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March 10, 2014

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

Re: Draft 2014-2018 Strategic Plan for Securities and Exchange Commission

To whom it may concern:

fi360, Inc. ("fi360")[1] and CEFEX Centre for Fiduciary Excellence, LLC ("CEFEX")[2] are pleased to submit comment on the Securities and Exchange Commission's ("SEC" or "Commission") Draft 2014-2018 Strategic Plan (the "Strategic Plan"). Most of our comments are provided in connection with the Commission's stated performance goal of measuring the population of SEC-registered investment advisers ("RIAs"), among other entities subject to SEC review, against the total number of advisers examined on an annual basis.[3]

fi360 and CEFEX have complementary expertise in this area. Specifically, fi360 and CEFEX offer training, certification programs and analytical tools that are designed to assist investment firms in fostering a culture of fiduciary excellence through implementation of best

[1] Founded in 1999, fi360 provides analytical tools to investment professionals and administers the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst® (AIFA®) designations. At present, there are more than 6,600 active AIF and AIFA designees. For more information on fi360, please see http://www.fi360.com/.

[2] Founded in 2006, CEFEX is an affiliate of fi360 and administers independent fiduciary assessments and certifications of registered investment advisers and other financial services firms. For more information, please see http://www.cefex.org/.

[3] *See* SEC Release No. 34-71466, *Draft 2014-2018 Strategic Plan for Securities and Exchange Commission*, February 3, 2014, Performance Goal titled "Percentage of investment advisers, investment companies, and broker-dealers examined during the year," at 19, available at http://www.sec.gov/about/sec-strategic-plan-2014-2018-draft.pdf (last accessed Feb. 27, 2014).

practices consistent with and, in some instances, more stringent than legal obligations under federal securities, pension and state trust laws.

Background

The examination cycle of RIAs over the many decades that the Commission has performed surprise inspections has been anything but predictable. In reviewing SEC annual reports beginning in 1981 and other studies, it is evident that the inspection cycle has fluctuated greatly over the decades, ranging from as much as a 30-year cycle[4] per adviser in the early '90s to as little as a five-year cycle in the years 1998-2003. Over a 30-year span between 1981 and 2010, the SEC's inspection cycle of non-investment company advisers equates to approximately 11.4 years per adviser[5] with as much as a 10-year variance across each five-year examination period.[6]

In the mid-1990s, following several years of congressional hearings regarding the SEC's lengthening inspection cycle for advisers, Congress passed the Investment Adviser Supervision Coordination Act of 1996, which divided oversight of registrants between the SEC and the states. Under this legislative mandate, within two years the number of SEC registrants dropped by nearly two-thirds, allowing the newly established Office of Compliance Inspections and Examinations ("OCIE") to achieve an inspection goal of visiting each advisory firm registered with the Commission once every five years.[7]

Much of the original problem was attributed to the rapid growth of financial planning firm registrations in the 1980s, causing the SEC to "reevaluate the current regulatory structure for advisers" and holding a Roundtable on Investment Advisers and Financial Planners in 1986.[8] Over time, there were other issues that caused the SEC to divert resources to other exam priorities. For example, in 1991, the Commission redirected some of its examination resources to an annual inspection program of money market funds at the largest 100 investment company complexes as well as larger RIAs – those managing at least $1 billion – placing the latter on a three-year inspection schedule.[9] The resulting diversion of resources prompted one

[4] *1991 Annual Report,* Securities and Exchange Commission (hereinafter referenced by year), at 46. Staff reported inspecting 3 percent of investment advisers not managing investment company assets; or 17,500 (RIAs) ÷ 574 (inspections) = 30.4 (years). All annual reports are available at https://www.sec.gov/about/annual_report/ (last reviewed Feb. 27, 2014).

[5] Exam cycles are approximate; calculated by citing SEC statistics for that year or by extracting registration and inspection data from SEC annual reports and dividing adviser registrations by inspections (and excluding mutual fund advisors where SEC annual reports provide that information).

