

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

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

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” programs, generally are designed to provide professional portfolio management services on a discretionary basis to clients who are investing less than the minimum investments for individual accounts usually required by the investment adviser 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. Because of this similarity of management, some of these investment advisory programs may meet the definition of investment company under the Act.

In 1997, the Commission adopted rule 3a-4, which clarifies that programs organized and operated in accordance with the rule are not required to register under the Investment Company Act or comply with the Act's requirements.<sup>1</sup> These programs differ from investment companies because, among other things, they provide individualized investment advice to the client. The

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<sup>1</sup> Status of Investment Advisory Programs Under the Investment Company Act of 1940, Investment Company Act Rel. 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 of 1933 for programs that meet the requirements of rule 3a-4. See 17 CFR 270.3a-4, introductory note.

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 in accordance with any reasonable restrictions the client imposes on managing the account. When an account is opened, the sponsor<sup>2</sup> (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.<sup>3</sup> 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.<sup>4</sup>

Additionally, the sponsor (or its designee) 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 consult with the client. Each client also must

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<sup>2</sup> 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.

<sup>3</sup> 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.

retain certain indicia of ownership of all securities and funds in the account.

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

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. Consideration Given to Information Technology**

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 the initial information collection or annual client contact. The Adopting Release specifically notes that the initial information collection and annual client contact can be done in-person, by telephone or through questionnaires.<sup>5</sup>

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<sup>4</sup> The sponsor also must provide a means by which clients can contact the sponsor (or its designee).  
<sup>5</sup> See Adopting Release, *supra* note 1, at n.33 and text following n.36.

#### **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.<sup>6</sup> 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 advisory program in accordance with rule 3a-4 does not necessarily indicate that the program is an investment company.

#### **6. Consequences of Not Conducting 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 statements also enables the portfolio manager to be familiar with the client's account and its

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<sup>6</sup> Rule 3a-4 is also consistent with a series of no-action letters the Commission's staff issued before the rule was adopted. 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 limited.

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.<sup>7</sup> The Commission also 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**

Not applicable.

**10. Confidentiality**

Not applicable.

**11. Sensitive Questions**

No information of a sensitive nature will be required under this collection of information.

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<sup>7</sup> See Status of Investment Advisory Programs under the Investment Company Act of 1940, Investment Company Act Rel. No. 20260 (July 27, 1995) [60 FR 39574 (Aug. 2, 1995)] (proposing release); Adopting Release, *supra* note 1.

The information collection collects basic Personally Identifiable Information (“PII”) that may include financial accounts and financial transactions. However, the agency has determined that the information collection does not constitute a system of record for purposes of the Privacy Act. Information is not retrieved by a personal identifier. A System of Records Notice has been published in the Federal Register at (SEC-69) 83 FR 6892 and can also be found at <https://www.sec.gov/about/privacy/secprivacyoffice.htm>.

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

The Commission staff estimates that 19,618,731 clients participate each year in investment advisory programs relying on rule 3a-4.<sup>8</sup> Of that number, the staff estimates that 3,531,372 are new clients and 16,087,359 are continuing clients.<sup>9</sup> The staff estimates that each year under the rule, investment advisory program sponsors engage in the following collections of information and associated burden hours:<sup>10</sup>

- To prepare, conduct and/or review initial interviews with new clients:
  - 1.5 hours: 80 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;

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<sup>8</sup> These estimates are based on an analysis of the number of individual clients from Form ADV Item 5D(a)(1) and (b)(1) of advisers that report they provide portfolio management to wrap programs as indicated in Form ADV Item 5I(2)(b) and (c), and the number of individual clients of advisers that identify as internet advisers in Form ADV Item 2A(11). From analysis comparing reported individual client assets in Form ADV Item 5D(a)(3) and 5D(b)(3) to reported wrap portfolio manager assets in Form ADV Item 5I(2)(b) and (c), we discount the estimated number of individual clients of non-internet advisers providing portfolio management to wrap programs by 10%.

<sup>9</sup> These estimates are based on the number of new clients expected due to average year-over-year growth in individual clients from Form ADV Item 5D(a)(1) and (b)(1) (about 8%) and an assumed rate of yearly client turnover of 10%.

<sup>10</sup> These estimates are based upon consultation with investment advisers that operate investment advisory programs that rely on rule 3a-4.

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.<sup>11</sup>

Based on the estimates above, the Commission estimates that the total annual burden of the rule's paperwork requirements is 41,003,148 hours.<sup>12</sup> We estimate that professional staff performs approximately 17,943,292 of these burden hours at a total cost of \$2.4 billion,<sup>13</sup> while support staff performs approximately 23,059,856 of these burden hours at a total cost of \$1.4 billion.<sup>14</sup> Thus, the Commission estimates the aggregate annual cost of the burden hours associated with rule 3a-4 is \$3.8 billion.<sup>15</sup>

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.

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<sup>11</sup> 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.

<sup>12</sup> This estimate is based on the following calculation: (16,087,359 continuing clients x 1 hour) + (3,531,372 new clients x 1.5 hours) + (19,618,731 total clients x (0.25 hours x 4 statements)) = 41,003,148 hours. We note that the breakdown of burden hours between professional and staff time discussed below may not equal the estimate of total burden hours due to rounding.

<sup>13</sup> The professional staff estimates are based on the following calculations: 17,943,292 hours = (3,531,372 new clients x 1.3 hours) + (16,087,359 continuing clients x 0.83 hours); and 17,943,292 hours x \$132/hour = \$2,368,514,540. The per hour cost estimates are based on figures for operations specialist positions found in SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

<sup>14</sup> The support staff estimates are based on the following calculations: 23,059,856 hours = (3,531,372 new clients x 0.2 hours) + (16,087,359 continuing clients x 0.17 hours) + (19,618,731 total clients x (0.25 hours x 4 statements)); and 23,059,856 hours x \$60/hour = \$1,383,591,362. The per hour cost estimates are based on figures for general clerk positions found in SIFMA's Office Salaries in the Securities Industry 2013, modified to account for an 1800-hour work year and inflation, and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

**Table 1: Summary of Revised Annual Responses, Burden Hours, and Burden Hour Costs Estimates for Each Information Collection**

IC	IC Title	Annual No. of Responses (in thousands)			Annual Time Burden (thousands of hrs)		
		<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>
IC1	Interview new clients	0	3,531	3,531	7,377	5,297	-2,080
IC2	Interview continuing clients	0	16,087	16,087	11,620	16,087	4,468
IC3	Prepare and mail quarterly account statements	66,153	78,475	12,322	16,538	19,619	3,081
Total for all ICs		66,153	98,094	31,940	35,535	41,003	5,469

**13. Cost to Respondents**

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 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.

**15. Changes in Burden**

The total annual hour burden of 41,003,148 hours represents an increase of 5,468,554 hours from the prior estimate of 35,534,594 hours. This increase is a result of the increase in the estimated number of clients, which was due to a change in the way the staff has made its estimates as a result of recent changes in Form ADV that provide more detailed information about this issue.

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

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<sup>15</sup> This estimate is based on the following calculation: \$3,752,105,902 = \$2,368,514,540+ \$1,383,591,362.



Not applicable.

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

Not applicable.

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

Not applicable.

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

Not applicable.