

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
RULE 206(4)-1

A. JUSTIFICATION

1. Necessity for the Information Collection

On November 4, 2019, the Securities and Exchange Commission (the “Commission” or “SEC”) proposed amendments to rules related to how advisers advertise to and solicit clients and investors¹. The proposed amendments to the advertising rule, rule 206(4)-1² under the Investment Advisers Act of 1940 (the “Advisers Act”)³, would replace the current advertising rule’s broadly drawn limitations with principles-based provisions.

Under the proposed rule investment advisers are prohibited from including in any advertisement any testimonial or endorsement unless the adviser clearly and prominently discloses, or the investment adviser reasonably believes that the testimonial or endorsement clearly and prominently discloses, that the testimonial was given by a client or investor, or the endorsement was given by a non-client or non-investor and, if applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or using the testimonial or endorsement.⁴

The proposed amendments would also would allow an investment adviser to include third-party ratings in advertisements if the adviser reasonably believes that any questionnaire or

¹ Investment Adviser Advertisements; Compensation for Solicitations, Release No. IA-5407 (November 4, 2019) [84 FR 67518 (Dec. 10, 2019)]

² 17 CFR § 275.206(4)-1.

³ 15 U.S.C 80b-4.

⁴ Proposed rule 206(4)-1(b)(1).

survey used in the preparation of the third-party rating is structured to make it equally easy for a participant to provide favorable and unfavorable responses, and is not designed or prepared to produce any predetermined result.⁵ In addition, the adviser would have to clearly and prominently disclose (or reasonably believe that the third-party rating clearly and prominently discloses): (i) the date on which the rating was given and the period of time upon which the rating was based, (ii) the identity of the third-party that created and tabulated the rating, and (iii) if applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or using the third-party rating. In many cases, third-party ratings are developed by relying significantly on questionnaires or client surveys. Investment advisers may compensate the third-party to obtain or use the ratings or rankings that are calculated as a result of the survey.

The proposed rule would impose certain conditions on the presentation of performance results in advertisements. Specifically, the proposed rule would require that advertisements that present gross performance provide or offer to provide promptly a schedule of fees and expenses deducted to calculate the net performance.⁶ In addition, the proposed rule would require that advertisements that present any related performance must include all related portfolios, except that related performance may exclude any related portfolio if (a) the advertised performance results are no higher than if all related portfolios had been included and (b) the exclusion of any related portfolio does not alter the presentation of the time periods prescribed by paragraph

⁵ Proposed rule 206(4)-1(b)(2).

⁶ Proposed rule 206(4)-1(c)(1)(i).

(c)(2)(ii).⁷ The proposed rule also would require that advertisements that present any extracted performance must provide or offer to provide promptly the performance results of all investments in the portfolio from which the performance was extracted.⁸ Finally, the proposed rule would require, for advertisements that present hypothetical performance, that the adviser: (i) adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the advertisement is disseminated; (ii) provide sufficient information to enable such person to understand the criteria used and assumptions made in calculating such hypothetical performance; and (iii) provide (or in the case of Non-Retail Persons, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such hypothetical performance in making investment decisions.⁹

The proposed amendments to rule 206(4)-1 described above would result in a new “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995.¹⁰ The title of the new collection of information we proposed is “Rule 206(4)-1 under the Investment Advisers Act.” OMB has not yet assigned a control number for “Rule 206(4)-1 under the Investment Advisers Act.” 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.

⁷ Proposed rule 206(4)-1(c)(1)(iii).

⁸ Proposed rule 206(4)-1(c)(1)(iv).

⁹ Proposed rule 206(4)-1(c)(1)(v).

¹⁰ 44 U.S.C. 3501 to 3520.

2. Purpose and Use of the Information Collection

The purpose of this collection of information is to provide advisory clients, prospective clients, and the Commission with information about an advisers advertising practices. We use the information to determine support and manage our regulatory, examination, and enforcement programs. Clients use this information to determine whether to hire an adviser.

