INVESTMENT ADVISER ASSOCIATION

September 14, 2023

Via Electronic Filing

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Petition for Rulemaking to Amend the Definition of "Small Entity" in Rule 0-7 under the Investment Advisers Act of 1940 for Purposes of the Regulatory Flexibility Act

Dear Ms. Countryman:

The Investment Adviser Association (**IAA**)[1] respectfully petitions the Securities and Exchange Commission pursuant to Rule 192 of the Commission's Rules of Practice[2] to initiate rulemaking proceedings to amend Rule 0-7 under the Investment Advisers Act of 1940 (**Advisers Act**),[3] which defines a small entity for purposes of the Regulatory Flexibility Act of 1980 (**Reg Flex Act**).[4] Specifically, we request that the Commission amend the definition to use the number of employees of an investment adviser as the appropriate size standard for purposes of determining the impact of its regulations on small advisers, including considering less onerous alternatives, as required by the Reg Flex Act.[5]

[1] The IAA is the leading organization dedicated to advancing the interests of fiduciary investment advisers. For more than 85 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. For more information, please visit www.investmentadviser.org.

[2] 17 CFR. § 201.192(a).

[3] 17 CFR § 275.0-7.

[4] Rule 0-7 includes the terms "small business" or "small organization" as defined in Section 601(3)-(4) of the Reg Flex Act. We note that the definition of "small entity" under Rule 0-7 is also used by the Commission in Rule 202.9 for purposes of the Small Business Regulatory Enforcement Fairness Act (**SBREFA**). The SBREFA, enacted in 1996 and amending the Reg Flex Act, requires, among other things, agencies to establish small entity penalty reduction or waiver policies. *See* Rule 202.9(a)(4).

[5] The IAA strongly supports the enactment of H.R. 2792, the "Small Entity Update Act," passed by the House of Representatives on May 30, 2023, which would require the Commission to report on and revise the definition of small entity every five years. Specifically, under the bill, "the SEC must provide specific and detailed recommendations to Congress on how the SEC can revise the definition of *small entity* to (1) align with specified statutory goals, including reducing unnecessary burdens on small entities; and (2) expand the number of entities covered. The SEC must also issue a proposed rule to implement these recommendations." *See* Summary: H.R.2792, available at https://www.congress.gov/bill/118th-congress/house-bill/2792#:~:text=This%20bill%20requires%20the%20Securities,small%20entity%20every%20five%20years.

The IAA's member firms manage assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. Our members play an important role in helping individuals navigate the complex financial markets and meet their financial goals, including investing for retirement, home ownership, or education. In addition, our members' investments on behalf of clients in businesses large and small help those companies grow and create jobs. The investment adviser industry itself is a strong contributor to our economy, steadily adding firms, jobs, and new investors.[6] And small businesses are the backbone of the investment adviser industry, with more than 92% having 100 or fewer employees.

However, the current definition of a small entity used by the Commission precludes the agency from satisfying its statutory obligations under the Reg Flex Act to accurately analyze the impact of its regulations on smaller advisers and consider less onerous alternatives. Specifically, the Commission defines a small adviser, in part, to include any adviser that has less than $25 million in assets under management (**AUM**).[7] However, with few exceptions, advisers are not permitted to register with the Commission unless they have at least $100 million in AUM,[8] thus making any analysis the Commission does regarding the impact on smaller advisers virtually meaningless and contrary to the legislative intent of the Reg Flex Act.

The IAA shares the Commission's goals of protecting investors and ensuring the integrity of the markets, and we strongly support effective regulations to achieve these goals. However, we also note that such regulations must be appropriately tailored to balance their burdens and benefits, take into account differences in the entities regulated, including with respect to size and resource constraints, and be no more onerous than is necessary to meet their objectives. A more realistic measure of what constitutes a smaller adviser would, in our view, help the Commission develop more effective regulations.

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[6] Our industry added 42,982 jobs in 2022, to reach total non-clerical employment of 971,487. *See* IAA's *2023 Investment Adviser Industry Snapshot* (**IAA Snapshot**), available at https://investmentadviser.org/wp-content/uploads/2023/06/Snapshot2023_Final.pdf. Unless otherwise noted, the data cited in this Petition is from the IAA Snapshot, which analyzes Form ADV information as of April 6, 2023.

[7] Based on the data the IAA analyzed for the IAA Snapshot, only 6% of SEC-registered advisers have less than $25 million AUM.

[8] Specifically, advisers are prohibited from registering with the SEC if they have: (1) less than $25 million AUM; or (2) between $25 million and $100 million *unless* subject to an exception (exempt from state registration or not subject to examination by a state). However, the following are generally excluded from the prohibition on SEC registration and *required* to be registered with the SEC: (1) advisers to SEC-registered investment companies; (2) advisers to business development companies; (3) certain pension consultants; and (4) related advisers. The following are generally permitted but not required to register with the SEC: (1) advisers expecting to be eligible for SEC registration; (2) multi-state advisers; and (3) internet advisers. *See* Section 203A of the Advisers Act; *see also Exemption for Certain Investment Advisers Operating Through the Internet*, 88 Fed. Reg. 50076 (Aug. 1 2023)(proposed amendments to exemption for internet adviser). According to our review of recent Form ADV filings, approximately 12% of registered advisers reported having $100 million or less in AUM.

As discussed below, we believe that the number of employees of an adviser – specifically 100 or fewer – is a more appropriate size standard for purposes of the Reg Flex Act because it would more precisely capture the small advisers under the Commission's jurisdiction that are entitled to the protections of the Act.[9] We note that advisers are already required to report the number of employees pursuant to Item 5.A of Form ADV Part 1A, making this new standard easy to implement. We also believe that the number of employees is a more evergreen measure than an asset-based test, which is subject to inflation and more generally susceptible to fluctuation.

