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**SUPPORTING STATEMENT**  
**RULE 206(4)-3**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

In connection with its proposal of a new rule under the Investment Advisers Act of 1940 (the “Advisers Act”) that would apply certain restrictions to advisers particularly in the context of soliciting government entity clients,<sup>1</sup> the Securities and Exchange Commission (the “Commission”) is proposing to amend Rule 206(4)-3 (17 CFR 275.206(4)-3) under the Advisers Act, which is entitled “Cash Payments for Client Solicitations,” to add a provision noting: “Solicitation activities involving a government entity, as defined in [the new proposed rule],” shall be subject to the additional limitations set forth in that section.”

Rule 206(4)-3 prohibits investment advisers from paying cash fees to solicitors for client referrals generally unless certain conditions are met. The rule requires that an adviser pay all solicitors’ fees pursuant to a written agreement that the adviser is required to retain.<sup>2</sup> When an adviser will provide only impersonal advisory services to the prospective client, the rule imposes no disclosure requirements. When the solicitor is affiliated with the adviser and the adviser will provide individualized services, the solicitor must, at the time of the solicitation, indicate to prospective clients that he is affiliated with the adviser. When the solicitor is not affiliated with the adviser and the adviser will provide individualized services, the solicitor must, at the time of the solicitation, provide the prospective client with a copy of the adviser's brochure and a

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<sup>1</sup> The proposed rule is Rule 206(4)-5 under the Advisers Act. The Commission is also proposing to amend Advisers Act Rule 204-2 (17 CFR 275.204-2). The proposing release is attached as Appendix A.

<sup>2</sup> Rule 204-2 requires advisers to keep records of documents required by Rule 206(4)-3. Accordingly, no recordkeeping burdens are addressed by this supporting statement.

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disclosure document containing information specified in rule 206(4)-3.

The information rule 206(4)-3 requires is necessary to inform advisory clients about the nature of the solicitor's financial interest in the recommendation so they may consider the solicitor's potential bias, and to protect investors against solicitation activities being carried out in a manner inconsistent with the adviser's fiduciary duty to clients. The likely respondents to this information collection would be each investment adviser registered with the Commission that compensates a solicitor in cash for referrals.

Rule 206(4)-3 contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>3</sup> The title of this collection is "Rule 206(4)-3 under the Investment Advisers Act of 1940 (17 CFR 275.206(4)-3)" and the Commission submitted it 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 3235-0242 (expiring on March 31, 2011). 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. Purpose of the Information Collection**

Investors need accurate information about compensation arrangements between an investment adviser and a solicitor in order to determine whether to retain an adviser recommended by the solicitor.

## **3. Role of Improved Information Technology**

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44 U.S.C. 3501 to 3520.

The Commission's use of computer technology in connection with this information collection, which has been previously approved by OMB, would not change. Investment advisers are currently permitted to provide the information required by rule 206(4)-3 electronically.<sup>4</sup>

#### **4. Efforts to Identify Duplication**

No other rule requires investment advisers to provide clients or prospective clients with the same information that is required by rule 206(4)-3 in its current form or as it is proposed to be amended.

#### **5. Effect on Small Entities**

The requirements for rule 206(4)-3 in its current form and as it is proposed to be amended are the same for all investment advisers registered with the Commission, including small entities. It would defeat the purpose of the rule to exempt small entities from these requirements. Furthermore, the Commission regulates primarily advisers that have assets under management of \$25 million or more. For purposes of Commission rulemaking, an investment adviser is a small business if it has assets under management of less than \$25 million and meets certain other requirements. Advisers with assets under management of less than \$25 million are eligible to register with the Commission only if they advise a registered investment company or are qualified under rule 203A-2.

#### **6. Consequences of Less Frequent Collection**

Rule 206(4)-3 requires a solicitor to provide the required disclosure at the time of the

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<sup>4</sup>

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).

solicitation; without this information at the time of the referral, the client would be unaware of the solicitor's financial interest in the recommendation.

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

Not applicable.

**8. Consultation Outside the Agency**

In its release proposing, in addition to the new rule, amendments to rule 206(4)-3, the Commission requests public comment on the proposed amendments. In addition, the Commission and staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment adviser profession through public conferences, meetings and informal exchanges. These various forums provide the Commission and 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 206(4)-3 requires solicitors to provide information to advisory clients and prospective clients. Accordingly, these disclosures would not be kept confidential.

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

The proposed amendments to rule 206(4)-3 would require every investment adviser that relies on the rule and that provides or seeks to provide advisory services to government entities

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to also abide by the limitations provided in proposed rule 206(4)-5. This collection of information would be found at 17 CFR 275.206(4)-3. Advisers that are exempt from Commission registration under section 203(b)(3) of the Advisers Act would not be subject to rule 206(4)-3.

