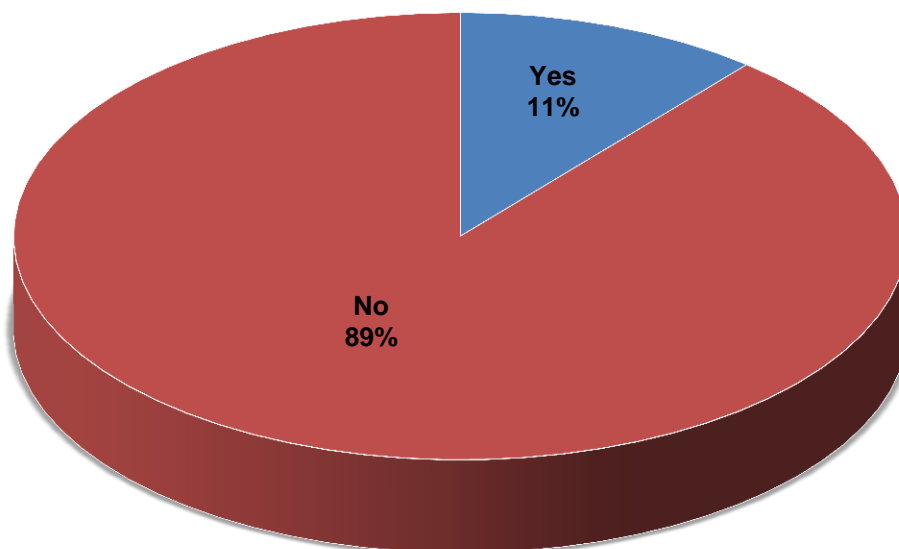
### 4. Responding Firms' Current Employees who Perform Investment Advisory Services



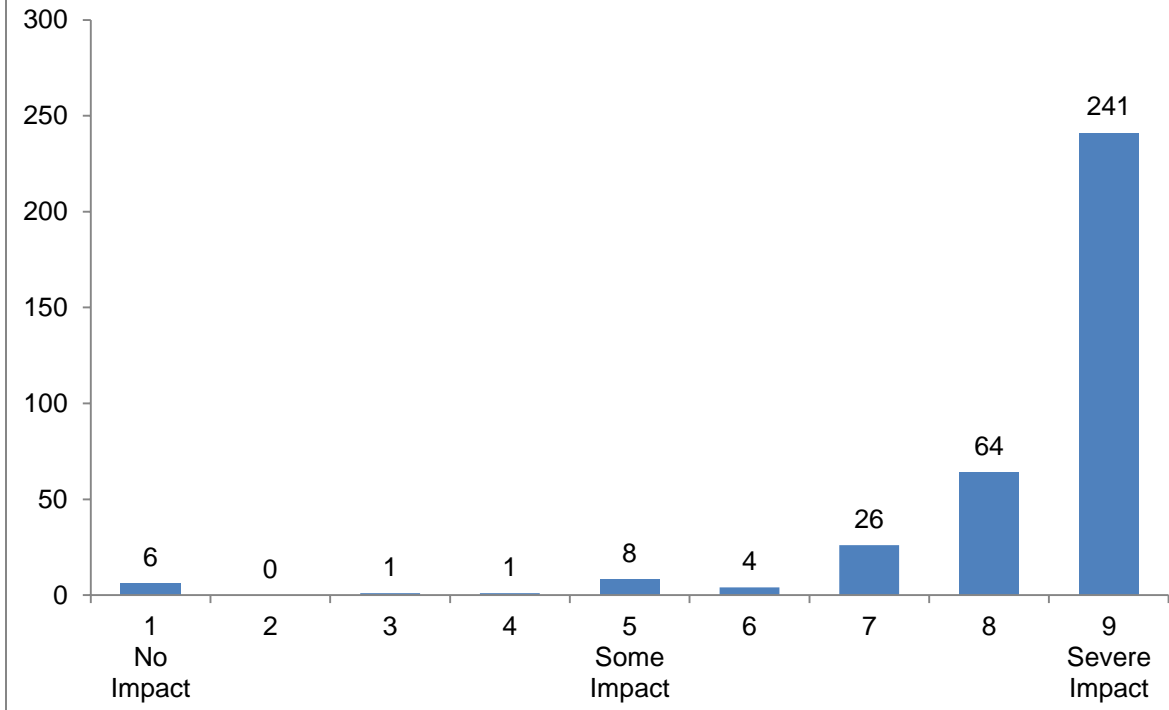
**5. Responding Firms Currently Affiliated with At Least One SRO**



