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SUPPORTING STATEMENT
Rule 206(4)-4

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 206(4) of the Investment Advisers Act of 1940 (“Advisers Act” or “Act”) (15 USC 80b-6(4)) prohibits any investment adviser from engaging in any act, practice or course of business which is fraudulent, deceptive or manipulative and gives the Securities and Exchange Commission (“Commission”) the power, by rules and regulations, to define and prescribe means reasonably designed to prevent such acts, practices and courses of business. The Commission adopted rule 206(4)-6 (17 CFR 275.206(4)-4) under the Advisers Act to codify the Commission’s position that it is a fraudulent and deceptive practice for an adviser to fail to disclose to clients and prospective clients, disciplinary events that are material to an evaluation of the adviser’s integrity or ability to meet contractual commitments to clients. In addition, the rule codifies the Commission’s position that certain investment advisers must disclose a financial condition reasonably likely to impair the adviser’s ability to meet contractual commitments to clients.

Rule 206(4)-4 contains “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995.¹ The title of this collection is “Rule 206(4)-4” under the Advisers Act and the Commission previously submitted this collection to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. OMB approved, and subsequently extended, this collection under control number 3235-0345 (expiring on July 31, 2008). An agency may not conduct or sponsor, and a person is

¹ 44 U.S.C. 3501 to 3520.

not required to respond to, a collection of information unless it displays a currently valid control number. This collection of information is codified at 17 CFR 275.206(4)-4 and is mandatory. Responses to the disclosure requirement are not kept confidential. Respondents are registered investment advisers with certain disciplinary history or a financial condition that is reasonably likely to affect contractual commitments. The information required by rule 206(4)-4 is necessary to provide clients and prospective clients with the information they need to make a reasoned decision with respect to choosing an adviser or continuing to employ an adviser. Clients need to know if their adviser's financial condition is likely to impair the adviser's ability to provide an adequate level of service. Similarly, clients need to know if their adviser or its management has been involved in a disciplinary event that reflects adversely on the adviser's integrity.

2. Purpose of the Information Collection

The rule is designed to codify the Commission's position with respect to the fiduciary obligation of investment advisers to disclose to clients and prospective clients certain disciplinary history and financial conditions. As discussed in Item 1 (above), Rule 206(4)-4 requires registered investment advisers to disclose to clients and prospective clients certain disciplinary history or a financial condition that is reasonably likely to affect contractual commitments. This collection of information is necessary for clients and prospective clients in choosing an adviser or continuing to employ an adviser.

3. Role of Improved Information Technology

Investment advisers are permitted to provide the information required by rule 206(4)-4 electronically.²

4. Efforts to Identify Duplication

The requirements of rule 206(4)-4 are not duplicated elsewhere for those investment advisers that must comply with the collection requirements contained in the rule. Rule 204-3 under the Advisers Act (17 CFR 275.204-3) requires investment advisers to furnish certain information to clients and prospective clients by providing either a copy of Part II of Form ADV (17 CFR 279.1), the investment adviser registration form, or a written brochure containing at least the information required by Part II of Form ADV. The requirement in rule 206(4)-4 to disclose certain disciplinary and financial information could be satisfied by adding this information to the adviser's brochure. Part II of Form ADV does not currently require advisers to describe this information.³

5. Effect on Small Entities

All advisers, regardless of their size, are equally subject to the collection requirements.

The requirements of rule 206(4)-4 apply equally to all investment advisers that are registered

² Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Investment Advisers Act Release No. 1562 (May 9, 1996) [61 FR 24644 (May 15, 1996)].

³ However, in April of 2000, the SEC proposed amendments to Form ADV that would require investment advisers to disclose this disciplinary and financial information. Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (April 5, 2000) [65 FR 20524 (April 17, 2000)]. In connection with this April 2000 proposal, when the SEC obtained OMB approval for our amendments to the Form ADV collection that would result from the proposed changes to Form ADV, the Commission included the paperwork burden of disclosing this disciplinary and financial information in a firm's brochure. This burden was approved in a collection titled "Form ADV," under control number 3235-0049. The proposal to amend Form ADV, Part II is still pending.

with the Commission and who have certain events in their disciplinary history or a financial condition that is reasonably likely to affect contractual commitments, including those advisers that are small entities. It would be incompatible with the objectives of the rule to exempt small entities from these requirements, which are designed to ensure clients are afforded the full protections attendant to an adviser's fiduciary duties as recognized by the Adviser's Act with respect to disclosure of certain disciplinary and financial information.