This collection of information is found at 17 CFR.206(4)-1 and it is mandatory. Responses provided to the Commission in the context of its examination and oversight program concerning the proposed amendments would be kept confidential subject to the provisions of applicable law. Disclosures made to investors under the proposed amendments would not remain confidential. The information collected takes the form of records retained by respondents and disclosures to respondents' clients, potential clients, and the Commission.

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 advisers are permitted to provide the information required by rule 206(4)-1 electronically.¹¹

4. Duplication

No other rule requires investment advisers to retain records or provide clients or prospective clients with the same information that is required by rule 206(4)-1.

5. Effect on Small Entities

The requirements for rule 206(4)-1 are the same for all investment advisers registered

¹¹ 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).

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

Amended Rule 206(4)-1 would require certain information regarding testimonials, third party ratings, and performances data used in investment adviser advertisements be disclosed in such advertisements to clients and potential clients; without this information, the client would be unaware of the limitations and potential misleading nature of the information contained in an advertisement.

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

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 has requested public comment on the information collection requirements in rule 206(4)-1 in the release proposing the amendments described above. The Commission has not yet received any comments in response to this request.

9. Payment or Gift

Not applicable.

10. Confidentiality

The information collected pursuant to rule 206(4)-1 requires advisers to provide information to advisory clients and prospective clients. Accordingly, these disclosures would not be kept confidential.

11. Sensitive Questions

[No information of a sensitive nature, including social security numbers, will be required under this collection of information. The information collection collects basic Personally Identifiable Information (PII) that may include names, job titles, work addresses, and phone numbers. 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.]]

12. Burden of Information Collection**a. Testimonials and endorsements in advertisements**

Under the proposed rule investment advisers are prohibited from including in any advertisement any testimonial or endorsement unless the adviser clearly and prominently discloses, or the investment adviser reasonably believes that the testimonial or endorsement clearly and prominently discloses, that the testimonial was given by a client or investor, or the endorsement was given by a non-client or non-investor and, if applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or

using the testimonial or endorsement.¹² We estimate that approximately 50 percent of registered investment advisers would use testimonials or endorsements in advertisements (because we estimate that 100 percent of registered investment advisers would advertise under the proposed rule, we estimate that the number of advisers that would use testimonials or endorsements in their advertisements would be 6,732 advisers (50 percent of 13,463 advisers)). We estimate that an investment adviser that includes testimonials or endorsements in advertisements would use approximately 5 testimonials or endorsements per year, and would create new advertisements with new or updated testimonials and endorsements approximately once per year. We estimate that an investment adviser that includes testimonials or endorsements in its advertisement would incur an internal burden of 1 hour to prepare the required disclosure for its testimonials and/or endorsements (approximately 0.2 hours per each testimonial and/or endorsement). Since each testimonial and/or endorsement used would likely be different, we believe this burden would remain the same each year. There would therefore be an annual cost to each respondent of this hour burden of \$337.00 to draft and finalize the required disclosure for the advisers' advertisements that contain testimonials or endorsements.¹³ We are not proposing an initial burden because we estimate that advisers would create new advertisements with new or updated testimonials and endorsements each year, and because we believe the disclosures would be brief and straightforward.

¹² Proposed rule 206(4)-1(b)(1).

¹³ This estimate is based on the following calculation: 1 hour (for preparation and review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)). The hourly wages used are from 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.

b. Third-party ratings in advertisements

Proposed rule 206(4)-1(b)(2) would allow an investment adviser to include third-party ratings in advertisements if the adviser reasonably believes that any questionnaire or survey used in the preparation of the third-party rating is structured to make it equally easy for a participant to provide favorable and unfavorable responses, and is not designed or prepared to produce any predetermined result. In addition, the adviser would have to clearly and prominently disclose (or reasonably believe that the third-party rating clearly and prominently discloses): (i) the date on which the rating was given and the period of time upon which the rating was based, (ii) the identity of the third-party that created and tabulated the rating, and (iii) if applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or using the third-party rating. In many cases, third-party ratings are developed by relying significantly on questionnaires or client surveys. Investment advisers may compensate the third-party to obtain or use the ratings or rankings that are calculated as a result of the survey. Due to the costs associated with third-party ratings, we estimate that approximately 50 percent, or 6,732 advisers, will use third-party ratings in advertisements, and that they will typically use one third-party rating on an annual basis.