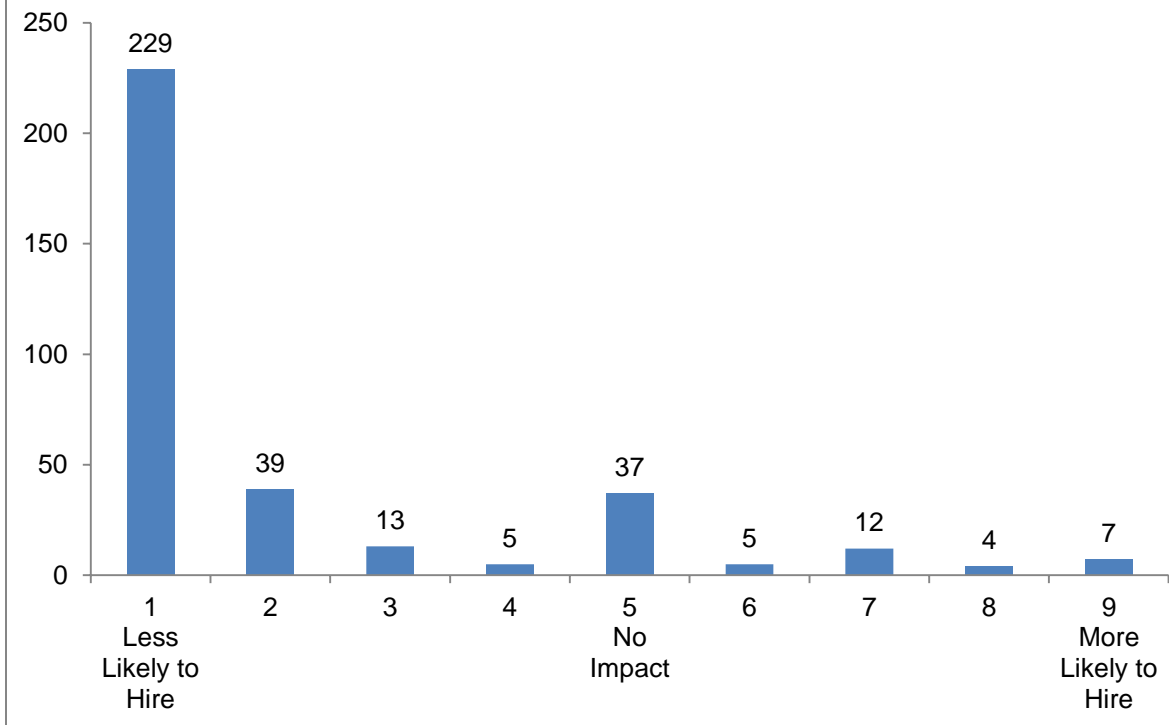
**6. Responding Firms Currently Receiving Any Transaction-Based Compensation for the Sale of Securities**



