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July 19, 2024

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

Re: File Number S7-2024-02, Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers

Dear Secretary:

The author of this Comment Letter is a rising second-year student at The Maurice A. Deane School of Law at Hofstra University. The author has completed a bachelor's degree in business management with a minor in legal studies from Farmingdale State College. The author is a staff member of the Hofstra Law Review studying administrative law, specifically the rulemaking process. All views are personal to the author.

The author enthusiastically supports the Proposal and concurrently offers three suggestions. It is commendable that the Securities and Exchange Commission (the "Commission") has focused on customer identification programs for investment advisers. This proposal furthers the Commission's ever-growing efforts to regulate financial markets and protect investors. These programs will ensure a safe and accountable America, protect investors, and enhance national security against the threat of terrorism and money laundering.

The author acknowledges that the rulemaking process requires the comment period to be open for at least thirty days.[1] It is truly commendable that the Commission has expanded the comment period to remain open for sixty days, doubling the minimum set forth by the Administrative Procedural Act.[2] Allowing extra time for public comment ensures authors can write well-informed letters discussing the rule. This also enhances rulemaking transparency, instilling faith that authors will have ample time to prepare a letter for the Commission's consideration.

The undersigned applauds the Commission along with the Department of Treasury for addressing the issues within our financial markets and protecting investors through this joint proposal. The proposed rule is yet another effort by the Commission to protect investors and ensure the integrity of the financial markets, which are deeply rooted within this country. Unfortunately, terrorism and money laundering are evils that loom in the shadows of this world. The proposed rule will reduce the risk of these negative elements infiltrating financial markets by mandating that investment advisers establish reasonable procedures to verify their customers' identities.

As a preamble, the author would like to express two global thoughts. Firstly, ill-gotten money flows through our global financial system daily, the true amount is vastly unknown. The Chief Executive Officer of Nasdaq recently stated that according to Nasdaq's research in 2023, more than three trillion dollars of illicit money flowed through the global financial system.[3] He further provided a breakdown stating, *inter alia*, "$782.9 billion in drug trafficking activity,

[1] *See* 5 U.S.C. § 553(d) (2024) (stating proposals must be published at least thirty days before their effective date).
[2] *See id.*
[3] Brian Sozzi, *Nasdaq CEO: Financial crime is now a multitrillion-dollar epidemic*, Yahoo Finance (Jan. 16, 2024 05:58 AM ET), https://finance.yahoo.com/news/nasdaq-ceo-financial-crime-is-now-a-multitrillion-dollar-epidemic-100545542.html.

$346.7 billion in human trafficking, and $11.5 billion in terrorist financing."[4] Further the increase in the popularity of non-fungible tokens ("NFTs") and cryptocurrencies has become yet another vehicle in which bad actors launder illicit funds.[5] These vehicles collectively do not require customer identification and can be exchanged instantly without geographic boundaries.[6] The risk of money laundering from domestic and international sources posed by these newly found vehicles provides issues in and of themselves.[7] These numbers are astonishing, the author commends the efforts of the Commission in this joint effort to curb these illicit funds from tainting our financial markets.

Secondly, in efforts to provide accountability and clarity as to identifying who is participating in financial markets, stronger regulation is required. Investment advisers are among a group that ill-intentioned individuals often exploit as a channel to introduce their illicit money into the financial markets. This is predominately because most investment advisers are not obligated to adopt any anti-money laundering procedures or procedures for countering the financing of terrorism, therefore, the bad actors can exploit this channel into the market with little or no due diligence.[8] An innocent investor who gives money to an investment adviser involved in money laundering is at risk of having their funds frozen, along with all the funds under the investment adviser's management, by the government pending an investigation. By imposing obligations on investment advisers to implement anti-money laundering procedures and procedures for countering the financing of terrorism such as customer identification programs, the Commission will obstruct a long-exploited channel used by bad actors to exploit

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[4] *See supra.*
[5] *See* DEPT. OF THE TREASURY, ILLICIT FINANCE RISK ASSESSMENT OF NON-FUNGIBLE TOKENS 9 (May 2024).
[6] *See supra.*
[7] *See supra.*
[8] *See* DEPT. OF THE TREASURY, 2024 INVESTMENT ADVISER RISK ASSESSMENT 2 (2024); *See e.g.* SEC, Press Release 2023-186, *SEC Charges New York Firm Concord Management and Owner with Acting as Unregistered Investment Advisers to Billionaire Former Russian Official* (Sep. 19, 2023), https://www.sec.gov/news/press-release/2023-186.

the benefits of our financial markets thereby protecting the everyday investors in our financial markets.

It is not easy to imagine a time without the regulations established by the Commission. Still, by studying the events that led to the creation of the Commission, one can truly understand the importance of the Commission's mission and rulemaking.

