U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF ADVOCACY
REGULATION • RESEARCH • OUTREACH

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VIA ELECTRONIC SUBMISSION

Andrea M. Gacki
Director
Financial Crimes Enforcement Network
P.O Box 39
Vienna, VA 22183

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

Re: Financial Crimes Enforcement Network and Securities and Exchange Commission Joint NPRM: Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers

Dear Ms. Gacki and Ms. Countryman:

On May 21, 2024, the Financial Crimes Enforcement Network (FinCEN) and the Securities and Exchange Commission (SEC) jointly published a notice of proposed rulemaking (NPRM) on Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers.[1] The rule would require certain investment advisers to establish and maintain a customer identification program (CIP). The program would enable the investment advisers to form a reasonable belief as to the genuine identity of their customers. This joint NPRM was published alongside a separate, but related, NPRM published by FinCEN on Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers (AML/CFT Program and SAR Proposed Rule).[2] The AML/CFT Program and SAR Proposed Rule would include certain investment advisers in the definition of "financial institution" under the Bank Secrecy Act[3] and, if adopted, will require the Secretary of Treasury and the SEC to

[1] 89 Fed. Reg. 44571 (May 21, 2024).
[2] 89 Fed. Reg. 12108 (Feb. 15, 2024).
[3] *Id.*

jointly prescribe a rule requiring certain investment advisers to implement reasonable procedures to verify the identification of their customers.[4]

On May 15, 2024, the Office of Advocacy (Advocacy) commented on the AML/CFT Program and SAR Proposed Rule raising concerns that FinCEN may have underestimated the potential impact of the proposed rulemaking on small entities because it used an inappropriate size standard to define affected small entities.[5] Although FinCEN is promulgating this rule jointly with the SEC, which Advocacy acknowledges has the statutory authority to use its own codified size standard under Rule 0-7 and the Investment Advisers Act of 1940 (Advisers Act) for purposes of the RFA,[6] Advocacy is still concerned that the size standard used in the proposed rule does not appropriately estimate the potential impact of the proposed rulemaking on small entities.

As such, Advocacy recommends that FinCEN and the SEC prepare a supplemental initial regulatory flexibility analysis (IRFA) that details the coverage of the SEC size standard proposed with the U.S. Small Business Administration's (SBA) size standard to fully consider the economic impact of the proposed rulemaking on small entities, as well as alternatives that may reduce those potential impacts. Separately, Advocacy recommends the SEC, in consultation with the SBA Office of Size Standards, Office of Advocacy, and other relevant stakeholders, undertake a rulemaking to amend Rule 0-7 to adopt a modernized and more appropriate size standard. Doing so will help ensure future SEC regulations better align with the purpose of the RFA, which asks agencies to identify barriers to small business competitiveness and seek a level playing field for small entities.[7]

I. Background

A. The Office of Advocacy

Congress established the Office of Advocacy (Advocacy) under Pub. L. 94-305 to represent the views of small entities before Federal agencies and Congress. Advocacy is an independent office within the SBA that seeks to ensure small business concerns are heard in the federal regulatory process. Advocacy also works to ensure that regulations do not unduly inhibit the ability of small entities to compete, innovate, or comply with federal laws. As such, the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration.

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[4] 89 Fed. Reg. 44571.

[5] U.S. Small Bus. Admin. Office of Advocacy, Comment Letter on Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers (May 15, 2024), https://advocacy.sba.gov/2024/05/15/advocacy-submits-comments-on-fincens-anti-money-laundering-countering-the-financing-of-terrorism-program-and-suspicious-activity-report-filing-requirements/.

[6] 17 C.F.R. § 275.0-7.

[7] U.S. SMALL BUS. ADMIN., OFF. OF ADVOC., THE RFA IN A NUTSHELL: A CONDENSED GUIDE TO THE REGULATORY FLEXIBILITY ACT 4 (June 2013), https://advocacy.sba.gov/wp-content/uploads/2019/07/The-RFA-in-a-Nutshell-2013-ed.pdf.

The Regulatory Flexibility Act (RFA),[8] as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),[9] gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, the RFA requires federal agencies to assess the impact of the proposed rule on small entities and to consider less burdensome alternatives. If a rule will not have a significant economic impact on a substantial number of small entities, agencies may certify the rule and the certification must be accompanied by a statement of factual basis that adequately supports its certification.[10]

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.[11] The agency must include a response to these written comments in any explanation or discussion accompanying the final rule's publication in the Federal Register, unless the agency certifies that the public interest is not served by doing so.[12]

Advocacy's comments are consistent with Congressional intent underlying the RFA, that "[w]hen adopting regulations to protect the health, safety, and economic welfare of the nation, federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public."[13]

