

This 80 hour average estimate took into account that many advisers would be the primary drafters of compliance policies and procedures for funds under rule 38a-1, and would be able to draw extensively from their fund compliance programs to supplement, as necessary, compliance policies and procedures for the advisory firm. Our estimate also took into account that approximately half of the investment advisers registered with us already have drafted procedures addressing many aspects of their compliance programs, and many investment advisers in this group have drafted comprehensive procedures.

Our 80 hour estimate also took into account that a significant number of smaller registered investment advisers—who typically employ one or a few persons and have complete oversight of their business operations—have not adopted written policies and procedures, but can draw on a number of outlines and model programs, and can develop less complex programs because they often do not participate in arranging or effectuating securities transactions that they recommend to their clients. Comments from a trade association representing many smaller advisers generally supported our underlying assessment in this regard. Comments from another investment adviser trade association noted that it would likely be the owner of (or senior person at) a smaller firm who tailors a model compliance program to suit the firm's particular business, and use of this person's time would be more costly to the firm than the compliance personnel used by larger firms.

We are adopting rule 206(4)-7 without change to its paperwork collection requirements. Accordingly, our estimate of the annual aggregate burden of collection for the amended rule remains 623,200 hours.

### C. Rule 204-2

In the Proposing Release, we estimated that the amendments to rule 204-2 requiring investment advisers to maintain copies of their compliance policies and procedures and copies of any records documenting the adviser's annual review of those policies, as required by rule 206(4)-2, would increase each registered investment adviser's average annual collection burden under rule 204-2 by 0.5 hours to 211.98 hours. We further estimated the amendments would increase the rule's annual aggregate burden by 3,895 hours.<sup>121</sup> One commenter objected that it would be onerous for advisers to

maintain copies of records generated by the adviser's annual compliance review. Because of the importance of these copies to our examination and oversight program, we are adopting the amendments to rule 204-2 without change.<sup>122</sup>

### VII. Summary of Final Regulatory Flexibility Analysis

We have prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604, related to the new rules and rule amendments that we are adopting today. A summary of the Initial Regulatory Flexibility Analysis ("IRFA"), which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release. Copies of the FRFA and the IRFA may be obtained by contacting Hester Peirce, Senior Counsel, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549-0506.

The FRFA summarizes the background of the new rules and rule amendments and discusses why these regulatory changes are needed to enhance compliance with the Federal securities laws by funds and advisers. These issues are addressed above. The FRFA also discusses comments received in response to the IRFA, the effect of the new rules and rule amendments on small entities, and the Commission's efforts at minimizing the effect on small entities. These issues are summarized below.

The FRFA explains that the new rules and rule amendments will govern all registered investment companies, business development companies, and advisers registered with the Commission, including small entities. For purposes of the Regulatory Flexibility Act,<sup>123</sup> a fund is a small entity if the fund, together with other funds in the same group of related funds, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>124</sup> The staff estimates, based on Commission filings, that there are approximately 186 small open- and closed-end investment companies, 18 small unit investment trusts, and 29

small business development companies.<sup>125</sup>

For purposes of the Regulatory Flexibility Act, an investment adviser generally is a small entity 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 \$5 million or more on the last day of its most recent fiscal year.<sup>126</sup> The Commission estimates that, as of October 14, 2003, there were approximately 571 small investment advisers registered with us.<sup>127</sup>

The FRFA discusses the comments that we received in response to issues raised in the IRFA.<sup>128</sup> Several commenters, including one trade association for investment advisers, cautioned that the new rules would impose significant costs on small advisers. Another trade association for advisers acknowledged that small advisers would bear a higher relative cost than their larger counterparts, but anticipated that the cost to small advisers would be offset by the fact that compliance policies and procedures would not have to cover as broad a range of activities as the policies and procedures of their larger counterparts.<sup>129</sup> A third commenter, however, noted that even though small firms might have less complex policies and procedures, the cost of drafting the basic policies and procedures would be the same as for larger firms and for some small firms the cost would be prohibitive.

Commenters recommended the following accommodations for small

<sup>125</sup> The number of small entities, which is current as of June 2003, is derived from analyzing information from Form N-SAR and various databases including Lipper. Some or all of these entities may contain multiple series or portfolios. If a registered investment company is a small entity, the portfolios or series it contains are also small entities.

<sup>126</sup> 17 CFR 275.0-7(a).

<sup>127</sup> The number of small investment advisers is derived from the Commission's Investment Adviser Registration Depository.

<sup>128</sup> The comment letters and a summary of comments prepared by our staff are available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC (File No. S7-03-03). The comment summary is also available on the Commission's Internet Web site (<http://www.sec.gov/rules/extra/s70303summary.pdf>).

<sup>129</sup> The Financial Planning Association estimated that it would cost a small firm with five employees between \$675 and \$3,900 to develop a compliance program.

<sup>121</sup> 7,790 registered investment advisers x 0.5 hours = 3,895 hours.

<sup>123</sup> 5 U.S.C. 601-612.

<sup>124</sup> 17 CFR 270.0-10.