SUPPORTING STATEMENT
for the Paperwork Information Collection
"Rule 3a-4"

A. JUSTIFICATION

1. Information Collection Necessity

Rule 3a-4 (17 CFR 270.3a-4) under the Investment Company Act of 1940 (15 U.S.C. 80a) ("Investment Company Act" or "Act") provides a nonexclusive safe harbor from the definition of investment company under the Act for certain investment advisory programs. These programs, which include "wrap fee" and "mutual fund wrap" programs, generally are designed to provide professional portfolio management services to clients who are investing less than the minimum usually required by portfolio managers but more than the minimum account size of most mutual funds. Under wrap fee and similar programs, a client's account is typically managed on a discretionary basis according to pre-selected investment objectives. Clients with similar investment objectives often receive the same investment advice and may hold the same or substantially similar securities in their accounts. Some of these investment advisory programs may meet the definition of investment company under the Act because of the similarity of account management.

In 1997, the Commission adopted rule 3a-4, which clarifies that programs organized and operated in a manner consistent with the conditions of rule 3a-4 are not required to register under the Investment Company Act or comply with the Act's requirements.[1] These programs differ from investment companies because, among other things, they provide

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1 Status of Investment Advisory Programs Under the Investment Company Act of 1940, Investment Company Act Release No. 22579 (Mar. 24, 1997) (62 FR 15098 (Mar. 31,1997)) ("Adopting Release"). In addition, there are no registration requirements under section 5 of the Securities Act

individualized investment advice to the client. The rule's provisions have the effect of ensuring that clients in a program relying on the rule receive advice tailored to the client's needs.

For a program to be eligible for the rule's safe harbor, each client's account must be managed on the basis of the client's financial situation and investment objectives and consistent with any reasonable restrictions the client imposes on managing the account. When an account is opened, the sponsor[2] (or its designee) must obtain information from each client regarding the client's financial situation and investment objectives, and must allow the client an opportunity to impose reasonable restrictions on managing the account.[3] In addition, the sponsor (or its designee) must contact the client annually to determine whether the client's financial situation or investment objectives have changed and whether the client wishes to impose any reasonable restrictions on the management of the account or reasonably modify existing restrictions. The sponsor (or its designee) must also notify the client quarterly, in writing, to contact the sponsor (or its designee) regarding changes to the client's financial situation, investment objectives, or restrictions on the account's management.[4]

The program must provide each client with a quarterly statement describing all activity in the client's account during the previous quarter. The sponsor and personnel of the client's account manager who know about the client's account and its management must be reasonably available to

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of 1933 for these programs. *See* 17 CFR 270.3a-4, introductory note.

2 For purposes of rule 3a-4, the term "sponsor" refers to any person who receives compensation for sponsoring, organizing or administering the program, or for selecting, or providing advice to clients regarding the selection of, persons responsible for managing the client's account in the program.

3 Clients specifically must be allowed to designate securities that should not be purchased for the account or that should be sold if held in the account. The rule does not require that a client be able to require particular securities be purchased for the account.

4 The sponsor also must provide a means by which clients can contact the sponsor (or its designee).

consult with the client. Each client also must retain certain indicia of ownership of all securities and funds in the account.

2. Information Collection Purpose

The requirement that the sponsor (or its designee) obtain information about each new client's financial situation and investment objectives when their account is opened is designed to ensure that the investment adviser has sufficient information regarding the client's unique needs and goals to enable the portfolio manager to provide individualized investment advice. The sponsor is required to contact clients annually and provide them with quarterly notices to ensure that the sponsor has current information about the client's financial status, investment objectives, and restrictions on management of the account. Maintaining current information enables the portfolio manager to evaluate each client's portfolio in light of the client's changing needs and circumstances. The requirement that clients be provided with quarterly statements of account activity is designed to ensure each client receives an individualized report, which the Commission believes is a key element of individualized advisory services.

3. Information Technology Role

Rule 31a-2(f) under the Act permits investment companies to maintain many types of records (and produce them for the Commission's examination as necessary) on magnetic tape, disk, or other computer storage media. Quarterly statements to clients are generally in paper form and are mailed to clients, and quarterly notices must be provided in writing. However, rule 3a-4 gives sponsors flexibility in the manner in which they comply with the requirements for annual client contact. The Adopting Release specifically notes that annual client contact may be made "in person, by telephone, or by letter or electronic mail that includes a questionnaire requesting the client to provide or update relevant information."[5]

4. Duplication

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or a change in a rule. Rule 3a-4 does not require duplicative reporting or recordkeeping.

5. Effect on Small Entities

The Commission does not believe that compliance with rule 3a-4 is unduly burdensome for large or small entities. The rule's requirements are consistent with providing individualized investment advice.[6] Moreover, sponsors that find the requirements of the rule to be overly burdensome are not required to operate their investment advisory programs in reliance on the safe harbor provided by the rule. Failure to operate an investment adviser program in accordance with rule 3a-4 does not necessarily indicate that the program is an investment company.

6. Consequences of Less Frequent Collection

Rule 3a-4's requirement for sponsors to obtain information regarding each new client's financial situation and investment goals is a one-time obligation incurred when a new client opens an account. The requirements for annual and quarterly client contact reflect the view that without regular contact with clients, portfolio managers are unlikely to have current information regarding each client's financial situation and investment objectives, which the managers need in order to provide individualized investment advice. The requirement for quarterly account activity

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5 *See* Adopting Release, *supra* note 1, at text following n.36.