B. The Proposed Rule

On May 21, 2024, FinCEN and the SEC jointly published an NPRM in the Federal Register on Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers.[14] Aimed at countering illicit finance in the investment adviser industry, the rule would require certain investment advisers to establish and maintain a customer identification program (CIP) to enable the investment advisers to form a reasonable belief as to the genuine identity of their customers. At a minimum, the proposed rule would require covered investment advisers' CIPs to implement "reasonable procedures" for:

(1) verification of the identity of any person seeking to open an account, to the extent reasonable and practicable;
(2) maintenance of the information used to verify the person's identity, including name, address, and other identifying information; and
(3) determination of whether the person appears on any lists of known or suspected terrorists or terrorist organizations issued by any government agency.[15]

While the Investment Advisers Act of 1940 and the regulations issued thereunder apply to a broad range of investment advisers, the proposed rule would only apply to "advisers registered or

[8] 5 U.S.C. § 601 et seq.
[9] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).
[10] 5 U.S.C. § 605(b).
[11] Small Business Jobs Act of 2010, Pub. L. 111-240, §1601.
[12] *Id.*
[13] *Id.*
[14] 89 Fed. Reg. 44571 (May 21, 2024).
[15] *Id.* at 44,592.

required to be registered with the SEC (referred to as 'registered investment advisers' or 'RIAs'), as well as those exempt from registrations under … the Act (referred to as 'exempt reporting advisers' or 'ERAs')."[16]

The agencies issued the proposed rulemaking as part of a broader effort to counter illicit finance in the investment adviser industry following the release of the 2024 Investment Adviser Risk Assessment on February 13, 2024.[17] On the same day, FinCEN published the AML/CFT Program and SAR Proposed Rule that would include certain investment advisers in the definition of "financial institution" under the Bank Secrecy Act (BSA), prescribe minimum standards for anti-money laundering/countering the financing of terrorism (AML/CFT) programs to be established by covered investment advisers, require covered investment advisers to report suspicious activity to FinCEN pursuant to the BSA, and make several other related changes to FinCEN regulations.[18]

This joint NPRM is an outgrowth of the AML/CFT Program and SAR Proposed Rule as a CIP is considered a foundational component of strong AML programs.[19] Collectively these two proposed regulations would, if adopted, constitute significant changes to the current regulatory requirements governing investment advisers.

II. Advocacy's Small Business Concerns

Advocacy believes that the IRFA included in the proposed rule is insufficient because the agencies may have underestimated the potential impact of the proposed rule on small entities because it used an inappropriate size, which may have led to the failure to adopt significant alternatives. Under the RFA, an IRFA must contain:

1) A description of the reasons why the regulatory action is being taken.
2) The objectives and legal basis for the proposed regulation.
3) A description and estimated number of regulated small entities.
4) A description and estimate of compliance requirements, including any differential for different categories of small entities.
5) Identification of duplication, overlap, and conflict with other rules and regulations.
6) A description of significant alternatives to the rule.[20]

Advocacy is concerned that the IRFA published by FinCEN and the SEC omits affected small entities and potential impacts to those entities in its analysis because the size standard used only covers a small percentage of affected small investment advisors. Advocacy further believes that,

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[16] *Id*. at 44,572.
[17] DEP'T. OF TREASURY, 2024 INVESTMENT ADVISER RISK ASSESSMENT (Feb. 13, 2024), https://home.treasury.gov/system/files/136/US-Sectoral-Illicit-Finance-Risk-Assessment-Investment-Advisers.pdf.
[18] 89 Fed. Reg. 12108 (Feb. 15, 2024).
[19] *See* Financial Crime Academy, *Uncovering the Elements of Customer Identification Program (CIP) for Anti-Money Laundering* (June 3, 2024), https://financialcrimeacademy.org/uncovering-the-elements-of-customer-identification-program-cip-for-anti-money-laundering/.
[20] 5 U.S.C. § 603.

while the agencies did consider alternatives in the IRFA, there are additional alternatives that the agencies should consider to reduce the impact of the rule on small entities.

A. The IRFA Fails to Provide an Accurate Description of the Small Entities to Which the Proposed Rule Will Apply

The RFA requires agencies to use the SBA's definition of small entity "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration 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."[21] Section 601 of the RFA sets forth, in relevant part, "[f]or the purposes of this chapter ... the term 'small entity' shall have the same meaning as the term 'small business' ..."[22] The term "small business" has the same meaning as the term "small business concern" under Section 3 of the Small Business Act.[23] SBA size standards are generally expressed in either millions of dollars (those preceded by "$") or number of employees (those without the "$"). Size standards are the average annual receipts or the average employment of a firm set by industry, except for where an agency chooses to use an alternative size standard as discussed above.[24] The SBA size standard for investment advisors, NAICS code 523940, is $47 million in average annual receipts.[25]

In 1982, The SEC consulted with Advocacy and first used an alternative size standard for the RFA after considering size standards adopted by the SBA in 1980.[26] In 1998, the SEC, in consultation with Advocacy, amended its alternative definition of a small entity for advisers to the size standard used today, over 25 years later. The SEC 1998 definition used in this rulemaking generally defines small advisers as those that are managing less than $25 million in customer assets.[27] The SEC and FinCEN used the same standard that was used for the AML/CFT Program and SAR Proposed Rule, rather than using the current size standards set forth by the SBA.

