115TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
115–884

INVESTMENT ADVISER REGULATORY FLEXIBILITY IMPROVEMENT ACT

AUGUST 3, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

[To accompany H.R. 6321]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 6321) to require the Securities and Exchange Commission to revise the definitions of a "small business" and "small organization" for purposes of assessing the impact of the Commission's rulemakings under the Investment Advisers Act of 1940, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On July 10, 2018, Representative Gwen Moore introduced H.R. 6321, the "Investment Adviser Regulatory Flexibility Improvement Act", requires the U.S. Securities and Exchange Commission (SEC or Commission) to better examine the regulatory burdens faced by small entities that are subject to the SEC's jurisdiction. H.R. 6321 requires the SEC to revise the definitions of a "small business" and "small organization" for purposes of assessing the impact of the SEC's rulemakings under section 275.0–7 of title 17, Code of Federal Regulations, and to provide alternative methods under which a business or organization may qualify as a small business or small organization.

BACKGROUND AND NEED FOR LEGISLATION

The Regulatory Flexibility Act requires all federal agencies to analyze the economic impact of regulations when there is likely to be a significant economic impact on a substantial number of small

entities and to consider regulatory alternatives that will achieve the agency's goal while minimizing the burden on small entities. For the purposes of the Investment Advisers Act of 1940 and the Regulatory Flexibility Act, the SEC's rules lay out the criteria for when investment advisers are considered small entities.

The goal of H.R. 6321 is to ensure that the Commission more broadly considers the regulatory burden of its regulations on small investment advisers by directing the Commission to revise its definitions of a "small business" and "small organization to account for alternative methods for accounting for which entities constitute such businesses and organizations."

SEC regulations currently define "small business" and "small organization" as investment advisers with less than $25 million in assets under management (AUM); with less than $5 million in total assets at the end of the most recent fiscal year; and who do not control, are not controlled by, and are not under common control with another investment adviser with more than $25 million in AUM or an entity with over $5 million in total assets at the end of the most recent fiscal year.

Prior to enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), mandatory SEC registration for investment advisers was set at AUM of at least $25 million. Title IV of the Dodd-Frank Act increased this mandatory SEC registration threshold from $25 million in AUM to at least $100 million in AUM.

The Committee is aware of concerns that the SEC's attention to the economic impact of its regulations on small investment advisory firms is both inadequate and while not intentional, the SEC's staff may not consider the effect of its rule on small investment advisers. With the increased threshold for SEC registration at $100 million in AUM, virtually no SEC-registered investment advisers could be deemed to be "small" for cost-benefit analysis purposes—even though more than 6,000 registered advisory firms employ 10 or fewer non-clerical employees. While H.R. 6321's subject matter is the treatment of small business and small organization for purposes of the Investment Advisers Act of 1940, the SEC has an obligation to broadly considers the impact of its regulations on all small entities that are subject to SEC oversight and regulation. The SEC should also direct self-regulatory organizations, FINRA, the PCAOB and FASB to consider the impact of rules and standards on small broker-dealers, investment companies, auditing firms of broker-dealers as well those entities that also comply with U.S. generally accepted accounting principles. The revisions to these definitions for smaller investment advisers should serve as the SEC's template to better tailor both regulations and guidance for these entities.

In revising the definitions of "small business" and "small organization" with regards to advisory firms, the bill directs the SEC to consider whether such alternative methods for qualifying as a "small business" or "small organization" should include a threshold based on the number of non-clerical employees of the business or organization. With respect to this and any other alternative methods, it would be the Commission's decision to determine what alternative methods are appropriate. The Committee would expect that the SEC would welcome public comments to inform its decisions.

Nonetheless, revising these definitions and considering whether such definitions should include more meaningful metrics will result in a better understanding of regulatory costs on small advisers and should lead to more tailored regulations, reduced burdens and improve the relationship and the delivery of advice to investors.