We estimate that advisers would incur an initial internal burden of 1.5 hours to draft and finalize the required disclosure for third-party ratings. Accordingly, we estimate the initial cost to each respondent of this hour burden to be \$505.50.¹⁴ The third-party rating provision requires investment advisers to disclose up to four pieces of information. We estimate that the total

¹⁴ \$337 per hour x 1.5 hours. *See supra* footnote 13 for a discussion of the blended hourly rate for a compliance manager and a compliance attorney.

burden for drafting and reviewing initial third-party rating disclosures for all investment advisers that we believe use third-party ratings in advertisements would be 10,098 hours,¹⁵ with a total initial internal cost of the hour burden of approximately \$3,403,026.¹⁶

In addition, since many of these ratings or rankings are done yearly (*e.g.*, 2018 Top Wealth Adviser), an adviser that continues to use a third-party rating in a retail advertisement would incur ongoing, annual costs associated with this burden. We estimate that these ongoing annual costs would be approximately 25 percent of the investment adviser's initial costs per year, since the adviser would typically only need to update its disclosures related to the date on which the rating was given and the period of time upon which the rating was based. Therefore, we estimate that an investment adviser would spend 0.375 burden hours annually associated with drafting the required third-party rating disclosure updates.¹⁷ Accordingly, we estimate the annual ongoing cost to each respondent of this hour burden to be \$126.38.¹⁸ The aggregated ongoing burden for investment advisers updating initial third-party rating disclosures for all investment advisers that we estimate would use third-party ratings in advertisements would be 2,524.5 hours,¹⁹ at a total ongoing annual cost of the hour burden of approximately

¹⁵ This estimate is based on the following calculation: 1.5 hours per adviser x 6,732 advisers.

¹⁶ This estimate is based on the following calculation: 10,098 hours per advisers in the aggregate x \$337 per hour.

¹⁷ This estimate is based in the following calculation: 25 percent of 1.5 hours.

¹⁸ This estimate is based in the following calculation: 0.375 hours per adviser x \$337.

¹⁹ This estimate is based in the following calculation: 0.375 hours x 6,732 advisers

\$850,756.50.²⁰

c. Performance Advertising

The proposed rule would impose certain conditions on the presentation of performance results in advertisements. Specifically, the proposed rule would require that advertisements that present gross performance provide or offer to provide promptly a schedule of fees and expenses deducted to calculate the net performance.²¹ In addition, the proposed rule would require that advertisements that present any related performance must include all related portfolios, except that related performance may exclude any related portfolio if (a) the advertised performance results are no higher than if all related portfolios had been included and (b) the exclusion of any related portfolio does not alter the presentation of the time periods prescribed by paragraph (c)(2)(ii).²² The proposed rule also would require that advertisements that present any extracted performance must provide or offer to provide promptly the performance results of all investments in the portfolio from which the performance was extracted.²³ Finally, the proposed rule would require, for advertisements that present hypothetical performance, that the adviser: (i) adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the advertisement is disseminated; (ii) provide sufficient information to enable such

²⁰ This estimate is based in the following calculation: 2,524.5 hours x \$337.

²¹ Proposed rule 206(4)-1(c)(1)(i).

²² Proposed rule 206(4)-1(c)(1)(iii).

²³ Proposed rule 206(4)-1(c)(1)(iv).

person to understand the criteria used and assumptions made in calculating such hypothetical performance; and (iii) provide (or in the case of Non-Retail Persons, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such hypothetical performance in making investment decisions.²⁴ As a result of these conditions, the proposed rule would include “collection of information” requirements within the meaning of the PRA for investment advisers presenting performance results in advertisements.

We estimate that almost all advisers provide, or seek to provide, performance information to their clients. Based on staff experience, we estimate that 95 percent, or 12,790 advisers, provide performance information in their advertisements. The estimated numbers of burden hours and costs regarding performance results in advertisements may vary depending on, among other things, the complexity of the calculations and whether preparation of the disclosures is performed by internal staff or outside counsel.

i. Gross Performance: Provide or offer to provide promptly a schedule of fees and expenses deducted to calculate net performance

We estimate that an investment adviser that elects to present gross performance in an advertisement will incur an initial burden of 5 hours in preparing a schedule of the fees and expenses deducted to calculate net performance, in order to provide such a schedule, which may be upon request.²⁵ We further estimate each adviser electing to present gross performance will include gross performance for 3 different portfolios.

