

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**RULE 206(4)-3**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Rule 206(4)-3 (17 CFR 275.206(4)-3) under the Investment Advisers Act of 1940, which is entitled “Cash Payments for Client Solicitations,” prohibits investment advisers from paying cash fees to solicitors for client referrals unless certain conditions are met. The rule requires that an adviser pay all solicitors’ fees pursuant to a written agreement that the adviser is required to retain.<sup>1</sup> When an adviser will provide only impersonal advisory services to the prospective client, the rule imposes no disclosure requirements. When the solicitor is affiliated with the adviser and the adviser will provide individualized advisory services to the prospective client, the solicitor must, at the time of the solicitation or referral, indicate to the prospective client that he is affiliated with the adviser. When the solicitor is not affiliated with the adviser and the adviser will provide individualized advisory services to the prospective client, the solicitor must, at the time of the solicitation or referral, provide the prospective client with a copy of the adviser's brochure and a disclosure document containing information specified in rule 206(4)-3.

Amendments to rule 206(4)-3, adopted in 2010 in connection with rule 206(4)-5, specify that solicitation activities involving a government entity, as defined in rule 206(4)-5, are subject to the additional limitations in rule 206(4)-5.

The information rule 206(4)-3 requires is necessary to inform advisory clients about the nature of the solicitor’s financial interest in the recommendation so the prospective clients may

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<sup>1</sup> Rule 204-2 requires advisers to keep records of documents required by Rule 206(4)-3. Accordingly, no

consider the solicitor's potential bias, and to protect clients against solicitation activities being carried out in a manner inconsistent with the adviser's fiduciary duty to clients. The likely respondents to this information collection would be each investment adviser registered with the Securities and Exchange Commission (the "Commission") that compensates a solicitor in cash for referrals.

Rule 206(4)-3 contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>2</sup> The title of this collection is "Rule 206(4)-3 under the Investment Advisers Act of 1940 (17 CFR 275.206(4)-3)" and the Commission submitted it to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. OMB approved this collection under control number 3235-0242 (expiring on November 30, 2015). 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.

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

Investors need accurate information about compensation arrangements between an investment adviser and a solicitor in order to determine whether to retain an adviser recommended by the solicitor.

## **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, would not change. Investment

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recordkeeping burdens are addressed by this supporting statement.

<sup>2</sup> 44 U.S.C. 3501 to 3520.

advisers are permitted to provide the information required by rule 206(4)-3 electronically.<sup>3</sup>

#### **4. Duplication**

No other rule requires investment advisers to provide clients or prospective clients with the same information that is required by rule 206(4)-3.

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

The requirements for rule 206(4)-3 are the same for all investment advisers registered with the Commission, including small entities. It would defeat the purpose of the rule to exempt small entities from these requirements. For purposes of Commission rulemaking, an investment adviser is a small business if it has assets under management of less than \$25 million and meets certain other requirements. Advisers with assets under management of less than \$25 million are eligible to register with the Commission only if they advise a registered investment company, are not regulated or required to be regulated as an investment adviser in the state in which they maintain their principal office and place of business, or are qualified under rule 203A-2.

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

Rule 206(4)-3 requires a solicitor to provide the required disclosure at the time of the solicitation or referral; without this information at the time of the solicitation or referral, the client would be unaware of the solicitor's financial interest in the recommendation.

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

Not applicable.

#### **8. Consultation Outside the Agency**

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<sup>3</sup> Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Investment Advisers Act Release No. 1562 (May 9, 1996).

The Commission and 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 staff with a means of ascertaining and acting upon paperwork burdens confronting the industry. In addition, the Commission requested public comment on the information collection requirements in rule 206(4)-3 before submitting 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**

Not applicable.

**10. Confidentiality**

The information collected pursuant to rule 206(4)-3 requires solicitors to provide information to advisory clients and prospective clients. Accordingly, these disclosures would not be kept confidential.

**11. Sensitive Questions**

No questions of a sensitive nature are asked. The information collection does not collect any Personally Identifiable Information (PII).

**12. Information Collection Burden**

We estimate that about 38% of the approximately 11,638 investment advisers registered with the Commission, or 4,422 advisers (11,638 x 38%) use rule 206(4)-3.<sup>4</sup> We estimate that the current estimate of 7.04 burden hours each year per respondent to comply with the rule will

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Estimate based on IARD data from Form ADV Item 8.H as of March 23, 2015.

continue, for a total of 31,130 hours (7.04 x 4,422). It is the experience of the Commission staff that the contract and solicitor disclosure documents used in compliance with the rule are generally quite brief and that on average not more than 11 referrals per adviser using the rule are made annually. We therefore estimate that compliance with the rule will result in 48,642 total annual responses (4,422 x 11). Compliance managers and clerical staff are likely to prepare and deliver these documents, and we estimate the hourly wage rate for compliance managers to be \$283,<sup>5</sup> including benefits, and the hourly rate for clerical staff to be \$57,<sup>6</sup> including benefits. Accordingly, we estimate the annual cost to each respondent of this hour burden to be \$1,196 (3.52 hours of professional time at \$283 per hour (approx. \$996), and 3.52 hours of clerical time at \$57 per hour (approx. \$200)) for a total annual cost of the hour burden of approximately \$5,292,249 (\$1,196 x 4,422). This is an increase of \$446,515 over the currently approved total annual cost of the hour burden of \$4,845,734 due primarily to our estimate of an increase in the number of registered investment advisers (4,422 versus 4,159) using rule 206(4)-3.

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

\$0.

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

Rule 206(4)-3 does not impose any costs on the Federal government because there are no separate filing requirements with the Commission.

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<sup>5</sup> Data from the Securities Industry and Financial Markets Association's Management & Professional Earnings in the Securities Industry 2013, 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 cost for a Compliance Manager is approximately \$283 per hour.

<sup>6</sup> Data from the Securities Industry and Financial Markets Association's Office Salaries Data 2013 Report, 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, suggest that the cost for a General Clerk is approximately \$57 per hour.

**15. Changes in Burden**

The number of responses per investment adviser and the number of hours per response have not changed since the last estimate. The number of respondents increased from 4,159 investment advisers to 4,422 investment advisers. As a result, the total burden hours for all respondents has increased from 29,279 hours to 31,130. This increase is due to our estimate, based on IARD data, of an increase in the number of registered investment advisers (4,422 versus 4,159) using rule 206(4)-3. The average burden per Commission registered adviser of 7.04 hours would not change.<sup>7</sup>

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

Not applicable.

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

The Commission is not seeking approval to omit the expiration date.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.

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<sup>7</sup> 31,130 (revised annual aggregate burden) divided by 4,422 (total number of registrants who rely on rule) = 7.04.