In the IRFA, the SEC and FinCEN claim that approximately 20,460 investment advisers (14,914 RIAs and 5,546 ERAs) would be subject to the rule and, of those, an estimated 389 investment advisers (276 RIAs and 113 ERAs) would be small entities. In other words, according to the agencies' IRFA, only an estimated 2% of investment advisers subject to the rule would be small entities. As such, the SEC and FinCEN jointly conclude that the proposed rule will not impact a substantial number of small entities.[28]

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[21] *Id.* § 601(3).
[22] *Id.* § 601(6).
[23] 15 U.S.C. § 632 (1994); 5 U.S.C. § 601(3). *See also* Nw. Mining v. Babbitt, 5 F. Supp. 2d 9, 14-15 (D.D.C. 1998).
[24] U.S. SMALL BUS. ADMIN., U.S. SMALL BUSINESS ADMINISTRATION TABLE OF SMALL BUSINESS SIZE STANDARDS MATCHED TO NORTH AMERICAN INDUSTRY CLASSIFICATION SYSTEM CODES 1, https://www.sba.gov/sites/default/files/2023-06/Table%20of%20Size%20Standards_Effective%20March%2017%2C%202023%20%282%29.pdf (effective Mar. 17, 2023).
[25] *Id.* at 26.
[26] *See Small Business Size Standards, Revisions of Methods of Establishing Size Standards and Definitions of Small Business*, 45 Fed. Reg. 15442 (Mar. 10, 1980).
[27] 89 Fed. Reg. 44592.
[28] *Id.*

The investment adviser industry has long questioned the use of the SEC's size standard, claiming that the SEC's definition is not representative of the composition of the investment advisor industry today. Investment advisers not only raised this concern in their comment letter on the AML/CFT Program and SAR Proposed Rule, asserting that it is inappropriate,[29] but in fact filed a petition for rulemaking to amend the SEC's size standard in 2023.[30] According to the investment advisers petition, any use of the SEC's definition of a small entity will fail to comply with the intent of the RFA:

> 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). However, with few exceptions, advisers are not permitted to register with the Commission unless they have at least $100 million in AUM, 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.[31]

Advocacy agrees that the current SEC standard does not align with the intent and spirit of the RFA. Further, Advocacy believes that the SEC and FinCEN should show how the rule would affect small advisors with less than $47 million in revenue and seek ways to reduce their burden. There are significant differences between the SEC's definition of a small investment adviser and the SBA's investment adviser size standard. First, the SBA size standard measures the firm's receipts while the SEC size standard measures the firm's assets under management. Second, the SBA size standards are updated every five years to adjust for inflation and other factors, and more appropriately defines small businesses within the Portfolio Management and Investment Advice industry.[32]

Additionally, the SEC size standard does not cover most small entities in the industry and, therefore, cannot adequately provide an appropriate small entity analysis under the RFA. As noted above, using the SEC's size standard of less than $25 million in assets under management and using the agencies' estimation of total entities that would be subject to the rule,[33] 2% of investment advisers subject to the proposed rule would be considered small entities. Using the SBA size standard of $47 million in annual receipts, however,

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[29] Inv. Adviser Ass'n, Comment Letter on Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers (Apr. 15, 2024), https://www.regulations.gov/comment/FINCEN-2024-0006-0023.

[30] Inv. Adviser Ass'n Letter to SEC 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 (Sept. 14, 2023), https://www.investmentadviser.org/wp-content/uploads/2023/09/IAA-Rulemaking-Petition-9.14.23.pdf?t=650356467cbe3.

[31] *Id.*

[32] U.S. SMALL BUS. ADMIN., SBA'S SIZE STANDARDS METHODOLOGY (Dec. 2023), https://www.sba.gov/sites/default/files/2023-12/Updated_Size_Standard_Methodology_WhitePaper_2023_Proposed_508_v0.pdf.

[33] Advocacy is also concerned that the count of 20,460 total firms that will be impacted by the proposed rule is correct. According to 2021 Statistics of U.S. Businesses data, the most recent available, there are 22,339 investment advisers in the industry. *See* U.S. CENSUS BUR., 2021 SUSB ANNUAL DATASETS BY ESTABLISHMENT INDUSTRY, https://www.census.gov/data/tables/2021/econ/susb/2021-susb-annual.html (last updated Dec. 2023).

there are over 17,000 small firms in the investment adviser industry according to the Census Bureau, almost 99% of the industry.

