

SUPPORTING STATEMENT REVISIONS TO FORM ADV

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 under the Investment Advisers 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”).

Form ADV is the two-part investment adviser registration form. Part 1 of Form ADV contains information used primarily by Commission staff, and Part 2 is the client brochure. The paperwork burdens associated with rules 203-1 and 204-1 are included in the approved annual burden associated with Form ADV and thus, do not entail a separate collection of information. Rule 203-1 requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-1 requires each SEC-registered adviser to file amendments to Form ADV at least annually. Part 2 of Form ADV and the amended rules contain collections of information for which the

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.

annual aggregate burden was affected as a result of the adopted amendments. The collections are 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: “Form ADV under the Investment Advisers Act of 1940.”³ Its OMB control number is 3235-0049. 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

The purpose of this collection of information is to provide advisory clients, prospective clients, and the Commission with information about the adviser, its business, conflicts of interest and its advisory personnel. We use the information to determine eligibility for registration with us and to manage our regulatory, examination, and enforcement programs. Clients use certain of the information to determine whether to hire an adviser and, if hired, how to manage that relationship.

This collection of information is found at 17 CFR 275.203-1, 275.204-1, and 275.279.1 and it is mandatory. Responses are not kept confidential. Respondents to the Form ADV collection of information are investment advisers registered with the Commission or applying for registration with the Commission. The information collected takes the form of disclosures to their clients, potential clients, and the Commission.

³ The Commission is also repealing rule 206(4)-4 (17 CFR 275.206(4)-4) (OMB control number 3235-0345). We are therefore also submitting an application for cancellation of the approved collection of information associated with rule 206(4)-4.

3. Role of Improved Information Technology

Investment advisers currently file their Form ADV, Part 1 electronically through the IARD system. The adopted amendments to Form ADV also require investment advisers to file their brochure electronically through the IARD. This method of collecting information reduces the regulatory burden upon investment advisers by (i) permitting them to electronically file applications for registration, and amendments thereto, at one central location, rather than filing Form ADV separately with the Commission, and the states for notice filing purposes, and (ii) enabling advisers to update only the information that is changed for purposes of the annual amendment or other types of amendments to Form ADV.

4. Efforts to Identify Duplication

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

5. Effect on Small Entities

The requirements of the adopted amendments to Form ADV 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 Part 2 of Form ADV. This is because small advisers usually have less complicated business practices, fewer employees, and therefore their brochures would be shorter, and easier to prepare, and they may have fewer brochure supplements.

6. Consequences of Less Frequent Collection

The collection of information required by the form is necessary to protect investors by providing clients and potential clients, as well as the Commission, with information about the adviser, adviser, its business, its conflicts of interest and its

advisory personnel. 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 hire an adviser and, if hired, how to manage that relationship. In addition, if the information is either not collected or is collected less frequently, the Commission's ability to protect investors would be reduced.

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, the Commission requested public comment on the effect of information collections under these amendments. A number of commenters expressed concerns that the paperwork burdens associated with our proposed amendments to Part 2 of Form ADV were understated.⁴ Several commenters stated that our estimates of the burdens of preparing and delivering brochure supplements were too low and that the requirement would impose heavy burdens on advisers, in particular, large advisory firms with thousands of employees and clients.⁵ Several commenters noted that these costs would increase particularly in the context of wrap fee programs.⁶ In response to comments on the requirements of Form ADV Part 2, the Commission made several substantive modifications to the proposed amendments that we believe in general will reduce the

⁴ See ASG Letter; Berlin Letter; Federated Letter; First Allied Letter; Fried Frank Letter; FSI Letter; IAA Letter; Jackson Letter; NAPFA Letter; NRS Letter; Pickard Letter; Sutherland Letter; Vineyard Letter.

⁵ See Merrill Lynch Letter; Morgan Stanley Letter; Schwab Letter; SIFMA Letter; Sutherland Letter.

⁶ See Federated Letter; MMI Letter; Morgan Stanley Letter.

paperwork burdens associated with the rule and form amendments. For example, the Commission modified the annual brochure delivery requirement to allow it to be satisfied by delivering just a summary of material changes in the brochure. The Commission revised Item 5 so that advisers do not need to include a fee schedule in brochures provided only to clients that are “qualified purchasers.” The Commission did adopt proposed disclosure of cash balance practices and proxy voting services from Items 8 and 17, respectively. The Commission is permitting supervised persons with certain disciplinary information disclosed through FINRA’s BrokerCheck system or the IAPD system to refer clients to that information in their brochure supplements (if they are provided electronically and contain a hyperlink to the BrokerCheck or the IAPD system, as relevant) rather than reproducing that information. When investment advice is provided to a client by a team, brochure supplements need only be provided for the five supervised persons with the most significant responsibility for the day-to-day advice provided to the client.