I. Background

A. Regulatory Flexibility Act

The Reg Flex Act was enacted to address concerns that federal regulations often disproportionately affect small businesses due to their limited resources, thus hindering their growth and competitiveness in the marketplace. The Reg Flex Act requires the Commission, among other things, to consider the impact of its rulemakings on the entities subject to its regulation that qualify as small businesses,[10] analyze effective alternatives that minimize small entity impact, and make such analyses available for public comment. Specifically, the Reg Flex Act is intended, in part, to:

> "establish as a principle of regulatory issuance that agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses … subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration."[11]

[9] While advisers with a smaller amount of AUM are generally likely to be small businesses, an AUM measure misses a significant number of other advisers that may manage higher AUM but still face similar resource constraints and other challenges that are characteristic of a small business. We believe that number of employees is a more realistic measure of an adviser's business and compliance challenges.

[10] This definition must be established pursuant to applicable standards set forth in the Reg Flex Act, the Small Business Act, 15 U.S.C. 631 *et seq.* or regulations promulgated by the Small Business Administration (**SBA**). *See* 5 U.S.C. 601(3) and 601(4). The Reg Flex Act also explicitly directs the SBA to monitor and report on federal agencies' compliance with the Act. *See* § 612 of the Reg Flex Act (requiring the "Chief Counsel for Advocacy of the Small Business Administration" to "monitor agency compliance with this chapter and … report at least annually thereon to the President and to the Committees on the Judiciary and Small Business of the Senate and House of Representatives").

[11] *See* Reg Flex Act, *Congressional Findings and Declaration of Purpose* (**Preamble**) at (b).

In essence, the Reg Flex Act directs agencies to be aware of the economic structure of the "entities they regulate and the effect their regulations may have on small entities."[12] This required analysis was "built into the regulatory development process at the earliest stages [to] help agency decision makers achieve regulatory goals with realistic, cost-effective, and less burdensome regulations."[13]

While the Reg Flex Act does not mandate different outcomes for smaller advisers,[14] it nevertheless provides critical protections for small businesses from unnecessary costs and burdens imposed by federal regulations by requiring that agencies undertake a realistic and analytical examination of issues facing small businesses. The Preamble to the Reg Flex Act explicitly states that "the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity…."[15] And, as noted by the SBA, "[i]n some cases, a small business may be unable to stay in business because of the cost of a regulation. Simply stated, fixed costs have a greater impact on small entities because small entities have fewer options for recovering them. Without the necessary facts, it is possible for an agency to cause serious unintended or unforeseen adverse impacts on small businesses."[16]

B. SEC Definition of a Small Adviser for Purposes of the Reg Flex Act

As defined in the Reg Flex Act, the term "small business" has the same meaning as the term "small business concern" defined in the Small Business Act,[17] *unless* "an agency, after consultation with the Office of Advocacy of the [SBA] and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."[18]

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[12] *See The RFA in a Nutshell: A Condensed Guide to the Regulatory Flexibility Act*, published by the SBA Office of Advocacy (June 2013), available at https://advocacy.sba.gov/resources/the-regulatory-flexibility-act/rfa-in-a-nutshell-a-condensed-guide-to-the-regulatory-flexibility-act/.

[13] *Id.*

[14] The Reg Flex Act does "not seek preferential treatment for small entities, nor does it require agencies to adopt regulations that impose the least burden on them, or mandate exemptions for them. Rather, it requires agencies to examine public policy issues using an analytical process that identifies barriers to small business competitiveness and seeks a level playing field for small entities, not an unfair advantage." *See A Guide for Government Agencies How to Comply with the Regulatory Flexibility Act*, published by the SBA Office of Advocacy (Aug. 2017) (**SBA Guide**), available at https://advocacy.sba.gov/resources/the-regulatory-flexibility-act/a-guide-for-government-agencies-how-to-comply-with-the-regulatory-flexibility-act/.

[15] *See* Reg Flex Act, Preamble at (a)(4).

[16] *See* SBA Guide at 1.

[17] Section 3 of the Small Business Act. 15 U.S. Code § 632(a).

[18] 5 U.S.C. § 601(3).

In 1982, the Commission adopted its own definitions of "small business" for purposes of the Reg Flex Act after considering size standards adopted by the SBA in 1980.[19] Specifically, the Commission noted that the SBA had determined to use a definition based in "terms of the number of employees" rather than dollar amount to "avoid distortions caused by inflation and the need for frequent revision of standards to reflect the effects in inflation."[20] The Commission determined that "the SBA size standards were generally inappropriate in the context of regulations affecting securities issuers and reporting companies" under the agency's jurisdiction.[21]

In our view, the Commission in 1982 adopted a somewhat arbitrary definition of a "small entity" pertaining to advisers for purposes of the Reg Flex Act. The 1982 definition included, among other criteria, a $50 million AUM threshold.[22] Specifically, a small entity included each adviser that managed assets with a total value of $50 million or less. However, this AUM threshold was based on the Commission's analysis in defining a small investment company under the Investment Company Act of 1940 for purposes of the Reg Flex Act.

According to the Commission, the threshold was "derived from an examination of adjusted expense ratios of approximately 500 registered investment companies" at the time. The Commission – without a reasonable explanation – chose this size standard for advisers as well, not based on an independent analysis of investment advisers, but rather "because of the

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[19] *See Small Business Size Standards, Revisions of Methods of Establishing Size Standards and Definitions of Small Business*, 45 Fed. Reg. 15442 (Mar. 10, 1980). The Small Business Act authorizes the SBA to define "small business" by regulation, which it does for each of the business categories listed in the North American Industry Classification System (**NAICS**), available at https://www.census.gov/naics/. The SBA provides a table of small business size standards (**SBA Table**) on its website at https://www.sba.gov/document/support-table-size-standards. For each NAICS code, SBA size standards vary by industry and are generally based on either number of employees or a revenue ceiling.

