

## SUPPORTING STATEMENT

### Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(d))

#### A. JUSTIFICATION

##### 1. Necessity of Information Collections

Pursuant to section 203A of the Investment Advisers Act of 1940 (“Advisers Act” or “Act”), an investment adviser that is regulated or required to be regulated as an investment adviser in the state in which it maintains its principal office and place of business is prohibited from registering with the Securities and Exchange Commission (“Commission” or “SEC”) unless that adviser has at least \$25 million in assets under management or advises a Commission-registered investment company. Advisers failing to meet either requirement are prohibited from registering with the Commission.<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>2</sup> amends section 203A to prohibit from Commission registration an adviser that: (i) has assets under management between \$25 million and \$100 million; (ii) is required to be registered as an investment adviser with the state in which it maintains its principal office and place of business; and (iii) if registered, would be subject to examination as an adviser by that state.<sup>3</sup> A mid-sized adviser that otherwise would be prohibited may register with the Commission if it would be required to register with 15 or more states.<sup>4</sup>

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<sup>1</sup> 15 U.S.C. 80b-3a.

<sup>2</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> See section 410 of the Dodd-Frank Act. The Commission also is adopting a rule that raises the threshold above which a mid-sized investment adviser must register with the Commission to \$110 million; but, once registered with the Commission, an adviser need not withdraw its registration until it has less than \$90 million of assets under management. Amended rule 203A-1(a)(1).

<sup>4</sup> See section 410 of the Dodd-Frank Act. A mid-sized adviser also will be required to register with the Commission if it is an adviser to a registered investment company or business development company under the Investment Company Act. *Id.*

Section 203A(c) of the Advisers Act authorizes the Commission to exempt an adviser from the prohibition on Commission registration if the prohibition would be “unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes” of section 203A of the Act.<sup>5</sup> Under this authority, the Commission adopted rule 203A-2 to provide certain types of advisers with exemptions from the prohibition on registration.

Rule 203A-2(e) currently provides that the prohibition on registration with the Commission does not apply to an investment adviser that is required to register in 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register in at least 25 states.<sup>6</sup> An investment adviser relying on this exemption also must: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with the required number of states; (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that it would be required by the laws of fewer than 25 states to register as an investment adviser with the state; and (iii) maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register for a period of not less than five years from the filing of a Form ADV relying on the rule.<sup>7</sup> The Commission recently amended the rule to align it with the Dodd-Frank Act’s multi-state exemption for mid-sized advisers by permitting all investment advisers required to

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<sup>5</sup> 15 U.S.C. 80b-3a(c).

<sup>6</sup> 17 CFR 275.203A-2(e)(1).

<sup>7</sup> 17 CFR 275.203A-2(e)(2)-(4). The five-year record retention period is a similar recordkeeping retention period as imposed on all SEC-registered advisers under rule 204-2 of the Adviser Act. See rule 204-2 (17 CFR 275.204-2).

register as advisers with 15 or more states to register with the Commission, and renumbered the rule as rule 203A-2(d).<sup>8</sup> The Commission also eliminated the cushion for advisers that must register with 25 to 30 states, and did not adopt a similar cushion for the 15-state threshold.<sup>9</sup> An investment adviser relying on this exemption is required to maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register for a period of not less than five years from the filing of a Form ADV relying on the rule.<sup>10</sup> The rule’s record maintenance requirement is a “collection of information” for Paperwork Reduction Act (“PRA”) purposes.<sup>11</sup>

Respondents to this collection of information are investment advisers required to register in 15 or more states absent the exemption that rely on rule 203A-2(d) to register with the Commission. The records kept by investment advisers in compliance with the rule are necessary for the Commission staff to use in its examination and oversight program.

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<sup>8</sup> Amended rule 203A-2(d). The adopting release is attached as Appendix A (“Appendix A”). We also note that amended rule 203A-2(d) permits an adviser to choose to maintain its state registrations and not switch to SEC registration. *See* amended rule 203A-2(d)(2) (adviser elects to rely on the exemption by making the required representations on Form ADV).

<sup>9</sup> Amended rule 203A-2(d).

<sup>10</sup> *See* amended rule 203A-2(d)(3). An investment adviser relying on this exemption also will continue to be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has reviewed applicable law and concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake on Schedule D to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser will be required by the laws of fewer than 15 states to register as an investment adviser with the state. *See* amended rule 203A-2(d)(2).