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 Form ADV is through filings with the Commission. These disclosures are not kept confidential.

11. Sensitive Questions

Not applicable.

12. Estimates of Hour Burden

The currently approved total annual burden for all advisers completing, amending, and filing Form ADV is 132,599 hours. As of May 3, 2010, there were 11,658 SEC registered advisers that file Form ADV through the IARD system.

In 2000, the Commission first proposed amendments to Form ADV, Part 2.⁷ In 2008, the Commission repropose amendments to Part 2 of Form ADV to enhance the disclosure statement advisers provide to their clients by providing advisory clients with clear, current, and more meaningful disclosure in a narrative, plain English format.⁸ Rules 203-1 and 204-1 already require every applicant for investment adviser registration with us to file Form ADV through the IARD and require every investment adviser registered with us to file amendments to Form ADV through the IARD at least annually.⁹ As adopted, the amendments to rules 203-1 and 204-1 and to Part 2 of Form ADV also require advisers registered with the Commission to prepare and electronically file firm

⁷ 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)) (“Proposing Release”).

⁸ Amendments to Form ADV, Investment Advisers Act Release No. 2711 (Mar. 3, 2008) [73 FR 13958 (Mar. 14, 2008)] (“Reproposing Release”).

⁹ Prior to the adoption of these amendments, advisers were required to submit Part 1 of Form ADV to us through the IARD system, but were not required to submit a copy of Part 2 of Form ADV to the Commission if they maintained in their files a copy of their Part 2 (and of any brochure they delivered to clients). The copy that they maintained in their files was considered filed with the Commission.

brochures required by Part 2A, and to prepare brochure supplements that they deliver to clients.

The Commission staff estimates that during the first year that an adviser completes Form ADV, including amended Part 2, an *average* investment adviser's total collection of information burden would be 36.24 hours per adviser,¹⁰ an increase of 13.99 hours over the currently approved burden of 22.25 hours.¹¹ The Commission staff expects that this average annual burden per adviser will apply to both new registrants applying for registration with the Commission, as well as to current registrants required to amend their Form ADVs as a result of the proposed revisions. This estimate includes time for preparation of brochures and brochure supplements in addition to the burden of preparing Part 1A.

The above estimate is an average that takes into consideration the thousands of advisers that have a small number of employees as well as the few advisers that have thousands of employees. As of May 3, 2010, approximately 81 percent of the 11,658 investment advisers registered with the Commission had 10 or fewer employees performing advisory functions on their behalf compared to less than one third of one percent of advisers who had more than 1,000 employees. The paperwork burdens of preparing a narrative firm brochure and brochure supplements are likely to vary substantially among advisers, because Part 2 gives an adviser considerable flexibility in

¹⁰ 9,482 small advisers x an estimated 15 hours/adviser + 2,140 medium-sized advisers x an estimated 97.5 hours/adviser + 36 large advisers x an estimated 1,989 hours/adviser = 422,484 hours total. 422,484 hours / 11,658 total advisers = 36.24 hours/adviser.

¹¹ (8,835 small advisers x an estimated 5 hours/adviser) + (1,952 medium-sized advisers x an estimated 50 hours/adviser) + (30 large advisers x an estimated 3,296 hours/adviser) = 240,655 hours total. 240,655 hours / 10,817 total advisers = 22.25 hours/adviser.

structuring its disclosure, the amount of disclosure required will vary among advisers, and the number of supplements that will need to be prepared depends on the number of supervised persons at a firm that provide investment advice.

