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DODD FRANK ACT WILL TRANSFORM THE INVESTMENT MANAGEMENT INDUSTRY IN COMING YEARS

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A year after its enactment, the passing of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] will likely result in the most comprehensive overhaul of financial market regulation since the Great Depression. Under Dodd-Frank, US regulatory agencies are required to adopt a total of 243 separate rules. The Securities and Exchange Commission (SEC) alone must adopt 95 of these rules, which will primarily affect the investment management industry. Dodd-Frank also mandates 16 separate studies of financial markets, with five of these studies to be recurring.

Although Dodd-Frank's scope is significant, the legislation marks only the beginning of a broader regulatory sea of change that will transform the investment management industry in coming years. Some changes are underway. Under Dodd-Frank, most alternative investment managers will be required to register with the SEC by March 30, 2012.[2] As part of the registration process, these new registrants will be required to identify a Chief Compliance Officer (CCO), develop and implement a governance and compliance program, and will be subject to periodic inspection by the SEC 's examination staff.[3]

Other changes bearing on asset managers include enhanced disclosure requirements for filings made on Form ADV Part 2[4], an investment adviser disclosure

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221 (proposed June 22, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3221.pdf.

[3] *Id.*

[4] *Id.*

document, which has evolved from a 'check the box' format to a narrative document with expanded information requirements.

Another notable change concerns new reporting requirements for monitoring systemic risks required under Form PF. The new Form PF filing will require investment managers to report various attributes of their portfolio holdings on a periodic basis.[5] Other changes indirectly affecting investment managers include changes to regulation of over-the-counter (OTC) derivatives and potential changes to industry fiduciary standards. Lastly, Dodd-Frank aside, other regulatory changes bearing on investment managers are in the works, including a new custody rule, 'pay-to-play' restrictions, Reg. SHO concerning short-selling, and new proxy voting rules and disclosures. These regulatory changes may serve as a catalyst to accelerate certain trends that have been underway within the industry. Specifically, product convergence among asset classes that traditionally have remained separate and distinct, may accelerate now that the SEC registration requirement no longer serves as a barrier to entry. We have seen some private equity fund managers starting to offer hedge fund products to their investors and some companies contemplating moves into the alternative segment by offering hedge funds and similar products.

Outside of regulatory change, other trends that continue are the consolidation of investment managers, fee compression, and managers' movement to open architecture models. In addition, technology and greater transparency have caused the investment management industry to become more global in terms of strategies and distribution. Although this global business approach has led to opportunity and growth, it remains uncertain whether global regulatory coordination will continue to lag, and potentially impede access to certain regions or countries due to the competitive disadvantages created by increased regulation.

During the financial crisis, the US and other national regulatory regimes continually voiced that regulatory reform must be a sustained and coordinated global effort.[6] The rationale behind this goal, in part, was to ensure that regulation did not create a competitive disadvantage for one region versus another.[7] With limited success in coordinating globally, the US and Europe at least, appear to have enacted similar regulatory changes.

Whether other regions and countries will follow suit remains unclear. As firms manage the raft of regulatory change, we should pause to place these changes in context.

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[5] Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Advisers Act Release No. IA-3145, 76 Fed. Reg. 8,068 (Feb. 11, 2011) (proposed Jan. 26, 2011).

[6] *E.g.,* James Quinn, *G20 summit: Timothy Geithner calls for global regulation*, DAILY TELEGRAPH, Mar. 26, 2009, http://www.telegraph.co.uk/finance/g20-summit/5057267/G20-summit-Timothy-Geithner-calls-for-global-regulation.html.

[7] *Id.*

In the aftermath of the financial crisis, regulators have developed a new set of standards and regulations to protect consumers and the integrity of financial markets. It is critical that firms ensure they are interpreting the intent of the rules based on their individual business models. What we have seen is that the 'new' rules are not completely prescriptive, and often there is scope to build a case, as long as the proper support structure is in place.

Lastly, institutional investors have had a hand in influencing the investment management industry and regulatory change. For example, institutional investors have pushed the industry for increased transparency, enhanced due diligence processes, and greater risk and management reporting.[8] Institutional investors have also influenced regulatory changes including the 'pay-to-play' restrictions and the custody rule. Industry pressures together with government-inspired regulatory changes will continue to alter the landscape of the investment management industry for some time to come. We believe that now is the time for investment managers to start change programs that will enable them to remain competitive – even in the face of such dramatic industry change – and find the best fit for their businesses.

[8] *See generally* Anthony Cowell et al., Transformation: The Future of Alternative Investments (KPMG 2010), *available at* http://www.kpmg.com/IM/en/IssuesAndInsights/ArticlesPublications/Pages/TransformationTheFutureofAlternativeInvestments.aspx.