6. Consequences of Less Frequent Collection

Rule 206(4)-4 requires an adviser to notify its existing clients promptly of a financial condition or disciplinary event described in the rule. For prospective clients, the adviser must provide the disclosure no later than when it enters into the advisory contract. Investors need to receive this information as soon as possible in order to act on it. A client may decide, for example, to terminate an advisory arrangement with an adviser if the adviser has been found in violation of an investment-related statute, or if the adviser has suffered a financial condition that is likely to impair the adviser's ability to fulfill its commitments to the client. Less frequent information collection would be incompatible with the objectives of rule 206(4)-4. For example, if the information required by the rule were to be either not collected or collected less frequently, the ability of advisory clients to make decisions about whether to hire or fire an adviser would be reduced.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Not applicable.

8. Consultation Outside the Agency

The Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment adviser industry through public conferences, meetings and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry. The Commission requested public comment on the collection of information requirements in Rule 206(4)-4 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to its request.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Estimate of Hour Burden

Rule 206(4)-4 requires registered investment advisers to disclose to clients and prospective clients certain disciplinary history or a financial condition that is reasonably likely to affect contractual commitments. For purposes of estimating the paperwork burden for investment advisers under rule 206(4)-4, we estimate that approximately 17% of registered advisers would be subject to rule 206(4)-4. Thus, of the 10,817 advisers registered with the Commission, the number of investment advisers subject to collection of information

requirements under the rule is approximately 1,839.⁴ We further estimate that complying with the collection of information will require approximately 7.5 hours annually for each adviser, for a total annual burden of 13,793 hours.⁵ The estimated total number of annual responses would be 2,759.⁶

We estimate that compliance professionals and clerical staff prepare the disclosures required under the collection. We estimate that approximately half of the burden will be performed by compliance professionals at an hourly wage of \$245, including benefits. We further estimate that the other half of the burden will be performed by compliance clerks at an hourly wage of \$56, including benefits. Accordingly, we estimate the annual aggregate cost of collection to be \$2,075,847.⁷

13. Estimate of Total Annual Cost Burden

Apart from the cost of the hour burden identified under Item 12 (above), there are no costs to respondents resulting from compliance with rule 206(4)-4.

14. Estimate of Cost to the Federal Government

There are no additional costs to the federal government.

⁴ $17\% \times 10,817 = 1,838.89$.

⁵ $1,839 \times 7.5 \text{ hours annually per respondent} = 13,792.5$

⁶ Under 3235-0345 as currently approved, each investment adviser is estimated to make an average 1.5 annual responses, in the form of disclosures added to Form ADV. $1,839 \times 1.5 = 2,758.5$.

⁷ Data from the SIA's Report on Office Salaries in the Securities Industry 2006 (the "SIA Report") suggest that the cost for a Compliance Manager is approximately \$245 per hour. Data from the SIA Report suggest that the cost for a Compliance Clerk is approximately \$56 per hour. $50\% \times 13,793 \text{ hours} = 6,896.5 \text{ hours}$. $(6,896.5 \text{ hours} \times \$245 \text{ per hour}) + (6,896.5 \text{ hours} \times \$56 \text{ per hour}) = \$1,689,642.5 + \$386,204 = \$2,075,846.5$.

15. Explanation of Changes in Burden

The number of responses per investment adviser and the number of hours per response have not changed since the last estimate. The number of respondents has increased from 1,683 investment advisers to 1,839 investment advisers. Accordingly, the total burden hours for all respondents has increased from 11,638 hours to 13,793 hours. This increase is due to an increase in the number of respondents.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to not Display Expiration Date

Not applicable.

18. Exceptions to Certification Statement

Not applicable.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.