The Commission believes that the revisions to Part 2 will impose a small burden on advisers in collecting information because there is a significant overlap between the information required by the previous Part 2 and the new Part 2A requirements and because advisers already collect information on the business background and disciplinary histories of their supervised persons to comply with state investment adviser representative registration requirements.¹² We expect that most of the paperwork burden from amended Part 2 will arise from an adviser drafting the narrative disclosure for its brochure and brochure supplements based on disclosures it and its supervised persons already made in Schedule F of Part 2 and in Form U4, and in expanding its discussion of how the adviser addresses certain conflicts of interest. Based on the aforementioned, we estimate that the average initial annual burden associated with Form ADV may range from as little as 5 hours for smaller advisers, to approximately 50 hours for medium-sized advisers, to approximately 1,989 hours each large adviser.¹³ Based on IARD data, we

¹² There are three entirely new items in the Part 2A we are adopting today—Item 2’s summary of material changes, Item 6’s performance fee disclosure requirement, and Item 15’s custody disclosure requirement. The remainder of the items in Part 2A either were generally covered by the previous Part 2 or were required disclosure under other Advisers Act rules, such as rule 206(4)-6 regarding proxy voting and rule 206(4)-4 regarding financial and disciplinary information. In addition, most states require that supervised persons of SEC-registered investment advisers that are investment adviser representatives file Form U4, which requires similar business background and disciplinary information as the brochure supplement.

¹³ For purposes of this estimate, we have categorized small advisers as those with 10 or fewer employees, medium-sized advisers as those with between 11 and 1,000 employees, and large advisers as those with over 1,000 employees.

estimate that there are approximately 9,482 small advisers, 2,140 medium-sized advisers, and 36 large advisers.¹⁴

The Commission believes that the initial paperwork burden will be higher than subsequent years because most advisers would have to redraft and disseminate a narrative brochure and brochure supplements. However, the efficiencies of filing through the IARD, over time, are expected to reduce the initial burdens associated with completing the revised Form ADV. As under the currently approved collection, the estimated initial burdens associated with using the revised form would be amortized over the estimated period that advisers would use their revised brochure.

Respondents under this collection of information will be advisers registered with the Commission as well as new applicants for investment adviser registration with the Commission. We estimate that approximately 1000 new investment advisers will register with us each year.¹⁵ Thus, in combination with the approximately 11,658 existing investment advisers registered with the Commission, we estimate that the total number of respondents under this collection of information will be 12,658 advisers. Based on the estimated average collection of information burden of 36.24 hours per adviser, the total initial collection of information would amount to 458,726 hours for new registrants and for currently registered advisers that re-file Form ADV (including Part 2) through the IARD system.¹⁶ Amortizing this total burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form

¹⁴ Unless otherwise noted, the IARD data cited below is based on advisers' responses to questions on Part 1A of Form ADV as of May 3, 2010.

¹⁵ Based on IARD data over the last five years.

¹⁶ (12,658 advisers x 36.24 hours) = 458,726 hours.

would result in an average burden of an estimated 152,909 hours per year,¹⁷ or 12.08 hours per year for each new applicant and for each adviser currently registered with the Commission that would re-file through the IARD.¹⁸

In addition to the burdens associated with initial completion and filing of the revised form, we estimate that, on average, each adviser filing Form ADV through the IARD system will likely amend its form two times during the year.¹⁹ One of the two amendments that firms on average make each year will be an interim updating amendment, and we estimate that this amendment will require 0.5 hours per amendment because interim amendments typically only amend one or two items²⁰ in Form ADV and thus should not require much time to prepare. The other amendment is the firm's annual updating amendment of Form ADV. Part 2A requires only a few additional requirements with the annual updating amendment than is required throughout the year—the summary of material changes since the last annual updating amendment, an updated fee schedule, and an updated figure for assets under management. We also expect that advisers will not have to spend a significant amount of time generally reviewing their brochure before filing their annual updating amendment as the instructions to the form and their fiduciary obligations require them to keep information they provide to clients free of material inaccuracies. Based on these considerations, we estimate that the average adviser will spend 6 hours per year completing their annual updating amendment to Form ADV.

¹⁷ 458,726 hours / 3 years = 152,909 hours/year.

¹⁸ 152,909 hours / 12,658 advisers = 12.08 hours/adviser.

¹⁹ In the Proposing Release, we estimated that each adviser, on average, filing Form ADV through the IARD system amended its form 1.5 times per year. We have updated this estimate based on IARD system data regarding the number of filings of Form ADV amendments.

²⁰ Based on IARD system data.