[20] *See Proposed Definitions of "Small Business" and "Small Organization" for Purposes of the Regulatory Flexibility Act*, Securities Act Rel. No. 6302, Exchange Act Rel. No. 17645, PUHCA Rel. No. 21970, Trust Indenture Act Rel. No. 619, Investment Company Act Rel. No. 11694, Investment Advisers Act Rel. No. 754, 46 Fed. Reg. 19251 (Mar. 30, 1981) (**1981 Proposal**), available at https://www.govinfo.gov/content/pkg/FR-1981-03-30/pdf/FR-1981-03-30.pdf.

[21] *Id.* The Commission adopted specific size standards regarding "disclosure, reporting and regulatory requirements applicable to business concerns and other organizations" under its jurisdiction pursuant to the securities laws. *See Final Definitions of "Small Business" and "Small Organization" for Purposes of the Regulatory Flexibility Act*, Securities Act Rel. No. 6380, Exchange Act Rel. No. 18452, PUHCA Rel. No. 22371, Trust Indenture Act Rel. No. 693, Investment Company Act Rel. No. 12194, Investment Advisers Act Rel. No. 791, 47 Fed. Reg. 5215, 5216 (Feb. 4, 1982) (**1982 definition**), available at https://archives.federalregister.gov/issue_slice/1982/2/4/5214-5223.pdf#page=2.

[22] Pursuant to the SEC's 1982 definition, small entities included each adviser that either (i) manages assets ("client assets") with a total value of $50 million or less as of the end of its most recent fiscal year, and performs no other advisory services; or (ii) performs other advisory services, manages client assets of $50 million or less if it manages client funds, and has assets related to its advisory business ("business assets") that do not exceed $50,000 ("balance sheet test"). The Commission noted that "[a]lthough using $50 million as the cut-off point *might classify as small a large proportion of investment advisers*, the Commission believes that this is reasonable and appropriate under the circumstances for purposes of the [Reg Flex Act]." (emphasis added) *See* 1981 Proposal at 19263.

similarities, with respect to the management of assets, between the investment company and the investment advisory businesses."[23]

In 1998, the Commission amended the definition of a small entity for advisers, among other things, to adjust the AUM threshold to reflect the enactment of the National Securities Markets Improvement Act of 1996 (**NSMIA**). When NSMIA was adopted, regulatory responsibility over advisers was allocated between the Commission and state securities regulators by generally prohibiting advisers with less than $25 million in AUM from registering with the Commission. The Commission reduced the $50 million AUM threshold in the 1982 definition to reflect the $25 million SEC registration threshold established for advisers in 1996, concluding that Congress "viewed 'small advisers' as those having less than $25 million of assets under management."[24]

However, the Commission inexplicably retained the balance sheet asset test for purposes of the small entity definition, raising it from $50,000 to $5 million, and stating that "the $25 million client asset threshold coupled with a $5 million total assets test more appropriately reflects [NSMIA's] allocation of regulatory responsibilities between the Commission and the states."[25] Keeping the balance sheet asset test resulted in further limiting the number of small businesses beyond the registration threshold established by NSMIA. In addition, the Commission excluded advisers from small entity status when they are affiliated with a large adviser through a control relationship.[26]

Thus, under current Rule 0-7, an investment adviser is deemed a small entity for purposes of the Reg Flex Act if it: (1) has less than $25 million AUM or such higher amount as the Commission may by rule deem appropriate;[27] (2) did not have total assets of $5 million or more

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[23] *See* 1982 definition at 5221. We disagree with the premise that advisers' management of assets for a registered investment company is sufficiently similar to the management of assets for other types of clients such that a separate analysis was not warranted.

[24] *See Definitions of "Small Business" or "Small Organization" Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933*, 63 Fed. Reg. 35508, 35511 (June 30, 1998) (**1998 definition**), available at https://www.govinfo.gov/content/pkg/FR-1998-06-30/pdf/98-17387.pdf.

[25] The Commission estimated that under the 1982 definition, approximately 75% of registered investment advisers qualified as small. However, under NSMIA's registration threshold, the Commission lost responsibility for regulating the vast majority of advisers that had previously been considered a small entity for purposes of the Reg Flex Act under the 1982 definition. *See* 1998 definition at 35511-35512.

[26] The Commission also sought to "simplify" the 1982 definition by retaining and applying the business asset test to "all advisers, rather than solely to advisers that render services other than or in addition to managing client assets." *See* 62 Fed. Reg. 4106 (Jan. 28, 1997).

[27] *See* Section 203A(a)(1)(A) of the [Advisers] Act (15 U.S.C. 80b-3a(a)(1)(A)) ("has assets under management of not less than $25,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this subchapter").

on the last day of the most recent fiscal year;[28] and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.

The Commission also amended the 1982 definition in a manner intended to explicitly coordinate Rule 0-7 with any future Commission rulemaking to increase the $25 million AUM registration threshold for advisers (*i.e.*, by using statutory and rule cross-references). Thus, the "amended rule provides that the maximum threshold for a small business will increase in tandem with any increase in the minimum threshold for [A]dvisers [A]ct registration." However, when the SEC registration threshold for advisers was effectively increased from $25 million to $100 million in 2010 under the Dodd-Frank Act, the Commission did not at that time amend the small entity definition in Rule 0-7.[29]

According to a recent Commission estimate, only approximately 489 of the total 15,402 SEC-registered advisers are deemed small entities for purposes of the Reg Flex Act.[30]

C. An Industry of Small Businesses

The investment adviser industry consists mostly of advisers that are small businesses – by any rational measure – helping individual investors meet their financial goals, including investing for retirement, home ownership, or education. This is underscored by recent industry statistics regarding SEC-registered advisers. For example, according to the IAA Snapshot, in 2022:

- 92% of advisers employed 100 or fewer people, accounting for 21% of the *total* AUM in the industry; of these advisers, 63% managed assets for individuals.

