
Public Comment on “Small Business and Small Organization Definitions for Investment Companies and Investment Advisers (Securities And Exchange Commission - Proposed Rule)

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March 2026

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Executive Summary

The Securities and Exchange proposal seeks to update the definition of “small entities” for investment companies under the Regulatory Flexibility Act. The purpose of the proposal is to recalibrate outdated regulatory thresholds so the Commission's rule making analysis more accurately reflects modern markets and resolves disproportionate regulatory burdens.

The proposal primarily addresses a structural misalignment that has emerged between past and present markets. The thresholds have not been updated since 1998 while the investment management industry has changed valuations, assets, and total resources. The same standards applied today burden moderate and small firms that do not qualify under this definition. This actively harms the effectiveness of the RFA’s requirement that agencies assess firms with limited compliance capacity.

To resolve these market issues, the proposal updates based on proportional asset-based thresholds. The proposal raises the net asset threshold from \$50 million to \$10 billion paired with a family of investment companies. For advisors, the proposal raises the regulatory asset threshold from \$25 million to \$1 billion. These adjustments are designed to capture firms that may have more operational constraints or resource costs.

The proposal also proposes a 10-year inflation adjustment mechanism which would recalibrate these thresholds to fit modern standards. It would use a standardized price index to prevent halting industry growth or erosion from inflation.

Overall, the proposal aims to combine transparency with updated standards in order to alleviate the smaller firms in investment management industries. This analysis aims to uncover the implications and solvency of current markets when integrated into this new proposal.

Introduction

The Securities and Exchange Commission (SEC) is proposing an update to current organizational definitions of “small business” and “small organizations” under the Investment Company Act of 1940 (the “Investment Company Act”) and under the Investment Advisers Act of 1940 (the “Advisers Act”).

The current thresholds have remained unchanged since 1982 when defining “small entity” leaving the definitions out of relevance for 21st century finances. Through this update, this proposal aims to specifically:

1. Raise current asset thresholds
 - a. Amend Rule 0-10 to increase the total asset threshold for investment companies from the current \$50 million to \$10 billion.
 - b. Amend Rule 0-7 to raise the RAUM threshold for investment advisors from \$25 million to \$1 billion.
 - c. Update aggregation rules to a “family of investment companies” to provide similarity with Form N-CEN and grouped equally when determining size
2. Inflation adjustments:
 - a. Creation (i.e. establishing) an inflation adjustment mechanism that will allow for the commission (SEC) to adjust the thresholds by order every 10 years, which serves as a preventative measure against “bracket creep” caused by economic expansion
3. Reporting consistency:
 - a. Marketing conforming changes to Form ADV (Part 1A, Item 12) to ensure that advisor reporting aligns with new definitions

The RFA serves as a safeguard which requires concrete federal agencies to evaluate the economic impact of their rules on smaller market entities. The definition of “small entity” acts as a safeguard filter. (*p.129*)

Whenever the SEC proposes new rules, the RFA provides a system of checks and balances as it urges consideration of alts that minimize the burden that would be placed on these smaller entities. By updating these definitions, the SEC can ensure that its RFA can accurately capture a segment of the industry.

These changes lead to individualized rulemaking (i.e. staggered compliance dates, simplified reporting, etc.). This system ensures that smaller forms are not forced to compete in a system of regulatory framework designed for only the largest global financial corporations.

Over the course of the last few years, the financial system has gone under stark changes and transformations since the thresholds were last updated in 1998. The industry has seen asset expansion followed along with an increase in concentration:

1. Asset expansion:

- a. 1982: Fund industry held approx. \$297 billion in assets. → in 2024 this dollar figure exceeded beyond \$41 trillion
- b. Because the 1998 thresholds remained fixed while the financial market continued to grow, the % of SEC advisors classified as “small” fell from ~75% to 3%. In investment companies alone, the percentage fell from 62% (1982) to 0.6% (2024)

2. Post Dodd-Frank context:

- a. After the 2008 “financial crisis” and the Dodd Frank Act, the cost of compliance had risen. Firms managing \$500 billion or \$2 billion had the same operational constraints as others that had to handle \$25 million.
- b. The current proposal allows for middle to small size firms to be included in the SEC’s impact studies and maintain a competitive market.

