SUPPORTING STATEMENT
PROPOSAL TO AMEND RULE 204-2

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 204 of the Investment Advisers Act of 1940 ("Advisers Act")[1] provides that investment advisers required to register with the Securities and Exchange Commission (the "Commission") must make and keep certain records for prescribed periods, and make and disseminate certain reports. Advisers Act rule 204-2[2] also sets forth mandatory requirements for maintaining and preserving specified books and records. The records that an adviser must keep in accordance with rule 204-2 must generally be retained for not less than five years.[3] These requirements constitute a mandatory "collection of information," within the meaning of the Paperwork Reduction Act. The collection has been previously approved and subsequently extended under Office of Management and Budget ("OMB") control number 3235-0278, and it is found at 17 CFR 275.204-2. 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 number. The respondents are investment advisers registered with us. Responses provided to the Commission in the context of its examination and oversight program are generally kept confidential.[4]

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1 15 U.S.C 80b-4.

2 17 CFR 275.204-2.

3 See rule 204-2(e) [17 CFR 275.204-2(e)]. The standard retention period required for books and records under rule 204-2 is five years, in an easily accessible place, the first two years in an appropriate office of the investment adviser.

4 See section 210(b) of the Advisers Act [15 U.S.C. 80b-10(b)].

The Commission is proposing to amend rule 204-2 in connection with its proposal to adopt a new rule, 206(4)-5, under section 206(4) of the Advisers Act[5] to address "pay to play" practices by investment advisers that provide, or are seeking to provide, advisory services to government clients.[6] The proposed rule would prohibit an investment adviser from providing advisory services, for compensation, to a government entity client, or to certain covered investment pools in which a government entity invests, for two years after the adviser, or certain of its executives or employees, makes a contribution to certain elected officials or candidates. The proposed rule would also prohibit an adviser from providing or agreeing to provide, directly or indirectly, payment to any third party for a solicitation of advisory business from any government entity, or for a solicitation of a government entity to invest in certain covered investment pools, on behalf of such adviser. Additionally, the proposed rule would prevent an adviser from coordinating or soliciting from others contributions to certain elected officials or candidates or payments to certain political parties.

The proposed amendments to rule 204-2 would require every investment adviser registered or required to be registered that provides or seeks to provide advisory services to government entities to maintain certain records of contributions made by the adviser or any of its covered associates. The proposed amendments would require an adviser to make and keep the following records: (i) the names, titles and business and residence addresses of all covered associates of the investment adviser; (ii) all government entities for which the investment adviser or any of its covered associates is providing or seeking to provide investment advisory services,

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5 15 U.S.C 80b-6(4).

6 The proposing release is attached as Appendix A. All terms used, but not defined in this Supporting Statement, are defined in Appendix A.

or which are investors or are solicited to invest in any covered investment pool to which the investment adviser provides investment advisory services, as applicable; (iii) all government entities to which the investment adviser has provided investment advisory services, along with any related covered investment pool(s) to which the investment adviser has provided investment advisory services and in which the government entity has invested, as applicable, in the past five years, but not prior to the effective date of the proposed rule; and (iv) all direct or indirect contributions or payments made by the investment adviser or any of its covered associates to an official of a government entity, a political party of a state or political subdivision thereof, or a political action committee. An adviser to a covered investment pool in which a government entity invests or is solicited to invest would be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government client. The adviser's records of contributions and payments would be required to be listed in chronological order identifying each contributor and recipient, the amounts and dates of each contribution or payment and whether such contribution or payment was subject to the exception for certain returned contributions pursuant to proposed rule 206(4)-5(b)(2). These records would be required to be maintained in the same manner, and for the same period of time, as other books and records under rule 204-2(a).

2. Purpose of the Information Collection

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. As noted above, respondents 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.[7]

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.[8]

4. Efforts to Identify Duplication

The collection of information requirements of the rule amendment 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 entities.[9] We estimate that, as of July 2009, less than ten percent of currently registered investment advisers that are small entities advise government entity clients and would have to comply with the new rule 206(4)-5, if adopted, and would therefore have to also comply with the related amendments to rule 204-2.[10] Moreover, small entities are likely to have fewer government clients or

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7 See id.