- Advisers focused on individuals as clients were likely to be small, with an average of just nine employees, two offices, and $330 million in AUM.

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[28] For purposes of this definition, total assets means total assets as shown on the balance sheet of an investment adviser or other "person" in a control relationship with the adviser. It "includes business assets, such as leases and equipment, as well as other types of assets, such as cash and accounts receivable." *See* 1998 definition.

[29] The Commission did, however, amend Rule 0-7 in 2011 to reflect changes to these rule cross-references resulting from the enactment of the Dodd-Frank Act. The Dodd-Frank Act created a new group of "mid-sized advisers" and further shifted primary responsibility for their regulatory oversight to the state securities authorities. Specifically, the Dodd-Frank Act prohibits from registering with the Commission an adviser that is registered as an adviser in the state in which it maintains its principal office and place of business and that has between $25 million and $100 million AUM.

[30] Based on IARD data as of Dec. 31, 2022. *See Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, 88 Fed. Reg. 53960 (Aug. 9, 2023), available at https://www.federalregister.gov/documents/2023/08/09/2023-16377/conflicts-of-interest-associated-with-the-use-of-predictive-data-analytics-by-broker-dealers-and.

- Fewer than 2% had a workforce of over 500 people, and over half had only one office, while the median adviser employed 8 people.

- Smaller advisers accounted for a disproportionately high percentage of industry employment relative to their AUM. For example, advisers with $100 million to $1 billion in AUM (just over 58% of firms) managed under 3% of total industry assets but accounted for almost 11% of employment.

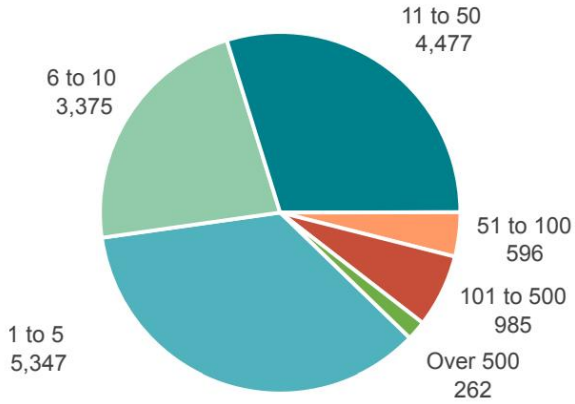
- New SEC registrants were overwhelmingly small businesses – 92% had less than $1 billion in AUM; these new firms accounted for 10% of the firms in the two smallest AUM categories (under $100 million and $100 million to $1 billion).

The following figures and table from the IAA Snapshot further illustrate that investment advisers registered with the Commission make up an industry of small businesses.

FIGURE 1I

Most Advisers are Small Businesses

Number of Advisers by Number of Non-Clerical Employees, 2022



Note: Excludes advisers reporting zero employees.

FIGURE 1J

Smaller Advisers Account for a High Proportion of Employees Relative to Assets Managed

2022

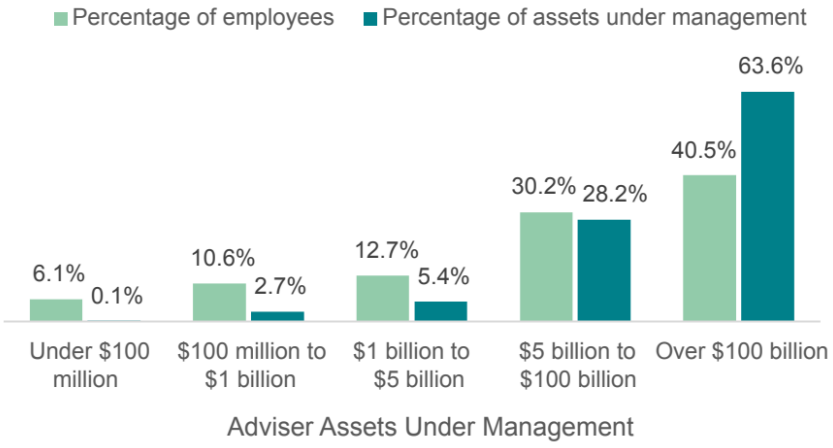


TABLE 1C

Most Advisers Are Small Businesses

2022

	Median	Top Quartile	Top Decile	Average	Range
Number of employees	8	20	65	64	0 to 36,687
Assets under management	$373 million	$1.4 billion	$6.2 billion	$7.5 billion	$0 to $6.6 trillion
Number of clients:					
Individuals	65	314	888	3,432	0 to 6.6 million
Pooled vehicles	0	4	14	8	0 to 2,368
Institutions	0	6	27	121	1 to 868,482
Number of offices	1	2	5	9	1 to 14,976

II. Discussion

The IAA has long advocated[31] for the Commission to adhere to the core principles of the Reg Flex Act that require the agency to realistically analyze and consider the impacts of its regulations on smaller advisers, which have been disproportionately burdened by one-size-fits-all regulations – both in isolation and cumulatively.[32] We have frequently called on the Commission to take steps to tailor its rules to minimize these impacts, for example through preserving a flexible, risk- and principles-based approach, where appropriate excluding or exempting smaller advisers from specific requirements, or scaling those requirements to the size of an adviser, and tiering and staggering compliance timetables within and among rules.[33]

We have also frequently called on the Commission to adopt a more realistic standard for small advisers for purposes of the Reg Flex Act. Unfortunately, the current asset-based size standard for small advisers is deeply flawed, as we discuss below. Under this standard, the Commission does not accurately analyze the impact of its regulations on small advisers as required under the Reg Flex Act because only a minute number of SEC-registered advisers are deemed to be small. This is so even though, as cited above, the vast majority of advisers regulated by the agency are in fact small businesses by any reasonable common-sense measure and are thus entitled to protections under the Reg Flex Act.

