Emerging Trends in Asset Management: An Overview of SEC Chair Gary Gensler's Remarks

By Isaac Mamaysky[1]

SEC Chair Gary Gensler made some interesting remarks at the Inaugural Conference on Emerging Trends in Asset Management.[2] He began by observing that registered investment advisers manage over $110 trillion in assets for more than 50 million clients, and the field is rapidly evolving with the advent of roboadvisers, AI, and wealth management apps.

Mr. Gensler made observations about a few recent trends:

(1) <u>Private Funds:</u> Of the $110 trillion in assets managed by RIAs, $25 trillion sits in thousands of private funds, which is $2 trillion more than what sits in the entire commercial banking sector. Mr. Gensler observed, "Private funds play an important role for investors, including retirement funds and endowments. Standing behind those entities are a diverse array of teachers, firefighters, municipal workers, students, and professors."

Mr. Gensler also noted that the largest hedge funds have assets equal to those of some commercial banks, and those hedge funds at times exceed 20-to-1 leverage. "Given that these funds touch so much of our economy, the SEC is working to enhance their efficiency, integrity, and resiliency."

With this goal, the SEC recently adopted rules requiring private fund advisers to issue reports about events that indicate significant stress, systemic risk, and investor harm. In addition, the SEC has proposed rules that require private fund advisers to provide detailed reports to investors regarding fees, expenses, performance, and preferential treatment of certain investors in the fund (such as through side letters). Proposed rules also require enhanced reporting for hedge funds.

(2) <u>Registered Funds:</u> Registered funds have grown to over $30 trillion in assets among 16,000 funds. The Chair praised ETFs, which "bring diversification to investors with even greater efficiency," and noted that the number of ETFs has grown by more than 50% in the last six years with assets held in ETFs now at $7 trillion. While money market funds and mutual funds have also seen growth and innovation, the Chair cautioned that "in times of stress, these funds' underlying structural liquidity mismatch can contribute to instability."

With these trends and concerns in mind, the SEC has proposed two separate rules – one to enhance transparency regarding fund names, and a second to establish disclosure requirements for funds and advisers that market themselves as having an ESG focus. "These proposals are

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[2] Gary Gensler, Chair of Securities and Exchange Commission, Remarks before the Inaugural Conference on Emerging Trends in Asset Management, *Honest and Unbiased Investment Management* (May 19, 2023), available at https://www.sec.gov/news/speech/gensler-honest-unbiased-investment-management-05192023.

about truth in advertising, from the name a fund uses to the information standing behind a funds' claims."

(3) Separately Managed Accounts: In the past five years, the number of separately managed accounts that are advised by RIAs has grown from 34 million to 53 million, with the vast majority of those accounts held by individual investors. This growth comes alongside new technologies, including artificial intelligence, natural language processing, and predictive data analytics, which underly the offerings of roboadvisers and wealth management apps.

Mr. Gensler noted that the use of predictive data analytics can create conflicts of interest, particularly to the extent that advisers or brokers are optimizing for their own interests rather than their client's. The Chair noted that new rule proposals are coming to address this issue.

To provide some historical context, Mr. Gensler explained that the SEC passed rules in 2019 regarding Regulation Best Interest for broker-dealers and the fiduciary standard for investment advisers, in response to investors lacking understanding about the difference between broker-dealer and investment adviser duties to investors. The Chair explained that investment advisers have a fiduciary duty to act in their investor's best interests and not place their own interests ahead of a client's. The SEC recently published bulletins clarifying the applicable standards.

(4) Third Party Service Providers: The use of third-party service providers by investment advisers and funds has grown in recent years. The SEC has proposed rules to make sure that advisers continue to meet their fiduciary obligations to clients regardless of whether the advisers use third-party providers or not.

(5) Qualified Custodians: Mr. Gensler observed that "Qualified custodians play a critical role to help ensure that investment advisers don't inappropriately use, lose, or abuse investors' assets." Coming out of the 2008 financial crisis and the Bernie Madoff fraud, Congress gave the SEC new authority to expand the regulation of adviser custody of client assets. The SEC recently proposed rules to "expand and enhance the role of qualified custodians so that investors receive the time-tested protections that they deserve for all of their assets, consistent with what Congress envisioned."

(6) Cybersecurity and Information Protection: The asset management industry relies on online information storage systems, while those who seek to infiltrate and harm those systems have become increasingly sophisticated. The SEC has proposed rules to enhance cybersecurity practices, incident reporting, and breach notification requirements for investment advisers and funds, among others.

Mr. Gensler's remarks provide an interesting lens into the SEC's view of emerging trends in asset management, along with corresponding rule-making and enforcement priorities.