

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Extension Information Collection Submission**  
**for**  
**Rule 206(3)-3T**

**A. JUSTIFICATION**

**1. Necessity of Information Collection**

Section 206(3) of the Investment Advisers Act of 1940 (“Advisers Act” or “Act”) (15 USC 80b-6(3)) requires an investment adviser to follow certain procedures if the adviser trades with its clients as principal (selling securities it owns to clients or buying securities from clients). Advisers Act rule 206(3)-3T (17 CFR 275.206(3)-3T) provides an alternative means for investment advisers that are also registered broker-dealers to comply with section 206(3).

Rule 206(3)-3T contains “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”) (44 U.S.C. 3501 *et seq.*). 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 control number. The title of this collection is “Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T,” and the Commission previously submitted this collection 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 this collection under control number 3235-0630 (expiring on March 31, 2011).

The rule contains two types of collections of information: information provided by an adviser to its advisory clients and information collected from advisory clients by an adviser. The information collection requirements of the rule consist of the following:

(i) prospective disclosure in writing of the conflicts arising from principal trades;

(ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) trade-by-trade oral or written disclosure of principal trading and oral or written client consent before each principal transaction; (iv) trade-by-trade written confirmation statements disclosing the capacity in which the adviser acted; and (v) delivering to the client an annual report itemizing the principal transactions. Providing the information required by rule 206(3)-3T is necessary for advisers also registered as broker-dealers to obtain the benefit of the alternative means of complying with section 206(3) of the Advisers Act.

## **2. Purpose of the Information Collection**

Rule 206(3)-3T establishes an alternative means for certain advisers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain advisory clients. The rule contains information collection requirements that provide important protections to investors when advisers engage in principal trades. Specifically, the rule requires advisers, among other things, to apprise their clients regarding the conflicts of interests arising from principal trades. The rule also requires advisers to provide information to clients regarding transactions that the adviser executed on a principal basis. We believe clients of advisers will primarily use the information collections for the purpose of monitoring principal trades.

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

Investment advisers are permitted to provide to clients the information required by rule 206(3)-3T electronically.<sup>1</sup>

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<sup>1</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 1932, and Investment Company Act of 1940*, Investment Advisers Act Release No. 1562 (May 9, 1996).

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

There are no rules that duplicate or conflict with rule 206(3)-3T. There are rules that require broker-dealers to provide certain information in a confirmation statement to their customers regarding the transactions they effect. While rule 206(3)-3T requires information in a confirmation statement, the rule is designed to work efficiently together with those rules by permitting firms to incorporate the required disclosure into one confirmation statement.

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

Small SEC-registered investment advisers that also are registered with the Commission as broker-dealers seeking to rely on the rule would be subject to the same disclosure requirements as larger entities.<sup>2</sup> In developing the requirements of the rule, the Commission considered the extent to which they would have a significant impact on a substantial number of small entities, and included flexibility where possible, calling for disclosures that are already generated by the relevant firms in one form or another whenever possible in the light of the objectives of the rule, to reduce the corresponding burdens imposed. It would defeat the purpose of the rule to exempt small entities from the rule.

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

Information must be given to a client at the following times: (i) before the adviser engages in principal trades with respect to the client's account, so the client can consent to prospective transactions; (ii) prior to the execution of each principal trade; (iii) after

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<sup>2</sup> Under Advisers Act rule 0-7, 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.

completion of each principal trade in the form of a confirmation statement; and (iv) annually, a report itemizing all principal transactions. Less frequent reporting would not give clients adequate information regarding principal trades executed by advisers.

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

The collection of information imposes no additional requirements regarding record retention.

**8. Consultation Outside the Agency**

The Commission and the 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 the staff with a means of ascertaining and acting upon paperwork burdens facing the industry. At the time the Commission issued temporary rule 206(3)-3T on an interim-final basis, it requested comment on the rule and the collection of information. The Commission also requested comment recently on its proposal to extend the rule, including on its previous PRA estimates, among other matters. No comments were submitted on the Commission's PRA estimates in response to either of these requests for comments.

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

**9. Payment or Gift to Respondents**

Not applicable.