HEARINGS

The Committee on Financial Services has not held a hearing examining matters relating to H.R. 6321.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 11, 2018, and ordered H.R. 6321 to be reported favorably to the House, without amendment, by voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by a voice vote, a quorum being present.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 6321 will require the SEC—within one year of enactment—to revise the definitions of "small business" and "small organization" with regards to investment advisory firms for purposes of assessing the impact of the SEC's rulemakings under the Investment Advisers Act of 1940. In making such revision, the bill directs the SEC to consider whether such alternative methods for businesses or organizations to qualify as a "small business" or "small organization" should include a threshold based on the number of non-clerical employees of the business or organization. This will allow for a better understanding of the regulatory costs on small advisers and a more tailored regulation to reduce burdens.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 17, 2018.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, H.R. 6323, and H.R. 6324.

If you wish further details on these estimates, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

MARK P. HADLEY
(For Keith Hall, Director).

Enclosure.

Securities and Exchange Commission Legislation

On July 11, the House Committee on Financial Services ordered eight bills to be reported related to the rules, regulations, and operations of the Securities and Exchange Commission (SEC). The bills are:

- H.R. 3555, the Exchange Regulatory Improvement Act, would require the Securities and Exchange Commission (SEC) to issue regulations regarding its definition of what constitutes a facility used by a national securities exchange;
- H.R. 6177, the Developing and Empowering our Aspiring Leaders Act of 2018, would direct the SEC to conduct a rulemaking to expand what types of asset acquisitions are considered qualifying investments for a venture capital fund;
- H.R. 6319, the Expanding Investment in Small Business Act, would require the SEC to conduct a study on the limitation on the amount of outstanding securities a closed-end fund may hold from a single issuer and still be classified as diversified;
- H.R. 6320, the Promoting Transparent Standards for Corporate Insiders Act, would require the SEC to conduct a study of various proposals to change agency rules regarding the use of written trading plans by certain securities traders;
- H.R. 6321, the Investment Adviser Regulatory Flexibility Improvement Act, would require the SEC to revise the definitions of a small business and small organization applicable for assessing the effect of the agency's rulemakings under the Investment Advisers Act of 1940 on those entities;
- H.R. 6322, the Enhancing Multi-Class Share Disclosures Act, would direct the SEC to issue a rule requiring securities issuers with multi-class stock structures to make disclosures regarding the voting power of certain individuals;

- H.R. 6323, the National Senior Investor Initiative Act of 2018, would direct the SEC to establish a taskforce to identify challenges that senior investors face and to report on its findings every two years; and
- H.R. 6324, the Middle Market IPO Underwriting Cost Act, would direct the SEC to study the costs associated with small and medium-sized companies undertaking an initial public offering and to report on its findings.

Using information from the SEC regarding the costs of similar activities, CBO estimates that implementing seven of those bills—H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, and H.R. 6324—would each have a gross cost of about $1 million for the agency to conduct the required studies and rulemakings and to issue reports. CBO estimates that implementing the eighth bill—H.R. 6323—would have a gross cost of $7 million over the 2019–2023 period for the SEC to establish and carry out the functions of the taskforce established under the bill.

However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending of implementing each of those bills would be negligible, assuming appropriation actions consistent with that authority. H.R. 6323 also would require the Government Accountability Office (GAO) to conduct a study on the economic costs of the financial exploitation of senior citizens and CBO estimates that implementing that section would cost GAO less than $500,000; such spending would be subject to the availability of appropriated funds.

None of the bills would affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply for any of the eight bills.

None of the bills would increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029, CBO estimates.

None of the bills contain intergovernmental mandates as defined in the Unfunded Mandate Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. All of them would require the SEC to take actions that could raise the agency's administrative costs and the fees it collects to offset those costs. If the SEC increased fees, it would increase the cost of an existing mandate on private entities required to pay those fees. CBO estimates that none of the bills would increase fees in an amount that would exceed the annual threshold for private-sector mandates established in UMRA ($160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has deter-

mined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires one directed rulemaking to require the SEC—within one year of enactment—to revise the definitions of "small business" and "small organization" to provide alternative methods under which a business or organization may qualify as a "small business" or "small organization."

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This Section cites H.R. 6321 as the "Investment Adviser Regulatory Flexibility Improvement Act".

Section 2. Definition of small business of small organization

This section requires the SEC—within one year of enactment—to revise the definitions for "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." In making such revision, the SEC shall consider whether such alter-

native methods should include a threshold based on the number of non-clerical employees of the business or organization.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows: H.R. 6321 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the House of Representatives.

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