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July 7, 2003

Via Electronic Mail

Mr. James Sloan
Director
Financial Crimes Enforcement Network
U.S. Department of Treasury
Section 352 Investment Advisor Rule Comments
P.O. Box 39
Vienna, VA 22183
regcomments@fincen.treas.gov

Re: Section 352 Investment Advisor rule Comments Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers

Dear Mr. Sloan:

The Office of Advocacy of the U.S. Small Business Administration (SBA) was created in 1976 to represent the views and interests of small business in Federal policy making activities.[1] The Office of Advocacy (Advocacy) monitors and reports on agencies' compliance with the Regulatory Flexibility Act of 1980 (RFA) as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).[2] These laws require Federal agencies to assess the impact of their policies and rulemakings on small entities. On August 13, 2002, President Bush signed Executive Order (EO) 13272, which requires agencies to improve their compliance with the RFA and to engage Advocacy earlier in the rulemaking process.[3] Because the Office of Advocacy is an independent office within SBA, the views of the Chief Counsel do not necessarily represent the views of the SBA or the Administration.

On June 23, 2003, the Office of Advocacy held a roundtable on the banking industry issues. At that roundtable, small business stakeholders raised concerns about the duplicative nature of the Financial Crimes Enforcement Network (FinCen) proposed rule on the Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers that was

[1] Pub. L. No. 94-305 (codified as amended at 15 U.S.C. §§634a-g, 637).

[2] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

[3] In addition, E.O. 13272 instructs regulatory agencies and Advocacy work closely together as early as possible in the regulation writing process to address disproportionate impacts on small entities and reduce their regulatory burden. Section 3(c) of the E.O. requires agencies to respond to Advocacy's written comments in an explanation or discussion of the final rule that is published in the *Federal Register*.

published in the Federal Register, Volume 68, Number 86, page 23646 on May 5, 2003. In response to the roundtable, Advocacy reviewed the proposed rule. The proposal requires certain investment advisers who manage client assets to establish anti-money laundering programs, to establish minimum requirements for such programs, and to delegate its authority to examine certain investment advisers for compliance with such program requirements to the Securities and Exchange Commission. The proposal implements Title III of the USA Patriot Act of 2001. In the proposal, FinCen certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. After reviewing the proposal, the Office of Advocacy is concerned that FinCen may not have fully considered the impact that the proposal may have on small entities.

Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Unless the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities, the agency is required to prepare an Initial Regulatory Flexibility Analysis (IRFA). The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities. In preparing its IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.[4]

Pursuant to section 605 of the RFA, an agency may certify that a rule will not have a significant economic impact on a substantial number of small entities in lieu of preparing an IRFA. The agency, however, must provide a factual basis for the certification.

RFA Compliance in the Proposal

In the proposal, FinCen prepared a certification in lieu of an IRFA. The certification states:

> It is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. The proposed rule will not impose significant burdens on those investment advisers covered by the rule because they are already subject to Form 8300 reporting and may build on their existing risk management procedures and prudential business practices to ensure compliance with this rule. In addition, investment advisers subject to the proposed rule will not be compelled to obtain more sophisticated legal or accounting advice than that already required to run their businesses.

[4] 5 U.S.C. § 603 and 5 U.S.C. § 607.

> Finally, FinCEN believes that the flexibility incorporated into the proposed rule will permit each investment adviser to tailor its anti-money laundering program to fit its own size and needs. In this regard, FinCEN believes that expenditures associated with establishing and implementing an anti-money laundering program will be commensurate with the size of an investment adviser. If an investment adviser is small, the burden to comply with the proposed rule should be de minimis.

The Office of Advocacy is concerned that the certification is not supported by a factual basis as required by the RFA. From what Advocacy can ascertain from the proposal, some investment advisors will be exempt from the proposal. However, there is not enough information to determine whether the number that will be exempt from the proposal would support a conclusion that the number of entities that will be impacted is not substantial. Advocacy encourages FinCen to provide the public with the data that explains exactly how many small entities will have to comply with this proposal.

Advocacy is also concerned about the lack of data to support FinCen's determination of no significant economic impact. Although FinCen states that the burden to comply with the proposed rule should be de minimis, there is no explanation as to how FinCen reached this conclusion. The proposal requires firms to develop a written program to prevent the firm from being used as a money laundering facility. In doing so, it requires each investment advisor to review the types of services that it provides and the nature of its clients to identify its vulnerabilities to money laundering and other terrorists financing activities. It then must develop and implement procedures and controls to reasonably address each vulnerability, assure compliance with these requirements, periodically assess the effectiveness of its procedures and controls, and train employees about the new procedures.

Advocacy asserts that complying with the requirements could be a time consuming and costly process. Although investment advisors may not be compelled to obtain more sophisticated legal or accounting advice, additional fees may be required to do the necessary review and prepare the necessary documents. Companies may also incur training costs. Furthermore, companies may incur costs due to the amount of time and money that may be required for training employees, as well as the cost of having the employees' usual job duties covered by someone else during the training period.

In addition, Advocacy understands that this proposal may be duplicative for small savings associations. Advocacy encourages FinCen to give careful consideration to comments filed by small associations, including those that may point out the duplicative nature of the proposal, and make appropriate adjustments before finalizing the rule.

Advocacy encourages FinCen to perform a threshold analysis to determine if its initial conclusion of no significant economic impact on a substantial number of small entities is accurate. If it is accurate, Advocacy suggests that FinCen publish a revised certification that includes a meaningful factual basis prior to the publication of the final rule. If the conclusion of no significant economic impact is not supported by the threshold analysis, Advocacy encourages FinCen to publish an IRFA prior to finalizing the rule.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule and to provide the information on those impacts to the public for comment. As noted above, Advocacy recommends that FinCen revise its certification to include a meaningful factual basis that provides an analysis to support the conclusion of no significant economic impact. If FinCen finds that the threshold analysis does not indicate that a certification is appropriate, Advocacy encourages FinCen to publish an IRFA to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on its operations. In addition to providing the public with specific information about the economic impact of the proposal, an IRFA should provide a meaningful discussion of alternatives that may minimize that impact while achieving the stated goals of the proposal.

As noted above, Section 3(c) of E.O. 13272 requires agencies to respond to Advocacy's written comments in an explanation or discussion of the final rule that is published in the Federal Register. The Office of Advocacy is available to work with FinCen to ensure compliance with the RFA while accomplishing FinCen's desire to prevent money laundering and terrorism. Thank you for the opportunity to comment on this important proposal. If you have any questions, please feel free to contact the Office of Advocacy at (202) 205-6533.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Jennifer A. Smith
Assistant Chief Counsel for
Economic Regulation & Banking