### 7. Level of Financial Impact SRO Membership would have on Responding Firms' Businesses

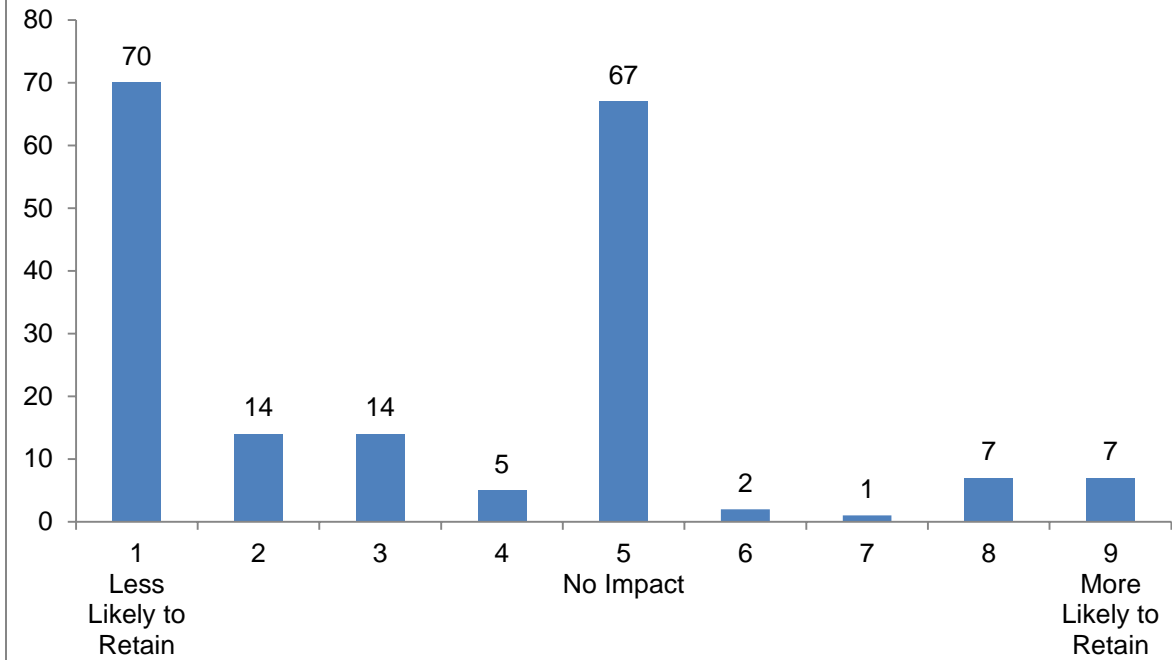


### 8. Responding Firms' Likelihood of Hiring Additional Staff if Required to Contribute to Ongoing Operation of an SRO

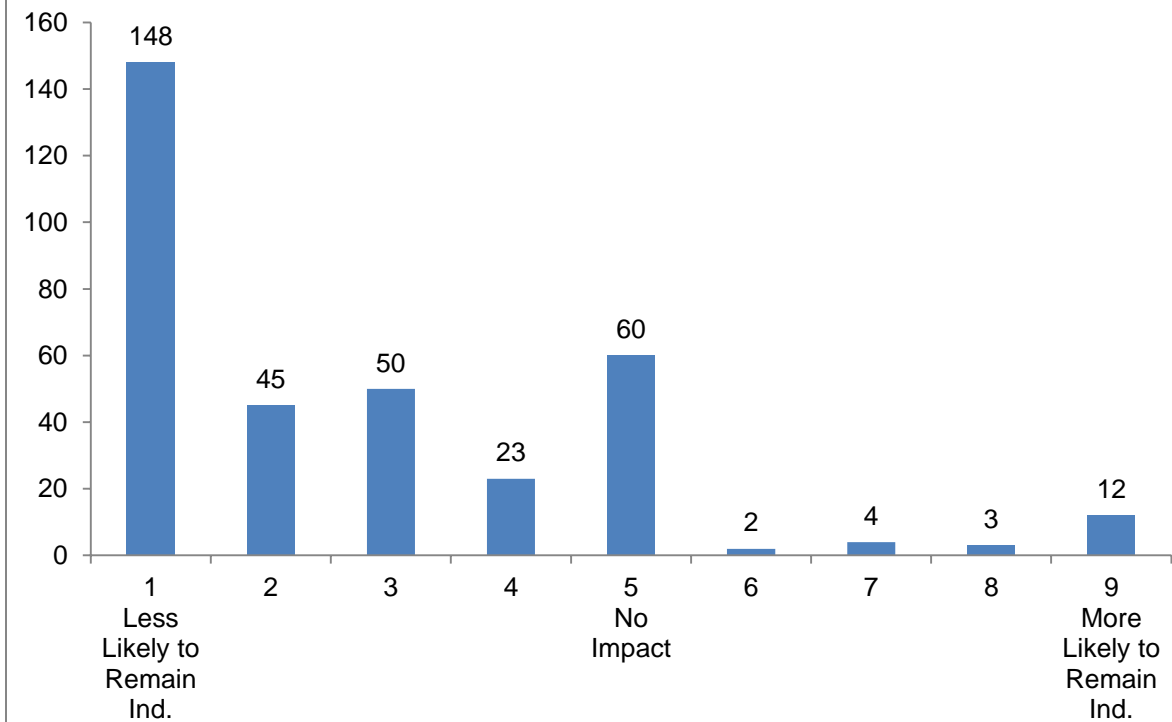




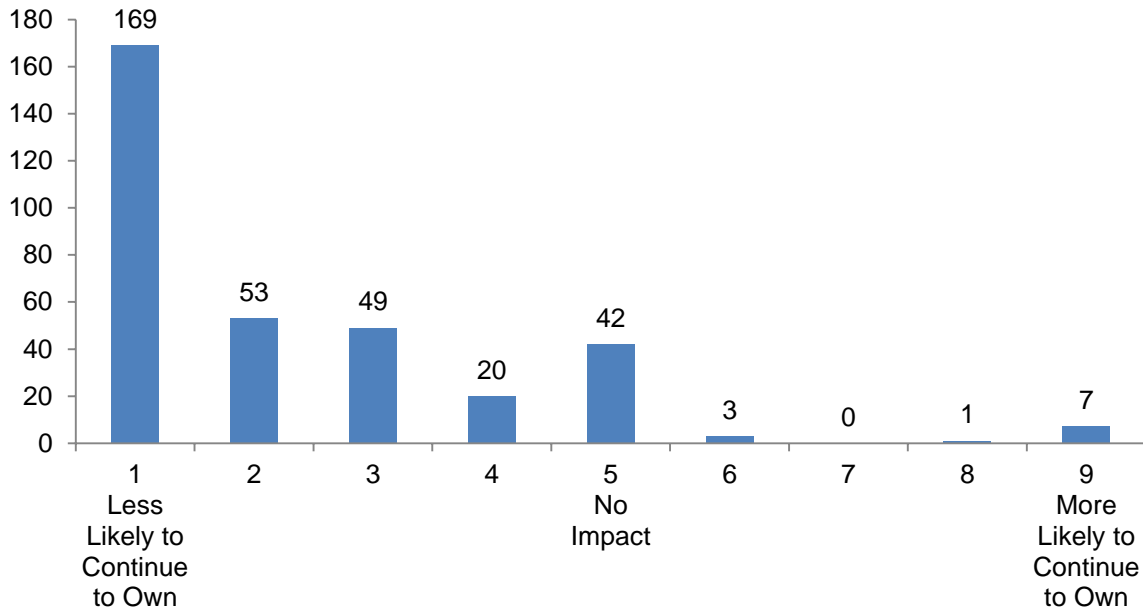