It is key to distinguish that this proposal affects a regulatory analysis instead of direct exemptions from conduct rules. The update changes the current scope of the SEC’s internalized research. It will not automatically exempt firms from existing securities under federal law.

This proposal does not alter the status RAUM thresholds for SEC registration (~\$100 million). Modernization ensures that the SEC’s policy process is adapting to the currently changing modern market instead of the outdated market of 1998.

Policy Gaps

1) Inherent problems within the current system

a) Threshold stagnation

One of the structural problems identified in the SEC proposal is threshold stagnation. The numerical thresholds used to define small entities under the Regulatory Flexibility Act have remained unchanged despite dramatic growth in various industries. The existing definitions were developed decades ago and reflect the scale of the market at that time rather than the current complexity of modern firms.

Since the early 1980s and 1990s, the investment management industry has expanded in the number of funds and total assets under management. Total US investment company assets have grown from 2 trillion to over 35 trillion in 2023 (Duvall, 2024). However, the thresholds used to classify firms as small entities have not kept pace with this expansion. Because the thresholds remain fixed in nominal terms, the proportion of firms qualifying as small entities has declined as average firm size increases.

The result is a regulatory definition that no longer reflects the economic reality of the market. According to the SEC's analysis, only about 0.6% of investment companies currently qualify as small entities under the existing definitions (United States Securities and Exchange Commission, 2025). This small share suggests that the regulatory thresholds fail to capture the population of firms that operate with limited compliance capacity or market power.

The threshold stagnation problem means that firms that function as relatively small participants in the market are excluded from the protections intended by the RFA simply because the numerical thresholds have not been updated to industry growth.

b) Analytical distortion

Threshold stagnation creates analytical distortion in regulatory analysis under the RFA. The RFA requires federal agencies to analyze the economic impact of proposed rules on small entities when a rule is expected to affect a substantial number of such firms (US Small Business Administration of Advocacy, 2017). This analysis is intended to ensure that agencies consider alternatives that reduce compliance burdens for smaller market participants.

When the small entity is too narrow, the RFA analytical triggers rarely activate. Since such a small number of firms qualify as small entities under the current thresholds, regulatory analysis concludes that proposed rules will not affect a substantial number of small entities (Administrative Conference of the United States, 2022).

However, the additional analytical requirements designed to evaluate regulatory burdens may not be conducted, which could weaken the effectiveness of the RFA framework.

Expanding the definition too broadly could create the opposite problem. If the threshold is set so high that a large share of the industry qualifies as a small entity, the category becomes diluted and no longer reflects firms that actually face resource constraints. This creates a calibration challenge in which regulators must set thresholds that capture genuinely smaller firms without classifying the majority of the industry as small.

The SEC proposal highlights this problem by emphasizing that the goal is to restore meaningful RFA analysis without undermining the purpose of the small entity category.

c) Market concentration & economies of scale

Another structural issue contributing to regulatory misalignment is market concentration within the investment management industry enjoyed by large fund complexes. Assets have become increasingly concentrated among a small number of large investment firms. These large complexes often manage massive sums of funds and assets which gives them significant operational advantages.

One key advantage is the ability to internalize compliance costs. Large firms typically maintain dedicated compliance departments capable of absorbing new regulatory requirements with relatively lower marginal cost (Beyer et al., 2010). Because compliance infrastructure is already in place, new obligations can be integrated into existing systems.

Smaller firms frequently lack these internal resources. Compliance costs for them are often fixed rather than scalable. This is essential because it means that new regulatory requirements can impose disproportionately higher costs relative to firm size (Government Accountability Office, 2016).

Smaller advisors may need to hire external consultants and develop new compliance systems in response to regulatory changes. This creates a structural asymmetry in which regulations apply uniformly across the industry but their economic impact varies based on firm size.

d) Advisor-specific structural issues

The SEC proposal identifies several advisor-specific structural issues related to how investment advisors are classified as small entities. One issue is the mismatch between federal registration thresholds.