²⁴ Proposed rule 206(4)-1(c)(1)(v).

²⁵ This estimate includes only the time spent by an adviser in preparing the schedule initially.

Advisers' staff generally would have to conduct diligence to determine which fees and expenses were applied and how to categorize them for purposes of the schedule. We believe many advisers that currently advertise performance will have this information already, but will use compliance staff to confirm and categorize the relevant fees and expenses. We expect that an accountant or financial personnel at the adviser will extract the relevant data needed to prepare the schedule. There would therefore be an initial burden cost of 5 hours, with an estimated cost of \$1,564, for each adviser to prepare its schedule with respect to each initial presentation of net performance of each portfolio.²⁶ We estimate that the initial burden, on a per-adviser basis, will be \$4,692.²⁷

For purposes of this analysis, we estimate that advisers will update their schedules 3.5 times each year.²⁸ We estimate that after initially preparing a schedule of fees and expenses, an adviser will incur a burden of 0.5 hours to update the schedule. Accordingly, we estimate that the amortized average annual burden with respect to preparation of schedules would be 10.25 hours per year.²⁹ The estimated amortized aggregate annual burden with respect to schedules is

²⁶ This estimate is based on the following calculation: 4.0 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) + 1.0 hour (for extraction of relevant fees and expenses) x \$216 (senior accountant) = \$1,564. *See supra* footnote 13 for a discussion of the blended rate.

²⁷ This estimate is based on the following calculation: \$1,564 for each schedule per initial presentation per portfolio X 3 portfolios per adviser.

²⁸ This estimate takes into account the Commission's experience with the hour and cost burden estimates we have adopted for rule 482 under the Securities Act, which requires in part that advertisements with respect to RICs and BDCs to be filed with the Commission or with FINRA. In our most recent hour and cost burden estimate for rule 482, we estimated that approximately 3.5 responses are filed each year per portfolio. We believe that estimate fairly represents the number of times an advertisement is filed for purposes of rule 482, and so use that same estimate in establishing how often an advertisement's performance is updated for purposes of this analysis.

²⁹ We estimate that the average investment adviser will have an amortized average annual burden of 10.25

131,098 hours per year for each of the first three years,³⁰ and the aggregate internal cost burden is estimated to be \$44,180,026 per year.³¹

We estimate that registered investment advisers may incur external costs in connection with the requirement to provide a schedule of fees and expenses. We estimate that the average annual costs associated with printing and mailing these documents upon request would be collectively \$500 for all documents associated with a single registered investment adviser.³² Accordingly, we estimate that the aggregate annual external costs associated with printing and mailing these documents in connection with Non-Retail Advertisements would be \$6,395,000.³³

ii. Related performance

We estimate that an investment adviser that elects to present related performance in an

hours ((1 initial schedule X 5 hours + 3.5 subsequent updates to schedule X 0.5 hours) (year 1) + (3.5 subsequent updates to schedule X 0.5 hours) (year 2) + (3.5 subsequent updates to schedule X 0.5 hours) (year 3) = 10.25 over 3 years. 10.25 hours X 3 portfolios = 30.75 hours per adviser; and 30.75 hours ÷ 3 years = 10.25 hours).

³⁰ We estimate that 10.25 burden hours on average per year X 12,790 advisers presenting performance results (*i.e.*, 95% of 13,463 total advisers).

³¹ This estimate is based on the following calculation: 131,098 hours per advisers in the aggregate per year X \$337 per hour.

³² We do not have specific data regarding how the cost of printing and mailing the schedule would differ, nor are we able to specifically identify how the cost of printing and mailing the schedule might be affected by the proposed rule. For these reasons, we estimate \$500 per year to collectively print and mail upon request the schedule associated with an investment adviser for purposes of our analysis. This estimate assumes only 25% of clients who receive the relevant advertisement request the schedule from the adviser and assumes that marketing personnel at the adviser would respond to each such request. However, we are requesting comment on this estimate. In addition, investors may also request to receive a schedule electronically. We estimate that there would be negligible external costs associated with emailing electronic copies of the schedules.