The events leading to the inception of the Commission occurred towards the end of the 1920s (i.e. the "Roaring Twenties").[9] On October 24th, 1929, a day referred to as "Black Thursday" the "Roaring Twenties" ended abruptly when stock prices plunged.[10] This sudden change led to an unprecedented selling frenzy ultimately leading the country into the longest economic downturn in American History, the Great Depression.[11] Many Americans whose retirements and savings were invested in the stock market, lost everything. In the aftermath of the 1929 market crash, President Herbert Hoover in 1932, requested that senators begin investigating stock market practices.[12]

The Pecora Investigation

The Committee on Banking and Currency, tasked with conducting this investigation, made solemn progress for almost a year until the chairman hired a new chief counsel, Ferdinand Pecora.[13] Pecora a former New York deputy district attorney, through the power of subpoena, gathered documents and testimony from the nation's largest financial institutions.[14] Pecora through his committee's investigation (referred to as the "Pecora Commission" or the "Pecora

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[9] *See* "Subcommittee on Senate Resolutions 84 and 239 (The Pecora Committee), Notable Senate Investigations, U.S. Senate Historical Office, Washington, D.C. https://www.senate.gov/about/powers-procedures/investigations/pecora.htm [hereinafter THE PECORA COMMITTEE].
[10] *See supra.*
[11] *See supra.*
[12] *See supra.*
[13] *See supra.*
[14] *See supra.*

Investigation") and diligent analysis, shed light on the abuses and wrongdoing that was running rampant within the stock market.[15] The findings were astonishing, the testimony from major banks revealed, *inter alia*, excessive executive compensation, manipulative short selling, and dubious loans that were imposed upon unknowing investors.[16] This investigation pulled back the curtain and brought to light the unsavory behavior of major financial institutions, leading to immense public support for direct federal regulation of the stock markets.[17]

The committee ultimately released a final report on June 16, 1934, but prior to this report Congress had already begun to act.[18] Following the findings of the Pecora Commission, Congress enacted the Banking Act, and the Securities Exchange Act of 1934.[19]

The proposed rule on Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers[20] (hereinafter the "Proposed Rule") seeks to continue the long-standing tradition of protecting investors by ensuring investors are not knowingly or unknowingly doing business with money launders.

The Securities Exchange Act of 1934

The Securities Exchange Act of 1934 was the Enabling Act or Organic Act, signed into law by President Roosevelt, which created the Securities and Exchange Commission.[21] The newly established Commission was to be headed by five commissioners appointed by the

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[15] *See* THE PECORA COMMITTEE *supra* note 3.
[16] *See* MICHAEL PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE 7 (The Penguin Press, 2010).
[17] *See supra* at 5.
[18] *See* THE PECORA COMMITTEE *supra* note 3.
[19] Once the Securities Exchange Act of 1934 was passed Ferdinand Pecora was appointed to serve as a commissioner of the Securities and Exchange Commission. *See* ELLEN TERRELL, *Signing of the Securities and Exchange Act of 1934*, LIBRARY OF CONGRESS RESEARCH GUIDES, (2024), https://guides.loc.gov/this-month-in-business-history/june/signing-securities-exchange-act-1934; *see also* THE PECORA COMMITTEE *supra* note 3.
[20] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[21] *See* Securities Exchange Act of 1934, 15 U.S.C. § 78d (1934).

President and confirmed by Congress.[22] It was further enumerated in the Enabling Act that no more than three commissioners could be part of the same political party and the terms of service shall be staggered as to limit the amount of commissioners to be appointed by a sitting President during the presidential term.[23]

The Securities Exchange Act of 1934 contained a unique provision expanding the authority of the Commission to allow it to delegate functions to a division of the Commission, an individual Commissioner, an administrative law judge, or an employee.[24] This provides the legal framework that justifies the Commission's distributing of functions among the members and staff.[25]

The Commission (created by section 4 of the Securities Exchange Act) and its Mission

In 1934 the Commission was founded as the result of our nation experiencing an economic depression and Congress realized the then-unregulated financial markets were much to blame. The newly formed Securities and Exchange Commission embraced, then and now, a threefold mission: 1) to protect investors, 2) to maintain fair, orderly, and efficient markets, and 3) to facilitate capital formation.[26]

The Commission seeks to protect investors by ensuring fairness throughout the markets we all, either directly or indirectly, rely on. To achieve this mission, the Commission promulgates rules and regulations that protect investors from fraud and prevent companies from deceiving investors.[27]

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[22] *See id.*
[23] *See id.*
[24] *See* Securities Exchange Act of 1934, 15 U.S.C. § 78d-1 (2024).
[25] *See id.*
[26] *See* Investor.gov, *The Role of the SEC*, Invester.gov U.S. Sec. and Exch. Comm. https://www.investor.gov/introduction-investing/investing-basics/role-sec (last visited Jun. 18, 2024).
[27] *See supra.*

Financial markets are an ever-changing enigma. The Commission oversees the trading that occurs from day to day, technological advancements, and other nuances that develop with time. The Commission then modernizes, creates, or adjusts the rules and regulations to ensure the fair, orderly, and efficient markets this nation (and many others) rely on.[28]

The Commission likewise plays a large role in the development of small businesses and job creation by facilitating capital formation and allowing start-up companies to raise capital from investors. [29]

The Proposed Rule

Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers

The Proposed Rule aims to extend customer identification rules from financial institutions to registered financial advisers.[30] This will ensure that financial advisers equally adopt the rules imposed on financial institutions.[31] This requirement would require financial advisers to, *inter alia*, implement reasonable procedures to verify the identity of their customers.[32] When the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001[33][hereinafter the "PATRIOT Act"] was adopted it required financial institutions governed under the Bank Secrecy Act[34] [hereinafter