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

9 Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year. 17 CFR 275.0-7(a).

10 The Commission estimates that, as of July 2009, there are approximately 706 small Commission-registered investment advisers. Of these 706 advisers, 57 indicate on Form ADV that they have state or local government clients. This number is based on registration

prospective clients and fewer covered associates. As such, to some extent small investment advisers may have reduced burdens under the proposed amendments as compared to other advisers.

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.[11] 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

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information available from Investment Adviser Registration Depository ("IARD") as of July 1, 2009.

[11] See rule 204-2(e) [17 CFR 275.204-2(e)]. The standard retention period required for books and records under rule 204-2 is five years, in an easily accessible place, the first two years in an appropriate office of the investment adviser.

In its release proposing new rule 206(4)-5 and related amendments to rule 204-2, the Commission requests public comment on the effect of information collection under these amendments.[12] In addition, the Commission and the staff of the Division of Investment Management continue to 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 facing the industry.

9. Gift 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.[13]

11. Sensitive Questions

None.

12. Estimate of Hour Burden

The current approved collection of information for rule 204-2 is based on an average of 181.15 burden hours each year, per Commission-registered adviser, for a total of 1,954,109 burden hours. The current total burden is based on an estimate of 10,787 registered advisers. Commission records indicate that currently there are approximately 11,340 registered investment advisers subject to the collection of information imposed by rule 204-2.[14] As a result of the

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12 See Appendix A, Section IV.A.

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

14 This figure is based on registration information from IARD as of July 1, 2009.

increase in the number of advisers registered with the Commission since the current total burden was approved, the total burden has increased by 100,176 hours (553 additional advisers[15] x 181.15 hours).

We estimate that approximately 1,764 Commission-registered advisers provide, or seek to provide, advisory services to government clients and to certain pooled investment vehicles in which government entities invest, and would thus be affected by the proposed rule amendments.[16] Under the proposed amendments, each respondent would be required to retain the records in the same manner and for the same period of time as currently required under rule 204-2. The proposed amendments to rule 204-2 are estimated to increase the burden by approximately two hours per Commission-registered adviser with government clients annually for a total increase of 3,528 hours. The revised annual aggregate burden for all respondents to the recordkeeping requirements under rule 204-2 thus would be 2,057,813 hours.[17] The revised

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15 11,340 – 10,787 = 553

16 This number is based on registration information available from 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. Based on this data point and other responses to Item 5.D., we further estimate that 289 (or 11.57%) of the 2,502 registered investment advisers that manage "other pooled investment vehicles" (and do not also indicate that they have state or municipal government clients) are advising pooled investment vehicles in which government clients invest, and we estimate that 79 (or 11.57%) of the 679 registered investment advisers that manage registered investment companies (and do not also indicate that they have state or municipal government clients) are advising registered investment companies that are available as an investment option in a government plan or program. The sum of 1,312, 289 and 79 is 1,680. The proposed rule also applies to those advisers that seek to obtain government clients, and we do not know the precise number of such advisers. We believe, however, that the percentage of advisers is likely not great because, according to IARD data, there has not been any appreciable growth or shrinkage over the past five years in the percentage of Commission-registered advisers who have state or municipal government clients; the percentage has been almost unchanged. Accordingly, we estimate that an additional 5% (or 84) of Commission-registered advisers are seeking government clients, for a total of 1,764 (1,680 + 84) registered advisers subject to the proposed rule.

17 1,954,109 (current approved burden) + 100,176 (burden for additional registrants) +

weighted average burden per Commission-registered adviser would be 181.46 hours.[18]

An adviser would likely use a combination of compliance clerks and general clerks to make and keep the information and records required under the rule, as amended. The Commission staff estimates the hourly wage for compliance clerks to be $63 per hour, including benefits, and the hourly wage for general clerks to be $49 per hour, including benefits.[19] For each adviser 181.46 hours burden hours would be required to make and keep the information and records required under the rule. We anticipate that compliance clerks would perform an estimated 31.46 hours of this work, and clerical staff also would perform the remaining 150 hours. The total cost per respondent therefore would be an estimated $9,331.98,[20] for a total burden cost of $105,824,653.20.[21]

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.