#### **10. Assurance of Confidentiality**

The rule contains two types of collections of information: information provided by an adviser to its advisory clients and information collected from advisory clients by an adviser. Although the rule does not call for any of the information collected to be provided to the Commission, to the extent advisers include any of the information required by the rule in a filing, such as Form ADV, the information will not be kept confidential. The collection of information delivered by clients to advisers would be subject to the confidentiality strictures that govern those relationships, and we would expect them to be confidential communications.

#### **11. Sensitive Questions**

Not applicable.

#### **12. Estimate of Hour Burden**

The Commission's estimates of the burden of each of the collections reflects the fact that the alternative means of compliance provided by the rule is substantially similar to the approach advisers currently employ to comply with the disclosure and consent obligations of section 206(3) of the Advisers Act and the approach that broker-dealers employ to comply with the confirmation requirements of rule 10b-10 under the Exchange Act.

The Commission's estimate of the burden hours that will be imposed by the collections of information in rule 206(3)-3T are set forth below. These burden hours consist of both initial and annual, or ongoing, burdens. Because the paperwork burdens imposed by rule 206(3)-3T are being extended, rather than being imposed initially, firms

relying on the rule already will have incurred the initial burdens, and generally will incur in the future only the annual burdens. We anticipate that certain additional firms also will choose to rely on the rule, and these firms will incur both initial and annual burdens.

**a. Prospective Disclosure Statement and Consent**

**i. Drafting prospective disclosure statement (initial burden)**

1.	Respondents initially relying on the rule per year	
	24*	
2.	Responses per respondent	
	1	
3.	Burden hours per response	
	5	
4.	Initial hours requested	_____
	<b>120</b>	

\*We estimate for PRA purposes, based on data from the Investment Adviser Registration Depository (“IARD”), that annually 24 advisers also registered as broker-dealers who do not maintain non-discretionary advisory accounts will choose to do so and rely on rule 206(3)-3T. These advisers thus will incur the initial burdens described above and throughout this supporting statement. We also estimate for PRA purposes, based on IARD data, that 380 advisers rely on rule 206(3)-3T, which estimate includes the 24 advisers that we anticipate will rely on the rule. We use this estimate of total advisers to estimate annual, as opposed to initial, burdens.

**ii. Distributing prospective disclosure statement (initial burden)**

1.	Number of new affected accounts per year	50,280*
2.	Responses per account	1
3.	Burden hours per response	0.1 (six minutes)
4.	Initial hours requested	_____
		<b>5,028</b>

\* We estimate for PRA purposes, based on IARD data, that advisers annually will initially rely on rule 206(3)-3T to engage in principal trades with 50,280 accounts, which will cause advisers (and in some cases, accountholders) to incur the initial burdens described above and throughout this supporting statement in connection with those accounts. We also estimate for PRA purposes, based on IARD data, that advisers are likely to rely on rule 206(3)-3T with respect to a total of 796,200 accounts. We use this estimate of total accounts to estimate annual, as opposed to initial, burdens. These account estimates take into account programs, such as mutual fund asset allocation programs, to which rule 206(3)-3T will not

apply and retirement accounts that are unlikely to participate in principal trading.

**iii. Reviewing prospective disclosure and responding to consent solicitation (initial burden)**

1. Number of new affected accountholders per year	50,280
2. Responses per accountholder	1
3. Burden hours per response	0.05 (3 minutes)
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4. Initial hours requested	<b>2,514</b>

**iv. Updating disclosure, maintaining records, and processing revocations and prospective consents (annual burden)**

1. Respondents relying on the rule	380
2. Responses per respondent	1
3. Burden hours per response	100
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4. Annual hours requested	<b>38,000</b>

**b. Trade-by-Trade Disclosure and Consent (initial and annual burden)**

i. Number of affected accountholders	716,580*
ii. Responses per accountholder	50*
iii. Burden hours per response	0.0083 (30 seconds)
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iv. Initial and annual hours requested	<b>297,381</b>

\*We estimate that 90 percent of the 796,200 accountholders, or 716,580 accountholders, will execute and return the consent. We also estimate that non-discretionary advisory accountholders at eligible advisers engage in an average of approximately 50 trades per year.