Under existing regulatory structures, advisors are generally required to register with the SEC once the assets reach \$100 million while smaller advisors may register with state regulators instead (US Securities and Exchange Commission, 2025). The definition used to determine whether an advisor qualifies as a small entity for RFA purposes does not align with these federal registration thresholds. This mismatch creates inconsistencies in how advisor size is evaluated across different regulatory frameworks.

Another complication arises from how advisor assets are calculated. The existing rules often require regulators to examine control relationships and total asset aggregation across related entities. Advisors that are part of larger corporate structures may need to combine assets across affiliated entities when determining whether they meet the small entity definition. This aggregation process can complicate the classification of firms, particularly when ownership relationships are complex or when advisors operate within broader financial groups.

Because these control relationships and total asset tests may have misalignment with standardized reporting structures, determining whether an advisor qualifies as a small entity can require additional interpretation. This creates uncertainty in the analysis and can lead to inconsistent classifications across firms. The SEC proposal seeks to address these issues by updating thresholds and aligning with modern structures.

2) Policy gaps

a) Calibration

The calibration gap refers to the mismatch between current regulatory thresholds defining small entities and the modern scale of the investment management industry. The existing thresholds were established decades ago when size and number of investment companies were significantly smaller.

Since then, the industry has expanded dramatically in terms of assets under number of funds and overall market complexity. Because the thresholds were not adjusted alongside this growth, they now classify only a very small portion of firms as small entities (Fichtner et al., 2017).

This miscalibration creates a regulatory imbalance. Firms that operate with limited resources compared to large financial institutions may exceed the outdated thresholds and fall outside the small entity category. As a result, regulatory analysis may fail to account for the compliance burdens experienced by moderately sized firms that lack the scale enjoyed by the largest asset managers.

This proposal attempts to address this calibration gap by updating the thresholds to reflect current market conditions and produce a more accurate representation of firm size distribution within the industry.

b) Analytical triggers

The analytical trigger gap arises from the interaction between outdated thresholds and requirements of the Regulatory Flexibility Act. Under the RFA, federal agencies must conduct additional inspection when a rule is expected to have a significant impact on a substantial number of small entities. This requirement is designed to ensure that regulators consider the unique cost faced by smaller firms when implementing new regulations.

However, when the definition of a small entity is so narrow that only a few firms qualify, the RFA's analytical requirements are triggered less frequently. This weakens the intended protective function of the statute. If only a tiny share of the industry meets the small entity definition, regulation may overlook how compliance costs disproportionately affect smaller firms that lack the internal compliance infrastructure of larger financial institutions (OECD, 2025).

This proposal seeks to address this trigger gap by expanding the set of firms classified as small entities. Doing so increases the likelihood that rule making will capture the fiscal impact on firms that operate with fewer resources.

c) Structural data issues

The structural data gap refers to limitations in how small entities are currently measured within regulatory data sets. Under the existing framework, determining whether an investment company qualifies often requires aggregating assets across groups of related investment companies (Shapiro, 2019). This concept is not tied directly to standardized regulatory reporting fields which means that analysts must interpret relations between funds manually.

This manual case-by-case interpretation reduces consistency in regulatory analysis across firms. This may propagate biases in regulatory oversight by opening a Pandora's box's worth of potential corrupt dealings between small business owners with vested interests and regulators. Without a standardized data structure, estimates may vary and disadvantage certain firms. To address this issue, the proposal replaces the older concept with the "family of investment companies" definition used in Form N-CEN which is a regulatory filing already submitted by investment companies.

Because Form N-CEN includes structured data fields identifying fund families, the SEC can measure asset aggregation using standardized datasets (Office of Financial Research, 2025). This change allows regulators to accurately identify which firms fall within the small entity category.

d) Inflation adjustments

The inflation adjustment gap stems from the lack of updates to the thresholds used to define small entities. Inflation and industry growth can increase the asset size of firms across the market. If regulatory thresholds remain fixed, their real valuation gradually erodes and fewer firms can qualify.