### 9. Responding Firms' Likelihood of Retaining Existing Staff if Required to Contribute to Ongoing Operation of an SRO



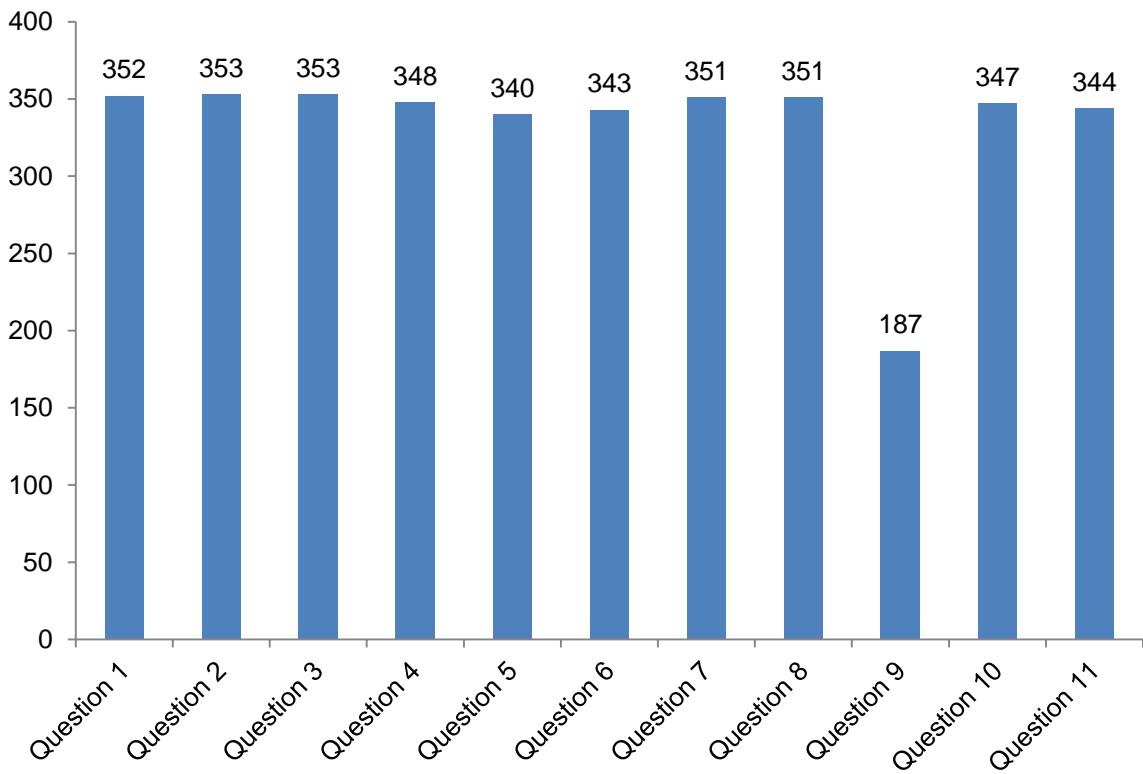
### 10. Responding Firms' Likelihood of Remaining an Independent Registered Investment Adviser if Required to Become Member of an SRO



