



SMALL ADVISERS AND FUNDS SUBCOMMITTEE

Draft Observations and Recommendations
for the Asset Management Advisory Committee

Three Core Areas of Observations and Recommendations



MODERNIZATION OF DEFINITIONS,
REPORTING & ECONOMIC ANALYSIS
RELEVANT TO ASSESSING IMPACT OF
REGULATIONS ON THE
"TYPICAL" REGISTRANT



TAKING MEASURE OF MARKET STRUCTURE
ISSUES IMPACTING THE AVAILABILITY (OR
ABSENCE) OF RESOURCES FOR
ADVISERS/FUNDS TO MANAGE RISK WHILE
MEETING CLIENT-SIDE DEMANDS



CALIBRATION OF EXISTING AND FUTURE
REGULATIONS TO CONSIDER/BALANCE
"RISK-BASED," "ACTIVITY-BASED," AND
"RESOURCE-BASED" REALITIES

Observations Relevant to Regulatory Definitions and Economic Analysis in Connection with Rulemaking

- Most registered investment advisory firms are small businesses by any common-sense definition.
- As highlighted in the 2021 IAA Report, of the nearly 14,000 SEC registered advisory firms, approximately 12,300 of those firms (nearly 88%) reported employing 50 or fewer individuals and manage less than \$2 Billion in AUM. The “typical” firm (median numbers) has 9 employees, has \$355M in AUM, and primarily serves individual families as clients. These businesses have humble revenues and tight budgets. They are “small businesses” by any measure.
- Regulator perspective on “best practices” often mirrors/reinforces the approach taken by large institutional firms to risk management and compliance, setting expectations difficult to achieve (operationally or financially) for small advisers/funds.
- Lack of scale and/or leverage in operating “spaces” present unique challenges not faced as acutely by large firms. The approach small advisers/funds must take toward risk management and compliance (as well as their approach to markets and counterparties) requires creativity and budgetary disciplines in order to account for a lack of leverage across all business needs, including access to “new issues” in the bond market, negotiation with FinTech vendors, licensing fee burdens, managing relationships with custodians, approaches taken to derivatives risk management, access to research, and deployment of cybersecurity tools (just to name a few).
- The economic analysis done in the context of rulemaking initiatives and proposals that the APA and Regulatory Flexibility Act require is critical work that remains truly relevant to the Commission’s informed consideration of the impact of rules and regulations (individually or in aggregate) on the everyday lives and work of most investment advisory firms. The analysis should be based upon a more realistic consideration of how small firms are affected.

Observations Impacting Definitions and Economic Analysis in Connection with Rulemaking

- The existing definitions of “Small Business,” “Small Organization,” and “Small Entity” utilized by the SEC in conducting economic analysis in connection with rulemaking are severely outdated.
- For example, Rule 0-7 promulgated under the Investment Advisers Act of 1940 (the “Advisers Act”), defines “small entities” under the Advisers Act for purposes of the Reg. Flex. Act, to be those with \$25 million or less in Assets Under Management (AUM). Given that the basic threshold for SEC registration is currently \$100 million in AUM, very few SEC-registered advisers are deemed to be “small” for cost-benefit purposes. Similar definitional insufficiencies exist in other relevant rules describing “small business” and “small organization” as they pertain to registered investment advisers. Current definitions intended to capture small businesses are insufficient and do not help the Commission to fulfill important regulatory policy goals of assessing economic impact on small businesses in the investment advisory industry.
- The Commission’s Division of Economic & Risk Analysis, historically, has engaged primarily in a rule-by-rule analysis of economic impacts (including assessment of the impact on small businesses in our industry). Given the breadth, scope, and depth of the regulatory requirements on all registrants and considering the growing aggregate or cumulative impact of compliance costs on the balance sheet health of small advisers/funds, economic analysis done in a vacuum has limited utility. While economic analysis on a rule-by-rule basis is necessary, it is insufficient to provide the Commission (and public commenters) the picture necessary to be fully informed in considering and commenting on rulemaking initiatives.

Market Structure and Regulatory Regime Observations

Where is the regulatory regime either lagging market needs, and/or disconnected from market realities? Where are those realities disproportionately impacting small firms (e.g. firms with “typical,” but limited, resources)?

1. Bond/FI Issuances Migrating to Private Markets / Constraints on obtaining “New Issues” for Typical Advisers/Funds
2. E-delivery for notices, disclosures, approvals and signatures still not permitted as the “default”
3. Data Security Legal Regime Remains Balkanized
4. Expectation / Resource Delta in Cybersecurity
5. Liquidity Rule and Derivatives Risk Management: Governance confusion persists
6. Proxy Voting: Continuing “disconnect” on use of proxy voting advisory services by advisers and funds as a method of fiduciary fulfillment
7. License Needs/Fees linked to agency regulations / Potential Monopolies (CUSIP and Benchmark Indices): CUSIP License Fee Regime has far “overreached” in the imposition of fees on advisers and funds, especially when advisers/funds only use the CUSIP numbers for internal recordkeeping and client reporting. Similar issues exist in the licensing regime for securities index providers. European regulators have been much more proactive with policy positions and regulatory actions that seek to curtail the overreach.