[28] See s*upra.*
[29] *See supra.* (The commission regulates the offer and sale of ALL investment interests or securities).
[30] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[31] *See id*.
[32] *See id.*
[33] *See* UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM (USA PATRIOT ACT) ACT OF 2001, 107 P.L. 56, 115 Stat. 272. (2001).
[34] *See* The Bank Secrecy Act, 31 U.S.C. § 5311 et seq. (2024).

the "BSA"], to impose programs to reasonably identify their customers in an effort to combat the financing of terrorism as well as money laundering.[35]

The purpose of the PATRIOT Act is to deter and punish terrorist acts around the world and in the United States by enhancing the law enforcement investigatory tools used to detect money laundering and the financing of terrorism.[36] This act successfully strengthened measures that ensure the United States financial system, and markets are not exploited by bad actors attempting to launder money or finance terrorism.[37] Bad actors often exploit anonymity when attempting to engage in money laundering.[38] This has led many of them to use blockchain and cryptocurrencies to avoid detection and prevent the attribution of ownership to their illicit funds.[39] This illustrates how an industry lacking customer identification can be exploited by illicit actors seeking to launder money under the cover of anonymity.[40] The PATRIOT Act amended 31 U.S.C. § 5318 (the BSA) by adding the Identification and Verification of Accountholders requirement.[41] This requirement was assigned to the U.S. Secretary of the Treasury to establish regulations outlining the minimum standards a financial institution must adhere to properly identify a customer opening an account.[42]

The Currency and Foreign Transactions Reporting Act of 1970 (i.e. the BSA), was enacted by Congress to authorize the Department of Treasury to impose requirements upon

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[35] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[36] *See* Financial Crimes Enforcement Network, *USA PATRIOT Act*, https://www.fincen.gov/resources/statutes-regulations/usa-patriot-act (Last visited Jun. 19, 2024).
[37] *See supra.*
[38] *See* Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern, 88 Fed. Reg. 72,701, 72,703 (Oct. 23, 2023) (to be codified at 31 C.F.R. pt. 1010).
[39] *See id.*
[40] *See id.*
[41] *See* UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM (USA PATRIOT ACT) ACT OF 2001, 107 P.L. 56, 115 Stat. 272. § 326 (2001).
[42] *See id.*

financial institutions and other businesses regarding, *inter alia*, record keeping and the reporting of suspicious activity that may resemble criminal activity.[43]

The Proposed Rule is in response to another joint rulemaking that would include investment advisers within the definition of "financial institutions" under the BSA.[44] The Proposed Rule seeks to mirror the established obligations for anti-money laundering procedures and procedures for countering the financing of terrorism imposed upon "financial institutions" in the BSA[45] by the PATRIOT Act.[46] Further, the BSA requires that regulations for "financial institutions" (a separate proposed rule seeks to add investment advisers as a class within "financial institutions"[47]) be prescribed by the appropriate federal functional regulator.[48] In accessing the appropriate federal functional regulator the Gramm-Leach-Bliley Act defines a list of institutions that serve as a federal functional regulator, this list embraces the Commission, and therefore the appropriate federal functional regulator for investment advisers (a profession engaged in financial market investments) is the Commission.[49]

The Proposed Rule applies to investment advisers who are defined as "[a]ny person who is registered or required to register with the SEC under section 203 of the Advisers Act (15 U.S.C. § 80b–3(a)), or any person that currently is exempt from SEC registration under section 203(l) or 203(m) of the Investment Advisers Act (15 U.S.C. § 80b–3(l), (m)).''[50] This includes

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[43] *See* Financial Crimes Enforcement Network, *The Bank Secrecy Act*, https://www.fincen.gov/resources/statutes-and-regulations/bank-secrecy-act (Last visited Jun. 19, 2024).
[44] *See id.*
[45] *See* 31 U.S.C. § 5318(I) (2024).
[46] *See* UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM (USA PATRIOT ACT) ACT OF 2001, 107 P.L. 56, 115 Stat. 272. §326 (2001) (Amending 31 U.S.C. § 5318 by adding subsection "I" "Identification and Verification of Accountholders").
[47] *See* Financial Crimes Enforcement Network: Anti-Money Laundering/ Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 12,108 (Feb. 15, 2024) (to be codified at 31 C.F.R. Parts 1010 and 1032).
[48] *See* 31 U.S.C. § 5318(I)(4) (2024).
[49] *See* 15 U.S.C. § 6809(2)(F) (2024).
[50] *See* 15 C.F.R. § 275.203(l)–1; 15 C.F.R. § 275.203(m)– 1.

investment advisers who are registered with the Commission, are required to register with the Commission, and advisers who are exempt from registration with the Commission.[51]

In passing the Investment Advisers Act of 1940, Congress imposed a fiduciary duty as an operation of law upon the investment adviser and the client due to the nature of the business conducted.[52] Accompanied with being designated a fiduciary, "[c]ourts have imposed … an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" his clients."[53] Congress gave the Commission the necessary enforcement authority under section 206(4) of the Investment Advisers Act of 1940, which enables the Commission to establish regulations that safeguard investors from, *inter alia*, fraud and money laundering by investment advisers.[54] The delegation made by Congress through the 1970 amendment to the Investment Advisers Act of 1940, gives the Commission the power to promulgate rules to define and prevent manipulative practices in the course of business.[55]