³³ This estimate is based upon the following calculations: \$500 per adviser x 12,790 advisers that provide performance information (*i.e.*, 95% of the 13,463 total advisers) = \$6,395,000. For purposes of this Paperwork Reduction Act analysis, based upon our experience, we assume that the burden of emailing these documents would be outsourced to third-party service providers and therefore would be included within these external cost estimates.

advertisement will incur an initial burden of 25 hours, with respect to each advertised portfolio, in preparing the relevant performance of all related portfolios. This time burden would include the adviser's time spent classifying which portfolios meet the proposed rule's definition of "related portfolio" – i.e., which portfolios have "substantially similar investment policies, objectives, and strategies as those of the services being offered or promoted."³⁴ This burden also would include time spent determining whether to exclude any related portfolios in accordance with the proposed rule's provision allowing exclusion of one or more related portfolios if "the advertised performance results are no higher than if all related portfolios had been included" and "the exclusion of any related portfolio does not alter the presentation of the time periods prescribed by rule 206(4)-1(c)(2)(ii)."³⁵ For purposes of making this determination, we assume that an adviser generally would have to run at least two sets of calculations – one with, and one without, a related portfolio, that will allow the adviser to consider whether the exclusion of the portfolio would result in performance that is inappropriately higher or performance that would not satisfy the time period requirement.³⁶ Finally, this time burden would include the adviser's time calculating and presenting the net performance of any related performance presented. There would therefore be an initial cost of \$8,425 for each adviser to comply with this proposed requirement to present all related portfolios in connection with any related performance.³⁷

³⁴ See proposed rule 206(4)-1(e)(12). Our estimate accounts for advisers that may already be familiar with any composites that meet the definition of "related portfolio."

³⁵ See proposed rule 206(4)-1(c)(1)(iii).

³⁶ Our estimate also accounts for firms that exclude accounts subject to investment restrictions that materially affect account holdings regardless of whether the exclusion increases or decreases overall performance, such as is required under GIPS.

³⁷ This estimate is based on the following calculation: 25.0 hours (for review of disclosures) x \$337 (blended

Today, advisers may advertise related performance using their own definition, which may vary between advisers. For purposes of this analysis, we estimate 80 percent of advisers will have other portfolios with substantially similar investment policies, objectives, and strategies as those being offered or promoted in the advertisement and choose to include related performance, as defined under the proposal. We estimate that after initially preparing related performance for each portfolio, investment advisers will incur a burden of 5 hours to update the performance for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant related performance 3.5 times each year.

Accordingly, we estimate that the amortized average annual burden would be 25.8 hours for each of the first three years for each investment adviser to prepare related performance in connection with this requirement.³⁸ The estimated amortized aggregate annual burden with respect to Retail Advertisements is 277,866 hours per year for each of the first three years,³⁹ and the aggregate internal cost burden is estimated to be \$93,640,842 per year.⁴⁰

rate for a compliance manager (\$309) and a compliance attorney (\$365)) = \$8,425. *See* Release No. IA-5407, *supra* footnote 1, at footnote 624 (discussing the blended hourly rate for a compliance manager and a compliance attorney).

³⁸ We estimate that the average investment adviser will make 4.5 presentations of related performance to meet this requirement in three years, for an amortized average annual burden of 14.2 hours ((1 initial presentation X 25 hours + 3.5 subsequent updates to presentations X 5 hours) (year 1) + (3.5 subsequent updates to presentations X 5 hours) (year 2) + (3.5 subsequent updates to presentations X 5 hours) (year 3) = 77.5 hours per adviser; and 77.5 hours ÷ 3 years = 25.8 hours).

³⁹ We estimate that 25.8 burden hours on average per year X 10,770 advisers presenting related performance (*i.e.*, 80% of 13,463 advisers).