Finally, we believe that the information required in the brochure supplements is unlikely to change frequently for any particular supervised person, and, as a result, that brochure supplements will be amended infrequently.²¹ We also estimate that changes to most of the supplement information is already tracked by advisers in order to allow them to keep Forms U4 for their investment advisory representatives current, and that tracking changes to this information for brochure supplement purposes as well will impose negligible additional costs. Accordingly, we estimate that it will require an average burden per adviser of one hour per year for interim amendments to brochure supplements, for a total burden on all advisers of 11,658 hours per year.²² Thus, we estimate that the total paperwork burden on advisers of amendments to Form ADV will be 87,435 hours per year.²³

In addition, an adviser may hire new employees who may begin providing investment advisory services that require preparation of a brochure supplement. We estimate that advisers on average will hire two new supervised persons each year for which a brochure supplement would have to be prepared.²⁴ We further estimate that, on

²¹ Largely for this reason, we have not broken down our estimated burden for preparing the annual updating amendment to Form ADV based on the size of the adviser since most of the difference in the initial Form ADV preparation burden was driven by the brochure supplement. We also do not believe that the burden for preparing an annual updating amendment to Part 2A of Form ADV will vary significantly based on the size of the adviser.

²² 1 hour per year x 11,658 advisers = 11,658 hours per year.

²³ 11,658 advisers x 1 interim brochure amendment per year x 0.5 hours = 5,829 hours per year for interim amendments. 11,658 advisers x 1 annual brochure amendment per year x 6 hours = 69,948 hours per year for annual amendments. 11,658 advisers x 1 hour per year for supplement amendments = 11,658 hours per year for supplement amendments. 5,829 + 69,948 + 11,658 = 87,435 hours.

²⁴ Estimate is weighted average based on analysis of changes in aggregate responses to Item 5.B(1) of Part 1A of Form ADV over the last 5 years and the number of investment advisers registered with the Commission.

average, an adviser will spend 0.5 hours preparing each new brochure supplement.²⁵

Preparation of these new supplements thus would require all advisers to spend 11,658 hours per year.²⁶

The revised total annual collection of information burden for advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants plus the burden associated with amendments to the form as well as creating new supplements for new employees, is estimated to be approximately 252,002 hours per year.²⁷ This burden represents an increase of 151,026 hours over that estimated in the Proposing Release.²⁸ This increase is attributable primarily to our increased estimates of the hourly preparation burden associated with Part 2 in response to comments.

As discussed in the Reproposing Release, in addition to these estimated burdens, under this collection of information there is also a burden of 16,455 hours associated with advisers' obligations to deliver to clients copies of their adviser codes of ethics upon request.²⁹ Thus, the estimated revised total annual hourly burden under this collection of

²⁵ See discussion at *supra* note Error: Reference source not found and accompanying text.

²⁶ Two new supervised persons per year x 0.5 hours per supplement x 11,658 investment advisers = 11,658.

²⁷ 152,909 hours per year attributable initial preparation of Form ADV + 87,435 hours per year for amendments to Form ADV + 11,658 hours per year for supplements for new employees = 252,002 hours.

²⁸ Revised burden 252,002 hours - proposing release burden of 100,976 hours = 151,026 hours.

²⁹ See Reproposing Release, *supra* note Error: Reference source not found at n.114 and accompanying text. As we estimated in the Reproposing Release (and on which we received no comment), we estimate that only one percent of an adviser's clients actually request a copy the adviser's code of ethics. (the estimated average number of clients per adviser) = 13 requests per registrant. See also Reproposing Release, *supra* note Error: Reference source not found at n.357 and accompanying text regarding the estimated average number of clients. We continue to estimate that responding to each such request involves a burden of 0.10 hours, amounting to an annual burden of 1.3 hours for each

information would be 268,457 hours.³⁰ This represents an increase of 135,858 hours per year from the currently approved burden.³¹

Based on our estimate that the total collection burdens associated with initial completion and filing of the revised Form ADV would amount to 152,909 hours,³² we expect that advisers would incur costs of approximately \$56,415,380 in providing the initial collection of information.³³ In addition, as we stated above, we estimate that on average, each adviser would amend their Form ADV two times during the year, totaling 87,435 hours for all advisers per year.³⁴ We estimate that advisers would incur annual costs of \$12,153,465 in meeting the requirements of preparing Form ADV amendments.³⁵ Finally, we estimate that advisers would spend 11,658 hours for all advisers per year creating brochure supplements for new employees hired each year. We estimate that advisers would incur annual costs of \$1,620,462 in creating these new supplements.³⁶ The total costs of collection of information associated with Form ADV would therefore be \$70,189,307.

adviser stemming from the obligation to deliver copies of their codes of ethics to clients. 13 requests per adviser x 0.10 hours = 1.3 hours/adviser. This obligation applies to both currently-registered (11,658 respondents) and newly-registered advisers (1000 respondents), for a total annual burden of 16,455 hours. 12,658 respondents x 1.3 hours = 16,455 hours.