Tasked with the duty to promulgate rules designed to reasonably prevent acts by investment advisers that are fraudulent, deceptive, or manipulative, the role of the Commission is fulfilled here with the implementation of the Proposed Rule.[56] The Commission is faithfully executing the power delegated to it by Congress through the 1970 amendment to the Investment

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[51] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,574 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[52] *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 190-92 (1963) (holding that proof of intent is not required to establish fraud because of the fiduciary duty between an investment adviser and a client. Failing to disclose material facts such as the investment adviser's interest in recommendations to clients constituted fraud).
[53] *See id.* at 194 (internal citations omitted).
[54] *See* Investment Advisers Act, 15 U.S.C. § 80b-6(4) (2024).
[55] *See id.*; *See also* Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 11 n.11 (1985) ("The amendment gives the Securities and Exchange Commission latitude to regulate nondeceptive activities as a "reasonably designed" means of preventing manipulative acts").
[56] *See id.*

Advisers Act of 1940, as outlined in the Proposed Rule.[57] The Proposed Rule aims to protect investors from deceptive and fraudulent acts of investment advisers by preventing them from doing business with money launderers. The Proposed Rule will allow for the early mitigation of potential threats and fraud, thereby protecting investors and their respective investments.

Addressing the "Redundant Compliance Obligation" Argument

Other comment letters[58] have attempted to bring to light the notion that the Proposed Rule creates redundancy in the imposition of customer identification programs since some investment advisers hold their client's investments at a custodian financial institution that already engages in customer identification procedures.

The drafters of the Proposed Rule appear to have addressed this concern under section (a)(6) which states:

> The CIP may include procedures specifying when the investment adviser will rely on the performance by another financial institution (including an affiliate) of any procedures of the investment adviser's CIP with respect to any customer of the investment adviser that is opening, or has opened, an account or has established an account or similar business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions[.][59]

This provision will allow investment advisers to incorporate a reasonable reliance on the procedures of another financial institution, such as the custodial holder of the customer's investments, within the adviser's customer identification procedure.[60] In order for the investment adviser to reasonably rely on another financial institution to fulfill these obligations, the financial institution, which has implemented an anti-money laundering

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[57] *See* Investment Advisers Act, 15 U.S.C. § 80b-6(4) (2024).
[58] *See* Letter from Brooke Salvini, Chair, AICPA Pers. Fin. Plan. Exec. Comm., to Sec'y Vanessa Countryman of the SEC (Jul. 1, 2024); *see also* Letter from Gregoria Bruggeman (last visited Jul. 7, 2024) https://www.sec.gov/comments/s7-2024-02/s7202402-472151-1324434.html.
[59] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,597 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[60] *See id.*

and countering the funding of terrorism program and will perform the requirements of the investment adviser's program, must enter into a contract with the investment adviser.[61] This can be satisfied by a reliance letter, and the financial institution must certify annually that it has implemented these programs and will continue to perform the requirements of the investment adviser.[62] Furthermore, the investment adviser would not be held responsible for the financial institution's failure to comply with the adviser's customer identification responsibilities, as long as the reliance was reasonable and the adviser was under contract with the financial institution.[63]

This provision negates the redundancy discussed by allowing investment advisors to draft their customer identification procedure in reliance on a contract entered into with a financial institution that is responsible for fulfilling the adviser's responsibilities. This will prevent the Proposed Rule from imposing financial or administrative burdens on small investment advisers by allowing them to rely on other financial institutions to fulfill the requirements of the Proposed Rule.

Three Suggestions

Firstly, it is possible that the retention of records can conflict with existing state laws therefore subjecting an investment adviser to litigation simply by complying with the federal law and in turn violating the state law.

Throughout the United States Americans are beginning to show a great concern over how governments and companies use their data. Seventy-one percent of Americans who answered a

[61] *See id.*
[62] *See id.* at 44,579.
[63] *See id.*

recent poll said they are worried about what governments do with their data.[64] Sixty-seven percent said they do not understand what companies are doing with their personal data.[65] An overwhelming majority believe they have little to no control over what companies and governments do with their data, seventy-three percent and seventy-nine percent, respectively.[66]

The growing concern over the use, collection, and storage of personal data, has prompted legislatures to act and attempt to ratify solutions that enable concerned Americans to protect their data.[67] In a recent press release from the U.S. Senate Committee on Commerce, Science, & Transportation, Committee Chairs Cantwell, and Rodgers revealed a draft of The American Privacy Rights Act of 2024.[68] This bill recognizes the concerns of many Americans and attempts to reconcile the feeling of having no control over their personal data by, *inter alia*, giving Americans the right to sue bad actors who violate their privacy rights and recover monetary damages.[69] The bill also seeks to require that companies allow people to access their stored data within the companies' database[s] and further allow people to delete their data at their discretion.[70]