This static structure leads to definitions becoming absolute. Without adjustments, the thresholds become outdated and cause the calibration problem that currently exists (OECD, 2025). As a result, regulatory frameworks may undergo large revisions rather than small updates.

This proposal attempts to address this problem by introducing an automatic inflation adjustment mechanism that updates the thresholds based on indicators. By allowing thresholds to adjust over time, the SEC aims to maintain the relevance of the definition and prevent future misalignment between regulatory categories and industry conditions.

3) Additional considerations

a) Distributional impacts of new thresholds

Future research and empirical analysis should examine how many investment advisers and investment companies would newly qualify as “small entities” under the proposed definitions. Understanding the size distribution of firms under the revised thresholds would help determine whether the recalibration restores a meaningful representation of smaller firms or whether it risks expanding the classification too broadly. Data from regulatory filings submitted to the SEC, including Form ADV and Form N-CEN disclosures, could provide a useful basis for such analysis.

b) Compliance cost scaling

Additional analysis should examine how regulatory compliance costs scale with firm size. A central concern of the RFA is that smaller firms may face disproportionately higher compliance burdens due to limited economies of scale. Empirical studies comparing compliance costs relative to assets under management could help determine whether regulatory costs decline as firms grow larger, thereby informing future calibration of small-entity definitions.

c) Alternative metrics

Further studies should evaluate whether alternative metrics of firm size may complement or improve asset-based thresholds. While assets under management provide a convenient measure, they may not fully capture organizational capacity or operational complexity. Alternate indicators include the total revenue figure of each investment firm; employment generated (employee count), or computing operational expenditures. These metrics could offer useful comparative benchmarks for defining small entities.

d) Inflation adjustment methods

SEC’s additional research is warranted regarding the methodology used for periodic inflation adjustments. The proposal introduces a ten-year adjustment mechanism intended to prevent the gradual obsolescence of regulatory thresholds. One mechanism could be the Consumer Price Index (CPI), which is transparent and widely used in public policy but primarily reflects household consumption. Another option is the GDP Deflator, which captures economy-

wide price changes and may therefore provide a broader benchmark, though it may still overlook sector-specific cost dynamics within financial services. Alternatively, adjustments could be linked to financial market indicators such as the S&P 500 or other asset-growth measures, which better reflect expansion in capital markets but may introduce volatility and overemphasize financial-sector performance.

Recommendations

1) Adopt updated thresholds with clarified justification

The SEC should proceed with updating the thresholds because recalibration is necessary to correct the misalignment created by decades of industry growth. The current thresholds were established when the industry was significantly smaller and their continued use has resulted in excluding the majority of firms that operate without large scale compliance infrastructure.

The SEC should provide greater empirical transparency in how the revised thresholds are justified. The Commission should clearly explain the data sources and analytical methods used to determine the proposed levels (Hahn & Dudley, 2025).

The agency could publish summary statistics showing the distribution of assets across firms, the proportion of entities that would qualify under the new thresholds, and how these classifications compare to historical definitions of small entities.

Providing this information would improve the credibility of the recalibration and allow policymakers to evaluate whether the updated thresholds accurately capture firms with limited compliance capacity.

2) Preserve analytical precision

While expanding the definition of small entities is necessary, the SEC must ensure that the revised thresholds do not become overly broad. If the definition captures too many firms, the concept of a small entity may lose analytical meaning.

The purpose of the RFA is to identify firms that face genuine resource constraints and may experience disproportionate compliance costs (Coates, 2025). If the classification includes a large share of the industry, the category becomes diluted and less useful for regulatory analysis.

To preserve analytical precision, the SEC should carefully calibrate the threshold so that they capture firms with limited operational scale while still distinguishing them from large market participants. This calibration can be supported by examining how compliance costs scale relative to assets under management and by evaluating how firms of different sizes allocate resources to compliance functions (Coates, 2025).

Maintaining this distinction ensures that regulatory impact analysis remains focused on the firms most likely to experience disproportionate burdens.

