

**SUPPORTING STATEMENT FOR PAPERWORK REDUCTION ACT SUBMISSION
PROPOSAL TO AMEND RULE 204-3
UNDER THE INVESTMENT ADVISERS ACT OF 1940
(17 CFR 275.204-3)**

A. JUSTIFICATION

1. Necessity for the Information Collection

The Securities and Exchange Commission (the “Commission”) is proposing to amend Part 2 of Form ADV,¹ and related rules, including rule 204-3, under the Investment Adviser Act of 1940, to provide advisory clients with brochure and brochure supplements that contain clear, current, and more meaningful disclosure in a narrative, plain English format.² The proposal would require advisers registered with the Commission to prepare and electronically file firm brochures through the Investment Adviser Registration Depository (“IARD”).

Rule 204-3 requires investment advisers to deliver their brochure to their new clients and prospective clients before or at the start of the advisory relationship and to update their brochure annually and to offer in writing, and to deliver upon request, the brochure to their existing clients annually. The amended rule 204-3 contains a collection of information for which the annual aggregate burden will likely be affected as a result of the proposed amendments. This collection is necessary to provide advisory clients, prospective clients, and the Commission with information about the adviser, its business, and its conflicts of interest. The title of the affected collection of information is: “rule

¹ 17 CFR 279.1.

² The related amendments are to Advisers Act rules 203-1 [17 CFR 275.203-1], 204-1 [17 CFR 275.204-1], 204-2 [17 CFR 275.204-2], and 204-3 [17 CFR 275.204-3]. The proposing release is attached as Appendix A.

204-3,” under the Investment Advisers Act of 1940. Its currently approved OMB control number is 3235-0047. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

2. Purposes of the Information Collection

Rule 204-3 requires investment advisers to deliver their brochures to their new clients and prospective clients before or at the start of the advisory relationship. The rule also requires advisers to offer in writing, and to provide upon request, annually updated brochures to their existing clients. The purpose of this collection of information is to provide investors accurate information about an investment adviser and its practices in order to determine whether to retain, or to continue to employ, that adviser. This collection of information is found at 17 CFR 275.204-3 and is mandatory. The likely respondents to this information collection are advisers registered with the Commission. Responses are not kept confidential.

3. Role of Improved Information Technology

The Commission’s use of computer technology in connection with this information collection, which has been previously approved by OMB, would not change. The Commission currently permits advisers to satisfy their obligations under this collection of information by delivering Part 2 of Form ADV electronically with client consent.³

4. Efforts to Identify Duplication

³ See *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, Investment Advisers Act Release No. 1562 (May 9, 1996) [61 FR 24644 (May 15, 1996)] (publishing Commission interpretive guidance with respect to use of electronic media to fulfill investment advisers’ disclosure delivery obligations).

The collection of information requirements of the proposed rule amendments are not duplicated elsewhere.

5. Effect on Small Entities

The requirements of the proposed amendments to rule 204-3 are the same for all investment advisers registered with the Commission, including those that are small entities. To some extent small advisers may have reduced burdens under the proposed amendments to rule 204-3. This is because small advisers usually have less complicated business practices, fewer employees, and fewer clients, and therefore their brochures and brochure supplements would be shorter, and would be delivered to fewer clients.

6. Consequences of Less Frequent Collection

The collection of information required by the rule is necessary to protect investors by providing clients and potential clients with information about the adviser, its business, and its conflicts of interest. The consequences of not collecting this information would be that clients and prospective clients may not have the information they need in order to evaluate the adviser's business practices and to determine whether to select or retain that adviser.

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

Not applicable.

8. Consultation Outside the Agency

In its release proposing amendments to Form ADV and related rules, including rule 204-3, the Commission requests public comment on the effect of information collections under these amendments. In addition, 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.

9. Payment or Gift to Respondents

None.

10. Assurance of Confidentiality

The information collected pursuant to rule 204-3 is by delivery of brochures and brochure supplements to advisory clients. These disclosures are not kept confidential.