A. The "asset-based" approach to establishing size standards for advisers for purposes of the Reg Flex Act does not accurately capture small advisers regulated by the Commission.

Using an asset-based size standard, *i.e.*, a standard based on an adviser's AUM and total firm balance sheet assets, does not accurately reflect the true burdens of SEC regulations being imposed on smaller advisers regulated by the agency as contemplated by the Reg Flex Act. Moreover, coupling the small entity definition for purposes of the Reg Flex Act with the SEC adviser registration thresholds imposed by NSMIA incorrectly conflates the principal goals of

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[31] *See, e.g., IAA Letter to SEC Regarding Adviser Proposals* (June 17, 2023), available at https://investmentadviser.org/resources/iaa-comment-letter-to-sec-regarding-adviser-proposals/; *IAA Letter to SEC Chair Gary Gensler Regarding Regulation of Investment Advisers* (May 17, 2021), available at https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/about/Comment_Letter_Compendiums/2021/May_17__2021_-_IAA_SEC_Dear_Chair_Letter_FINAL.pdf. *See also presentation of IAA made to the Commission's Asset Management Advisory Committee* (**AMAC**) (Sept. 27, 2021), available at https://www.sec.gov/files/iaa-presentation-karen-barr-gail-bernstein-092721.pdf.

[32] We note that AMAC similarly recommended that the definition of small entity used for purposes of the Reg Flex Act be modernized to more accurately identify smaller advisers. *See AMAC Final Report and Recommendations for Small Advisers and Funds* (Nov. 3, 2021), available at https://www.sec.gov/files/final-recommendations-amac-sec-small-advisers-and-funds-110321.pdf.

[33] A more accurate definition of smaller advisers would also enable the SEC to use the ever-increasing amount of data that is required to be reported to the agency to tailor regulations and its examination program more appropriately for smaller advisers.

each statute and has resulted in disproportionate and significant regulatory burdens being imposed on smaller advisers regulated by the Commission.

In adopting the 1982 definition, the Commission acknowledged concerns raised by the SBA with utilizing an asset-based size standard instead of an employee-based standard. The SBA was concerned with the distortions caused by inflation and the inevitable need for frequent revision of any asset-based measure. The Commission, however, opted for an asset-based size standard, rejecting "using the number of employees as a measure of smallness for investment companies and investment advisers" under the rationale that "(1) neither the investment company nor the adviser industry is labor intensive; and (2) investment companies are generally externally managed and operated by their investment advisers so that most investment companies have few employees."[34] This reasoning fails on both fronts. First, it does not follow that because an investment company may have few employees, an investment adviser will also have few employees. Second, there is no doubt that regulatory compliance depends heavily on human resources – and is in fact increasingly "labor intensive."

The Commission also explicitly declined in 1982 to index the AUM threshold for inflation arguing that doing so "is not necessary because $50 million is only an estimate and it can be *changed in the future as necessary*." [emphasis added] Yet, the Commission has never adjusted the asset-based definition of small entity for inflation nor considered increasing the AUM size standard for Reg Flex Act purposes to realistically reflect the significant increase in the number of smaller advisers regulated by the agency during the 25 years since the rule was amended in 1998.

Using an assets-based size standard that is tied to the SEC registration threshold as the measure for being considered "small" does not accurately reflect the burdens of regulations being imposed on smaller advisers under the SEC's jurisdiction. In determining to couple the small entity definition with the adviser registration thresholds, the Commission cited to a Congressional report stating that NSMIA "allows states to assume the primary role with respect to regulating advisers that are small, local businesses, managing less than $25 million in client assets, while the Commission's role is focused on larger advisers with $25 million or more in

[34] Notably, when the Commission considered the 1982 definition, the SBA had suggested that the Commission raise the "cut-off point to $100 million to increase the number of investment advisers that will be eligible for regulatory relief," indicating the view that a larger number of advisers should be considered small than the Commission appeared to be contemplating. *See* 1982 definition at 5220. Another commenter had also suggested raising the cut-off point to $100 million, "but would add, as alternatives, 'maintains 25 or less accounts or employs 5 or less persons.'" However, the Commission rejected these suggestions because, in part, it had "no information about the specific number of employees of investment advisers or how many investment advisers employ 5 or less persons." The Commission further believed that "[a]side from the difficulty of defining 'employee' (whether to include half-time, full-time, temporary, permanent, partners, etc.), an attempt to solicit this information from investment advisers would impose unnecessary burdens on them to provide information, contrary to the spirit of the Paperwork Reduction Act." However, this rationale no longer applies because advisers are now required to report the number of employees pursuant to Item 5.A of Form ADV Part 1A, which would make implementation of an employee-based size standard simple and straightforward.

client assets under management."[35] It appears that based on this language alone, the Commission concluded that *for purposes of the Reg Flex Act*, "Congress viewed 'small advisers' as those having less than $25 million of assets under management." We believe that this conclusion was wrong and not supported either by the language of NSMIA or its legislative history and is incompatible with the explicitly stated purposes of the Reg Flex Act to protect small businesses regulated by the Commission from unnecessarily onerous compliance burdens.

