SUPPORTING STATEMENT
RULE 206(3)-2

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 206(3) of the Investment Advisers Act of 1940 (15 U.S.C 80b-6(3)) ("Advisers Act" or "Act") makes it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly:

> [A]cting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.

This specific conflict of interest provision addresses instances in which an adviser deals with an advisory client as a principal, as well as instances when an adviser acts as agent for another. Principal transactions occur when the adviser sells securities it owns to the client or when it buys securities from the client for its own account. Agency cross transactions occur when an adviser acts as broker to both the advisory client and the opposite party to the transaction. Section 206(3) of the Advisers Act requires an investment adviser to obtain a client's consent in writing prior to engaging in any principal or agency cross transaction.

The Securities and Exchange Commission (the "Commission") adopted rule 206(3)-2 (17 CFR 275.206(3)-2) to permit investment advisers to enter into agency cross transactions under

section 206(3) with less burden.[1] Rule 206(3)-2 permits an adviser to obtain a blanket consent from a client for agency cross transactions, provided the adviser furnishes certain specified information to the client at specified times. The information requirements of the rule consist of the following: (a) prior to obtaining the client's consent, appropriate disclosure must be made to the client as to the practice of, and the conflicts of interest involved in, agency cross transactions; (b) at or before the completion of any such transaction the client must be furnished with a written confirmation containing specified information and offering to furnish upon request certain additional information; and (c) at least annually, the client must be furnished with a written statement or summary as to the total number of transactions during the period covered by the consent and the total amount of commissions received by the adviser or its affiliated broker-dealer attributable to such transactions.

The Commission adopted rule 206(3)-2 under the authority of sections 206(3) and 211(a) (15 U.S.C. 80b-3, 80b-11(a)) of the Advisers Act. The premise of rule 206(3)-2 is that appropriate disclosure of agency cross transaction practices is made in advance and that a client is furnished with information as to each transaction immediately after it occurs. The overreaching that section 206(3) is designed to prevent can thereby be sufficiently minimized so that the adviser need not obtain a client's consent prior to entering into each agency cross transaction as otherwise would be required by section 206(3). Accordingly, the information

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[1] Agency Cross Transactions for Advisory Clients, Investment Advisers Act Release No. 589 (June 1, 1977). Section 206 (15 U.S.C. 80b-6) applies to all investment advisers as defined in section 202(a)(11) (15 U.S.C. 80b-2(a)(11)) regardless of whether such advisers are required to be registered. Rule 206(3)-2 (17 CFR 275.206(3)-2) formerly was available only to registered investment advisers, however, the rule was amended in 1997 to make it available to all investment advisers in light of changes to the registration provisions of the Advisers Act under the National Securities Markets Improvement Act of 1996. Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1633 (May 15, 1997).

requirements of rule 206(3)-2 are necessary to make the rule consistent with investor protection. Disclosure regarding the practice of agency cross transactions apprises the client of the inherent conflicts of interest involved in such transactions. Disclosure regarding each transaction upon its completion permits the client to review each transaction to determine whether the terms of the transaction should be challenged as unfair or the blanket consent should be revoked. Similarly, annual disclosure of all such transactions permits the client to make an informed judgment as to whether to continue the consent.

2. Purpose of the Information Collection

Clients of investment advisers primarily use the information collected for the purpose of monitoring agency cross transactions as described in Item 1, above. In addition, Commission staff reviews the information during its routine investment adviser inspections to assess compliance with the rule.

3. Role of Improved Information Technology

Investment advisers are permitted to provide to clients the information required by rule 206(3)-2 electronically.[2]

4. Efforts to Identify Duplication

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

5. Effect on Small Entities

The requirements of rule 206(3)-2 apply equally to all investment advisers, including small entities. The rule functions as a safe harbor which small entities may choose to use for

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[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 1932, and Investment Company Act of 1940, Investment Advisers Act Release No. 1562 (May 9, 1996).

affecting an agency cross transaction without having to obtain specific prior consent from the client. Exempting small entities would defeat the rule's purpose and deprive them of the benefits of the rule. No reasonable alternative exists that would permit the Commission to afford special treatment to small entities while continuing to protect investors.

6. Consequences of Less Frequent Collection

Information must be given to a client at the following times: (a) before the adviser engages in any agency cross transaction with respect to the client's account, so the client can consent to prospective transactions; (b) at or before completion of each agency cross transaction to give the client the opportunity to evaluate the transaction; (c) at least annually, to summarize all cross agency transactions since the adviser gave the last such summary. Less frequent reporting would not give a client adequate opportunity to evaluate an adviser's actions or the corresponding inherent conflicts associated with agency cross transactions.