11. Sensitive Questions

Not applicable.

12. Estimates of Hour Burden

Rule 204-3 currently requires an investment adviser to deliver to clients, at the start of an advisory relationship, a copy of Part 2 of Form ADV or a written document containing at least the information required by Part 2 of Form ADV. The rule currently requires no further brochure delivery unless the client accepts the adviser's required annual offer. The brochure assists the client in determining whether to hire or retain an adviser.

The amendments to rule 204-3 would require advisers registered with us to deliver their brochures and brochure supplements at the start of an advisory relationship and to deliver their firm brochure annually thereafter.⁴ The amendments also would require that advisers deliver updates of the brochure and brochure supplements to clients

⁴ Proposed rule 204-3(b).

only when disciplinary information in the brochure or supplements becomes materially inaccurate.⁵ The updates could take the form of a revised brochure (or supplement) or a “sticker” containing the updated information.⁶

The total annual burden currently approved by OMB for rule 204-3 is 6,902,278 hours and is based on the requirements of the rule as proposed in 2000.⁷ This currently approved burden is based on each adviser having, on average, an estimated 670 clients.⁸ Our records currently indicate that the 10,817 advisers registered with the Commission have, on average, 1,013 clients.⁹ These changes, along with our proposal to require

⁵ Proposed rule 204-3(e).

⁶ This represents a departure from the originally proposed requirements which would have required an ongoing obligation to deliver updates involving any material information in the brochure or supplement, not just disciplinary information.

⁷ Following issuance of the proposing release in 2000, OMB approved a burden of 411,075 hours. That estimate assumed, in part, that approximately 8,100 advisers were registered with us and that each adviser had, on average, 49 clients. OMB subsequently approved an increase in the annual burden to 6,902,278 hours to reflect assumptions regarding an increased number of SEC-registered advisory firms and an increased estimate with respect to the average number of clients per adviser. This currently approved burden is based on the 2000 proposed delivery requirements (initial delivery plus interim stickering) and assumptions (an initial bulk mailing at 0.25 hours and 2 stickers per year for each SEC-registered firm at 0.5 hours per sticker) that were discussed in the 2000 proposing release.

⁸ This average was based on advisers’ responses to Item 5.C of Part 1A of Form ADV as of October 5, 2001.

⁹ This average is based on advisers’ responses to Item 5.C of Part 1A of Form ADV as of September 30, 2007, excluding the two advisers that reported the largest number of clients. Those advisers account for over 43 percent of all advisory clients of SEC registrants and not excluding them would raise the average client count to 1,778 clients. These two firms provide advisory services primarily over the Internet and currently meet their brochure obligations electronically, thus essentially entirely eliminating for these advisers any PRA burden associated with delivery under this rule. Therefore, we believe that it is appropriate to exclude these firms from our calculations. Even removing these advisers discussed above, the “typical” adviser registered with the Commission, has far fewer clients than suggested by this average. The average is still heavily weighted by the responses received from the few largest advisers. We note that the next five advisory firms with the largest numbers of clients account for more than an additional 15 percent of all clients. In contrast, the majority (over 60 percent) of advisers registered with us have 100 or fewer clients, and the vast majority (over 90 percent) have

annual brochure delivery along with interim delivery only of brochure and supplement updates that involve disciplinary information (in lieu of the originally proposed ongoing delivery obligation) alter the collection of information burden from that currently approved.

We expect that advisers will send their brochures annually in a “bulk mailing” to clients. We estimate that, with a bulk mailing, an adviser will require no more than 0.25 hours to send the adviser’s firm brochure to each client, or an annual burden of 253.25 hours per adviser.¹⁰ Thus, we estimate the total burden hours for 10,817 advisers to distribute their firm brochure to existing clients initially and annually thereafter to be 2,739,405 hours per year.¹¹

Advisers also will be required to distribute interim updates disclosing new or revised disciplinary information in their brochure or supplements. We anticipate that in any given year, the number of such interim updates that advisers will be required to deliver is approximately 541.¹² We further estimate that an adviser will require no more

500 or fewer. Based on a median, we estimate that the “typical” adviser registered with us has approximately 63 clients – that is, half of Commission-registered advisers have more than 63 clients and half have fewer. This median is consistent with advisers’ modal response (the most common response) to Item 5.C of Part 1A, which was “26 to 100 clients.”