**c. Principal Transactions Report**

**i. Programming computer systems (initial burden)**

1. Respondents initially relying on the rule per year	24
2. Responses per respondent	1
3. Burden hours per response	5
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4. Initial hours requested	<b>120</b>

**ii. Electronically-generated reports (initial and annual burden)**

1. Affected accounts	716,580
2. Responses per account	1
3. Burden hours per response	.05 (3 minutes)
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4. Initial and annual hours requested 35,829

d. Total Burden Hours Requested

120
5,028
2,514
38,000
297,381
120
35,829
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<b>378,992</b>

The total hour burden, expressed on a per-eligible-adviser basis, is therefore approximately 997 hours per eligible adviser (378,992 hours divided by the estimated 380 advisers that will rely on rule 206(3)-3T).

The dollar cost estimates corresponding to each hour burden described above are as follows:

a. **Prospective Disclosure Statement and Consent**

i. Drafting prospective disclosure statement (initial burden)

1.	Total hour burden	120
2.	Hour burden per adviser	5
3.	Cost per hour     \$67*	
4.	Cost per adviser   \$335*	
5.	Total cost	<hr style="width: 100%; border: 0.5px solid black;"/>
	<b>\$8,040*</b>	

\*We expect that the internal preparation function will most likely be performed by compliance professionals. Data from SIFMA’s Office Salaries in the Securities Industry 2010 (“Industry Salary Report”), modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a Compliance Clerk is approximately \$67 per hour. \$67 per hour x 5 hours on average per adviser = \$335 on average per adviser of initial internal costs for preparation of the prospective disclosure. \$335 on average per adviser of initial internal costs x 24 advisers expected to incur this initial burden = \$8,040 in total burden-related costs for the preparation of the prospective disclosure.



ii. <u>Distributing prospective disclosure statement (initial burden)</u>	
1. Total hour burden	5,028
2. Hour burden per adviser	210
3. Cost per hour \$50*	
4. Cost per adviser	\$10,500*
5. Total cost	<u>\$251,400*</u>

\* We expect that the distribution function for the prospective written disclosure and consent solicitation will most likely be performed by a general clerk. Data from the Industry Salary Report, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a General Clerk is approximately \$50 per hour. 50 per hour x 5,028 total hours = \$251,400 (which, if divided by the estimated 24 advisers that will choose initially to rely on rule 206(3)-3T, equals a total cost for distribution of approximately \$10,500 on average per adviser).

iii. <u>Reviewing prospective disclosure and responding to consent solicitation (initial burden)</u>	
1. Total hour burden (on accountholders)	2,514
2. Total number of new accountholders	50,280
3. Hour burden per accountholder	0.05 (3 minutes)*
4. Cost per accountholder	\$0.50*
5. Cost per hour	\$10*
6. Total cost	<u>\$25,140*</u>

\*We expect that reviewing prospective disclosure and responding to the consent solicitation will be undertaken by accountholders, of which we estimate there are approximately 50,280 that will be subject to this initial burden. We do not believe there will be a significant difference in burden between those clients that consent and those that do not. As such, the burden per accountholder is 2,514 hours ÷ 50,280 accounts = 0.05 hours (3 minutes). We estimate the cost per accountholder to review the disclosure and respond to the consent solicitation will be \$0.50. As such, the total cost for these accountholders will be 50,280 accountholders x \$0.50 per account = \$25,140 (which, if divided by the total number of burden hours, equals a cost per hour of \$10).

iv. <u>Updating disclosure, maintaining records, and processing revocations and prospective consents (annual burden)</u>	
1. Total hour burden	38,000
2. Hour burden per adviser	100
3. Cost per hour	\$67*

4. Cost per adviser	\$6,700*
5. Total cost	<u>\$2,546,000*</u>

\*We expect that this function will most likely be performed by compliance professionals at \$67 per hour. See Industry Salary Report. 100 hours on average per adviser per year x \$67 per hour = \$6,700 on average per adviser per year. \$6,700 on average per adviser per year x 380 eligible advisers = \$2,546,000.