We do not believe Congress intended through NSMIA to define a "small adviser" for purposes of the Reg Flex Act, or to effectively exempt the Commission from its separate and distinct regulatory obligations under the Reg Flex Act to consider the impact of its regulation on smaller advisers that are under the agency's jurisdiction. Neither NSMIA nor the Congressional report cited by the Commission mentions the Reg Flex Act nor are we aware of any legislative history that demonstrates Congressional intent with respect to the interplay between the Reg Flex Act and the SEC's registration thresholds for advisers. We thus believe that coupling the Reg Flex Act test with the SEC registration threshold for advisers is inconsistent with the purpose of the Reg Flex Act. Moreover, we note that Rule 0-7 itself departs from the NSMIA registration threshold by including a second total assets test on top of AUM, which further decreases the number of smaller advisers beyond what was contemplated for registration under NSMIA, and thus further limits the SEC's obligation to perform a Reg Flex Act analysis.

As outlined in this Petition, we believe that a more accurate measure of whether an adviser is a small business for purposes of the Reg Flex Act is the number of employees of the adviser based on data that is readily available on an adviser's Form ADV. As noted above, while advisers with lower AUM are likely to be small businesses, these advisers comprise only a subset of the larger group of advisers that are small businesses facing small-business challenges. Basing the size standard on number of employees also has the additional benefit of being more "evergreen" compared to asset-based standards that are far more susceptible to fluctuation and will inevitably be distorted with the passage of time.[36]

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[35] *See* Senate Report on S. 1815, "The Securities Investment Promotion Act of 1996," S. Rep. No. 293, 104th Cong., 2d Sess. 1–4 (1996) (legislation would focus SEC supervision "on investment advisers most likely to be engaged in interstate commerce" and focus state supervision "on advisers whose activities are most likely to be centered in their home state"; "legislation allows states to assume the primary role with respect to regulating advisers that are small, local businesses, managing less than $25 million in client assets, while the Commission's role is focused on larger advisers with $25 million or more in client assets under management").

[36] Specifically, we recommend removing both the AUM and the total balance sheet assets of the adviser from the definition of small entity for purposes of the Reg Flex Act. As noted above, the current definition also generally excludes an adviser from the definition if it is affiliated with a larger adviser. We believe that this exclusion is overly broad and does not account for separate legal entities that may be part of a corporate group but nonetheless operate independently. Moreover, the exclusion presumes that an ownership interest equates to significant economic or financial resources being provided by an affiliate to an adviser. We would expect the Commission, as part of the notice and comment process, to seek input on all elements of the proposed definition, including what specific factors would appropriately include as small entities those advisers that are substantially managed and resourced independently of any control affiliate.

B. SEC regulations typically impose significant burdens on advisers that are highly labor intensive, especially for smaller advisers.

Regulations imposed by the Commission often require substantial fixed investments by advisers in infrastructure, personnel, and technology. Depending on the requirements of new regulations, advisers may need to develop and maintain new or upgraded systems and create and implement related policies and procedures, relating, for example, to documentation and recordkeeping, contract and vendor management – including due diligence and monitoring of outsourcing – compliance monitoring and testing, operations, custody, business continuity planning, and more.

The Commission increasingly expects that advisers will incur the bulk of the costs associated with compliance of new regulations initially, rather than on an ongoing basis. While initial undertakings are likely to pose a greater burden on smaller advisers that may not have as much capacity to take on these immediate, substantial costs, we disagree with the Commission's repeated assessment that these costs will be transitory. On the contrary, the costs relating to ongoing compliance will continue to impose substantial burdens on smaller advisers.

New regulations burden smaller advisers in unique ways and these burdens are only increasing. These considerable costs and burdens also create meaningful barriers to entry for new smaller and emerging businesses, and increase pressure on existing smaller advisers for industry consolidation, thereby reducing competition and the investment choices available to investors.

Smaller advisers typically lack the internal infrastructure of larger firms. They have fewer resources to spend, limited leverage to access the services of and negotiate terms with third parties and service providers, and very little ability to recognize savings through in-house leveraging of resources or scaling. They have a limited number of personnel, many of whom perform multiple functions within the adviser, and face increasing challenges attracting and retaining qualified personnel, including for compliance roles. As a result of these constraints and limited resources, smaller advisers face significant challenges to address ever increasing regulatory burdens. Smaller advisers today are required to meet governance, operational, data management, security, and compliance demands at an unprecedented level.

Because human resources are so critical to an adviser's compliance efforts, we believe that, even if the Commission were to raise the current asset-based thresholds, an asset-based size standard is problematic, as discussed below. We believe, instead, that an employee-based standard would more accurately and appropriately reflect the small-business nature of the adviser industry for purposes of the Reg Flex Act analysis. Accordingly, as discussed further below, we request that the Commission amend Rule 0-7 to replace the current asset-based size standard with an employee-based standard, specifically 100 or fewer employees.