³⁰ 16,455 hours + 252,002 hours = 268,457 hours.

³¹ Revised burden 268,457 hours - currently approved burden of 132,599 hours = 135,858 hours.

³² See above nn. Error: Reference source not found and Error: Reference source not found and accompanying text.

³³ See Appendix A at nn. 328 and 382. \$22,775,400 + \$33,639,980 = \$56,415,380.

³⁴ See above note Error: Reference source not found and accompanying text.

³⁵ See Appendix A at note 383. 87,435 hours per year for amendments x \$139 per hour = \$12,153,465.

³⁶ See Appendix A at note 384. 11,658 hours per year for new supplements x \$139 per hour = \$1,620,462.

13. Estimate of Total Annual Cost Burden

We estimate that some advisers may incur a one-time initial cost including outside legal fees in connection with preparation of Form ADV (including preparation of Part 2). As we discuss above, advisers subject to the Form ADV requirements vary widely in terms of the size, complexity and nature of their advisory business, and thus, the amount of disclosure required, would vary substantially among advisers. Accordingly, the amount of time, and thus cost, required for outside legal review is likely to vary substantially among those advisers who elect to obtain outside legal assistance. We estimate that the initial per adviser cost related to preparation of Form ADV may range from as little as \$3,200 for smaller advisers, to \$4,400 for medium-sized advisers, to as much as \$10,400 for larger advisers.³⁷ Similarly, whether an adviser even seeks outside legal services in drafting their Form ADV will depend on the size, complexity and nature of their advisory business. We believe that a substantial percentage of advisers, particularly smaller advisers, are unlikely to seek such outside legal services. In addition to outside legal services we estimate that some advisers may incur a one-time initial cost, in addition to the projected hourly per adviser burden discussed above, for outside compliance consulting services related to preparation of their Form ADV (including preparation of Part 2).

We estimate that a quarter of small and half of medium advisers, or 2,371 and 1,070 advisers, respectively, are likely to seek outside compliance consulting services in

³⁷ Outside legal fees are in addition to the projected hourly per adviser burden discussed above. \$400 per hour for legal services x 8 hours per small adviser = \$3,200. \$400 per hour for legal services x 11 hours per medium-sized adviser = \$4,400. \$400 per hour for legal services x 26 hours per large adviser = \$10,400. The hourly cost estimate of \$400 on average is based on our consultation with advisers and law firms who regularly assist them in compliance matters..

their preparation of Form ADV.³⁸ We estimate that a quarter of small advisers, or 2,370 advisers, and a quarter of medium advisers, or 535 advisers, are likely to engage outside legal services.³⁹ We estimate that all of the 36 large advisers will engage outside legal services in preparation of Form ADV. Thus, we estimate that approximately 2,941 advisers will elect to obtain outside legal assistance and approximately 3,441 advisers will elect to obtain outside consulting services, for a total cost among all respondents of \$22,775,400.⁴⁰

14. Estimate of Cost to the Federal Government

There are no costs to the government directly attributable to Form ADV.

15. Explanation of Changes in Burden

The total burden hours for all respondents has increased from the currently approved 132,599 hours per year to 268,457 hours per year. This increase is mainly due to the following factors: (1) the initial burden associated with advisers preparing clearly written, meaningful, narrative brochures and brochure supplements containing current disclosure of the business practices, conflicts of interest and background of the investment adviser and its advisory personnel, (2) the burden associated with advisers expanding their discussion of how the adviser addresses certain conflicts of interest and (3) the burden associated with related amendments to rules 203-1 and 204-1.

³⁸ $9,482 \text{ small advisers} \times 0.25 = 2,371$. $2,140 \text{ medium-sized advisers} \times 0.5 = 1,070$.

³⁹ $2,140 \text{ medium-sized advisers} \times 0.25 = 535$.

⁴⁰ For outside legal services, $(\$4,400 \times 535 \text{ medium advisers}) + (\$3,200 \times 2,370 \text{ small advisers}) + (\$10,400 \times 36 \text{ large advisers}) = \$ 10,312,400$. For compliance consulting services, $(\$3,000 \times 2,371 \text{ small advisers}) + (\$5,000 \times 1,070 \text{ medium advisers}) = \$12,463,000$. $\$10,312,400 + \$12,463,000 = \$22,775,400$.

We also estimate that certain investment advisers will, as stated above, incur additional one-time costs of \$22,775,400 to obtain outside legal assistance and outside consulting services to assist in preparation of Form ADV.

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.