

**SUPPORTING STATEMENT
REVISIONS TO RULE 204-3**

A. JUSTIFICATION

1. Necessity for the Information Collection

The Securities and Exchange Commission (the “Commission”) adopted amendments to 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 brochures and brochure supplements that contain clear, current, and more meaningful disclosure about the adviser, its business, conflicts of interest and its advisory personnel in a narrative, plain English format.² The amended rules and form require advisers registered with the Commission to prepare and electronically file firm brochures through the Investment Adviser Registration Depository (“IARD”).

The amended rule 204-3 contains a collection of information for which the annual aggregate burden has changed as a result of the adopted amendments. This collection is necessary to provide advisory clients, prospective clients, and the Commission with information about the adviser, its business, conflicts of interest and its advisory personnel. The title of the affected collection of information is: “rule 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.

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 adopting release is attached as Appendix A.

2. Purpose of the Information Collection

Rule 204-3 requires investment advisers to deliver their brochures and brochure supplements at the start of an advisory relationship and to deliver annually thereafter the full updated brochure or a summary of material changes to their brochure.³ The rule also requires that advisers deliver an amended brochure or brochure supplement (or just a statement describing the amendment) to clients only when disciplinary information in the brochure or supplement becomes materially inaccurate.⁴ 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, has not changed. 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.⁵

³ See rule 204-3(b).

⁴ See rule 204-3(b).

⁵ 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).

4. Efforts to Identify Duplication

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

5. Effect on Small Entities

The requirements of the adopted 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 adopted 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 requested public comment on the effect of information collections under these amendments. In response to the request, some commenters noted that some advisers will incur costs in creating systems to track which brochure

supplements need to be delivered to which clients as supervised persons providing investment advice to particular clients change over time. Comments relating to the collection of information were considered by the Commission prior to adoption of the 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 previously required 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. The rule previously required no further brochure delivery unless the client accepted 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 require advisers to deliver their brochures and brochure supplements at the start of an advisory relationship and to deliver annually thereafter the full updated brochure or a summary of material changes to their brochure.⁶ The amendments also require that advisers deliver an amended brochure or brochure supplement (or just a statement describing the amendment) to clients only when disciplinary information in the brochure or supplement becomes materially inaccurate.⁷

The total annual burden currently approved by OMB for rule 204-3 is 6,902,278 hours. This currently approved burden is based on each adviser having, on average, an estimated 670 clients. Our records now currently indicate that the 11,658 advisers registered with the Commission have, on average, 1,300 clients.⁸ This change, along with our amendments permitting annual delivery of a summary of material changes to the brochure (instead of the entire brochure) alters the collection of information burden from that currently approved.

We expect that advisers will send their brochure or summary of material changes annually in a “bulk mailing” to clients that may include clients’ account statements, periodic reports, or other important documents. We estimate that, with a bulk mailing, an adviser will require no more than 0.02 hours to send the adviser’s brochure or summary of material changes to each client, or an annual burden of 26 hours per adviser.⁹ Thus,

⁶ See rule 204-3(b).

⁷ See rule 204-3(b).

⁸ This average is based on advisers’ responses to Item 5.C of Part 1A of Form ADV as of May 3, 2010, excluding the three advisers that reported the largest number of clients. Those advisers 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.

⁹ (0.02 hours per client x 1,300 clients per adviser based on IARD data as of May 3, 2010) = 26 hours per adviser. We note that the burden for *preparing* brochures is already incorporated into the burden estimate for Form ADV discussed above.

we estimate the total burden hours for 11,658 advisers to distribute their firm brochure to existing clients initially and annually thereafter to be 303,108 hours per year.¹⁰ We have revised our estimate of the amount of time it will take an adviser to deliver its brochure or summary of material changes based on our view that most advisers will make their annual delivery as part of the mailing of an account statement or other periodic report that they already make to clients, and thus the additional burden will be adding a few pages to the mailing.

