

**SUPPORTING STATEMENT**  
**Rule 204A-1**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 204A of the Investment Advisers Act of 1940 (“Advisers Act” or “Act”) gives the Securities and Exchange Commission (“Commission”) authority to adopt rules to require policies and procedures designed to prevent misuse of material, nonpublic information. The Commission adopted rule 204A-1 under the Advisers Act to require SEC-registered investment advisers to adopt codes of ethics.<sup>1</sup> An adviser’s code of ethics must set forth standards of conduct expected of personnel of the adviser, and address conflicts that arise from personal trading by personnel of the adviser.

Each adviser’s code of ethics is required to (i) set forth standards of conduct expected of advisory personnel (including compliance with the federal securities laws); (ii) safeguard material nonpublic information about client transactions; and (iii) require the adviser’s “access persons” to report their personal securities transactions. The code of ethics also requires access persons to obtain the adviser’s approval before investing in an initial public offering (“IPO”) or private placement. The code of ethics also requires prompt reporting, to the adviser’s chief compliance officer or another person designated in the code of ethics, of any violations of the code. Finally, the code of ethics requires the adviser to provide each supervised person with a copy of the code and any amendments, and require the supervised persons to acknowledge, in writing, their receipt of these copies.

The collection of information under rule 204A-1 is necessary to establish and maintain standards of business conduct for supervised persons of investment advisers and to facilitate

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<sup>1</sup> 17 CFR 275.204A-1.

investment advisers' efforts to prevent fraudulent personal trading by their supervised persons. The collection of information is mandatory. The respondents are investment advisers registered with the Commission, and certain of their supervised persons who must submit reports of their personal trading activities to their firms. These investment advisers use the information collected to control and assess the personal trading activities of their supervised persons. Responses to the reporting requirements will be kept confidential to the extent each investment adviser provides confidentiality under its particular practices and procedures.

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

The purposes of the information collection requirements in rule 204A-1 are to (i) ensure that advisers maintain codes of ethics applicable to their supervised persons; (ii) provide advisers with information about the personal securities transactions of their access persons for purposes of monitoring such transactions; (iii) provide advisory clients with information with which to evaluate advisers' codes of ethics; and (iv) assist the Commission's examination staff in assessing the adequacy of advisers' codes of ethics and assessing personal trading activity by advisers' supervised persons.

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

The Advisers Act permits advisers to maintain required records through electronic media.<sup>2</sup> The rule does not require the reporting of any information to, or the filing of any documents with, the Commission. Therefore, the Commission's uses of computer technology in its various electronic filing systems will be of no effect.

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<sup>3</sup> 17 CFR 270.17j-1

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

The rule requires access persons of investment advisers to report basic information about their personal securities trading activities. Access persons of advisers who manage portfolios for investment companies are subject to requirements under rule 17j-1 under the Investment Company Act of 1940 (the “Investment Company Act”) to report basic information about their personal securities trading activities.<sup>3</sup> Rule 17j-1 contains provisions designed to prevent access persons from filing personal securities transactions reports under rule 17j-1 if such reports would duplicate personal securities transaction information that is required to be recorded under Advisers Act rule 204-2(a)(13).<sup>4</sup> Rule 204A-1 is designed to coordinate with, rather than conflict with or duplicate, the requirements of rule 17j-1.

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

The requirements for rule 204A-1 are the same for all investment advisers registered with the Commission. It would defeat the purpose of the rule to exempt small entities from these requirements. However, small entities that have only one supervised person are exempted from the requirement for access person securities reporting and IPO and limited offering preclearance. The rule also affords advisers the flexibility to tailor a code of ethics that fits the nature of their business. Small firms, which generally have less complex and more limited operations, likely need less complex codes than their larger counterparts.

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

Less frequent information collection would be incompatible with the objectives of the rule. For instance, it could delay detection of improper personal securities transactions by access

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<sup>3</sup> 17 CFR 270.17j-1

<sup>4</sup> 17 CFR 275.204-2(a)(13) requires that registered investment advisers make and keep books related to information required by rule 204A-1.

persons and may not allow advisers to identify conflicts of interest that access persons may have with advisory clients.