<sup>11</sup> The PRA burden for Form ADV reflects the required representations on Schedule D of Form ADV. *See* Appendix A, section VI.B.

The title of the new collection of information is: “Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(d)).” We have submitted this collection of information to OMB for review, and OMB has not yet assigned this collection a control number. 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. This collection of information will be found at 17 CFR 275.203a-2(d) (currently 17 CFR 275.203a-2(e)) and is mandatory to qualify for and maintain Commission registration eligibility under rule 203A-2(d) (currently rule 203A-2(e)). Responses provided to the Commission in the context of its examination and oversight program are generally kept confidential under section 210(b) of the Advisers Act.<sup>12</sup>

## **2. Purposes of Information Collection**

The information collected under rule 203A-2(d) permits the Commission’s examination staff to determine an advisers’ eligibility for registration with the Commission under this exemptive rule.

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

An investment adviser registering or registered with the Commission under rule 203A-2(d) is required to maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register for five years from the filing of a Form ADV.<sup>13</sup> Advisers are permitted to meet the recordkeeping obligation under the rule micrographically or electronically, and their storage of this required record in such media is governed by Advisers Act rule 204-2(g).<sup>14</sup>

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<sup>12</sup> 15 U.S.C. 80b-10(b).

<sup>13</sup> Amended rule 203A-2(d)(3).

<sup>14</sup> 17 CFR 275.204-2(g). Rule 204-2 requires that the record be arranged and indexed in a way that permits easy location, access, and retrieval of any particular record, 17 CFR

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

The recordkeeping requirement of rule 203A-2(d) is not duplicated elsewhere for investment advisers that must comply with this collection requirement.

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

The collection of information requirements are the same for all investment advisers registering or registered with the Commission, including those that are small entities. Under section 203A, as amended by the Dodd-Frank Act, advisers with assets under management of less than \$100 million generally are not eligible to register with the Commission; however, under rule 203A-2(d), these entities, which include small entities, are permitted to register with the Commission if they meet the conditions of the rule. The recordkeeping requirement under the rule affects small advisers and larger advisers similarly, because the required information is about the adviser maintaining the records and about its regulatory requirements and business, which should be readily available to any adviser regardless of size. It would defeat the purpose of the rule to exempt small entities from these requirements. Moreover, although the records are mandatory, the rule is a permissive exemption. A small adviser can choose not to rely on the rule and thus not be subject to the collection of information.

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

An adviser registering with the Commission under rule 203A-2(d) is required to maintain a record of the states in which the investment adviser has determined it would,

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275.204-2(g)(2)(i)-(ii), and that the micrographic or electronic duplicate of the record be separately stored for five years, 17 CFR 275.204-2(g)(2)(iii). An investment adviser must establish and maintain procedures to keep the required records so as to reasonably safeguard the records from loss, alteration, or destruction; to limit access to the records to properly authorized personnel and the Commission; and to reasonably ensure any reproduction of a non-electronic original is complete, true, and legible when retrieved. See 17 CFR 275.204-2(g)(3).

but for the exemption, be required to register for a period of not less than five years from the filing of a Form ADV.<sup>15</sup> 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 period between examinations. If the required information is not collected, the Commission's examiners would not be able to verify that an investment adviser's reliance on rule 203A-2(d) in registering with the Commission was appropriate.

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

Rule 203A-2(d) includes a recordkeeping provision under which an adviser relying on the rule to register with the Commission is required to maintain certain information, specified more fully in Item 1 above, for five years. Although this period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), the long-term retention of these records is designed to contribute to the effectiveness of the Commission's examination and inspection program, and is necessary for the Commission's inspection program to determine compliance with the Advisers Act, including an adviser's continued eligibility to register with the Commission. 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 period between examinations.

#### **8. Consultations Outside of the Agency**

In its release proposing new rules and rule amendments to implement the Dodd-Frank Act, the Commission requested public comment on the effect of information collection under this rule. The comments received are discussed below in Item 12 in connection with the current estimates of the hour burden associated with rule 203A-2(d). In addition, the Commission and the staff of the Division of Investment Management

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<sup>15</sup> Amended rule 203A-2(d)(3).

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.

**9. Payment or Gifts to Respondents**

None.