3) Formalize inflation adjustments

To prevent the emergence of outdated thresholds, the SEC should formalize the mechanism for periodic inflation adjustments. The proposal to update the thresholds every ten years is an important step toward maintaining relevance and accuracy with current markets. Regular updates

would allow regulatory thresholds to evolve alongside changes in the broader economy and investment management industry.

The adjustment process should remain transparent and accountable. Even if the updates occur through administrative orders rather than extensive procedures, the SEC should provide public notice explaining the adjustment methodology and resulting threshold levels.

This transparency will ensure that stakeholders understand how the thresholds are being updated in order to maintain confidence in the regulatory framework (OECD, 2025).

4) Improve data transparency

The SEC should improve the transparency and consistency of the data used to identify small entities within the industry. Reliable regulatory analysis depends on accurate and standardized reporting structures. The proposal's reliance on Form ADV for investment advisors and Form N-CEN for investment companies provides a strong foundation for improving data consistency (Duvall, 2024).

To strengthen this approach, the SEC should ensure these forms capture information necessary to identify firm size and asset aggregation across related entities. Clear reporting standards would allow regulators to determine whether firms qualify as small entities without relying on manual interpretation or inconsistent methodologies. Improved data transparency would allow individuals to better analyze how regulatory requirements affect firms of different sizes.

By enhancing the consistency of reporting through Forms ADV and N-CEN, the SEC can ensure that future regulatory analyses are based on reliable and replicable data. This will improve the overall quality of rulemaking analysis and allow the Commission to more accurately assess the impact of changes on smaller market participants.

Policy Implications

1) Regulatory trade-offs

Updating the definitions of small entities creates an important tradeoff between analytical rigor and procedural burden. Expanding the number of firms classified strengthens the operation of the RFA by ensuring that regulatory analysis more accurately captures the effects of proposed rules on firms with limited compliance capacity.

When more entities qualify as small, agencies are more likely to conduct IRFAs and consider regulatory alternatives that reduce unnecessary burdens (US Securities and Exchange Commission, 2025).

Broader inclusion may also increase frequency with which these analyses are required. This could lengthen the rulemaking process and require administrative resources. While these procedural costs are relatively modest compared to potential regulatory impacts on smaller firms, they represent an operational trade off.

Regulators must balance the need for more comprehensive analysis with the practical constraints of the rule making process.

2) Economic trade-offs

Recalibrating the definition of small entities has economic implications for how regulatory costs are recognized across firms of different sizes. One benefit of expanding the small entity category is that it allows regulatory analysis to better reflect compliance asymmetries within the investment management industry (Administrative Conference of the United States, 2022).

Large fund complexes often operate with established compliance departments capable of absorbing new regulatory requirements at a relatively low marginal cost. Smaller firms may face higher proportional compliance costs because they must build or outsource regulatory infrastructure.

By recognizing these asymmetries more explicitly, updated thresholds can help ensure that regulatory analysis considers whether rules impose disproportionate burdens on smaller market participants (Administrative Conference of the United States, 2022).

If the threshold expands too broadly, the classification may include firms that possess sufficient scale and compliance capacity. This weakens the analytical focus on firms that genuinely face resource constraints.

3) Firm-specific competition trade-offs

The proposed changes also carry competitive implications for market structure within the investment management industry. When regulatory definitions fail to recognize the challenges

faced by smaller firms, large complexes may benefit indirectly because they can easily absorb regulatory compliance costs. Over time, this dynamic can contribute to market concentration as smaller firms face relatively higher operational barriers (Mclaughlin et al., 2016).

Updating the small entity definition may help mitigate this risk by improving regulatory analysis of how rules affect smaller market participants. This can support a more competitive market environment by ensuring that regulatory frameworks do not reinforce the structural advantages of large complexes. Regulators must also avoid expanding the small entity category so broadly that it includes firms with significant market presence. Maintaining a clear distinction between smaller and larger firms is essential for preserving competitive balance and precision.

4) Administrative trade-offs

The proposal introduces administrative trade offs related to the use of periodic inflation adjustments. Establishing a mechanism to update thresholds improves the durability of the regulatory framework by preventing thresholds from becoming obsolete over time. Regular adjustments allow definitions to evolve alongside changes in the market side.

