August 9, 2019

Via Electronic Filing

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

Re: List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act; File No. S7-10-19

Dear Ms. Countryman:

The Investment Adviser Association[1] appreciates the opportunity to provide comments on the SEC's List of Rules to be reviewed for their impact on small entities, pursuant to Section 610 of the Regulatory Flexibility Act **(RFA)**.[2] We strongly support the Commission's retrospective review of regulations governing investment advisers, both as to their impact on smaller advisers and more broadly.

As a threshold matter, we again urge the Commission to redefine "small business" or "small organization" for purposes of treatment as a "small entity" under the RFA in order to more realistically assess the impact of its regulations on smaller investment advisers.[3] We also urge the Commission to tailor its regulations more appropriately for smaller advisers.

Our specific comments relate to Rule 206(4)-5 under the Advisers Act (the **Pay-to-Play Rule**),[4] which was included in the List of Rules to be reviewed. We strongly support the

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[1] The IAA is a not-for-profit association dedicated to advancing the interests of SEC-registered investment advisers. The IAA's member firms manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information please visit our website: www.investmentadviser.org.

[2] *See* List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act, SEC Rel. Nos. 33-10660; 34-86302; 39-2527; IA-5284; IC-33543 (July 3, 2019), 84 Fed. Reg. 33024 (July 11, 2019) **(List of Rules)**.

[3] *See* Rule 0-7 under the Investment Advisers Act of 1940 (**Advisers Act**). *See* Letter from Karen L. Barr, President and Chief Executive Officer, Investment Adviser Association, to The Honorable Walter J. Clayton, U.S. Securities and Exchange Commission (May 10, 2017), *available at* https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/170510cmnt.pdf (**Clayton Letter**).

[4] Political Contributions by Certain Investment Advisers, 17 CFR 275.206(4)-5.

Commission's goals in preventing investment professionals from "buying business" through campaign contributions. However, the Pay-to-Play Rule is unnecessarily complex, costly, and burdensome and should be more narrowly tailored to its intended purpose.

I. The Commission Should Update the Definition of "Small Business" or "Small Organization" to Provide Alternative Methods Under Which an Investment Adviser May Qualify as a Small Entity

As we have previously commented, the current asset-based definition of small business or small organization makes the Commission's analysis of the economic impact of its regulations on smaller investment advisers under the RFA virtually meaningless.[5] Rule 0-7 under the Advisers Act defines "small business" or "small organization" as including an investment adviser that has less than $25 million in assets under management (**AUM**).[6] Given that the threshold to be eligible for SEC registration is $100 million in regulatory AUM (**RAUM**) (with limited exceptions), few SEC-registered investment advisers are deemed to be "small" for purposes of the RFA – even though the vast majority of SEC-registered investment advisers are small businesses by any logical measure. As of April 2019, 56.9 percent (7,387) of SEC-registered investment advisers reported on Form ADV that they employ 10 or fewer non-clerical employees, and 87.5 percent (11,367) reported employing 50 or fewer individuals.[7] In fact, the median number of non-clerical employees of all SEC-registered advisers is nine.[8]

These advisers have been significantly burdened by "one-size-fits-all" regulations, and related staff guidance and OCIE expectations, the impacts of which, both in isolation and cumulatively, effectively require substantial fixed investments in infrastructure, technology, personnel, and systems relating to documentation, monitoring, operations, compliance, custody, business continuity planning, cybersecurity, and more. It is thus critically important to utilize a

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[5] *See, e.g.*, Letter from Gail C. Bernstein, General Counsel, Investment Adviser Association, to Brent J. Fields, U.S. Securities and Exchange Commission, on List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act (Dec. 27, 2018), *available at* https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/December_27__2018_-_IAA_Comment_Letter_to_SEC_re_List_of_Rules_to_be_Reviewed_Pursuant_to_the_Regulatory_Flexibility_Act__File_No__S7-25-18.pdf and Clayton Letter.

[6] 17 CFR 275.0-7(a)(1) (defining an investment adviser as a small entity for purposes of the Advisers Act and the Regulatory Flexibility Act if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) 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).