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[64] *See* Collen McClain et al., *How Americans View Data Privacy*, Pew Rsch. Ctr. (Oct. 18, 2023), https://www.pewresearch.org/internet/2023/10/18/how-americans-view-data-privacy/.
[65] *See supra.*
[66] *See supra.*
[67] *See* Press Release, U.S. S. Comm. on Com., Sci., & Transp., Comm. Chairs Cantwell, McMorris Rodgers Unveil Historic Draft Comprehensive Data Priv. Legis. (Apr. 7, 2024), https://www.commerce.senate.gov/2024/4/committee-chairs-cantwell-mcmorris-rodgers-unveil-historic-draft-comprehensive-data-privacy-legislation; *see also* Bloomberg Law, *Which States Have Consumer Data Privacy Laws?*, Bloomberg Law (Mar. 18, 2024), https://pro.bloomberglaw.com/insights/privacy/state-privacy-legislation-tracker/#row-66719688de6e5.
[68] *See* Press Release, U.S. S. Comm. on Com., Sci., & Transp., Comm. Chairs Cantwell, McMorris Rodgers Unveil Historic Draft Comprehensive Data Priv. Legis. (Apr. 7, 2024), https://www.commerce.senate.gov/2024/4/committee-chairs-cantwell-mcmorris-rodgers-unveil-historic-draft-comprehensive-data-privacy-legislation.
[69] *See supra.*
[70] *See supra.*

Many states, such as California, have already enacted legislation that creates an array of privacy rights and imposes obligations upon businesses that collect data.[71] California was the first state to incorporate comprehensive consumer privacy legislation with the California Consumer Privacy Act ("CCPA"), amended by the California Privacy Rights Act ("CPRA") [hereinafter collectively referred to as the "California Acts"].[72] The California Acts created eight specific rights for consumers: 1) the right to know what data was collected by a business, who it was collected from, why it was collected, and if sold who to; 2) the right to delete the data collected from the consumer; 3) the right to opt out of the sale of personal information; 4) the right to opt into the sale of personal information of consumers under the age of 16; 5) the right to non-discriminatory treatment; 6) a cause of action against a company involved in a data breach; 7) the right to correct the inaccurate personal information; and 8) the right to limit the use and disclosure of sensitive personal information. [73]

Within the California Acts, the consumer's right to request that a business delete any personal information that the business had collected from the consumer is one potential conflict with the Proposed Rule.[74] Albeit, the California Acts includes a provision that allows businesses to decline to comply with a consumer request to delete information if the information is necessary for the business to comply with a legal obligation, this can become an issue as to what information is necessary to retain to comply with the Proposed Rule.[75] Further as other states begin to draft and enact legislation to create privacy rights for citizens it is foreseeable that some

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[71] *See* Bloomberg Law, *California Consumer Privacy Laws*, Bloomberg Law https://pro.bloomberglaw.com/insights/privacy/california-consumer-privacy-laws/#ccpa-cpra (Last visited Jun. 18,2024).
[72] *See supra*; *see also* Cal. Civ. Code §1798.100 *et seq.* (2024).
[73] *See* Bloomberg Law, *California Consumer Privacy Laws*, Bloomberg Law https://pro.bloomberglaw.com/insights/privacy/california-consumer-privacy-laws/#ccpa-cpra (Last visited Jun. 18,2024).
[74] *See* Cal. Civ. Code § 1798.105(a) (2024).
[75] *See* Cal. Civ. Code § 1798.105(d)(8) (2024).

states may neglect to include provisions that allow for investment advisers to retain the necessary information for customer identification in compliance with the Proposed Rule.[76]

The state of New York has proposed legislation called the "New York Privacy Act" (hereinafter "NYPA") that seeks to give New York consumers more control over their personal data and require businesses to be held accountable for the storage and use of that information.[77] The NYPA offers similar protections to the California Acts in an effort to provide consumers with more control over their data. Similar to the California Acts, sections 1105(2) and 1105(2)(a) of the NYPA expressly state the act does not restrict the controller's ability to use the consumer's data, "to the extent reasonably necessary and proportionate" to comply with federal, state, or local laws.[78] It is notable that section 1105(2)(a) states "provided that no law enforcement agency or officer thereof shall access personal data without a subpoena … except where otherwise provided specifically in federal law[.]"[79] The Proposed Rule states under section 1032.220(a)(2)(iii)(D) that the customer identification procedures must include "When the investment adviser should file a Suspicious Activity Report in accordance with applicable law and regulation."[80] A notably distant but foreseeable conflict here could arise when an investment adviser uses non-documentary methods to verify the customer's identity as discussed in section 1032.220 (a)(2)(ii)(B) of the Proposed Rule[81] and subsequently is required by their procedure to file a suspicious activity report ("SAR").

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[76] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,574 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[77] *See* S. 365B 2023-2024. Reg. Sess. (NY 2023).
[78] *See id.*
[79] *See id.*
[80] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,596 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[81] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,596 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).

31 C.F.R. § 1010.312 requires that a financial institution must verify and record the name of the individual conducting a transaction for which the financial institution is required to submit an SAR.[82] The methods for identifying an individual for an SAR are enumerated and discuss only documentary evidence that can be used (i.e. a passport, or a driver's license among other things).[83] If pursuant to the Proposed Rule[84] a customer was identified using non-documentary methods and the investment adviser then was required to file a SAR, the NYPA[85] could exclude the investment adviser from disclosing and including the non-documentary evidence since it is not one of the enumerated documents.[86] The NYPA[87] could exclude personal data (i.e. the name and address) that was obtained through a method other than one that is enumerated in 31 C.F.R. § 1010.312 without a subpoena. Potential conflicts such as these deserve attention as more states develop privacy laws.