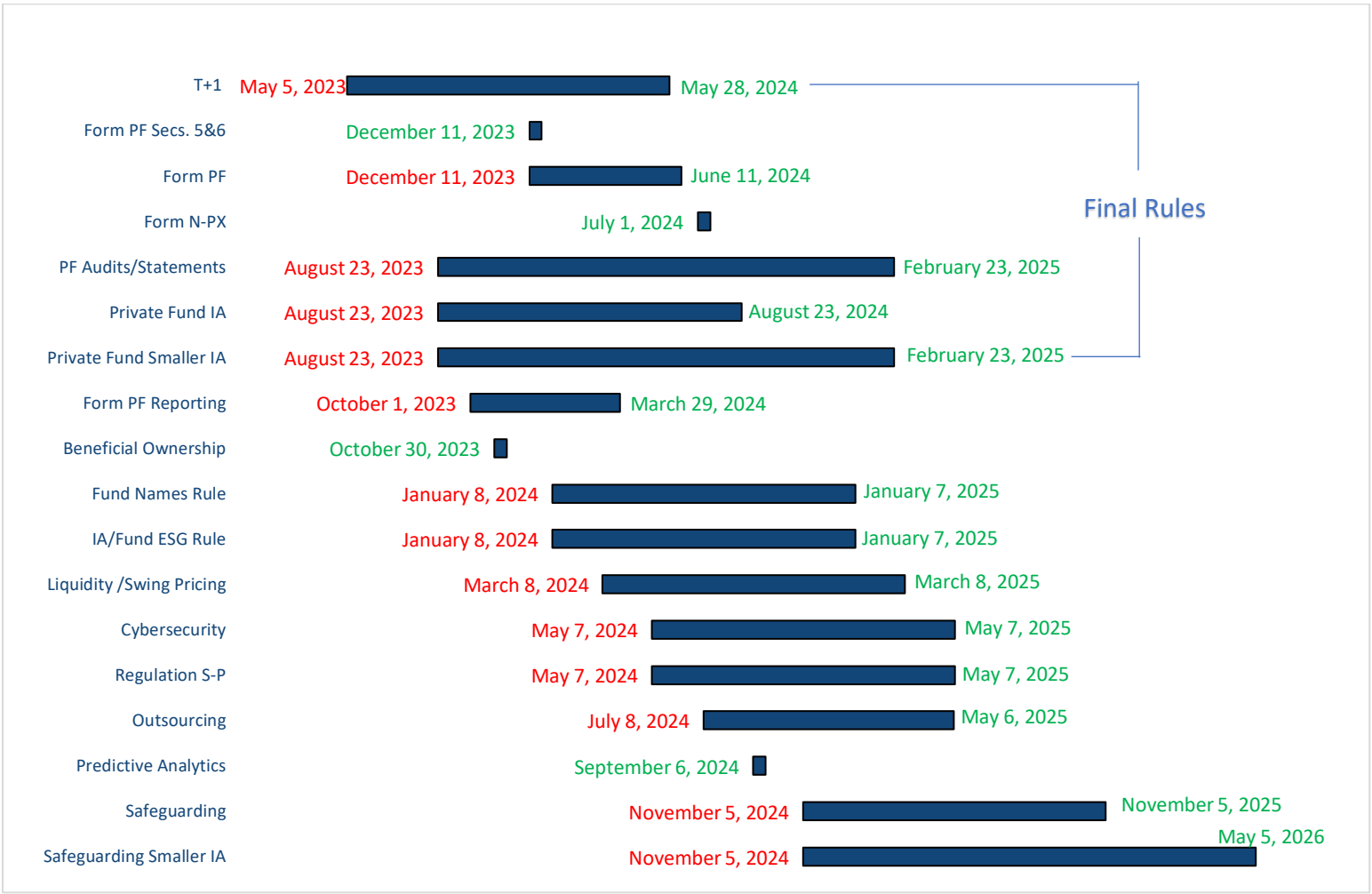
C. The scale and speed of the Commission's recent rulemaking activities further exacerbate our concerns regarding the current definition of small advisers for purposes of the Reg Flex Act.

Our concerns regarding the current definition of small advisers for purposes of the Reg Flex Act have been greatly exacerbated by the sheer scale and speed of the Commission's rulemaking activities over the past two years. As noted above, the Reg Flex Act requires the Commission to accurately consider the impacts its regulations will have on smaller advisers, including operational limitations and resource constraints.

However, the Commission has proposed or adopted more than a dozen consequential regulations during the past two years – some that are highly interrelated – which will significantly and suddenly overhaul the current regulatory regime for advisers on a scale that is unprecedented. Moreover, the many implementation challenges associated with these rulemakings and the proposed overlapping compliance dates will demand advisers to devote significant and increased operational, personnel, and compliance resources during an unreasonably short period of time. Advisers will be forced to re-allocate the time and resources that are already budgeted to – and for the existing needs of – their compliance programs to implement these new regulations concurrently and in a compressed time frame.

The following graph illustrates the daunting task small advisers will face in implementing the many new and proposed regulations beyond existing obligations and under the timelines being contemplated by the Commission.

Select SEC Rulemakings Affecting Investment Advisers[37] Effective & Compliance Dates



[37] We have selected final and proposed SEC rules that will have a significant impact on advisers, particularly smaller advisers, for illustrative purposes only. With respect to SEC rules that are in the proposal stage or awaiting publication in the *Federal Register* as of September 13, 2023, the graph illustrates implementation timelines that are based on reasonable assumptions regarding the effective dates and the compliance dates being proposed by the Commission for each proposal.

To make matters worse for smaller advisers, the Commission's dramatic departure from the longstanding principles-based approach to regulating advisers to more prescriptive regulation makes it all the more challenging for smaller advisers to adapt and scale regulatory requirements to their specific circumstances. Thus, we feel compelled now to petition the Commission to amend its definition of a small entity as it pertains to advisers for purposes of the Reg Flex Act.

D. The definition of a "small entity" for purposes of the Reg Flex Act should be based on advisers that employ 100 or fewer people.

The IAA believes that the number of employees of an adviser – specifically 100 or fewer – is a more meaningful and accurate measure for classifying advisers as small entities for purposes of the Reg Flex Act, given that implementation of regulation requires human resources and AUM does not adequately capture many small advisers or reflect the burden of regulatory compliance. Moreover, the data on the number of employees is readily available in Form ADV and often used in other contexts to define the relative size of companies, and, as noted above, an employee-based measure is less susceptible to frequent and dramatic fluctuation.

