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June 2, 1997

The Honorable Alfonse M. D'Amato
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Thomas J. Bliley, Jr.
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Subject: Securities and Exchange Commission: Rules Implementing Amendments to the Investment Advisers Act of 1940 (Rule 203A-2)

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission, entitled "Rules Implementing Amendments to the Investment Advisers Act of 1940 (Rule 203A-2)" (RIN: 3235-AH07). We received the rule on May 16, 1997. It was published in the Federal Register as a final rule on May 22, 1997. 62 Fed. Reg. 28112.

The final rule, which was issued simultaneously with six other rules relating to the amendment of the Investment Advisers Act by the National Securities Markets Improvement Act of 1996, particularly title III, the Investment Adviser Supervision Coordination Act, exempts four types of advisers from the prohibition on SEC registration. These are: (1) certain pension consultants, (2) nationally recognized statistical rating organizations, (3) certain advisers affiliated with SEC-registered investment advisers, and (4) newly formed advisers that have a reasonable expectation of becoming eligible for SEC registration within 120 days.

Enclosed is our assessment of the SEC's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review indicates that the SEC complied with the applicable requirements.

If you have any questions about this report, please contact James Vickers, Assistant General Counsel, at (202) 512-8210. The official responsible for GAO evaluation work relating to the Securities and Exchange Commission is Jean Stromberg, Director, Financial Institutions and Markets Issues. Ms. Stromberg can be reached at (202) 512-8678.

Robert P. Murphy
General Counsel

Enclosure

cc: The Honorable Jonathan G. Katz
Secretary
Securities and Exchange Commission

ENCLOSURE

ANALYSIS UNDER 5 U.S.C. § 801(a)(1)(B)(i)-(iv) OF A MAJOR RULE
ISSUED BY
THE SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"RULES IMPLEMENTING AMENDMENTS TO THE
INVESTMENT ADVISERS ACT OF 1940 (RULE 203A-2)"
(RIN: 3235-AH07)

(i) Cost-benefit analysis

The SEC has submitted to our Office a cost-benefit analysis of the final rule. The analysis concludes that the quantifiable costs associated with the rule are $600,000 for the Pension Consultant exemption, $18,000 for the Nationally Recognized Statistical Rating Organization exemption, $300,000 for the Affiliated Adviser exemption, and $8,700 for the New Adviser exemption for a total of $926,700.

The analysis lists quantifiable benefits of $5,000,000 for the Affiliated Adviser exemption and $2,000,000 for the New Adviser exemption. In addition, another benefit includes permitting real estate advisers to pension plans to continue to register with the SEC, which will allow the advisers to comply with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA). Also, new advisers would not have to register initially with a state or states, then deregister and register with the SEC if they had the expectation of being eligible for SEC registration within 120 days.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607 and 609

The SEC prepared an Initial Regulatory Flexibility Analysis (IRFA) in connection with the proposed rule, which was summarized in the notice of proposed rulemaking (61 Fed. Reg. 68480, 68491-92, December 27, 1996), and was available to the public in its entirety. One comment was received in response to the IRFA.

The preamble to the final rule contains a summary of the Final Regulatory Flexibility Analysis, a complete copy of which was submitted to our Office and was available to the public. The analysis describes the reason for the final rule and the legal basis for it; descriptions and estimates of the number of small entities affected by the rule; a discussion of the recordkeeping, reporting, and other compliance requirements; and the steps taken to minimize the burdens on small entities.

The SEC estimated that of the 23,350 investment advisers currently registered with the SEC, 17,650 advisers would be considered small entities. After July 8, 1997,

approximately 850 of those small entities would remain eligible for registration with the SEC.

The comment received in response to the IRFA concerned the impact of the proposed rule on small entities that manage funds regulated under ERISA. ERISA protects a plan's named fiduciary from liability for the individual decisions of an "investment manager" appointed by the fiduciary to manage the plan's assets. "Investment manager" is defined by ERISA to include investment advisers registered under the Advisers Act. Although ERISA has been amended to include state-registered investment advisers as "investment managers," the amendment expires 2 years after enactment. When this amendment expires, small advisers effectively will not be able to manage ERISA funds.

While the SEC found that it would be inconsistent with the Coordination Act to grant an exemption for the above-described small entities, the Commissioner has written to the congressional committees concerned urging that the sunset provision be eliminated and the ERISA exemption be made permanent.

Also, in response to concerns expressed, the final rule increases the threshold for Commission registration from $25 to $30 million of assets under management.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the SEC is not subject to title II of the Unfunded Mandates Reform Act of 1995.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

The final rule was promulgated using the notice and comment procedures of 5 U.S.C. § 553. A notice of proposed rulemaking was published on December 27, 1996, 61 Fed. Reg. 68480, and requested the submission of comments. The SEC received 105 comments in response to the proposed rule. The comments received and actions taken as a result of the comments are discussed in the preamble to the final rule, including the redrafting of certain language on the Form ADV-T for greater clarity.

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

The final rule requires the collection of information which is subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act. OMB has approved the information collection contained on the Form ADV and has

issued OMB No. 3235-0049 following the submission of revised burden hour estimates. The SEC now estimates that the annual burden estimate for all respondents to Form ADV is 18,128 hours.

Statutory authorization for the rule

The SEC cites section 203A(c) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-3A(c)) as authority for the promulgation of the final rule.

Executive Order No. 12866

The rule, promulgated by an independent regulatory agency, is not subject to the review requirements of Executive Order No. 12866.