

**SUPPORTING STATEMENT
PROPOSAL TO AMEND RULE 204-2**

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 204-2, 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 204-2 requires registered advisers to make and keep certain books and records for prescribed periods. The title of the affected collections of information is: “rule 204-2” under the Investment Advisers Act of 1940. Its currently approved OMB control number is 3235-0278. 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.

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.

2. Purpose of the Information Collection

Rule 204-2 requires SEC-registered investment advisers to maintain copies of certain books and records relating to their advisory business. The purpose of the information collection is to assist the Commission's examination and oversight program in determining compliance with the Advisers Act and rules. The respondents to this information collection are investment advisers registered with the Commission. Responses provided to the Commission in the context of its examination and oversight program are generally kept confidential.³ This collection of information is found at 17 CFR 275.204-2 and is mandatory.

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 maintain records required by the rule through electronic media.⁴

4. Efforts to Identify Duplication

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

5. Effect on Small Entities

The requirements of the proposed amendments to rule 204-2 are the same for all investment advisers registered with the Commission, including those that are small

³ See Section 210(b) of the Advisers Act (15 U.S.C. 80b-10(b)).

⁴ See Electronic Recordkeeping by Investment Companies and Investment Advisers, Investment Advisers Act Release No.1945 (May 24, 2001) (66 FR 29224 (May 30, 2001)).

entities. To some extent small advisers may have reduced burdens under the proposed amendments to rule 204-2. This is because small advisers usually have less complicated business practices and fewer clients, and therefore their obligations under rule 204-2 would be easier to comply with.

6. Consequences of Less Frequent Collection

Less frequent information collection would be incompatible with the objectives of the rule and could hinder the Commission's oversight and examination program for investment advisers and thereby reduce the protection to investors.

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

The collection requirements under rule 204-2 generally require advisers to maintain documents for five years, and in some cases longer. The current retention period would not be affected. Although this period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), OMB has previously approved the collection with this retention period. The retention periods in rule 204-2 are warranted because the recordkeeping requirements in rule 204-2 of the Advisers Act are designed to contribute to the effectiveness of the Commission's examination and inspection program. Because the period between examinations may be as long as five years, it is important that the Commission have access to records that cover the entire period between examinations.

8. Consultation Outside the Agency

In its release proposing amendments to Form ADV and related rules, including rule 204-2, 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

Responses provided to the Commission pursuant to rule 204-2 in the context of the Commission's examination and oversight program are generally kept confidential.⁵

11. Sensitive Questions

Not applicable.

12. Estimate of Hour Burden

The amendments to rule 204-2 would require SEC-registered advisers to prepare and preserve a memorandum describing any legal or disciplinary event listed in Item 9 in Part 2A and Item 3 in Part 2B of Form ADV, if the event is not disclosed in the adviser's brochure or the relevant brochure supplement. Additionally, the amendments would also require SEC-registered investment advisers to prepare and preserve documentation of the method they use to compute managed assets for purposes of Item 4.E. in Part 2 of Form ADV, if that method differs from the method used to calculate "assets under management" in Part 1A of Form ADV. These records would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204-2(a).

⁵ See section 210(b) (15 U.S.C. 80b-10(b)) of the Investment Advisers Act of 1940.

We estimate that the proposed amendments to rule 204-2 would result in a burden increase of four hours for each of the Commission-registered advisers that would be required to prepare and preserve additional records as a result of the amendments.⁶ We estimate that 325 advisers will use a method for computing managed assets in Part 2 that differs from the method used to compute assets under management in Part 1A and thus would be required to prepare and preserve documentation describing the method used in Part 2.⁷ We also estimate that 162 advisers will conclude that the materiality presumption in Part 2 is overcome with respect to a legal or disciplinary event, will determine not to disclose that event, and therefore would be required to prepare and preserve a memorandum describing the event.⁸

In the 2000 release proposing amendments to rule 204-2, Commission staff had estimated that 110 advisers would have to prepare and preserve additional records in

⁶ In 2000, the Commission first proposed amendments to Form ADV and rule 204-2. At the time the proposed rule did not require documentation for Item 4.E computations that differed from Part 1A, Item 5.F of Form ADV. We estimate that the additional recordkeeping requirement applicable to advisers who use an alternative method of asset calculation will take approximately the same amount of time (4.0 hrs) as that required by advisers who compose memoranda with respect to undisclosed legal/disciplinary events.

⁷ Based on the Commission staff's conversations with industry professionals, we anticipate that approximately three percent of the 10,817 advisers registered with us as of September 30, 2007 will use a method for computing managed assets in Part 2 of Form ADV that differs from the method used to compute assets under management in Part 1A of Form ADV. $10,817 \text{ advisers} \times 0.03 = 324.51 \text{ advisers}$.