**10. Assurances of Confidentiality**

Responses to the recordkeeping responses required under rule 203A-2(d) in the context of the Commission's examination and oversight program are generally kept confidential.<sup>16</sup>

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

As of April 7, 2011, there were approximately 40 advisers relying on the exemption under rule 203A-2(e).<sup>17</sup> Although it is difficult to determine a precise number of advisers that will rely on the exemption as amended because such reliance is entirely voluntary, we estimate that approximately 155 advisers will rely on the exemption.<sup>18</sup>

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<sup>16</sup> See Section 210(b) of the Advisers Act.

<sup>17</sup> Based on IARD data as of April 7, 2011, of the approximately 11,500 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule.

<sup>18</sup> Based on IARD data as of April 7, 2011, 100 of the advisers that have less than \$90 million of assets under management currently file notice filings with 15 or more states. This number may overestimate the number of advisers required to be registered with 15 or more states, and therefore eligible for the amended multi-state exemption, because

These advisers will incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold. These estimates are based on an estimate that each year an investment adviser will spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain these records.<sup>19</sup> Accordingly, the revised total initial and annual burden of the recordkeeping requirements of rule 203A-2(d) will be 1,240 hours (an additional 920 hours).<sup>20</sup>

As discussed in Item 15 below, these estimates are higher than the estimates the Commission established, and requested public comment on, in the release proposing new rules and rule amendments to implement the Dodd-Frank Act (“Proposing Release”). Comments we received related to these estimates pertained to costs associated with rule 203A-2(d), not costs associated with the rule’s collection of information requirements.<sup>21</sup>

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notice filing requirements may differ from registration requirements. In addition, we are unable to determine the number of advisers currently registered with the states that are registered with 15 or more states that may rely on the exemption and register with us. We expect this number to be small based on the scope of business of an adviser that has less than \$25 million in assets under management and because section 222(d) of the Advisers Act provides a de minimis exemption for limited state operations without registration. For purposes of this analysis, we estimate the number is 15. As a result, we estimate that approximately 155 advisers will rely on the exemption (40 currently relying on it + estimated 100 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

<sup>19</sup> 0.5 hours x 15 states = 7.5 hours + 0.5 hours = 8 hours.

<sup>20</sup> 155 advisers relying on the exemption x 8 hours = 1,240 hours. 1,240 new burden hours – 320 current burden hours = 920 additional burden hours.

<sup>21</sup> Commenters generally agreed with the Commission’s proposal to align the multi-state exemption for small advisers with the statutory exemption for mid-sized advisers. A few, however, recommended a lower threshold of required state registrations for eligibility for the multi-state exemption, but the Commission has determined not to lower the threshold further in light of the Congressional determination to set the threshold at 15 states and the



We anticipate that investment advisers will likely utilize senior operations managers to maintain the required records. The Commission estimates the hourly wage rate for a senior operations manager to be \$331 per hour, including benefits.<sup>22</sup> Each adviser relying on the exemption will incur average initial and annual recordkeeping costs associated with rule 203A-2(d) of \$2,648 per adviser.<sup>23</sup> The Commission staff estimates that the total recordkeeping costs will be approximately \$410,440 per year (an additional \$304,520).<sup>24</sup>

### **13. Estimate of Total Annual Cost Burden**

Excluding the burden hours identified in Item 12, the collection of information requirement for rule 203A-2(d) is not expected to impose additional non-labor or capital costs. The Commission anticipates that most advisers registering under the rule will generate the necessary records in the ordinary conduct of their advisory businesses.

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

There are no costs to the federal government directly attributable to rule 203A-2(d).

### **15. Explanation of Changes in Burden**

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Commission's stated purpose to align the rule with the Dodd-Frank Act. See Appendix A, notes 659-660 and accompanying text for additional examples of public comments relating to rule 203A-2.

<sup>22</sup> Data from the Securities Industry Financial Markets Association's *Management & Professional Earnings in the Securities Industry 2010*, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the hourly rate for this position is \$331.

<sup>23</sup> 8 hours x \$331 = \$2,648.

<sup>24</sup> [115 advisers newly relying on the exemption x \$2,648] + [40 advisers currently relying on the exemption x \$2,648] = \$304,520 + \$105,920 = \$410,440.

The estimated annual aggregate burden of 1,240 represents an increase of 40 hours from the Commission established, and requested comment on, in the Proposing Release, based on an increase in the estimated number of investment advisers that will rely on amended 203A-2(d).

**16. Information Collections Planned for Statistical Purposes**

Not applicable.

**17. Approval to Display Expiration Date**

Not applicable.

**18. Exception to Certification Requirement**

Not applicable.

**B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS**

Not applicable.