Using the number of employees is also consistent with the principles used by the SBA in establishing its size standards, which we believe are consistent with the principles of the Reg Flex Act. Specifically, the SBA, among other factors, considers the "economic characteristics comprising the structure of an industry, including degree of competition, average firm size, start-up costs and entry barriers, and distribution of firms by size." The SBA also "considers technological changes, competition from other industries, growth trends, historical activity within an industry, unique factors occurring in the industry which may distinguish small firms from other firms, and the objectives of its programs and the impact on those programs of different size standard levels."[38]

Based on these considerations, we believe that an adviser with 100 or fewer employees, as reported in its Form ADV, should be deemed a small entity for purposes of the Reg Flex Act. This threshold is reasonable in light of the fact that under the most recent SBA Table, industries that use the number of employees as the size standard, as opposed to revenue, use thresholds ranging between 100 and 1,500 employees.[39]

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[38] *See* 13 CFR § 121.102.

[39] As noted above, in 2022, 92% of advisers employed 100 or fewer people and a majority of these advisers managed assets primarily for individual and retail clients. When viewing the SBA Table through the lens of businesses that offer services primarily to retail consumers, the number of employees ranges from 100 to 500 employees for those businesses that are subject to employee-sized standards.

Moreover, we note that employee thresholds between 100 and 500 are used in other instances with respect to the applicability of various regulations to smaller business. For example: employers with 100 or more employees are required to submit reports to the Equal Employment Opportunity Commission (**EEOC**) and the Department of Labor every year for information about employees' job categories, ethnicity, race, and gender (*see* EEOC website at https://www.eeoc.gov/data/eeo-data-collections); pursuant to FINRA guidance, a "small firm" is defined to mean a

III. Proposed Amended Rule 0-7 under the Advisers Act

In accordance with our comments above, we recommend that the Commission propose an amended Rule 0-7 as set forth below. Exhibit A provides the current text of Rule 0-7 marked to reflect our suggested changes:

§ 275.0-7 Small entities under the Investment Advisers Act for purposes of the Regulatory Flexibility Act.

(a) For purposes of Commission rulemaking in accordance with the provisions of Chapter Six of the Administrative Procedure Act (5 U.S.C. 601 *et seq.*) and unless otherwise defined for purposes of a particular rulemaking proceeding, the term *small business* or *small organization* for purposes of the Investment Advisers Act of 1940 shall mean an investment adviser registered with the Commission that has 100 or fewer *employees* as of the investment adviser's most recent fiscal year.

(b) For purposes of this section, employee means any person that is included in determining the number of employees reported by the adviser under Item 5.A of Form ADV (17 CFR 279.1).

* * *

firm that "has at least 1 and no more than 150 registered persons" (*see* FINRA Article 1 Definitions at https://www.finra.org/rules-guidance/rulebooks/corporate-organization/article-i-definitions); in the European Union (EU), small and medium-sized enterprises are defined as firms employing fewer than 250 persons (*see* official EU website at https://ec.europa.eu/eurostat/web/structural-business-statistics/information-on-data/small-and-medium-sized-enterprises#:~:text=SMEs%20are%20defined%20as%20employing,more%20than%20EUR%2043%20million.

We appreciate the Commission's consideration of our petition to amend Rule 0-7 and stand ready to provide any additional information that may be helpful. Please contact me or IAA General Counsel, Gail Bernstein, at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,

/s/ Karen L. Barr

Karen L. Barr
President & CEO

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
William A. Birdthistle, Director, Division of Investment Management

Meagan E. Singer, Office of Advocacy, U.S. Small Business Administration

EXHIBIT A

Amendments to Rule 0-7 to Reflect IAA Recommendations

§ 275.0-7 Small entities under the Investment Advisers Act for purposes of the Regulatory Flexibility Act.

(a) For purposes of Commission rulemaking in accordance with the provisions of Chapter Six of the Administrative Procedure Act (5 U.S.C. 601 *et seq.*) and unless otherwise defined for purposes of a particular rulemaking proceeding, the term *small business* or *small organization* for purposes of the Investment Advisers Act of 1940 shall mean an investment adviser registered with the Commission that has 100 or fewer *employees* as of the investment adviser's most recent fiscal year ~~an investment adviser that:~~.

~~(1) Has assets under management, as defined under Section 203A(a)(3) of the Act (15 U.S.C. 80b-3a(a)(2)) and reported on its annual updating amendment to Form ADV (17 CFR 279.1), of less than $25 million, or such higher amount as the Commission may by rule deem appropriate under Section 203A(a)(1)(A) of the Act (15 U.S.C. 80b-3a(a)(1)(A));~~

~~(2) Did not have total assets of $5 million or more on the last day of the most recent fiscal year; and~~

~~(3) Does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more (or such higher amount as the Commission may deem appropriate), or any person (other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year.~~

(b) For purposes of this section, ***employee*** means any person that is included in determining the number of employees reported by the adviser under Item 5.A of Form ADV (17 CFR 279.1)~~:~~.

~~(1) **Control** means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise.~~

~~(i) A person is presumed to control a corporation if the person:~~

~~(A) Directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or~~

(B) Has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.

(ii) A person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.

(iii) A person is presumed to control a limited liability company (LLC) if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC;

(B) Has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or

(C) Is an elected manager of the LLC.

(iv) A person is presumed to control a trust if the person is a trustee or managing agent of the trust.

(2) **Total assets** means the total assets as shown on the balance sheet of the investment adviser or other person described above under paragraph (a)(3) of this section, or the balance sheet of the investment adviser or such other person with its subsidiaries consolidated, whichever is larger.