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

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

**8. Consultations 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. The Commission requested public comment on the collection of information requirements in rule 204A-1 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to this request.

**9. Payment or Gift to Respondents**

Not applicable.

**10. Assurances of Confidentiality**

Responses from access persons to the reporting requirements under rule 204A-1 are kept confidential to the extent each investment adviser provides confidentiality under its particular practices and procedures. If information collected pursuant to the rule is reviewed by the Commission's examination staff, it will be accorded the same level of confidentiality accorded to other responses provided to the Commission in the context of its examination and oversight program.<sup>5</sup>

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<sup>5</sup> See section 210(b) of the Advisers Act (15 U.S.C. 10(b)).

**11. Sensitive Questions**

Not applicable.

**12. Estimates of Hour Burden**

Rule 204A-1 requires SEC-registered investment advisers to establish a written code of ethics for their supervised persons. We estimate that each adviser would be required to spend 6 hours annually, on average, documenting its code of ethics. In preparing this estimate, we have taken into account that investment advisers currently maintain certain policies and procedures that could serve as the core of their codes of ethics. For instance, advisers are required to maintain written policies and procedures reasonably designed to prevent the misuse of material nonpublic information, to keep records of their advisory representatives' personal securities transactions, adopt policies and procedures reasonably designed to prevent their supervised persons from violating the Advisers Act, and advisers who advise investment companies have codes of ethics pursuant to Investment Company Act rule 17j-1. There are approximately 10,643 investment advisers registered with the Commission that we estimate will incur this burden, for a total of 63,858 hours.<sup>6</sup>

Rule 204A-1 also requires each adviser's code of ethics to include provisions under which the adviser's access persons report their personal securities transactions and holdings to the adviser. For purposes of estimating the paperwork burden for access persons under rule 204A-1, we assume that advisers will treat all their non-clerical employees as access persons.<sup>7</sup> We continue to estimate that investment advisers have 84 non-clerical employees on average, although this estimate likely overstates the number of such employees at the majority of advisory

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<sup>6</sup> 10,643 advisers x 6 hours = 63,858 total annual hours.

<sup>7</sup> We are aware that many investment advisers currently elect to treat all employees as "advisory representatives" or access persons for purposes of personal securities reporting under Advisers Act rule 204-2(a)(12) and Company Act rule 17j-1, respectively.

firms. Based on this average, we estimate that 894,012 access persons would be subject to the collection of information under the rule.<sup>8</sup>

These access persons are required to file an initial report of their personal securities holdings upon becoming access persons, and an annual holdings report at least once a year thereafter. We estimate access persons would spend 0.7 hours on average completing each such report. Access persons also are required to file transaction reports once each quarter stating whether they had any personal securities transactions during such quarter and providing basic information about any such transactions. We estimate access persons would spend 0.6 hours on average completing such reports each year.<sup>9</sup> Thus, the total annual burden hours for all access persons under the rule would be 1,162,216 hours.<sup>10</sup>

Rule 204A-1 also requires each adviser's code of ethics to include provisions under which the adviser provides each supervised person with a copy of the code of ethics and any amendments, and obtains written acknowledgment of receipt from the supervised person. We continue to estimate that each investment adviser has 100 supervised persons on average, although this estimate overstates the number of supervised persons at the majority of advisory firms, and that each adviser will be required to provide a copy and obtain an acknowledgment 55 times each year, on average. This is based on our estimate that advisers will amend their codes

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<sup>8</sup> 84 access persons x 10,643 investment advisers = 894,012.

<sup>9</sup> In preparing this 0.6 hour annual estimate, we assumed access persons would have no transactions to report for three quarters each year (at 0.1 hours to complete each report affirming no activity) and one transaction to report one quarter each year (at 0.3 hours to complete such report listing the transaction).

