

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission for**  
**“Rule 204-3”**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Rule 204-3, the “brochure rule,” requires an investment adviser to deliver their brochure and brochure supplements to their new clients or prospective clients before or at the start of the advisory relationship and to deliver annually thereafter the full updated brochure or a summary of material changes to their brochure. The rule also requires that advisers deliver an amended brochure or brochure supplement (or just a statement describing the amendment) to clients only when disciplinary information in the brochure or supplement becomes materially inaccurate. The brochure assists the client in determining whether to retain, or continue employing, the adviser. Advisers registered with the Commission are required to prepare and electronically file firm brochures through the Investment Adviser Registration Depository (“IARD”).

Rule 204-3 contains a collection of information titled “Rule 204-3 under the Investment Advisers Act of 1940,” found at 17 CFR 275.204-3, which is mandatory. Its currently approved OMB control number is 3235-0047. An agency may not sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The likely respondents to this information collection are investment advisers registered with the Commission.

The collection of information the brochure rule requires is necessary for several reasons. It enables the client or prospective client to evaluate the adviser’s background and qualifications, and to determine whether the adviser’s services and practices are

appropriate for that client. It informs the client of the nature of the adviser's business, which may inform or limit the client's rights under the advisory contract. It apprises the client of situations in which the interests of the adviser may potentially be adverse to or in conflict with those of the client. Under some circumstances, it enables the client to consider the financial condition of the adviser in deciding whether to entrust funds or securities to the custody of the adviser or whether to pay large advisory fees in advance. The information that Rule 204-3 requires to be contained in the brochure is also used by the Commission and staff in its enforcement, regulatory, and examination programs. Responses are not kept confidential.

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

Investors need accurate information about an investment adviser and its practices in order to determine whether to retain, or to continue to employ, that adviser. The Commission and staff need the information in its enforcement, regulatory, and examination programs.

## **3. Consideration Given to Information Technology**

The Commission's use of computer technology in connection with this information collection, which has been previously approved by OMB, has not changed. The Commission currently permits advisers to satisfy their obligations under this collection of information by delivering Part 2 of Form ADV electronically with client consent.<sup>1</sup>

## **4. Duplication**

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<sup>1</sup> See Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Investment Advisers Act Release No. 1562 (May 9, 1996) (61 FR 24644 (May 15, 1996)) (publishing Commission interpretive guidance with respect to use of electronic media to fulfill investment advisers' disclosure delivery obligations).

The collection of information requirements of rule 204-3 are not duplicated elsewhere.

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

The requirements of rule 204-3 are the same for all investment advisers registered with the Commission, including those that are small entities.<sup>2</sup> To some extent small advisers may have lesser burdens under rule 204-3. This is because small advisers usually have less complicated business practices, fewer employees, and fewer clients, and therefore their brochures and brochure supplements would be shorter, and would be delivered to fewer clients.

#### **6. Consequences of Not Conducting Collection**

The collection of information required by the rule is necessary to protect investors by providing clients and potential clients with information about the adviser, its business, and its conflicts of interest. The consequences of not collecting this information would be that clients and prospective clients may not have the information they need in order to evaluate the adviser's business practices and to determine whether to select or retain that adviser.

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

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

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<sup>2</sup> Under Advisers Act rule 0-7, for purposes of the Regulatory Flexibility Act an investment adviser generally is a small entity if it: (i) Has assets under management 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 total assets of \$5 million or more on the last day of its most recent fiscal year.

**8. Consultation Outside 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 204-3 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**

None.

**10. Confidentiality**

The information collected pursuant to rule 204-3 is by delivery of brochures and brochure supplements to advisory clients and prospective clients. These disclosures are not kept confidential.

**11. Sensitive Questions**

Not applicable.

**12. Burden of Information Collection**

Rule 204-3, the “brochure rule,” requires an investment adviser to deliver their brochure and brochure supplements to their new clients or prospective clients before or at the start of the advisory relationship and to deliver annually thereafter the full updated brochure or a summary of material changes to their brochure. The rule also requires that

advisers deliver an amended brochure or brochure supplement (or just a statement describing the amendment) to clients only when disciplinary information in the brochure or supplement becomes materially inaccurate.

The total annual burden currently approved by OMB for rule 204-3 is 386,098 hours. This currently approved burden is based on 11,658 advisers registered with the Commission having, on average, an estimated 1,300 clients each. Our records now indicate that the 10,754 advisers registered with the Commission have, on average, an estimated 1,200 clients.<sup>3</sup> We are updating and revising the total collection of information burden based upon new data.<sup>4</sup>

We expect that advisers will send their brochure or summary of material changes annually in a “bulk mailing” to clients that may include clients’ account statements, periodic reports, or other important documents. We continue to estimate that, with a bulk mailing, an adviser will require no more than 0.02 hours to send the adviser’s brochure or summary of material changes to each client, or an annual burden of 24 hours per adviser.<sup>5</sup>

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<sup>3</sup> This average is based on advisers’ responses to Item 5.C.(1) of Part 1A of Form ADV as of January 2, 2013, excluding the three advisers that reported the largest number of clients. Those advisers provide advisory services primarily over the Internet and currently meet their brochure obligations electronically, thus essentially entirely eliminating for these advisers any PRA burden associated with delivery under this rule. Therefore, we believe that it is appropriate to exclude these firms from our calculations.

<sup>4</sup> The data are collected from the Form ADVs filed through the IARD system as of January 2, 2013.