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

The rule itself imposes no additional requirements regarding record retention. However, Commission-registered investment advisers may otherwise be required to maintain and preserve certain information required under rule 206(3)-2 for more than three years. Rule 204-2 under the Advisers Act (17 CFR 275.204-2) generally requires that registered investment advisers maintain certain records for not less than five years, including (a) written communications received and sent by the adviser relating to its recommendations and the placing or execution of any order to purchase or sell any security, and (b) all written agreements entered into by the investment adviser with any client.

The long-term retention of these records is necessary for the Commission's inspection

program to ascertain compliance with the Advisers Act.

8. Consultation Outside the Agency

The Commission requested public comment on the collection of information requirements in rule 206(3)-2 before submitting this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to its request.

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, as well as informal exchanges. These various forums provide the Commission and the staff with a mechanism to ascertain and act upon paperwork burdens confronting the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

The information collected pursuant to the rule takes the form of disclosures made by advisers to their clients. These disclosures are not kept confidential.

11. Sensitive Questions

Not applicable.

12. Estimate of Hour Burden

The reporting burden will vary depending upon the number of clients for which an adviser enters into agency cross transactions and the number of such transactions. The currently-

approved annual aggregate burden of the collection under rule 206(3)-2 is 11,088 hours. This approved annual aggregate burden was based on estimates that less than 10%, or 693, of all advisers then registered with the Commission used the rule. We are updating those prior calculations based on current information about the number of registered advisers who report in their Form ADV filings that they or an affiliate engage in agency cross transactions. Based on current data, we estimate that approximately 631 SEC-registered investment advisers use rule 206(3)-2.[3]

Based on the experience of examination staff, we estimate that each adviser relying on the rule has an average of 10 clients who receive confirmation statements and annual statements for agency cross transactions and that each of those clients receive approximately 2 confirmation statements per year. Thus, each adviser relying on the rule annually will prepare 20 confirmation statements for agency cross transactions[4] and 10 annual statements. Also, we estimate that an adviser would be required to provide disclosure to 2 clients per year in connection with obtaining the initial consent to engage in agency cross transactions. These estimates result in an annual average of 32 responses per adviser, thus, based on the estimate that each of these responses require one half an hour, we estimate a burden amounting to 16 hours

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[3] This estimate is based on information reported by advisers through the Investment Adviser Registration Depository ("IARD"). Based on IARD data as of June 1, 2009, of the approximately 11,309 SEC-registered advisers, 631 responded "yes" to Form ADV, Part 1A, Item 8.B.1, a question pertaining to agency cross transactions. This represents approximately 5.6% of total population of SEC-registered advisers.

[4] 10 clients x 2 agency cross transactions per client = 20 confirmation statements.

annually per adviser.[5] This results in a total annual aggregate burden under the rule of 10,096 hours.[6] This amounts to a reduction of 992 hours.

Compliance attorneys and compliance clerks are likely to prepare and deliver these documents. We estimate that approximately 75 percent of these burden hours will be performed by clerical employees and about 25 percent will be performed by compliance attorneys. Based upon an average cost of $63 per hour for a compliance clerk and an average cost of $270 per hour for a compliance attorney,[7] the total cost of the information collection requirements of Rule 206(3)-2 is estimated at approximately $1,158,516 annually.[8] These estimates of average burden hours and average costs of those average burden hours are made solely for the purposes of the Paperwork Reduction Act and are not derived from a comprehensive or representative survey or study, or the cost of Commission rules and forms.

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5 32 annual responses per adviser x 0.5 hours per response = 16 hours annually per adviser.

6 16 hours x 631 advisers = 10,096 hours.

7 The figure of $63 per hour for a Compliance Clerk is from the SIA Report on Office Salaries in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead. The figure of $270 per hour is based on reported industry wages for a Compliance Attorney taken from the SIA Report on Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

8 (0.75 x 10,096 x $63) + (0.25 x 10,096 x $270) = $477,036 + $681,480 = $1,158,516. This cost estimate is lower than that previously submitted in connection with this collection. This decrease in estimated cost results primarily from a decrease in the number of advisers using the rule annually and the corresponding decrease in the annual aggregate burden under the rule.

13. Estimate of Total Annual Cost Burden

It is estimated that there is no cost burden for the rule, excluding any cost of the burden hours as identified in Item 12 above.

14. Estimate of Cost to the Federal Government

There are no costs to the federal government directly attributable to Rule 206(3)-2.

15. Explanation of Changes in Burden

Neither the number of responses per investment adviser nor the number of hours per response changed since the last estimate. However, as discussed in Item 12 above, the number of respondents has decreased from approximately 693 investment advisers to approximately 631 investment advisers. Accordingly, the total burden hours for all respondents has decreased from 11,088 hours to 10,096 hours. The decreased burden reflects the decrease in the estimated number of investment advisers relying on the rule since the last extension request.

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.