Implementing such adjustments require a consistent methodology. To achieve this, regulators must specify the indicators used to calculate inflation adjustments and ensure that stakeholders understand future thresholds. This is essential because periodic updates could create uncertainty for firms attempting to determine whether they qualify as small entities (Carmona et al., 2024). By pairing automatic adjustment mechanisms with public guidance, regulators can ensure the framework remains durable.

Summary Of Recommendations

The SEC's proposed modernization under the "small entities" definition represents an effort to preserve analytical integrity and fair market competition. The development of new industry conditions caused some companies to become overshadowed and distorted which requires new regulation. To counter this structural misalignment, the proposal raises the asset threshold to \$10 billion and investment advisor threshold to \$1 billion.

This recalibration is essential because the RFA relies on accuracy and transparency to allow firms with limited compliance capacity to flourish. Updating these thresholds allows the SEC to conduct more representative impact assessments and rulemaking processes to consider a dynamic regulation mechanism.

The periodic inflation adjustment mechanism allows for this proposal to work in real time without outdated terms and market standards. Careful calibration allows for the most efficient and beneficial outcomes for investors, companies, and consumers. Overall, the proposal and new definition allows firms to adapt to new industry standards while still maximizing impact with resource constraints.

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Appendix

Implementation strategies

1) Governance changes

Implementation of the updated small entity definitions should be overseen by the Division of Investment Management within the US Securities and Exchange Commission. The Division of Investment management is responsible for regulating investment advisors and mutual funds. This makes it the most appropriate entity to administer and interpret the revised thresholds.

Governance would involve integrating the new thresholds into existing rulemaking analysis conducted under the Regulatory Flexibility Act. When proposing new rules affecting advisors or investment funds, the Division would apply the updated definitions to determine whether a rule is expected to have significant economic impact on a substantial number of small entities (Carey, 2014).

Internal guidance should be updated accordingly to ensure consistent application across future regulatory proposals.

Additionally, the Division should coordinate with the SEC's Office of the General Counsel and Economic Analysis Staff to ensure that the revised thresholds are incorporated into cost benefit analysis and regulatory impact statements.

2) Monitoring industry costs (standardized to all firms in a particular sector)

To ensure that the revised thresholds remain analytically meaningful, the SEC should implement ongoing monitoring of industry classifications and compliance costs. One key metric would be the percentage of registered advisors and funds that qualify as small entities under the updated thresholds (Hahn, 2025). Monitoring this percentage over time would help determine whether the calibration remains appropriate.

If the share becomes extremely small, the definition may again become too narrow. If the share becomes overly large, the classification may use its analytical usefulness.

Another monitoring mechanism should focus on compliance cost ratios across firm size tiers. Because regulatory compliance often involves fixed costs, smaller firms typically experience higher costs relative to their assets under management or revenues (US Government Accountability Office, 2016).

Tracking these ratios across various scope of firms would help regulators determine whether regulatory burdens remain proportional as well as costs.

The SEC could incorporate this monitoring into existing economic analysis processes by periodically reviewing industry data from filings such as Form ADV and fund registration reports.

3) Capturing inflation effects through cyclical feedback loops

To maintain long term alignment between regulatory thresholds and industry structure, the SEC should establish structured feedback loops tied to periodic inflation adjustments. Each time thresholds are updated to reflect inflation, the Commission should reassess whether the resulting distribution of small entities remain consistent with the objectives of the Regulatory Flexibility Act. The review should examine both quantitative indicators and qualitative evidence regarding compliance burdens.

The Commission should also incorporate input from the Office of the National Ombudsman in order to monitor regulatory burdens on smaller market participants. These organizations often receive direct feedback from firms experiencing regulatory challenges and provide valuable insight into whether updated thresholds accurately capture firms with limited compliance capacity.

By combining periodic threshold adjustments with continuous monitoring and stakeholder feedback, the SEC can ensure small entity definitions remain responsive to changes in the asset management industry and the underlying goals of the act.