13. Estimate of Total Annual Cost Burden

We expect advisory firms may incur one-time costs to establish or enhance current

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3,528 (burden for proposed amendments) = 2,057,813 hours.

18 2,057,813 (revised annual aggregate burden) divided by 11,340 (total number of registrants) = 181.46.

19 Our hourly wage rate estimate for a compliance manager and compliance clerk is based on data from the Securities Industry Financial Markets Association's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93, for compliance clerks to account for bonuses, firm size, employee benefits and overhead.

20 (31.46 hours per compliance clerk x $63) + (150 hours per clerical staff x $49) = ($1,981.98 + $7,350.00) = $9,331.98.

21 $9,331.98 per adviser x 11,340 advisers = $105,824,653.20.

systems to assist in their compliance with the proposed amendments to rule 204-2. These costs would vary widely among firms. Small advisers may not incur any system costs if they determine a system is unnecessary due to the limited number of employees they have or the limited number of government entity clients they have. Large firms likely already have devoted significant resources into automating compliance and reporting and the new rule could result in enhancements to these existing systems. We believe they could range from the tens of thousands of dollars for simple reporting systems, to hundreds of thousands of dollars for complex systems used by the large advisers.

We further anticipate that approximately one-third of advisers that we estimate would be subject to the proposed rule and rule amendments may also engage outside legal services to assist in drafting policies and procedures.[22] We estimate the cost associated with such an engagement would include fees for approximately three hours of outside legal review for a smaller firm, 10 hours for a medium firm, and 30 hours for a large firm, at a rate of $400 per hour. For a smaller firm we estimate a total of $1,200 in outside legal fees for each of the estimated 325 advisers that would seek assistance, for a medium firm we estimate a total of $4,000 for the estimated 164 advisers that would seek assistance, and for each of the 102 larger firms we estimate a total of $12,000.[23] Thus, we estimate that approximately 591 investment advisers will incur these additional costs, for a total cost of $2,270,000 among advisers affected by the proposed rule amendments.

The currently approved collection of information for rule 204-2 also includes a non-labor

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[22] Based on staff observations, we estimate 75% of larger firms, 50% of medium firms, and 25% of smaller firms would seek to outsource all or a portion of this type of legal work.

[23] As noted above, we estimate 75% of larger firms, 50% of medium firms, and 25% of smaller firms would seek the assistance of outside counsel.

cost estimate of $13,551,390. The non-labor costs imposed by the rule include the estimated costs of 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 by 103,704 hours (from 1,954,109 to 2,057,813 hours). We estimate there would be a proportional increase in the non-labor cost estimate to $14,228,959.[24]

14. Estimate of Cost to the Federal Government

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

15. Explanation of Changes in Burden

The number of responses per investment adviser has not changed since the last estimate. However, as discussed in Item 12 above, the number of respondents subject to additional records requirements as a result of the proposed amendments is 1,764, which would yield a 3,528 hour burden increase under the proposal. In addition, the total estimated number of registered advisers has increased from approximately 10,787 investment advisers to approximately 11,340 investment advisers. As a result, the total burden hours for all respondents has increased from an estimated 1,954,109 hours per year to an estimated 2,057,813 hours per year.

We expect advisory firms may incur one-time costs to establish or enhance current systems to assist in their compliance with the proposed amendments to rule 204-2. These costs would vary widely among firms, ranging from the tens of thousands of dollars for simple reporting systems, to hundreds of thousands of dollars for complex systems. We further anticipate that approximately one-third of advisers (approximately 591) that we estimate would be subject to the proposed rule and rule amendments may also engage outside legal services to assist in drafting policies and procedures, for an estimated total cost of $2,270,000 among

[24] (2,057,813 hours/1,954,109 hours) x $13,551,390 = $14,228,959.

advisers affected by the proposed rule amendments.

The currently approved collection of information for rule 204-2 also includes a non-labor cost estimate of $13,551,390. The non-labor costs imposed by the rule include the estimated costs of 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 by 103,704 hours (from 1,954,109 to 2,057,813 hours). We estimate there would be a proportional increase in the non-labor cost estimate to $14,228,959.

16. Information Collection Planned for Statistical Purposes

None.

17. Approval to not Display Expiration Date

None.

18. Exceptions to Certification Statement

None.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.