[7] *See* our upcoming *2019 Evolution Revolution, A Profile of the Investment Adviser Profession by IAA and NRS, available at* https://www.investmentadviser.org/publications/evolution-revolution.

[8] *Id.*

more meaningful metric beyond AUM, which alone does not accurately reflect the nature of an adviser's business. Because regulatory compliance depends on financial and human resources, using an AUM-based test risks missing the true burdens of regulation on advisers, most of which are quintessential small businesses.

We recommend that the Commission develop an alternative method for classifying investment advisers as small entities for purposes of the RFA.[9] We believe, for example, that the number of non-clerical employees would be a more realistic and effective measure of which advisers should be considered "small." This measure would more appropriately reflect the potential burdens on smaller advisers. Moreover, the data is readily available in Form ADV and often used in other contexts to define the relative size of companies.[10] We recommend that the Commission use the number of non-clerical employees as a metric for whether an adviser is a small entity for purposes of the RFA.

II. The Commission Should Tailor its Regulations Better For Smaller Advisers

We urge the Commission to use its discretion to tailor regulations more appropriately for smaller advisers, just as it has in other contexts. For example, public companies that meet the definition of a "smaller reporting company" under Rule 12b-2 of the Securities Exchange Act of 1934 are not required to report certain information, or are permitted to provide scaled disclosure or report information in lieu of some requirements in their periodic reports. Further, a smaller reporting company that qualifies as a "non-accelerated filer" is not required to provide an auditor attestation of management's assessment of internal control over financial reporting and, in contrast to other reporting companies, has more time to file its periodic reports.[11] In addition, the SBA Study identified other independent federal agencies that have differing compliance

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[9] The IAA thus supports H.R. 2436, the "Investment Adviser Regulatory Flexibility Improvement Act." The bill provides that "Not later than the end of the 1-year period beginning on the date of the enactment of this Act, the Securities and Exchange Commission shall revise the definitions of a 'small business' and 'small organization' under section 275.0-7 of title 17, Code of Federal Regulations, to provide alternative methods under which a business or organization may qualify as a 'small business' or 'small organization' under such section. In making such revision, the Commission shall consider whether such alternative methods should include a threshold based on the number of nonclerical employees of the business or organization." *See* H.R. 2436, Investment Adviser Regulatory Flexibility Improvement Act, *available at* https://www.congress.gov/116/bills/hr2436/BILLS-116hr2436ih.pdf.

[10] *See Independent Regulatory Agency Compliance with the Regulatory Flexibility Act*, for the Office of Advocacy, United States Small Business Administration (**SBA Study**) (noting, among other things, that the SBA's definition of small business incorporates number of employees), *available at* https://www.sba.gov/sites/default/files/rs410tot.pdf.

[11] We note that the Commission recently proposed amendments to Rule 12b-2 in order to promote capital formation for smaller reporting issuers. *See* Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, SEC Rel. No. 34-85814 (May 9, 2019).

requirements for small businesses, involving partial exceptions, a choice of alternative methods for compliance, extended compliance timetables, and tiered requirements.[12]

The Commission has substantial data to assist it in tailoring its rules for smaller or different types of advisers. For example, the Commission engaged in this type of analysis when it most recently amended Form ADV, Part 1 to increase the threshold for collecting certain data from $150 million in separately managed account RAUM (as proposed) to $500 million (as adopted). We commend the Commission for this appropriate tailoring of the reporting requirement, which enabled the Commission to collect 95% of the data that it would have collected using the $150 million threshold, while relieving approximately 3,000 advisers from having to report derivatives and borrowings information.[13] The Commission should similarly revisit the impact of other rules, including the Pay-to-Play Rule (as discussed below) and various aspects of the compliance program rule (Rule 206(4)-7 under the Advisers Act), as well as consider the cumulative cost of compliance for smaller advisers.