Advisers are now 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 583.¹¹ We further estimate that an adviser will require no more than 0.1 hours per client for delivery of each such update.¹² This represents about 130 hours per interim update.¹³ Thus, the aggregate annual hour burden for affected advisers to deliver interim updates to their brochures or supplements will be approximately 75,790 hours per

¹⁰ (0.02 hours per client x 1,300 clients per adviser) x 11,658 advisers based on IARD data as of May 3, 2010 = 303,108 hours.

¹¹ Of the advisers registered with the Commission, 13% report disciplinary events on their Form ADVs (as of May 10, 2010, only 1,559 of all 11,658 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 given year, 5% of advisers will be required to deliver a single interim update to each of their clients, resulting in a total of approximately 583 interim updates per year. $0.05 \times 11,658 \times 1 \text{ update} = 583 \text{ updates}$.

¹² 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. Since this mailing may not be included with a mailing of a statement or other periodic report, we estimate that it will take slightly more time than to deliver the annual brochure or summary of material changes.

¹³ $0.1 \text{ hours per client} \times 1,300 \text{ clients per adviser} = 130 \text{ hours per update}$.

year.¹⁴ Because most medium advisers tend to resemble small advisers in terms of the number of employees providing investment advisory services,¹⁵ we estimate that only large advisers will need to design and implement systems to track changes in supervised persons providing investment advice to particular clients. We estimate that on average each of the 36 large advisers will spend 200 hours per year designing and implementing such systems, for a total of 7,200 hours per year.¹⁶ Thus, 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 386,098 hours per year, or 33.1 hours per adviser.¹⁷ This includes estimated time for large advisers to design and implement systems to track that the right supplements are delivered to the right clients as personnel providing investment advice to those clients change. This represents a decrease of 6,516,180 hours from the currently approved PRA burden.¹⁸ The decreased burden results primarily from our revised estimate of the time it will take firms to deliver their brochures, supplements and amendments. We estimate the burden associated with annual and interim delivery of brochures, supplements and the summary of material changes would represent an annual cost of \$18,918,802.¹⁹

¹⁴ 583 updates x 130 hours = 75,790 hours.

¹⁵ According to IARD data, only 4% of medium advisers report in response to Item 5.B(1) of Part 1A of Form ADV that more than 250 employees perform investment advisory functions.

¹⁶ 36 large advisers x 200 hours per year per large adviser = 7,200 hours per year.

¹⁷ 303,108 hours (initial and annual delivery) + 75,790 hours (interim delivery of updates to disciplinary information) + 7,200 (supplement tracking systems) = 386,098 hours. 386,098 hours / 11,658 advisers = 33.1 hours per adviser.

¹⁸ 6,902,278 hours – 386,098 hours = 6,516,180 hours.

¹⁹ Based on data from the Securities Industry and Financial Markets Association's *Report on Management & Professional Earnings in the Securities Industry 2008*, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery of amendments to Part 2 will also most likely be performed by a clerk at an estimated cost

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.

15. Explanation of Changes in Burden

The total burden hours for all respondents has decreased to 386,098 hours per year from the currently approved burden. This decrease is mainly due to our revised estimate of the time it will take firms to deliver their brochures, supplements and amendments. The adopted amendments to rule 204-3 allow advisers to: (1) significantly reduce the hourly and cost burdens associated with delivery of brochures, supplements and the summary of material changes by arranging to deliver these documents to some or all clients by electronic media and (2) minimize burdens associated with delivery by mailing some of these documents along with quarterly statements or other routine mailings they already send to clients. Finally, the burdens have been reduced because, in addition to the annual delivery requirement, interim amendments are now required only when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed.

The number of responses decreased by 5,768,700 because interim amendments are now required only when there is new disclosure of a disciplinary event, or a material change to disciplinary information already disclosed.

for a general clerk of \$49 per hour. $386,098 \text{ hours} \times \$49 = \$18,918,802$. We estimate that advisers will not incur any incremental postage costs in these mailings because we assume that advisers will mail annual summary of material changes with another mailing the adviser was already delivering to clients and that advisers were already delivering to clients disclosure of new material disciplinary events on an interim basis under rule 206(4)-4.

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.