The author proposes an amendment as a solution to the potential conflicts that may arise between the Proposed Rule and state privacy laws, a preemption clause. The legal foundation for a preemption clause is routed in the United States Constitution's Supremacy Clause, art. VI, cl. 2:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.[88]

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[82] *See* 31 C.F.R. § 1010.312 (2024).
[83] *See id.*
[84] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,596 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[85] *See* S. 365B 2023-2024. Reg. Sess. (NY 2023).
[86] *See* 31 C.F.R. § 1010.312 (2024).
[87] *See* S. 365B 2023-2024. Reg. Sess. (NY 2023).
[88] U.S. CONT. art. VI, §2.

The Supreme Court of the United States has recognized that an agency rule can preempt state law when there is a conflict with state law, that stands as an obstacle to the objective of the rule.[89] Although agencies, without a specific delegation from Congress, lack the authority to pronounce preemption, agencies "have a unique understanding of the statutes they administer and an attendant ability to make informed determinations about how state requirements may pose an 'obstacle to the accomplishment and execution of the full purposes and objective of Congress.'"[90] The analysis of whether a federal agency regulation can pre-empt state regulation rests upon whether Congress has given the agency the power to act as it has.[91]

The Commission has promulgated rules under congressional authority that encompass an express preemption clause, an example is Rule CF.[92] Rule CF states that "no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof" shall require registration of, prohibit or limit the sale of, or impose conditions on; a covered security.[93] The preemption of state law within the rule is limited and explicitly states that "any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions [regarding fraud, deceit or unlawful conduct]"[94] thereby limiting the scope of the preemption of state law.

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[89] *See* Geier v. Am. Honda Motor Co., 529 U.S. 861, 886 (2000) (holding that a rule promulgated by the Department of Transportation preempted a state law cause of action. The plaintiffs sought to recover under state tort law for injuries sustained due to the lack of an airbag in a vehicle. The rule in conflict gave the defendants an option to install airbags by allowing manufacturers to use a mix of passive restraint systems other than airbags. Because the common law cause of action for no airbags presented an obstacle to the objective of the rule, seeking a variety and mix of passive restraint systems, the no airbag cause of action was preempted).

[90] *See id.* at 577.

[91] *See* Capital Cities Cable v. Crisp, 467 U.S. 691 (1984) (holding the Federal Communications Commission ("FCC") regulation requiring television signals be transmitted across state lines in full, preempted the Oklahoma Alcoholic Beverage Board ("OABC") ban on the retransmission of television signals containing advertisements from out-of-state liquor companies. The Court reasoned that the OABC conflicted with the full transmission required by the FCC regulation and therefore was an obstacle to the objective of the regulatory scheme and preempted the conflicting state provision).

[92] *See* 15 U.S.C. § 77r (2024).

[93] *See* 15 U.S.C. § 77r(a) (2024).

[94] *See* 15 U.S.C. § 77r(c) (2024).

Here, it is evident that Congress set forth the clear objective via the PATRIOT Act and Bank Secrecy Act that Customer Identification Programs are to be regulated by the appropriate federal functional regulator, in the case of the Proposed Rule, the federal functional regulator is the Commission.[95] Thereby Congress has conferred the authority upon the Commission to set forth and impose the Customer Identification program requirements and it would follow that Congress gave the power to the Commission to pre-empt any conflicting state laws that would obstruct the objective delegated upon the Commission.[96] The author asks the Commission to consider adding a provision to pre-empt state privacy laws insofar as they can possibly (as more state privacy laws continue to be proposed) conflict with the collection and retention of personal data used to identify customers under the Proposed Rule. Further, the potential conflict in SAR reporting could prove troublesome in the everlasting efforts of the Commission to protect investors and facilitate efficient financial markets.

Secondly, the concerns of Americans over the retention of their information may be alleviated if the Proposed Rule imposed a standard of security to be implemented by investment advisers in compliance with 17 C.F.R. § 248.30 Procedures to safeguard customer records, 17 C.F.R. § 248.201 Duties regarding the detection, prevention, and mitigation of identity theft, and 17 C.F.R. § 229.106(b) Cyber Security Risk Management and Strategy.[97]

Section 248.30 also referred to as Regulation S-P, requires every investment adviser that is registered with the Commission to adopt written policies that address safeguards for the protection of customer records and information.[98] The policies must be designed to ensure the

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[95] *See* 15 U.S.C. § 6809(2)(F) (2024).
[96] *See* U.S. CONT. art. VI, §2; *see also* Geier v. Am. Honda Motor Co., 529 U.S. 861, 886 (2000); *see also* Capital Cities Cable v. Crisp, 467 U.S. 691 (1984).
[97] *See* 17 C.F.R. § 248.30 (2024); *see also* 17 C.F.R. § 248.201 (2024); *see also* 17 C.F.R. § 229.106(b) (2024).
[98] *See* 17 C.F.R. § 248.30 (2024).

security of the customer's information; protect against any anticipated harm; and protect against the unauthorized use of customer information.[99]