<sup>5</sup> (0.02 hours per client x 1,200 clients per adviser based on IARD data as of January 2, 2013) = 24 hours per adviser. We note that the burden for *preparing* brochures is already incorporated into a separate burden estimate for Form ADV. Since we expect that most advisers will make their annual delivery as part of a mailing of an account statement or other periodic report they already make to clients, we estimate that the additional burden will be adding a few pages to the mailing.

Thus, we estimate the total burden hours for 10,754 advisers to distribute their firm brochure to clients annually to be 258,096 hours per year.<sup>6</sup>

Advisers are also required to distribute interim updates disclosing new or revised disciplinary information in their brochure or supplements. We anticipate that in any given year, the number of such interim updates that advisers will be required to deliver is approximately 538.<sup>7</sup> We further estimate that an adviser will require no more than 0.1 hours per client for delivery of each such update.<sup>8</sup> This represents about 120 hours per interim update.<sup>9</sup> Thus, the aggregate annual hour burden for affected advisers to deliver interim updates to their brochures or supplements will be approximately 64,560 hours per year.<sup>10</sup> We estimate that large advisers will need to design and implement systems to track changes in supervised persons providing investment advice to particular clients. We do not expect that such systems will be necessary for small advisers or medium

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<sup>6</sup> (0.02 hours per client x 1,200 clients per adviser) x 10,754 advisers based on IARD data as of January 2, 2013 = 258,096 hours.

<sup>7</sup> Of the advisers registered with the Commission, 15.4% report disciplinary events on their Form ADVs (as of January 2, 2013, only 1,656 of all 10,754 registered advisers indicated at least one “yes” answer to a question related to disciplinary events in Form ADV, Part 1A, Item 11). Thus, we anticipate that a correspondingly small number of advisers will be required to disclose new or updated disciplinary information. The Commission staff estimates that in any given year, 5% of advisers will be required to deliver a single interim update to each of their clients, resulting in a total of approximately 538 interim updates per year.  $0.05 \times 10,754 \times 1 \text{ update} = 538 \text{ updates}$ .

<sup>8</sup> This burden estimate relates only to the amount of time it will take advisers to *deliver* interim updates to clients, as required by the rule amendments. The burden for *preparing* interim updates is already incorporated into a separate burden estimate for Form ADV. Since this mailing may not be included with a mailing of a statement or other periodic report, we estimate that it will take slightly more time than to deliver the annual brochure or summary of material changes.

<sup>9</sup> 0.1 hours per client x 1,200 clients per adviser = 120 hours per update.

<sup>10</sup> 538 updates x 120 hours = 64,560 hours.

advisers.<sup>11</sup> We estimate that on average each of the 44 large advisers will spend 200 hours per year designing and implementing such systems, for a total of 8,800 hours per year.<sup>12</sup> Thus, rule 204-3 now results in a total collection of information burden of 331,456 hours per year, or 31 hours per adviser.<sup>13</sup> This includes estimated time for large advisers to design and implement systems to track that the right supplements are delivered to the right clients as personnel providing investment advice to those clients change. This represents a decrease of 54,642 hours from the currently approved PRA burden.<sup>14</sup> The decreased burden results primarily from a decrease in the number of advisers that are required to deliver their brochures, supplements and amendments. We estimate the burden associated with annual and interim delivery of brochures, supplements and the summary of material changes would represent an annual cost of \$17,235,712.<sup>15</sup>

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<sup>11</sup> For purposes of the estimates in this section, we have categorized small advisers as those with 10 or fewer employees, medium-sized advisers as those with between 11 and 1,000 employees, and large advisers as those with over 1,000 employees. According to IARD data, only 4% of medium advisers report in response to Item 5.B.(1) of Part 1A of Form ADV that more than 250 employees perform investment advisory functions.

<sup>12</sup> 44 large advisers x 200 hours per year per large adviser = 8,800 hours per year.

<sup>13</sup> 258,096 hours (initial and annual delivery) + 64,560 hours (interim delivery of updates to disciplinary information) + 8,800 (supplement tracking systems) = 331,456 hours. 331,456 hours / 10,754 advisers = 31 hours per adviser.

<sup>14</sup> 386,098 hours – 331,456 hours = 54,642 hours.

<sup>15</sup> Based on data from the Securities Industry and Financial Markets Association's *Office Salaries in the Securities Industry 2011*, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery requirements of rule 204-3 will most likely be performed by a clerk at an estimated cost for a general clerk of \$52 per hour. 331,456 hours x \$52 = \$17,235,712. We estimate that advisers will not incur any incremental postage costs in these mailings because we assume that advisers will mail annual summary of material changes with another mailing the adviser was already delivering to clients and that advisers were already delivering to clients disclosure of new material disciplinary events on an interim basis under rule 206(4)-4.

**13. Costs to Respondents**

There are no costs directly attributable to rule 204-3.

**14. Costs to the Federal Government**

There are no costs to the government directly attributable to rule 204-3.

**15. Changes in Burden**

The estimated total burden hours has decreased to 331,456 hours per year from the currently approved burden based on new information on the number of SEC-registered investment advisers that we obtained from Form ADVs filed through the IARD as of January 2, 2013.

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

Not applicable.

**17. Approval to Omit OMB Expiration Date**

Not applicable.

**18. Exceptions to Certification for Paperwork Reduction Act Submissions**

Not applicable.

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

Not applicable.