¹⁰ (0.25 hours per client x 1,013 clients per adviser) = 253.25 hours per adviser. This is the same hour estimate we made in the 2000 proposal and for which we received no comment. We note that the burden for *preparing* brochures and brochure supplements is already incorporated into the burden estimate for Form ADV discussed above. We anticipate that most advisers will make their annual delivery of their brochure as part of the annual bulk mailings they already make to clients.

¹¹ (0.25 hours per client x 1,013 clients per adviser) x 10,817 advisers = 2,739,405.25 hours.

¹² Just under fifteen percent of the advisers currently registered with the Commission report any disciplinary events at all on their Form ADVs (as of September 30, 2007, only 1,620 of all 10,817 registered advisers indicated at least one “yes” answer to a question related to disciplinary events in Form ADV, Part 1A, Item 11). Thus, we anticipate that a correspondingly small number of advisers will be required to disclose new or updated disciplinary information. The Commission staff estimates that in any

than 0.5 hours per client for delivery of each such update.¹³ This represents about 507 hours per interim update.¹⁴ Thus, the aggregate annual hour burden for affected advisers to deliver interim updates to their brochures and supplements will be approximately 274,287 hours per year.¹⁵ As a result, the rule amendments requiring annual delivery and interim updating of advisers' brochures and supplements yields a total collection of information burden for rule 204-3 of 3,013,692 hours per year, or 279 hours per respondent.¹⁶ This represents a decrease of 3,888,586 hours from the currently approved PRA burden.¹⁷ We estimate that this revised collection of information burden would represent an annual cost of \$168,766,752.¹⁸

13. Estimate of Total Annual Cost Burden

\$0.

14. Estimate of Cost to the Federal Government

There are no costs to the government directly attributable to rule 204-3.

given year, five percent of advisers, will be required to deliver a single interim update to each of their clients, resulting in a total of approximately 541 interim updates per year.
 $0.05 \times 10,817 \times 1 \text{ update} = 540.85 \text{ updates.}$

¹³ This burden estimate relates only to the amount of time it will take advisers to *deliver* interim updates to clients, as required by the rule amendments. The burden for *preparing* interim updates is already incorporated into the burden estimate for Form ADV discussed above.

¹⁴ $0.5 \text{ hours per client} \times 1,013 \text{ clients per adviser} = 506.5 \text{ hours per update.}$

¹⁵ $541 \text{ updates} \times 507 \text{ hours} = 274,287 \text{ hours.}$

¹⁶ $2,739,405 \text{ hours (initial and annual delivery)} + 274,287 \text{ hours (interim delivery of updates to disciplinary information)} = 3,013,692 \text{ hours. } 3,013,692 \text{ hours} / 10,817 \text{ advisers} = 278.61 \text{ hours per adviser.}$

¹⁷ $6,902,278 \text{ hours} - 3,013,692 \text{ hours} = 3,888,586 \text{ hours.}$

¹⁸ We expect that delivery of amendments to Part 2 will also most likely be performed by compliance professionals at an estimated cost for a Compliance Clerk of \$56 per hour. $3,013,692 \text{ hours} \times \$56 = \$168,766,752.$

15. Explanation of Changes in Burden

As discussed in Item 12 above, the total annual burden currently approved by OMB for rule 204-3 is 6,902,278 hours. Our proposal to require annual brochure delivery along with interim delivery only of brochure and supplement updates that involve disciplinary information (in lieu of the originally proposed ongoing delivery obligation) would substantially reduce the respondents' information collection burden and would decrease such burden from currently approved 6,902,278 hours to 3,013,692 hours.

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. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.