The current approved collection of information for rule 206(4)-3 is based on an estimate that 20% of the 10,817 Commission-registered advisers (or 2,163 advisers) rely on the rule, at an average of 7.04 burden hours each year, per respondent, for a total of 15,228 burden hours (7.04 x 2,163).

Commission records indicate that currently there are approximately 11,340 registered investment advisers,<sup>5</sup> 20% of which (or 2,268) are likely subject to the collection of information imposed by rule 206(4)-3. As a result of the increase in the number of advisers registered with the Commission since the current total burden was approved, the total burden has increased by 739.2 hours (105 additional advisers<sup>6</sup> x 7.04 hours). We assume that approximately 20% of the Commission-registered advisers that use rule 206(4)-3 (or 454 advisers) provide, or seek to provide, advisory services to government clients and would thus be affected by the proposed rule

amendments.<sup>7</sup> Under the proposed amendments, each respondent would be prohibited from

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<sup>5</sup> This figure is based on registration information from IARD as of July 1, 2009.

<sup>6</sup> 2,268 (20% of current registered investment advisers) – 2,163 (20% of registered investment advisers when burden estimate was last approved by OMB) = 105.

<sup>7</sup> In light of the 11.57% of registered investment advisers that indicate they have state or municipal government clients, we conservatively estimate that 20% of the advisers who rely on rule 206(4)-3 are soliciting government entities to be advisory clients or to invest in covered investment pools those advisers manage. According to registration information available from

certain solicitation activities with respect to government clients, which would eliminate the need to enter into and retain the written agreement required under rule 206(4)-3 with respect to those clients. Accordingly, the proposed amendments to rule 206(4)-3 are estimated to decrease the burden by 20%, or approximately 1.4 hours, per Commission-registered adviser that uses the rule and has or is seeking government clients annually, for a total decrease of 635.6 hours. The revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 206(4)-3 thus would be 15,331.6 hours.<sup>8</sup> The revised weighted average burden per Commission-registered adviser would be 6.76 hours.<sup>9</sup>

**13. Estimate of Total Annual Cost Burden**

\$0.

**14. Estimate of Cost to the Federal Government**

Rule 206(4)-3 does not impose any costs on the Federal government because there are no separate filing requirements with the Commission.

**15. Explanation of Changes in Burden**

The number of respondents increased from 2,163 investment advisers to 2,268 investment advisers. As a result of the increase in the number of advisers registered with the Commission since the current total burden was approved, the total burden has increased by 739.2

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Investment Adviser Registration Depository (“IARD”) as of July 1, 2009, there are 1,312 SEC-registered investment advisers (or 11.57% of the total 11,340 registered advisers) that indicate in Item 5.D.(9) of Form ADV that they have state or municipal government clients.

<sup>8</sup>  $15,228 \text{ (current approved burden)} + 739.2 \text{ (burden for additional registrants)} - 635.6 \text{ (reduction in burden for proposed amendment)} = 15,331.6 \text{ hours.}$

<sup>9</sup>  $15,331.6 \text{ (revised annual aggregate burden ) divided by } 2,268 \text{ (total number of registrants who rely on rule)} = 6.76.$

hours (105 additional advisers<sup>10</sup> x 7.04 hours).

However, we assume that approximately 20% of the Commission-registered advisers that use rule 206(4)-3 (or 454 advisers) provide, or seek to provide, advisory services to government clients and would thus be affected by the proposed rule amendments.<sup>11</sup> Under the proposed amendments, each respondent would be prohibited from certain solicitation activities with respect to government clients, which would eliminate the need to enter into and retain the written agreement required under rule 206(4)-3 with respect to those clients. Accordingly, the proposed amendments to rule 206(4)-3 are estimated to decrease the burden by 20%, or approximately 1.4 hours, per Commission-registered adviser that uses the rule and has or is seeking government clients annually, for a total decrease of 635.6 hours.

Thus, the revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 206(4)-3 thus would increase from 15,228 hours to 15,331.6 hours.<sup>12</sup> The revised weighted average burden per Commission-registered adviser would be 6.76 hours.<sup>13</sup> This increase is due to the combination of an increase in the estimated number of respondents that is partially offset by a reduction in the hour burden associated with certain advisers who formerly would have had to comply with rule 206(4)-3's requirements with respect to their solicitations of government clients, but would instead be subject to the proposed new rule's

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<sup>10</sup> 2,268 (20% of current registered investment advisers) – 2,163 (20% of registered investment advisers when burden estimate was last approved by OMB) = 105.

<sup>11</sup> See supra note Error: Reference source not found.

<sup>12</sup> 15,228 (current approved burden) + 739.2 (burden for additional registrants) - 635.6 (reduction in burden for proposed amendment) = 15,331.6 hours.

<sup>13</sup> 15,331.6 (revised annual aggregate burden) divided by 2,268 (total number of registrants who rely on rule) = 6.76.

requirements with respect to those solicitations.

**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.