Section 248.201 also referred to as Regulation S-ID, requires that an investment adviser establish an Identity Theft Program.[100] This program must be designed to detect, prevent, and mitigate the existence of identity theft in connection with any identifying customer information retained by the financial institution.[101]

Section 229.106(b) also referred to as Regulation S-K, requires that the registrant discloses a description of the processes used for accessing, identifying, and managing risks from cybersecurity threats.[102] The disclosure must provide enough detail for a reasonable investor to understand.[103] The final rule also includes a non-exhaustive list of items to be included within the disclosure including, *inter alia*, whether the registrant engages with any third parties for cybersecurity risk assessment.[104]

The Proposed Rule mandates that the investment adviser must, at a minimum, retain identifying information about the customer.[105] This includes the customer's taxpayer identification number and a description of any document used to verify the customer's identity.[106] The Proposed Rule specifically requires noting any identifying numbers or information contained in the description of that document.[107]

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[99] *See id.*
[100] *See* 17 C.F.R. § 248.201(d) (2024).
[101] *See* 17 C.F.R. § 248.201 (2024).
[102] *See* 17 C.F.R. § 229.106(b) (2024).
[103] *See id.*
[104] *See id.*
[105] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,596 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[106] *See id.*
[107] *See id.*

In the administrative proceeding, *In re* Voya Financial Advisors, Inc., 2018 SEC LEXIS 2595 (2018), the Commission imposed a civil money penalty for violations of Regulation S-P and Regulation S-ID.[108] In that proceeding the Commission found that, due to deficient policies and procedures within the company, intruders had gained access to the personal information of at least 5,600 customers and used that information to create new customer profiles.[109]

Voya Financial Advisors, Inc. ("VFA") violated Regulation S-P because VFA's procedures to protect customer information and prevent and respond to a cybersecurity event were deficient as VFA did not update the procedures to apply to independent contractors.[110] VFA gave the independent contractor access to the portal containing customer identification information.[111] Over six days, intruders placed fraudulent calls to VFA posing as the independent contractor, seeking a username and password reset to the portal.[112] After successfully receiving usernames and passwords, the intruders proceeded to gain access to customer information.[113] Due to deficient cybersecurity controls, VFA was unable to terminate the portal accounts being used by the intruders.[114]

VFA also violated Regulation S-ID by not updating the identity theft protection program after significant changes to the company's external cybersecurity risks.[115] VFA did not train employees regarding the response needed after detecting an intrusion into the portal.[116] When VFA discovered that intruders had accessed customer identification information, VFA lacked

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[108] *See In re* Voya Financial Advisors, Inc., 2018 SEC LEXIS 2595 (2018).
[109] *See id.* at 4-5.
[110] *See id.* at 12-15.
[111] *See id.* at 4-6.
[112] *See id.*
[113] *See id.*
[114] *See In re* Voya Financial Advisors, Inc., 2018 SEC LEXIS 2595, 4-6 (2018).
[115] *See id.* at 17-18.
[116] *See id.*

procedures to block the intruders from accessing customer accounts using the customer identification information, such as changing security codes or using other security measures.[117]

In light of the facts in that proceeding, the Commission found that VFA willfully violated Regulation S-D as well as Regulation S-ID.[118] The Commission ordered that a civil money penalty of one million dollars be paid for the violations.[119] This proceeding illustrates that the failure to adequately protect customer identification information and implement procedures to respond to cybersecurity events and potential identity theft can lead to a violation of federal regulations.[120]

Under the recordkeeping section of the Proposed Rule, the Commission may choose to impose a standard of care provision requiring, within the customer identification procedures, a procedure for safeguarding customer records and information against potential risks and harms described in 17 C.F.R. § 248.30 and 17 C.F.R. § 248.201.[121] Requiring investment advisers under the Proposed Rule to describe the processes used to manage cybersecurity risks will further protect investors and their personal data.

A provision consistent with 17 C.F.R. § 229.106, would require investment advisers to disclose the processes they use to protect investor data from cybersecurity risks.[122] The author suggests that this disclosure should take place when the investment adviser provides the customer with notice that they are seeking information to reasonably identify the customer.[123]

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[117] *See id.*
[118] *See id.* at 25-26.
[119] *See In re* Voya Financial Advisors, Inc., 2018 SEC LEXIS 2595, 31-32 (2018).
[120] *See id.*
[121] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,596 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275); *see also* 17 C.F.R. § 248.30 (2024); *see also* 17 C.F.R. § 248.201 (2024).
[122] *See* 17 C.F.R. § 229.106(b) (2024).
[123] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,597 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).

Implementing a procedure such as this will provide customers with the knowledge that the information that they will provide to the investment adviser will be reasonably safeguarded against cybersecurity risks. Further, since the proposed rule allows investment advisers to electronically maintain records[124] the investment adviser should disclose any third party tasked with the cybersecurity risk assessment of the customer's electronically maintained data consistent with 17 C.F.R. § 229.106(b). For example, the Commission could include a provision under section (a)(5) of the Proposed Rule.[125] Section (a)(5) states adequate notice is to be given to the customer that the investment adviser is requesting information to verify the customer's identity.[126] The suggested provision would state that this notice should include verbiage from the investment adviser that states; in accordance with our policies and procedures, any identifying information or records provided in response to this request will be reasonably safeguarded from cybersecurity events. Requiring investment advisers to include this statement within the notice informs the customer that their provided identifying information will be reasonably safeguarded.