[6] Examination variances broken down by five-year periods between 1981 and 2010 are: 1981-1985, four-year variance (i.e. ranging from an eight to 12-year inspection cycle); 1986-1990, five years; 1991-1995, 10 years; 1996-2000, 10 years; 2001-2005, one year; and 2006-2010, three years.

[7] *1998 Annual Report*, at 54.

[8] *1986 Annual Report*, at 45.

[9] *1991 Annual Report*, at 48.

SEC commissioner to observe that the inspection cycle for smaller advisers "has become virtually nonexistent."[10]

Other regulatory challenges intervened that threatened to disrupt the five-year inspection goal for each firm. Immediately prior to 2000, inspection staff was diverted to conduct reviews related to the so-called Y2K issue that required checking for outdated computer codes, and in 2004 the SEC increased its investment company inspections due to market timing and late trading problems.[11] Concerned with its ability to properly oversee the burgeoning number of registrants, in 2003 the Commission solicited public comment on the potential for third party compliance reviews to supplement OCIE examinations.[12] At about the same time, Congress fortuitously increased the agency's budget, which led to a 47 percent increase in OCIE's budget and allowed the SEC to hire an additional 233 new inspection staff in its regional and district offices,[13] thereby ameliorating, to a certain extent, the original slippage.

Following the 2008 financial crisis and widely publicized revelations of the Madoff and other Ponzi schemes,[14] the idea of third-party compliance reviews re-emerged. Specifically, SEC Chairman Mary Schapiro testified before Congress that the Commission was considering annual third-party audits of RIAs on an unannounced basis to confirm the safekeeping of assets held in custody. Chairman Schapiro also added that she expected SEC staff to recommend proposing a rule that would require certain advisers to have third-party compliance audits, although a rule was never proposed.[15]

Also following the 2008 financial crisis, Congress required the Commission to conduct an intensive review of its inspection program in Section 914 of the Dodd-Frank reform package. In response, SEC staff released a Section 914 report (the "914 Report") in January 2011 that, among other things, charted the rapid growth of the number of RIAs between 2004 and 2010 as

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[10] Remarks of Richard Y. Roberts, Commissioner, to the Investment Counsel Association of America, Annual Membership Conference, April 24, 1992, Washington, D.C., available at http://www.sec.gov/news/speech/1992/042492roberts.pdf (accessed Feb. 20, 2014).

[11] *2004 Annual Report*, at 57.

[12] *See* SEC Release No. IC-25925, *Compliance Programs of Investment Companies and Investment Advisers,* available at http://www.sec.gov/rules/proposed/ic-25925.htm (last accessed Feb. 27, 2014).

[13] GAO Report, *Securities and Exchange Commission: Review of Fiscal Year* 2003 and 2004 *Budget Allocations,* July 2004, at 11, available at http://www.gao.gov/assets/250/243519.pdf (last accessed Feb. 27, 2014).

[14] *See,* e.g. Marks, Keith, and Kohm, Korrine, "Pressures and Changes Around SEC Examinations, *Charles Schwab Compliance Review,* Vol. 19, Issue 6, October 2010. The authors commented that "Since the Madoff Ponzi scheme unraveled, the SEC's Office of Compliance Inspections and Examinations has been under the microscope," at 1. Available at http://www.ascendantcompliance.com/acm/acmfiles/pdf/MarksandKohm-SEC_Exam_Pressures.pdf (last accessed Feb. 27, 2014).

[15] SEC Chairman Mary Schapiro, "Testimony Concerning Enhancing Investor Protection and Regulation of the Securities Markets," before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 26, 2009, available at http://www.sec.gov/news/testimony/2009/ts032609mls.htm (last accessed March 7, 2014).

well as an overall decline in the number of OCIE examiners.[16] SEC staff concluded that in addition to the growing disparity between those key numbers, other issues had affected the inspection cycle, such as the need for additional for-cause examinations and examinations of higher-risk advisers.[17]