### 11. Responding Firms' Likelihood of Continuing to Own Small Investment Adviser Firm if Required to Become Member of an SRO



### Number of Responses per Question



## **EXHIBIT 2: SUBMITTED COMMENTS BY MASSACHUSETTS INVESTMENT ADVISERS REGARDING THE POTENTIAL ESTABLISHMENT OF AN SRO**

- If the objective is to eliminate smaller firms...it would work I'm sure.
- Although I firmly believe that investment advisors should be regulated for consumer protection, I do not see what an SRO would add to existing regulation, and I am not sure how I could continue my practice given the likely cost. Putting small RIAs out of business may well hurt consumers.
- Increasing costs through an SRO will likely drive out competition and create an industry watchdog that is not sufficiently independent as to root out bad actors.
- This proposed regulation serves no purpose other than to kill jobs. Beef up the SEC and hire the right people there with proper financial incentives.
- This bill is a disaster - the potential financial impact on smaller advisors would be devastating - staff reductions, less client service, and a movement toward larger firms, which tend to be more removed from meeting client needs. Clients lose and only the larger firms and the SRO would benefit.
- My guess is, that membership requirements of an SRO would force me to close my doors after 20 years in business.
- The projected cost of an SRO would be highly detrimental to my ability to stay in business. Further, I do not see that there would be any value received, for my business, or my clients, or the general public, if such additional regulatory cost limits investment advisory firms to only large entities that can afford the additional cost burden.
- As a small investment adviser firm, the addition of SRO fees would be onerous. I have enjoyed my work for over 15 years because I can afford to take on clients even if the work is not very profitable. I work very hard for compensation well below the average in the industry - my choice - however SRO fees would likely cause me to retire as I won't raise the fees I charge clients.
- This level of expense would likely eliminate many advisors that serve middle America.
- I offer my services at a very low price for the good of society and my profession. In many years I do not break even. I would be unwilling to reach deeper in my pocket to cover SRO membership.

- It's obvious that requirement to join an SRO would put me out of business.
- This would force me to not take on smaller clients, denying quality advice to a market underserved by fee-only advisers. Additional costs will also prevent me from hiring staff as soon as I otherwise would like to.
- I am a very small business and any additional cost would force me out of business.
- We are a new start-up advisor in 2012. Any [additional] cost would more than likely force us to cease doing business.
- I would have to either fire my part time assistant, quit, sell the firm, or raise fees on the middle class clients I serve. Furthermore, in my opinion, FINRA has a terrible integrity issue.
- Proposed cost will force myself & firm out of business. Cannot afford the membership because I am a small business.
- This kind of thing could wipe out the small guy. I help a lot of people that don't have a lot of money - often for free. People would have no choice but to go to a B/D... .
- As a small RIA firm, controlling costs is a high priority. We are currently a hybrid firm, so are well aware of the enormous regulatory burdens placed on us by our Broker/Dealer via FINRA. As a result we are transitioning all our clients to our fee only platform to reduce costs of being a hybrid. To now be faced w/ this burden again would be very detrimental to our success in the future.
- **This proposal can easily put me out of business.** My average gross compensation over the last 2 years has been under \$40,000/year. That is before spending an average of around \$10,000 on legal expenses to comply with current regulations. An additional \$10,000 payment to an SRO could easily put me out of business... .
- As a firm with less than \$10,000,000 under management, I would probably have to close my firm and become an [investment adviser representative] under another [Registered Investment Adviser]. [I] would lose some independence... .
- If smaller, independent RIA's are saddled with new significant expense to fund the SRO, consumers will have fewer unbiased, fee-only, independent sources for advice.