Third, while the Proposed Rule effectively achieves the overarching goal of protecting investors, to further discern bad actors from defrauding investors the Commission should consider expressly stating that investment advisers are not exempt from private action and can still be liable under other federal and state laws. To deter bad actors and achieve maximum compliance with the implementation of customer identification verification procedures, the Commission should consider expressly stating within the rule that although the Commission enforces the Proposed Rule, investment advisers are not exempt from private action for investor

[124] *See id.* at 44,578 §1032.220(a)(3)(i)(D).
[125] *See* Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers, 89 Fed. Reg. 44,571, 44,597 (May 21, 2024) (to be codified at 17 C.F.R. pt. 275).
[126] *See id.*

fraud under other federal anti-fraud laws or state securities laws known as "Blue Sky" laws.[127] This would signify to investment advisers that even though the Proposed Rule is enforced by the Commission, they are not immune from civil liability for defrauding investors. An example of a regulation promulgated by the Commission in which this type of provision is illustrated is Regulation D.[128]

Regulation D is a rule established by the Commission to assist small businesses in raising capital through the sale of securities, in line with the Commission's primary mission.[129] Regulation D exempts smaller companies from having to register[130] the securities with the Commission pursuant to the registration requirements imposed by section 5 of the Securities Act of 1933 ("hereinafter Section 5").[131] Although securities that satisfy the exemption outlined in Regulation D are not required to register with the Commission under Section 5, Regulation D clearly states these securities or "transactions" are not exempt from other federal securities laws.[132] Regulation D goes further to state that "[n]othing in Regulation D obviates the need to comply with any applicable state law relating to the offer and sale of securities."[133] The inclusion of these provisions within Regulation D reiterates that securities that qualify under Regulation D, are not immune from actions brought under other federal securities laws or state "blue sky" laws.

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[127] *See* Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) (defining "blue sky" laws as state enacted laws that target ""speculative schemes which have no more basis than so many feet of 'blue sky'"; or, as stated by counsel in another case, "to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations."").
[128] *See* 17 C.F.R. § 230.500 (2024).
[129] *See id.*; *see also* Investor.gov, *The Role of the SEC*, Invester.gov U.S. Sec. and Exch. Comm. https://www.investor.gov/introduction-investing/investing-basics/role-sec (last visited Jun. 18, 2024).
[130] *See* Brown v. Earthboard Sports USA, Inc., 481 F.3d 901, 906 (6th Cir. 2007) (noting if the qualifications are met for exemption under Regulation D, they are also exempt from state registration requirements under the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416).
[131] *See* Securities Act of 1933, 15 U.S.C. § 77e (2024).
[132] *See* 17 C.F.R. § 230.500(a) (2024).
[133] *See* 17 C.F.R. § 230.500(b) (2024).

The Proposed Rule aims to safeguard investors from fraudulent activities and deception that arise when unscrupulous individuals exploit financial markets for money laundering. By implementing customer identification procedures, investment advisers will be able to prevent illicit money from ever entering the markets. This in turn will boost investor confidence in the overall markets. While the proposed rule targets bad actors attempting to enter financial markets through investment advisers, it should also ensure that the advisers are not complicit in these actions. The Commission should consider adding an express provision similar to Regulation D[134] to reiterate that violations of the Proposed rule will not only be enforced by the Commission.

The suggested amendment would purport to remind investment advisers that they are not only accountable to the Commission when it comes to compliance with the Proposed Rule, but also to their investors, to which they have a fiduciary duty not to defraud.[135] In the provision, should the Commission see fit, the author proposes it should include that violations of the Proposed Rule are not to be exclusively enforced by the Commission, rather investors who are defrauded by the act or omissions of the investment adviser, can bring action against said adviser under federal securities laws or applicable state securities laws. The provision described above would not only ensure that investment advisers establish procedures as directed by the Proposed Rule but also ensure that investment advisers strictly adhere to those procedures to avoid defrauding investors and exposing themselves to civil liability.

Conclusion

The Proposed Rule thoroughly adheres to and compliments the overall mission of the Commission. Through the implementation of this rule the Commission furthers the threefold

[134] *See* 17 C.F.R. § 230.500 (2024).
[135] *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) (see n. 52 *supra*).

mission: 1) to protect investors, 2) to maintain fair, orderly, and efficient markets, and 3) to facilitate capital formation.

For all the foregoing reasons the author enthusiastically supports the Proposal and concurrently offers three suggestions *supra* for the Commission's diligent consideration. In considering the implementation of customer identification programs, the Commission should consider the potential conflicts with the ever-growing state privacy laws. Further, in addition to entrusting investment advisers with storing and retaining customer records and electronic data, the Commission should contemplate mandating reasonable procedures for safeguarding customer information and disclosing third parties responsible for cybersecurity risks. Lastly, the Commission should consider expressly stating that investment advisers who violate the Proposed Rule or fail to reasonably implement the Proposed Rule, can be held liable by investors under federal or state securities laws. It is commendable that the Commission has focused on customer identification programs for investment advisers and provided the opportunity to comment on the Commission's proposal upholding the transparent rulemaking process apparent in this proposal.

Sincerely,

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