The 914 Report also estimated that the additional de-registration of 3,350 mid-sized advisers required under Dodd-Frank would result in a 28 percent drop of registrants. While obviously welcome, staff indicated it would provide only temporary relief.[18] The influx of new private fund registrations mandated by Dodd-Frank and future growth in other adviser registrations "would outstrip the Commission's examination resources without the commitment of substantial new funding" by Congress, according to the Report.[19] SEC staff recommended Congress consider three options to improve the program: 1) impose user fees on SEC-registered advisers to fund their examinations by OCIE; 2) authorize one or more self-regulatory organizations ("SRO") to examine registrants; or 3) authorize the Financial Industry Regulatory Authority ("FINRA") to examine dual registrants (those advisory firms also registered as broker-dealers).[20]

Today, the examination program is approximately at a 13-14 year inspection cycle,[21] and legislative efforts to either create an SRO to oversee investment advisers or to impose user fees to pay for the exams have gone nowhere in Congress, leaving the Commission with few alternatives to truly enhance adviser examinations. SEC leadership continues to call for additional resources, most recently at the annual *SEC Speaks* program, in which SEC Chairman Mary Jo White reiterated the point that "it also is incumbent upon me to raise my voice when the SEC is not being provided with sufficient resources… Given the critical role we play for investors and our expanded responsibilities, obtaining adequate funding for the SEC is and must be a top priority."[22]

[16] Staff of the Division of Investment Management of the U.S. Securities and Exchange Commission, *Study on Enhancing Investment Advisers Examinations,* January 2011, charts cited at 8, 11, available at http://www.sec.gov/news/studies/2011/914studyfinal.pdf (last accessed Feb. 27, 2014).

[17] *Id.* at 15.

[18] *Id.* at 19.

[19] *Id.* at 20.

[20] *Id.* at 4.

[21] *See,* e.g., *Recommendation of the Investor Advisory Committee: Legislation to Fund Investment Adviser Examinations,* at 1, Nov. 22, 2013, available at http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-examinations-recommendation-2013.pdf (last accessed Feb. 27, 2014).

[22] White, Mary Jo, *Chairman's Address at SEC Speaks 2014,* Feb. 21, 2014, available at http://www.sec.gov/News/Speech/Detail/Speech/1370540822127#.Uw-6NHco4dU (last accessed Feb. 27, 2014).

Given the challenges in crafting a five-year strategic plan that meets one of the SEC's most critical objectives, i.e. to promptly detect and deter securities law violations,[23] fi360 and CEFEX believe, and would respectfully suggest, that leveraging private sector assistance through third-party compliance reviews – the same concept considered by the Commission in 2003 and advanced by Chairman Schapiro in 2009 – is an appropriate and more assured means of enhancing investment adviser examinations and increasing investor protection.

Discussion

In the Commission's 2003 Release (the "2003 Release") discussing compliance programs of investment companies and investment advisers,[24] the Commission sought comment on the utility of requiring each fund and adviser to

> undergo periodic compliance reviews by a third party that would produce a report of its findings and recommendations. Our examination staff could use these reports to identify quickly areas that required attention, permitting us to allocate examination resources better and, as a result, *to increase the frequency with which our staff could examine funds and advisers* [Emphasis added].[25]

The 2003 Release went on to elaborate on the practical aspects of this approach, noting that there are many organizations that currently provide compliance reviews, including 'mock audits,' and have personnel with experience in designing, implementing and assessing the effectiveness of compliance programs. The 2003 Release also noted that the Commission frequently requires an adviser or fund to engage a compliance consultant as a condition for settlement of an enforcement action.

Further, in her 2009 testimony SEC Chairman Schapiro elaborated on the role she envisioned firms would play when responding to audits as well as the third-party auditors:

> The list of certifying [broker-dealer and investment adviser] firms would be publicly available on the SEC's website so that investors can check on their own financial intermediary. In addition, the name of any auditor of the firm would be listed, which would provide both investors and regulators with information to then evaluate the auditors.[26]

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[23] *See* SEC draft Strategic Plan, "Strategic Objective 2.2: The SEC promptly detects and deters violations of the federal securities laws," at 17.

[24] SEC Release No. IC-25925, *Supra* note 12.

[25] *Id.*

[26] Testimony by SEC Chairman Schapiro, *supra* note 15.

