

**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

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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 recordkeeping burdens are addressed by this supporting statement.

nature of the solicitor's financial interest in the recommendation so the prospective clients may 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 December 31, 2018). 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 and Use 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

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

collection, which has been previously approved by OMB, would not change. Investment 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)**

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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).

Not applicable.

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

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**

Not applicable.

## **12. Burden of Information Collection**

We estimate that about 34.8% of the approximately 12,643 investment advisers registered

with the Commission, or 4,395 advisers (12,643 x 34.8%) 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 continue, for a total of 30,941 hours (7.04 x 4,395). 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 48,345 total annual responses (4,395 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 \$298,<sup>5</sup> including benefits, and the hourly rate for clerical staff to be \$60,<sup>6</sup> including benefits. Accordingly, we estimate the annual cost to each respondent of this hour burden to be \$1,260 (3.52 hours of professional time at \$298 per hour (approx. \$1,049), and 3.52 hours of clerical time at \$60 per hour (approx. \$211) for a total annual cost of the hour burden of approximately \$5,538,403 (\$1,260 x 4,395). This is an increase of \$246,154 over the currently approved total annual cost of the hour burden of \$5,292,249 due primarily to our estimate of increases in salary due to inflation, notwithstanding a decrease in the number of registered investment advisers (4,395 versus 4,422) using rule 206(4)-3.

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<sup>4</sup> Estimate based on IARD data from Form ADV Items 8.H.1 and 8.H.2 as of March 31, 2018. Firms that responded “Yes” to either Item 8.H.1 or 8.H.2 are included in the 4,395 number.

<sup>5</sup> Data from the Securities Industry and Financial Markets Association’s Management & Professional Earnings in the Securities Industry 2018, 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 \$298 per hour.

<sup>6</sup> Data from the Securities Industry and Financial Markets Association’s Office Salaries Data 2018 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 \$60 per hour.

**13. Cost to Respondents**

\$0.

**14. 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.

**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 decreased from 4,422 investment advisers to 4,395 investment advisers. As a result, the total burden hours for all respondents has decreased from 31,130 hours to 30,941. This decrease is due to our estimate, based on IARD data, of a decrease in the number of registered investment advisers (4,395 versus 4,422) 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**

Not applicable.

**18. Exceptions to Certification Statement for Paperwork Reduction Act****Submission**

Not applicable.

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<sup>7</sup> 30,941 (revised annual aggregate burden) divided by 4,395 (total number of registrants who rely on rule) = 7.04.

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

Not applicable.