⁸ Approximately 1,620 advisers registered with the Commission report disciplinary information in Part 1A of their Form ADV as of September 30, 2007. We anticipate that most of these advisers will include all disciplinary information in their brochures and supplements, but that approximately 10 percent of these advisers, or 162, will need to prepare and preserve a memorandum explaining their basis for not disclosing a legal or disciplinary event listed in Part 2 that is not disclosed in their brochures and supplements. $1,620 \text{ advisers} \times 0.10 = 162 \text{ advisers}$.

accordance with the amendments to rule 204-2.⁹ However, we now estimate that a total of 487 advisers will have to prepare and preserve additional records in accordance with amendments to rule 204-2.¹⁰ Only 110 of these are already accounted for in the currently approved burden estimate. We estimate that the additional 377 advisers whom we anticipate will be subject to the amended provisions of rule 204-2, will yield a 1,508 hour burden increase.¹¹

The approved annual aggregate burden for rule 204-2 is currently 1,762,267 hours based on an estimate of 9,728 registered advisers,¹² or 181.15 hours per registered adviser.¹³ Taking into account the estimated increased burden of 1,508 hours as discussed above, as well as an increase of 1,089 registered advisers,¹⁴ the revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 204-2 is therefore estimated to be 1,961,048 total hours.¹⁵

⁹ Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (Apr. 5, 2000) [65 FR 20524 (Apr. 17, 2000)].

¹⁰ 325 advisers that we estimate would prepare memoranda regarding alternative method for calculating assets under management + 162 advisers that we estimate would prepare memoranda regarding unreported nonmaterial disciplinary events = 487 advisers.

¹¹ 487 advisers – 110 advisers = 377 advisers. 377 advisers x 4.0 hours = 1,508 hours.

¹² Please note that all references to previously approved hour and cost burdens were correct at the time these amendments were proposed. Since then an extension package which adjusted our estimates was approved by OMB.

¹³ 1,762,267 hours / 9,728 registered advisers = 181.15 hours per adviser.

¹⁴ As stated above, our IARD data show that as of September 30, 2007 there were 10,817 advisers registered with the SEC. 10,817 – 9,728 = 1,089.

¹⁵ 1,762,267 current burden hours + 1,508 hours due to an increase in the estimated number of registered advisers subject to additional recordkeeping under the amendments + (1,089 due to an increase of total number of registered advisers x 181.15 hours per adviser) = 1,961,048. 1,961,048 total hours / 10,817 advisers = 181.29 hours per adviser. The annual average burden per SEC-registered adviser is therefore 181.29 hours.

An adviser would likely use a combination of compliance clerks and clerical staff to make and keep the information and records required under the rule. The Commission staff estimates the hourly wage for compliance clerks to be \$56 per hour, including benefits,¹⁶ and the hourly wage for clerical staff to be \$41 per hour, including benefits.¹⁷ For each adviser, 181.29 burden hours would be required to make and keep the information and records required under the rule. Compliance clerks would perform an estimated 31.29 hours, and clerical staff also would perform an estimated 150.0 hours. The total cost per respondent therefore would be an estimated \$7,902.24,¹⁸ for a total burden cost of \$85,478,530.¹⁹

13. Estimate of Total Annual Cost Burden

As stated above, we estimate that 162 advisers may incur a one-time cost including outside legal fees in connection with preparation of a memorandum explaining their basis for not disclosing a legal event listed in Part 2 in their brochures or supplements.²⁰ We estimate this one-time cost would include fees for approximately three hours of outside legal review and would amount on average to approximately

¹⁶ The \$56/hour for compliance clerks is from the SIFMA's Report on Office Salaries in the Securities Industry 2006, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

¹⁷ The \$41/hour for clerical staff is from the SIFMA's Report on Office Salaries in the Securities Industry 2006, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

¹⁸ $(31.29 \text{ hours per compliance clerk} \times \$56) + (150.0 \text{ hours per clerical staff} \times \$41) = (\$1,752.24 + \$6,150.00) = \$7,902.24$

¹⁹ $\$7,902.24 \text{ per adviser} \times 10,817 \text{ advisers} = \$85,478,530.$

²⁰ See above footnote Error: Reference source not found and accompanying text.

\$1,200 per adviser.²¹ We believe that approximately 80 percent of the advisers preparing such memoranda would likely engage outside legal services to assist in their preparation. Thus, we estimate that approximately 130 advisers will incur these costs,²² for a total cost among all respondents of \$156,000.²³

The currently-approved collection of information for rule 204-2 also includes a non-labor cost estimate of \$12,221,000. The non-labor costs imposed by the rule include mechanisms to store information on electronic media or on paper and building space. As discussed above, we estimate the annual aggregate hour burden under the collection would increase from 1,762,267 hours to 1,961,048 hours. We estimate there would be a proportional increase in the non-labor cost estimate to \$13,559,510.²⁴ The total annual cost burden associated with rule 204-2 would be \$13,755,510.²⁵

14. Estimate of Cost to the Federal Government

There are no costs to the government directly attributable to rule 204-2.

15. Explanation of Changes in Burden

²¹ Outside legal fees are in addition to the projected hourly per adviser burden discussed above. \$400 per hour for legal services x 3 hours per adviser = \$1,200. The hourly cost estimate is based on our consultation with advisers and law firms who regularly assist them in compliance matters.

²² 162 advisers x 0.80 = 129.6.

²³ \$1,200 x 130 advisers = \$156,000.

²⁴ (1,961,048 hours/1,762,267 hours) x \$12,221,000 = \$13,599,510.

²⁵ \$156,000 + \$13,599,510 = \$13,755,510

The number of responses per investment adviser has not changed since last estimate. However, as discussed in Item 12 above, the number of respondents subject to additional records requirements as a result of the amendments has increased from estimated 110 to 487, which would yield a 1,508 hour burden increase under the proposal. In addition, the total estimated number of registered advisers has increased to 10,817. As a result, the total estimated burden associated with rule 204-2 has increased from currently approved 1,762,267 hours to estimated 1,961,048 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.