6 Rule 3a-4 is also consistent with a series of no-action letters the Commission issued from 1982 until the rule's adoption in March 1997. Compliance with the rule generally should not be burdensome to those sponsors that operated their programs in a manner consistent with these previously issued no-action positions. In addition, sponsors typically already provide quarterly statements to clients, so the burden of the quarterly activity report is likely to be less for sponsors.

statements also enables the portfolio manager to be familiar with the client's account and its management. This requirement also provides current information to clients about their accounts, which might prompt them to update the sponsor regarding changing financial situations or goals.

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

None.

8. Consultation Outside the Agency

The Commission proposed rule 3a-4 for public comment before its adoption and made rule changes based on the comments it received from the public.[7] The Commission requested public comment on the collection of information requirements in rule 3a-4 before it submitted this request for extension and approval to OMB. The Commission received no comments in response to this request.

The Commission and staff of the Division of Investment Management also participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and informal exchanges. These forums provide the Commission and the staff useful means to identify and address paperwork burdens that may confront the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

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[7] *See* Investment Company Act Release No. 20260 (July 27, 1995), (60 FR 39574 (Aug. 2, 1995)) (proposing release); Adopting Release, *supra* note 1.

12. Estimate of Time Burden

The Commission staff estimates that 11,291,005 clients participate each year in investment advisory programs relying on rule 3a-4. Of that number, the staff estimates that 903,280 are new clients and 10,387,725 are continuing clients.[8] The staff estimates that each year under the rule, investment advisory program sponsors engage in the following collections of information and associated burden hours:[9]

- To prepare, conduct and/or review initial interviews with new clients:
  1.3 hours: 70 minutes of professional time;
  10 minutes of staff time.

- To prepare, conduct and/or review annual interviews with continuing clients:
  1 hour: 50 minutes of professional time;
  10 minutes of staff time.

- To prepare and mail each quarterly client account statement, including the notice to update information:
  15 minutes: 15 minutes of staff time.[10]

Based on the estimates above, the Commission estimates that the total annual burden of the rule's paperwork requirements is 22,852,994 hours.[11] We estimate that professional staff performs

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8 These estimates are based on an analysis of information filed on Form ADV and available industry data on investment advisers and wrap accounts. *See, e.g.,* Cerulli Associates, *The Cerulli Edge: Managed Accounts Edition, Channel Analysis; IBDs and TPVs Issue* at 10, 12-14 (4th quarter 2008).

9 These estimates are based upon consultation with investment advisers that operate investment advisory programs that rely on rule 3a-4.

10 The staff bases this estimate in part on the fact that, by business necessity, computer records already will be available that contain the information in the quarterly reports.

11 This estimate is based on the following calculation: (10,387,725 continuing clients x 1 hour) + (903,280 new clients x 1.3 hours) + (11,291,005 total clients x (0.25 hours x 4 statements)) = 22,852,994 hours.

9,823,174 of these burden hours at a total cost of $1.1 billion,[12] while support staff performs 13,029,820 of these burden hours at a total cost of $678 million.[13] Thus, the Commission estimates the aggregate annual cost of the burden hours associated with rule 3a-4 is $1.8 billion.[14]

The estimate of average burden hours is made solely for the purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of Commission rules.

13. Annual Cost Burden Estimate

Rule 3a-4 does not impose any paperwork related cost burden not discussed in item 12 above. We expect that sponsors mail quarterly account statements to their clients in the ordinary course of their business and therefore we do not believe the requirement in rule 3a-4 to mail quarterly client account statements or quarterly notices would impose additional postage or printing costs.

14. Cost to the Federal Government

The rule imposes no costs on the federal government.

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12 The professional staff estimates are based on the following calculations: 9,823,174 hours = (903,280 new clients x 1.1 hours) + (10,387,725 continuing clients x 0.85 hours); and 9,823,174 hours x $117/hour = $1,149,311,358. The per hour cost estimates are based on figures for operations specialist positions found in SIFMA's Management & Professional Earnings in the Securities Industry 2011, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

13 The support staff estimates are based on the following calculations: 13,029,820 hours = (903,280 new clients x 0.2 hour) + (10,387,725 continuing clients x 0.15 hours) + (11,291,005 total clients x (0.25 hours x 4 statements); and 13,029,820 hours x $52/hour = $677,550,640. The per hour cost estimates are based on figures for general clerk positions found in SIFMA's Office Salaries in the Securities Industry 2011, modified to account for an 1800-hour work year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

14 This estimate is based on the following calculation: $1,826,861,998 = $1,149,311,358 + $677,550,640.

15. Changes in Burden

The total annual hour burden of 22,852,994 hours represents an increase of 17,245,466 hours from the prior estimate of 5,607,528 hours. This increase principally results from an increase in the estimated number of clients, which was due to a change in the way the staff has made its estimates. The change in annual burden hours also reflects changes in the estimated burden hours associated with several of the collections of information required under the rule (certain burden estimates increased and certain burden estimates decreased). These changes in estimated burden hours per collection of information result from changes in burden hours reported by representatives of investment advisers that rely on rule 3a-4 that Commission staff surveyed.

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.