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ComplianceAlert

A Summary Report on the Obama Regulatory Reform Proposal

This is a summary report outlining the Obama Regulatory Reform Proposal issued on June 16, 2009. It focuses on the sections of the proposal most likely to affect investment advisers, funds, and broker-dealers.

New Regulatory Bodies Proposed:

1. Financial Services Oversight Council/Financial Consumer Coordinating Council
2. National Bank Supervisor (NBS)
3. Consumer Financial Protection Agency (CFPA)
4. Office of National Insurance (ONI)

Current Regulatory Bodies/Programs to be dissolved:

1. SEC's Supervised Investment Bank Holding Company Program
2. Office of the Comptroller of the Currency (OCC)
3. Office of Thrift Supervision (OTS)
4. Federal Thrift Charter

The OCC and OTS would effectively be rolled up into the new NBS. The Federal Thrift Charter would be eliminated, but the interstate branching rules would still be applied to state and national banks.

The Federal Reserve would be given broad oversight authority over any and all banks or non-banks that pose a systemic risk to the U.S. economy. In addition, the SEC would be given enhanced oversight and authority over the securities markets under the Obama Plan to “protect investors, improve disclosure, raise standards, and increase enforcement.”

The OTC derivatives market would become subject to regulation, but the exact regulatory authority with direct oversight responsibility was not named in the proposal. The SEC would most likely have authority over securities based derivatives. The SEC and CFTC are currently working together to amend the Commodities Exchange Act (CEA).

The key points of the proposal affecting investment advisers, funds, insurance companies and distributors, private funds and their managers, and broker-dealers are summarized in the chart below:ⁱ

Regulatory Proposal under the Obama Plan	Potential affect on Registered Investment Advisers (RIAs) and Broker-Dealers (BDs)	Potential affect on Compliance Departments
1. Creation of the new Financial Services Oversight Council	RIAs and brokers may feel the effects of this new entity since it will have the authority to gather information from any financial firm and refer matters to other agencies.	Compliance departments may have new reporting requirements to the Council.
2. Require hedge funds and other private pools of capital to register under the Investment Advisers Act.	This included hedge funds, private equity funds, and venture capital funds. Only those funds that meet a certain threshold criteria (not yet named) will become subject to registration. In addition to the managers becoming subject to the Advisers Act requirements, the funds themselves will also have to report certain information to the SEC on a periodic basis. SEC is considering changes to the IC Act to accommodate private fund reporting.	A massive registration effort will result from this proposal, especially since many funds that registered in 2004 have since de-registered. Compliance requirements for hedge funds, advisers to hedge funds, and broker-dealers with related hedge funds or other pooled funds will increase. This rule may require prime brokers to increase their back-office staff and enhance systems used to accommodate increased compliance reporting standards.
3. Rule 2a-7 amendments are proposed under the Investment Company Act to prevent “runs on money funds” during economic crises.	RIAs to money funds will be affected by the new amendments and the manner in which the funds are distributed in the BD world may also change. Money funds may be required to change their disclosures, reporting requirements, duration of holdings, and liquidity and credit risk.	Compliance Officers to money funds will be most affected. Fund compliance programs will need to be updated to accommodate any changes to Rule 2a-7. Board approval may be required. Fund administrators will need to update their operating and reporting systems. BDs that sell money funds may need to modify marketing materials and add new disclosures.
4. Establish the new Office of National Insurance to oversee the insurance markets on a national level.	This agency will have direct authority over insurance companies and the distributors that sell the products via regulation of insurance producers. A federal charter is still on the table, but not required under the proposal.	Insurance companies and BDs that specialize in variable insurance distribution will have to step up their compliance efforts and modify existing programs. This rule could help standardize the industry and decrease the state-by-state burdens placed on firms. States may lobby hard against this proposal.

<p>5. The creation of a new regulatory framework for OTC derivatives, including CDS’.</p>	<p>Any firm that holds or issues these securities will be affected by the new regulations. Clearinghouses will be developed for these securities to increase transparency in the market. The way in which transactions take place will change, systems will be created, and trading will be “normalized.”</p>	<p>Compliance programs will need to be modified to accommodate any new rules, exchanges, or systems created. Any firm that sells, issues, or holds these securities will need to make these changes. The increased transparency should help with the pricing challenges associated with these products. The long term overall affect should be positive for most firms, but the initial changes and pricing will be a volatile time.</p>
<p>6. Creation of a new Consumer Financial Protection Agency (CFPA)</p>	<p>RIAs and BDs should not be too affected by this one. The goal of the agency to provide protection over non-securities type products such as credit cards, bank loans, savings accounts, and payment products. However, the agency may be brought in when an enforcement matter involves substantial consumer harm.</p>	<p>Compliance at bank-affiliated firms that offer credit/debit cards on accounts will have to accommodate the requirements of this new agency.</p>
<p>7. SEC’s ability to create a new fiduciary standard for broker-dealers</p>	<p>Both RIAs and BDs may be affected by this one. The lines continue to blur between RIAs and BDs that provide advice to customers. FINRA is lobbying heavily to become the new SRO for advisers and this will happen more easily if the SEC grants this new fiduciary status to BDs.</p>	<p>Compliance at both RIAs and BDs could change dramatically if FINRA becomes the SRO for advisers. New rules would be implemented under FINRA. Even if this does not happen, BDs will have to update their compliance, supervisory, sales programs and WSPs to account for their new fiduciary role, if granted.</p>
<p>8. Enhanced enforcement authority for the SEC</p>	<p>The Obama Plan offers new powers to the SEC under many sections, including expanded enforcement authority via increased sanctions. SEC fines are likely to increase significantly and other SROs may follow suit.</p>	<p>Compliance will come under increased pressure due to the higher sanctions imposed by the SEC. The role of compliance will be elevated at all firms. Higher penalties for non-compliance will induce firms to take compliance more seriously.</p>

¹ The chart does NOT contain all elements of the Obama Plan. The proposals deemed most relevant to firms conducting a securities business, specifically investment advisers, funds, private funds, and broker-dealers are included. Topics that have been previously proposed under other guidelines, such as credit rating agencies and pricing issues, are not included here even though they may also impact certain firms.