**b. Trade-by-Trade Disclosure and Consent (initial and annual burden)**

i. Total hour burden	297,381
ii. Hour burden per adviser	783*
iii. Cost per hour	\$67*
iv. Cost per adviser	\$52,461*
v. Total cost	<u>\$19,924,527*</u>

\*The burden for the average adviser would be 297,381 total hours per year ÷ 380 eligible advisers = approximately 783 hours on average per adviser per year. We expect that this function will most likely be performed by compliance professionals at \$67 per hour. See Industry Salary Report. 783 hours on average per adviser per year x \$67 per hour = \$52,461 on average per adviser per year. \$52,461 on average per eligible adviser per year x 380 eligible advisers = approximately \$19,924,527 total cost per year.

**c. Principal Transactions Report**

i. Programming computer systems (initial burden)

1. Total hour burden	120
2. Hour burden per adviser	5
3. Cost per hour	\$77*
4. Cost per adviser	\$385*
5. Total cost	<u>\$9,240*</u>

\*We expect that the internal programming function most likely will be performed by computer programmers. Data from the Industry Salary Report, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a Sr. Computer Operator is approximately \$77 per hour. 5 hours on average per adviser x \$77 per hour = \$385 on average per adviser (or, across all the 24 advisers that we estimate initially will rely on rule 206(3)-3T, \$9,240).

ii. Electronically-generated reports (initial and annual burden)

1. Total hour burden	35,829
2. Hour burden per adviser	94
3. Cost per hour	\$50*
4. Cost per adviser	\$4,700*
5. Total cost	<u>\$1,791,450*</u>

\*We expect that the generation and delivery of annual principal trade reports will most likely be performed by general clerks at \$50 per hour. \$50 per hour x 35,829 total hours per year = \$1,791,450 (or, if divided among all 380 eligible advisers, approximately \$4,700 on average per adviser per year).

**d. Total Costs Associated with Burden Hours Requested**

Burden hours	Associated Cost
120	\$8,040
5,028	\$251,400
2,514	\$25,140
38,000	\$2,546,000
297,381	\$19,924,527
120	\$9,240
35,829	\$1,791,450
<u>378,992</u>	<u>\$24,555,797</u>

**13. Estimate of Total Cost Burden**

The Commission estimates that there are four additional initial cost burdens for the rule, excluding any cost of the burden hours as identified in Item 12 above.

**a. Professional fees for preparation of disclosure statement**

i. Advisers initially relying on the rule per year	24
ii. Cost burden per adviser	\$1,200
iii. Initial cost burden	<u>\$28,800</u>

**b. Printing and distributing prospective disclosure statement**

i. Accounts initially subject to the rule	50,280
ii. Cost burden per account	\$1.50
iii. Initial cost burden	<u>\$75,420</u>

**c. Reprogramming computer systems to generate trade-by-trade confirmations**

i. Advisers initially relying on the rule per year	24
ii. Cost burden per adviser	\$20,000
iii. Initial cost burden	<u>\$480,000</u>

**d. Programming computer systems to generate annual principal transactions report**

i. Advisers initially relying on the rule per year	24
ii. Cost burden per adviser	\$10,000
iii. Initial cost burden	<u>\$240,000</u>

**e. Total Additional Cost Burden Estimate**

\$28,800
\$75,420
\$480,000
\$240,000
<u>\$824,220</u>

The total additional costs, expressed on a per-eligible-adviser basis, are therefore approximately \$2,169 per eligible adviser (\$824,220 divided by the estimated 380 advisers that will rely on rule 206(3)-3T).

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

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

**15. Explanation of Changes in Burden**

We have reduced the estimated hour burden from 494,440 hours to 378,992 hours to reflect that not all advisers eligible to rely on rule 206(3)-3T will incur certain initial

(as opposed to annual, or ongoing) burdens. Advisers relying on rule 206(3)-3T already have incurred these initial burdens, and generally will incur in the future only the annual burdens. Firms that do not rely on the rule but who choose to do so in the future will incur both initial and annual burdens. The number of responses per investment adviser and the number of hours per response have not changed since the previous estimate. We revised the costs discussed in Item 13 above -- reducing the costs from \$13,050,300 to \$824,220 -- for the same reason.

**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.