Regulatory Definitions & Economic Analysis - Recommendations

1. Modernize the definition of “Small Entities” for Regulatory Flexibility Act considerations. Modernize other definitions relevant to the universe of firms captured in assessing economic analysis and impact on investment advisers and funds operating as small businesses in the context of SEC rulemaking.
 - A. Acknowledge that AUM is less effective in identifying “small businesses.” Consideration of human and financial resources available to operate the business have much greater utility.
 - B. As applied to Advisers: Example - Fewer than 50 employees or annual revenue less than \$25M.
 - C. As applied to Investment Companies (Funds): Example - Principal Adviser to fund has fewer than 50 employees or annual revenue less than \$25M.
2. Modernize Economic Analysis and Reporting.
 - A. Periodic Assessment and Reporting by the Commission's Division of Economic & Risk Analysis on Cumulative Impacts of Regulation on Small Advisers and Funds (conducted every 5 years).
 - B. Public Reporting of Economic Analysis Reports on Cumulative Impacts of Regulation on Small Advisers and Funds.

Recommendations Driven by Evolution of Market Structure and Observations on Regulatory Lag or Disconnect

3. Bond Market Study: We recommend that the Commission convene a Roundtable to study the drivers of the growing “inaccessibility” (for both small advisers and retail investors) to “new issues” in the Bond market, that has been exacerbated by other market developments, such as the expansion of the private debt markets (e.g., 144A offerings), which are less accessible to individual investors and the typical registered advisory firm/small fund). The goal should be to facilitate a level playing field for individual investors (and the typical investment advisory firm/fund) to gain greater access to quality “new issues” in the bond market and to determine what action can be taken to promote continued growth of the public market for quality “new issues” in the bond market.
4. E-delivery and E-Signatures: We recommend that the Commission move swiftly to make it legally acceptable for investment advisers and funds to utilize an electronic notice and access regime for delivery of all notices, disclosures, and information as the default method of delivery of required information, with the right of any investor to opt out and continue to receive paper (e.g. no affirmative consent required for e-delivery). We also recommend that the Commission move swiftly to make it legally acceptable for investment advisers and funds to utilize electronic signatures for all client contracts, consents, and approvals of any nature; once again, as the default practice.
5. Regulatory Coordination on Data Security and Privacy: We recommend that the Commission’s Office of Legislative Affairs take an advocacy role in encouraging Congress to establish a data security and privacy law regime applicable to the financial services sector, centralized at the federal level.
6. Calibrated Guidance on Cybersecurity, Business Continuity, and Disaster Recovery: We recommend that the Staff or Commission consider issuing guidance on “best practices” in these three important areas that is tailored separately to large enterprises and small businesses.

Recommendations Driven by Evolution of Market Structure and Observations on Regulatory Lag or Disconnect

6. Proxy Voting by Small Advisers and Small Funds: We recommend that the Commission and Staff consider their work on the use/reliance of/on proxy voting advisory firms as unfinished. We recommend that Commission and Staff fully consider the extent to which reliance on the issuer diligence and recommendations performed/made by proxy voting advisory firms enhances (rather than detracts from) the ability of small advisers and funds to fulfill their fiduciary duty in the context of proxy voting.
7. Liquidity Rule and Derivatives Risk Management Program: There continues to be confusion on the balance of governance and oversight by the fund board (relative to the role of the investment adviser to the fund) in the context of the Derivatives Risk Management Program. While, under the rule, the fund's investment adviser is not eligible to serve as the derivative risk manager, fund boards report interest in more guidance in relation to the role of the fund's investment adviser relative to the derivatives risk manager and the delineation of duties between the fund board, fund adviser, and derivatives risk manager.
8. CUSIP and Index License Fee Regime: We recommend that the Commission study whether to remove specific reference to "CUSIP" relative to securities identifiers in its rules and regulations. We also recommend that the Commission study whether it has legal jurisdiction to regulate CUSIP and securities index licensing fee practices as they pertain specifically to fee imposition on investment advisers and funds. If statutory authority exists, we recommend the Commission take regulatory action to limit the licensing fees charged to the issuers of the securities identified by the CUSIP number and, with respect to securities indices, limit licensing fees to circumstances where an adviser or fund is using reference to the index in an advertisement (and not in connection with regulatory and client reporting, or internal purposes). Even if the Commission determines that there are statutory or jurisdictional limitations on its ability to act on this, the Commission should take a formal public policy position and coordinate with the FTC in exploring the impact of current monopolies that may exist, as the European regulators have done.