III. The Pay-to-Play Rule is Unnecessarily Complex and Imposes Significant Penalties on a Strict Liability Basis

The Pay-to-Play Rule imposes a significant economic burden on advisers of all sizes, due to its complexity and its significant penalties. It imposes a two-year compensation ban if an investment adviser or its "covered associate" makes certain political contributions to an "official" of a government entity client. Each aspect of the rule is complicated, requiring compliance officers to parse technical terms such as "covered associate," "contribution," "government entity," "official," and "regulated person," identify these individuals and entities, conduct diligence into contributions made by employees before they were hired or promoted to "covered associate" positions, monitor reports of contributions by employees, analyze the rule's impact on employees of affiliates and parent companies, implement policies and procedures to ensure compliance with the third-party solicitor provisions of the rule, create procedures to prevent "indirect" violations, and much more. The costs and compliance burdens imposed by the rule are substantial.

The penalties under the Pay-to-Play Rule apply strictly without regard to the intent underlying contributions and on a presumption that even a relatively modest and routine campaign contribution is *per se* problematic. And because of the extremely harsh penalties and strict liability nature of the rule, many investment advisers adopt conservative policies and procedures that go beyond the rule's technical requirements, in some instances prohibiting all

[12] *See* SBA Study at 15-16.

[13] *See* Form ADV and Investment Advisers Act Rules, SEC Rel. No. IA-4509 (Aug. 25, 2016) at 17-18; *see also* Letter from Robert C. Grohowski, General Counsel, Investment Adviser Association, to Brent J. Fields, U.S. Securities and Exchange Commission, on Amendments to Form ADV and Advisers Act Rules (Aug. 11, 2015), *available at* https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/150811cmnt.pdf.

political contributions by firm employees. Indeed, the Pay-to-Play Rule may be negatively affecting participation in the political process while at the same time imposing unnecessary and costly burdens on investment advisers.

IV. The Commission Should Consider a More Tailored Approach For Advisers of All Sizes to Achieve The Underlying Objectives of the Pay-to-Play Rule

We urge the Commission to consider alternative approaches that are more tailored to its underlying objectives, focusing the reach of the Pay-to-Play Rule on areas where abuse may be more likely or has in fact occurred. In particular, we encourage the Commission to rethink the way the Pay-to-Play Rule currently imposes draconian penalties for even the most minor violations or "foot faults." To do otherwise conflates serious misconduct with ordinary administrative matters where no scienter, recklessness, or harm is involved. To the extent the Commission maintains the rule's current approach, we specifically suggest that the Commission consider: (i) reducing the lengthy two-year "time out" period for providing compensated advisory services following certain triggering contributions; (ii) consider ways to reduce the due diligence burdens associated with the look back provisions, particularly with respect to employee contributions prior to their hiring; (iii) materially increase the *de minimis* contribution exceptions – currently $350 per election to a candidate for whom the employee is entitled to vote and $150 per election to a candidate for whom the employee is not entitled to vote;[14] (iv) streamline the process for granting exemptive orders relating to the two-year time-out; and (v) provide certain self-executing exemptions for inadvertent or minor violations.

In addition, the Commission should eliminate logistical aspects of the rule that generate cost without accomplishing any regulatory objective or policy. The requirement that a sub-adviser obtain and maintain a list of government entity investors in mutual funds it sub-advises is a prime example. Typically, there is little or no direct relationship between a sub-adviser and mutual fund investors, so the requirement to maintain records of government entity investors is not appropriately targeted to any material risk of misconduct. Accordingly, the SEC should review and revise the recordkeeping aspect of the rule.

[14] The adopting release for the rule suggested that the SEC "may consider increasing the $350 amount in the future if, for example, the value of it decreases materially as a result of further inflation." *See* Political Contributions by Certain Investment Advisers, SEC Rel. No. IA-3043 (July 1, 2010).

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We appreciate the Commission's consideration of our comments and would be happy to provide any additional information that may be helpful. Please contact the undersigned at [redacted] if we can be of further assistance.

Respectfully Submitted,

/s/ Gail C. Bernstein

Gail C. Bernstein
General Counsel

cc: The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison Herren Lee, Commissioner
Dalia Blass, Director, Division of Investment Management