Finally, the proposed rule assumes that the number of investment advisers registered with the SEC will remain constant throughout the rule's implementation. However, if small investment advisers newly register at some point in the future, the number of small entities impacted by the rule would grow.

Considering the difference in the number of small investment advisers subject to the proposed rule under the different definitions, Advocacy urges FinCEN and the SEC to use the SBA size standard in its IRFA to provide a more accurate reflection of the impact of the joint NPRM on regulated small entities. Further, Advocacy recommends that the SEC and FinCEN provide detail on how the rule will affect regulated non-registered and newly registered small investment advisers that are not included in the analysis. Ideally, this would include estimates of and impacts to the small investment advisers earning less than $47 million in annual revenue that are currently excluded from the IRFA under the SEC size standard of $25 million assets under management and still affected by the rule.

Advocacy also recommends the SEC, in consultation with the SBA Office of Size Standards, Office of Advocacy, and other relevant stakeholders, undertake a rulemaking to amend Rule 0-7 to adopt a modernized and more appropriate size standard. Not only is the current size standard out of line with current industry realities and the SBA standard as discussed in detail above, the standard is also significantly outdated, having last been amended more than 25 years ago. A more accurate size standard will help ensure future SEC regulations better align with the purpose of the RFA, which asks agencies to identify barriers to small business competitiveness and seek a level playing field for small entities, not an unfair advantage.[34]

B. The RFA Requires Agencies to Consider Less Costly Alternatives for Small Entities

In the joint NPRM, the SEC and FinCEN considered four significant alternatives that would accomplish the agencies' stated objectives, while also minimizing any significant economic effect on small entities.[35] Specifically, four alternatives considered by the agency were: "(1) exempting advisers that are small entities from all or part of the proposed rule; (2) establishing different requirements, to account for resources available to small entities; (3) clarifying, consolidating, or simplifying the compliance requirements under the proposed rule for small entities; and (4) using design rather than performance standards."[36] The agencies provided no additional detail on these proposed alternatives in the published NPRM and, as such, failed to provide small entities with sufficient information to comment on. For example, it is highly unlikely that affected small entities can effectively comment on a proposed alternative that simply states, "using design rather than performance standards" without more information.

However, the agencies declined to adopt any significant alternatives despite acknowledging in their IRFA that the agencies, "would expect that smaller advisers may not already have CIP

[34] U.S. SMALL BUS, ADMIN., OFF. OF ADVOC., *supra* note 7, at 4.
[35] 89 Fed. Reg. at 44593.
[36] *Id*.

programs, or they may not already have CIP programs that meet certain elements that would be required under the proposed rule," and that the agencies, "would expect a smaller adviser to find it more costly, per dollar managed, to comply with the requirements because it would not be able to benefit from a larger adviser's economies of scale."[37]

These two conclusions are incompatible and, as such, Advocacy urges the agencies to reconsider the adoption of the proposed alternatives, especially since a significantly higher number of small investment advisers would be impacted had the agencies used an appropriate and updated size standard. Further, Advocacy urges the agencies to provide more detail about the alternatives they did consider so small entities can provide meaningful comments as to whether those alternatives could be adopted in a way that maintains the agencies' policy goals while reducing the burden on small advisers.

C. The Agencies Should Provide Clear Guidance to Assist Small Entities with Compliance

Given the requirements of the proposed rulemaking, providing clear guidance for complying with the agency's rulemaking would prove useful to small entities and help eliminate any potential confusion as to the proposed rule's requirements. As the agencies acknowledged in the NPRM, small entities often lack the resources of their larger competitors, which may hinder their ability to fully understand the new regulatory requirements and achieve full compliance. Advocacy therefore encourages the agencies to provide clear guidance to assist small entities in complying with the requirements of the proposed rule.

III. Conclusion

As stated above, the IRFA prepared by SEC and FinCEN uses a size standard that does not adequately analyze the impacts of affected small entities under the RFA. As such, Advocacy recommends that FinCEN and the SEC prepare a supplemental IRFA that assesses affected small entities under the SBA's size standard to fully consider the economic impact of the proposed rulemaking on small investment advisors, as well as alternatives that may reduce those potential impacts. Advocacy further encourages the agencies to reconsider the adoption of significant alternatives that may reduce the regulatory burden on small entities, particularly considering the significant impact of the rule on small entities.

If you have any questions or require additional information, please contact me or Assistant Chief Counsel Graham Owens at (202) 205-6701 or by email at Graham.Owens@sba.gov.

Sincerely,

/s/
Major L. Clark, III
Deputy Chief Counsel
Office of Advocacy
U.S. Small Business Administration

[37] *Id.*

/s/
Graham Owens
Assistant Chief Counsel
Office of Advocacy
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Copy to: Richard L. Revesz, Administrator
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