

SUPPORTING STATEMENT REVISIONS TO 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 204-2² 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.

On November 19, 2010, the Commission proposed amendments to rule 204-2 as part of a broader set of proposed new rules and rule and form amendments meant to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).⁴ The

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 Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3110 (Nov. 19, 2010) [75 FR 77052 (Dec. 10, 2010)] (“Implementing

Commission adopted the amendments on June 22, 2011.⁵ Specifically, the Commission amended rule 204-2 to update the rule’s “grandfathering provision” for investment advisers that are currently exempt from registration under the “private adviser” exemption, but will be required to register when the Dodd-Frank Act’s elimination of the “private adviser” exemption in section 203(b)(3) of the Advisers Act becomes effective on July 21, 2011.⁶ Under the amended grandfathering provision, an adviser that was exempt from registration under section 203(b)(3) of the Advisers Act prior to July 21, 2011 is not required to maintain certain books and records concerning performance or rate of return of a private fund or other account for any period the adviser was not registered with the Commission.

2. Purpose of the Information Collection

The purpose of the information collection in rule 204-2 is to assist the Commission’s examination and oversight program in determining compliance with the Advisers Act and rules. 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.⁷

The purpose of our amendment to the grandfathering provision in rule 204-2 is to assure

Proposing Release”); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁵ See *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011) (“Implementing Adopting Release”).

⁶ See Section 403 of the Dodd-Frank Act (eliminating the current “private adviser” exemption in section 203(b)(3) of the Advisers Act [15 U.S.C. 80b-3(b)(3)]). The Commission also adopted a technical amendment to rule 204-2(e)(3)(ii) to cross-reference the new definition of “private fund” added to the Advisers Act by the Dodd-Frank Act where that term is used in rule 204-2, and a technical amendment to rule 204-2(a)(14)(ii) to replace the term “assets under management” with the term “regulatory assets under management.” However, these amendments are technical, and will not increase or decrease the collection burden on advisers.

⁷ See section 210(b) of the Advisers Act [15 U.S.C. 80b-10(b)].

that advisers newly subject to the rule due to elimination of the “private adviser” exemption in existing section 203(b)(3) do not face a retroactively-imposed recordkeeping requirement.

However, the amended grandfathering provision requires these advisers to continue to preserve any books and records in their possession that pertain to the performance or rate of return of a private fund or other account for the two and five year periods otherwise required by the rule.

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, will 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 adopted rule amendments are not duplicated elsewhere.

5. Effect on Small Entities

The requirements of the adopted amendments to rule 204-2 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 204-2. This is because small advisers usually have less complicated business practices, fewer employees and fewer clients, and therefore may be less likely to have to prepare the memoranda required by the rule.

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)].

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.⁹ This retention period has not been affected by the amendments to rule 204-2. 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

In the Implementing Release, the Commission requested public comment on the effect of information collections under these amendments. Commenters did not comment on the effect of the information collections under these amendments. 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 See *supra* note 3.

9. Payment 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.¹⁰

11. Sensitive Questions

None.

12. Estimate of Hour Burden

The total annual collection of information burden currently approved by OMB for rule 204-2 is 2,115,376 hours. This currently approved annual aggregate burden is based on an estimate of 11,658 registered advisers, or approximately 181.45 burden hours per registered adviser.

We do not believe that our amendment to the "grandfathering provision" in rule 204-2 will change our current approved average annual hourly burden per adviser under rule 204-2. Most, if not all, advisers likely gather the records and documents necessary to support the calculation of performance or rate of return as those records or documents are produced or at the time a calculation is made. However, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) of the Advisers Act will change our estimates of the total annual burden associated with the rule.¹¹ Specifically, we estimate that the Dodd-Frank Act will reduce the number of

¹⁰ See *supra* note 7.

¹¹ Section 410 of the Dodd-Frank Act has amended section 203A of the Advisers Act [15 U.S.C. 80b-3A] to create a new group of "mid-sized advisers" and shift primary responsibility for their regulatory oversight to the state securities authorities. It has accomplished this by prohibiting from registering with the Commission an investment adviser that is registered as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between \$25

registered advisers to 9,750.¹² Thus, we estimate that the total burden under amended rule 204-2 will be 1,769,138,¹³ a reduction of 346,238 hours.¹⁴

An adviser will likely use a combination of compliance clerks and general clerks to make and keep the information and records required under the rule. The Commission staff estimates the hourly wage for compliance clerks to be \$67 per hour, including benefits, and the hourly wage for general clerks to be \$50 per hour, including benefits.¹⁵ For each adviser 181.45 burden hours will be required to make and keep the information and records required under the rule. We anticipate that compliance clerks will perform an estimated 31.45 hours of this work, and clerical staff will perform the remaining 150 hours. The total cost per respondent therefore will be an estimated \$9,607.15,¹⁶ for a total burden cost of approximately \$93,669,713.¹⁷

13. Estimate of Total Annual Cost Burden

The reduction in the number of advisers subject to the rule will also reduce the total non-labor cost burden of the rule. The current approved non-labor cost burden associated with rule

million and \$100 million. In addition, as discussed above, section 403 of the Dodd-Frank Act eliminates the “private adviser” exemption in section 203(b)(3) of the Advisers Act.

¹² See Implementing Adopting Release, *supra* note 5, at n. 655 and accompanying text.

¹³ 9,750 registered advisers x 181.45 hours = approximately 1,769,138.

¹⁴ 2,115,376 hours – 1,769,138 hours = 346,238 hours.

¹⁵ 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 2010, 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.

¹⁶ (31.45 hours per compliance clerk x \$67) + (150 hours per clerical staff x \$50) = (\$2,107.15 + \$7,500) = \$9,607.15.

¹⁷ \$9,607.15 per adviser x 9,750 advisers = approximately \$93,669,713.

204-2 is \$34,965,063, or an average of approximately \$3,000 per adviser.¹⁸ Due to the reduction in the number of advisers subject to rule 204-2, we estimate that the new total non-labor cost burden will be \$29,250,000¹⁹ a reduction of \$5,715,063.²⁰

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

As discussed in Items 12 and 13 above, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) of the Advisers Act have caused us to reduce our estimates of the total annual burdens associated with the rule. We have reduced our estimate of the number of advisers subject to the rule from 11,658 to 9,750, resulting in commensurate reductions in our estimates of the total annual hour burden and total annual cost burden of 346,238 hours and \$5,715,063 respectively.

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.

¹⁸ \$34,965,063 / 11,658 advisers = approximately \$3,000.

¹⁹ 9,750 x \$3,000 = \$29,250,000.

²⁰ \$34,965,063 - \$29,250,000 = \$5,715,063.