In the dozen or so years since the concept of third-party audits was originally put out for comment, the number of compliance firms available to perform such audits has undoubtedly increased.

Similarly, CEFEX has pioneered a form of third-party audit called a 'fiduciary assessment,' which we believe can be considered complementary to regulatory compliance reviews, and may even be more cost-effective. For example, CEFEX fiduciary assessments are based on the ISO standard 19011, which provides for qualitative system audits of a service-oriented business. The CEFEX assessment program also relies in part on quantitative tools for assessing prudent practices of investment advisory firms by importing data from Morningstar's extensive database and then comparing similar investment products to their assigned peer group, based on factors such as organization stability, style drift, expense ratios, and risk-adjusted performance. In addition, firms that wish to be certified as conforming to fiduciary best practices and listed on CEFEX's publicly accessible database are also subject to a review of compensation models and how conflicts of interest are managed. This kind of registry, by coincidence, is consistent with the same concept advocated by Chairman Schapiro's testimony in 2009 supporting public access to certifying audits and the auditors. Thus, CEFEX's ISO-like program can serve as a model of a developed system that assures quality control of fiduciary assessment practices. Moreover, the CEFEX program could be modified to fulfill specific regulatory requirements.

In addition, given the Commission's consideration of a uniform fiduciary standard, fiduciary assessments would promote commonly accepted prudent processes and introduce a means of identifying non-conforming practices, thereby encouraging firms to adopt a fiduciary culture and hence improve their own internal compliance controls. The importance of a strong compliance culture, which has been reinforced in various communications by the SEC and FINRA, can be found in the Commission's draft Strategic Plan as well. Strategic Goal 2, which would promote compliance with federal securities laws, goes on to say that the "SEC will continue to enhance its National Examinations and Enforcement programs," including "leveraging the knowledge of third parties."

Quality-control systems based on standardization across industries and international boundaries, such as the CEFEX program, are not novel concepts. In other industries reliant upon quality-control standards, private certification programs are overseen by nationally recognized accreditation bodies that utilize ISO standards, thereby ensuring consistent implementation of assessments and interpretation of a specific standard. The Commission should consider the same kind of approach to complement its existing resources rather than exclusively waiting on the legislative and appropriations processes to catch up and effectively address SEC resource constraints in the area of compliance examinations. Moreover, although we are aware that the 914 Report raised the possibility of authorizing FINRA to examine dual registrants, we believe that relying upon the private sector would be more cost-effective and better received by the advisory community as a more transparent option.[27]

Summary

As discussed above, it is obvious that the SEC is challenged by the continued robust growth in the number of investment adviser registrants amid a time when Congress is faced with a budget sequester and other fiscal restraints. Combined with the current fiscal austerity climate and legislative gridlock in Washington, the Commission cannot be assured of a sustainable financial commitment to its National Examination Program without considering other alternatives.

We believe that as part of the Commission's five-year Strategic Plan, it should consider alternatives that will complement its current resources and exam program while promoting greater investor protection. Specifically, we believe that the use of private certification programs overseen by regulating accreditation bodies is a model the Commission can use to effectively multiply the resources devoted to compliance activities, without materially raising costs. Accordingly, revisiting the original concept of third-party compliance reviews could serve as a key initiative in the Commission's longer-term strategy. Based on our own experience in operating a successful fiduciary assessment program over the last eight years, we strongly believe the use of third-party audits would enhance the goals and objectives of the SEC's Strategic Plan and materially improve investor protection.

We would be happy to answer any questions that the Commission may have with respect to the information presented in this letter.

Very truly yours,

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[27] *See*, e.g. Tittsworth, David, Investment Adviser Association, Testimony before the House Committee on Financial Services, "Hearing on the Investment Oversight Act of 2012," June 6, 2012., stating, "We particularly oppose extending FINRA's jurisdiction to investment advisers due to its lack of transparency and accountability, questionable track record, the costs involved, and its experience and bias favoring the broker-dealer regulatory model." Available at http://financialservices.house.gov/uploadedfiles/hhrg-112-ba-wstate-dtittsworth-20120606.pdf (last accessed March 7, 2014).

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