<sup>10</sup> (0.7 hours holdings report + 0.6 hours transactions report) x 894,012 access persons = 1,162,216 hours.

every other year and hire five new supervised persons each year.<sup>11</sup> We further estimate each iteration will take an investment adviser 0.05 hours on average, for an annual burden of 2.75 hours per adviser and a total burden of 29,268 hours for all advisers.<sup>12</sup>

Based on these estimates, the total annual burden for advisers and access persons under rule 204A-1 would be 1,255,342 hours.<sup>13</sup> The total number of respondents would be 904,655,<sup>14</sup> and the total annual responses would be 2,958,754.<sup>15</sup> Compliance professionals and clerical staff are likely to record and prepare and deliver copies of the codes of ethics and amendments. Accordingly, we estimate the annual cost to each respondent for this aspect of the rule to be \$1,817 (6 hours of professional time to record the code of ethics at \$279 per hour (approx. \$1,674),<sup>16</sup> and 2.75 hours of clerical time to deliver codes of ethics and amendments at \$52 per

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<sup>11</sup> Over any two-year period, 100 copies of amendments for all 100 supervised persons in year 1 + 10 copies of complete code for new supervised persons in year 1 through 2 = 110 copies, divided by 2 years = 55 copies.

<sup>12</sup> 0.05 hours per copy x 55 copies per year = 2.75 hours. 2.75 hours x 10,643 investment advisers = 29,268 hours total.

<sup>13</sup> 63,858 hours by advisers to record their codes of ethics + 1,162,216 hours for reporting by access persons + 29,268 hours for advisers to deliver copies of codes and amendments = 1,255,342.

<sup>14</sup> Under 3235-0596 as currently approved, investment advisers themselves are respondents, as are non-clerical employees who are deemed access persons for purposes of the PRA analysis and are required to submit reports of their personal securities transactions to their investment adviser for monitoring purposes. Each investment adviser has, on average, 84 non-clerical employees.  $10,643 + (10,643 \times 84) = 904,655$ .

<sup>15</sup> Under 3235-0596 as currently approved, each investment adviser is estimated to deliver its code of ethics to an average of 55 supervised persons each year, and these supervised persons are required to return written acknowledgements of receipt, for a total of 110 annual responses per adviser. In addition, an average of 84 access persons of each adviser are required to submit an average of 2 personal securities transactions reports to their adviser, for a total of 168 annual responses per adviser.  $10,643 \times (110 + 168) = 2,958,754$ .

<sup>16</sup> Data from the Securities Industry and Financial Markets Association's Report on Management & Professional Earnings in the Securities Industry 2011 suggest that the cost for a Compliance Manager is approximately \$279 per hour.

hour (approx. \$143)),<sup>17</sup> for an annual cost of \$19,338,331.<sup>18</sup> Access persons are responsible for filing their initial holdings reports and transaction reports. Accordingly, we estimate the annual cost to each adviser for this aspect of the rule to be \$7,753 (((0.7 hours holdings report + 0.6 hours transactions report) x 84 access persons) x \$71 per hour),<sup>19</sup> for an annual cost of \$82,515,179.<sup>20</sup> The grand total estimated annual cost of rule 204A-1 is \$101,853,510.<sup>21</sup>

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

\$0

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

There are no additional costs to the federal government.

**15. Explanation of Changes in Burden**

We have revised the estimated burden based on new information on the number of SEC-registered investment advisers that we obtained from Form ADVs filed through the IARD. The number of responses per investment adviser and the number of hours per response have not changed since the last estimate. The decrease in hour burden is due to a decrease in the estimated number of respondents.

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

Not applicable.

**17. Approval to not Display Expiration Date**

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<sup>17</sup> Data from the Securities Industry and Financial Markets Association's Report on Office Salaries in the Securities Industry 2011 ("SIFMA Office Report") suggest that the cost for a General Clerk is approximately \$52 per hour.

<sup>18</sup>  $\$1,817 \times 10,643 = \$19,338,331$ .

<sup>19</sup> Data from the SIFMA Office Report suggest that the cost for a Senior Retail Sales Assistant is approximately \$71 per hour.

<sup>20</sup>  $\$7,753 \times 10,643 = \$82,515,179$ .

<sup>21</sup>  $\$82,515,179 + \$19,338,331 = \$101,853,510$ .



Not applicable.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.