

Why GAO Did This Study

Over the past decade, hedge funds, private equity funds, and other private funds proliferated but were largely unregulated, causing members of Congress and Securities and Exchange Commission (SEC) staff to raise questions about investor protection and systemic risk. To address this potential regulatory gap, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) brought certain advisers to private funds under the federal securities laws, requiring them to register with SEC. The Dodd-Frank Act also requires GAO to examine the feasibility of forming a self-regulatory organization (SRO) to provide primary oversight of private fund advisers. This report discusses (1) the feasibility of forming such an SRO, and (2) the potential advantages and disadvantages of a private fund adviser SRO.

To address the mandate, GAO reviewed federal securities laws, SEC staff's recently completed study on its investment adviser examination program that was mandated by the Dodd-Frank Act, past regulatory and legislative proposals to create an SRO for investment advisers, and associated comment letters. GAO also interviewed SEC and SRO staffs, other regulators, and various market participants and observers.

We provided a draft of this report to SEC for review and comment. SEC staff provided technical comments, which we incorporated, as appropriate.

View [GAO-11-623](#) or key components. For more information, contact A. Nicole Clowers, 202-512-8678, clowersa@gao.gov

PRIVATE FUND ADVISERS

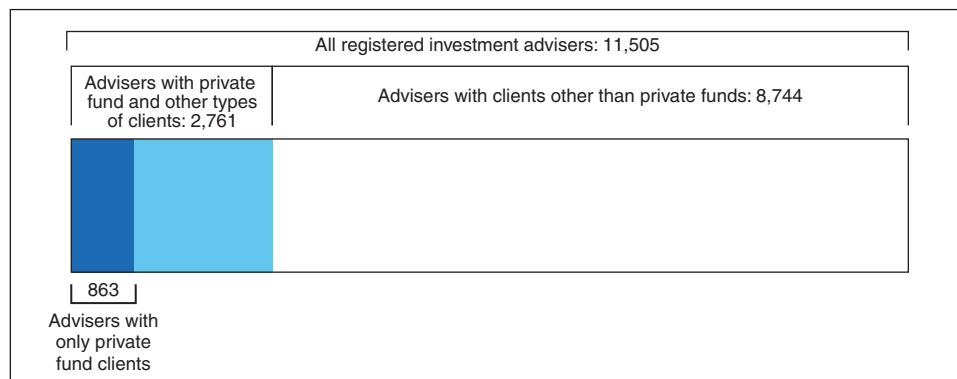
Although a Self-Regulatory Organization Could Supplement SEC Oversight, It Would Present Challenges and Trade-offs

What GAO Found

Regulators, industry representatives, investment advisers, and others told GAO that it was difficult to opine definitively on the feasibility of a private fund adviser SRO, given its unknown form, functions, and membership. Nonetheless, the general consensus was that forming a private fund adviser SRO could be done, as evidenced by the creation and existence of other SROs. At the same time, they said that the formation of a private fund adviser SRO would require legislation and would not be without challenges. SEC staff and securities law experts said that the federal securities laws currently do not allow for the registration of a private fund adviser SRO with SEC. In addition, regulators, industry representatives, and others told GAO that forming such an SRO could face challenges, including raising the necessary start-up capital and reaching agreements on its fee and governance structures. Some of the identified challenges are similar to those that existing securities SROs had to confront during their creation.

Creating a private fund adviser SRO would involve advantages and disadvantages. SEC will assume responsibility for overseeing additional investment advisers to certain private funds on July 21, 2011. It plans to oversee these advisers primarily through its investment adviser examination program. However, SEC likely will not have sufficient capacity to effectively examine registered investment advisers with adequate frequency without additional resources, according to a recent SEC staff report. A private fund adviser SRO could supplement SEC's oversight of investment advisers and help address SEC's capacity challenges. However, such an SRO would oversee only a fraction of all registered investment advisers, as shown in the figure below. Specifically, SEC would need to maintain the staff and resources necessary to examine the majority of investment advisers that do not advise private funds and to oversee the private fund adviser SRO, among other things. Furthermore, by fragmenting regulation between advisers that advise private funds and those that do not, a private fund adviser SRO could lead to regulatory gaps, duplication, and inconsistencies.

Number of Registered Investment Advisers, as of April 1, 2011



Source: GAO analysis of SEC information.