⁴⁰ This estimate is based on the following calculation: 277,866 hours per advisers in the aggregate per year X \$337 per hour.

iii. Extracted performance

We estimate that an investment adviser that elects to present extracted performance in an advertisement will incur an initial burden of 10 hours in preparing the performance results of the entire portfolio from which the performance is extracted in order to provide such performance results to investors, which may be promptly upon request. There would therefore be an initial cost of \$3,370 for each adviser to prepare such performance.⁴¹

For purposes of this analysis, we assume 5 percent of advisers will include extracted performance. We estimate that after initially preparing the performance of the entire portfolio from which extracted performance is extracted, investment advisers will incur a burden of 2 hours to update the performance for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant “entire portfolio” performance 3.5 times each year.

Accordingly, we estimate that the amortized average annual burden would be 10.3 hours for each of the first three years for each investment adviser to prepare the performance of the entire portfolio from which the presentation of extracted performance is extracted.⁴² The estimated amortized aggregate annual burden with respect to the “entire portfolio” requirement is

⁴¹ This estimate is based on the following calculation: 10.0 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) = \$3,370. *See* Release No. IA-5407, *supra* footnote 1, at footnote 624 (discussing the blended hourly rate for a compliance manager and a compliance attorney).

⁴² We estimate that the average investment adviser will make 4.5 presentations of “entire portfolio” performance to meet this requirement in three years, for an amortized average annual burden of 5.7 hours ((1 initial presentation X 10 hours + 3.5 subsequent presentations X 2 hours) (year 1) + (3.5 subsequent presentations X 2 hours) (year 2) + (3.5 subsequent presentations X 2 hours) (year 3) = 31 hours; and 31 hours ÷ 3 years = 10.3 hours).

6,932 hours per year for each of the first three years,⁴³ and the aggregate internal cost burden is estimated to be \$2,336,084 per year.⁴⁴

We estimate that registered investment advisers may incur external costs in connection with the requirement to provide performance results of an entire portfolio from which extracted hypothetical performance is extracted. We estimate that the average annual costs associated with printing and mailing this information upon request would be collectively \$500 for all documents associated with a single registered investment adviser. Accordingly, we estimate that the aggregate annual external costs associated with printing and mailing these documents in connection with extracted performance presented would be \$336,500.⁴⁵

iv. Hypothetical performance

We estimate that an investment adviser that elects to present hypothetical performance in an advertisement will incur an initial burden of 5 hours in preparing and adopting policies and procedures reasonably designed to ensure that hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the advertisement is disseminated. For purposes of this analysis, we assume 50 percent of advisers will include hypothetical performance in advertisements.

⁴³ We estimate that 10.3 burden hours on average per year x approximately 673 advisers presenting extracted performance (*i.e.*, 5% of 13,463 advisers).

⁴⁴ This estimate is based on the following calculation: 6,932 hours per advisers in the aggregate per year X \$337 per hour.

⁴⁵ This estimate is based upon the following calculations: \$500 per adviser x approximately 673 advisers presenting extracted performance (*i.e.*, 5% of 13,463 advisers) = \$336,500. For purposes of this Paperwork Reduction Act analysis, based upon our experience, we assume that the burden of emailing these documents would be outsourced to third-party service providers and therefore would be included within these external cost estimates.

Advisers' compliance personnel typically would draft policies and procedures to evaluate whether hypothetical performance is relevant to each recipient. There would therefore be an initial burden cost of 5 hours related to the adoption of such policies and procedures, with an

estimated cost of \$2,650, for each adviser to prepare its policies and procedures.⁴⁶

For purposes of this analysis, we estimate that advisers that use hypothetical performance will disseminate advertisements containing hypothetical performance 20 times each year. We estimate that after adopting appropriate policies and procedures, an adviser will incur a burden of 0.25 hours to categorize each investor based on its policies and procedures. Accordingly, we estimate that the average annual burden with respect to preparation of schedules would be 10 hours per year.⁴⁷ The estimated aggregate annual burden is 67,320 hours per year,⁴⁸ and the aggregate internal cost burden is estimated to be \$35,679,600 per year.⁴⁹

Additionally, we estimate that an investment adviser that elects to present hypothetical performance in an advertisement will incur an initial burden of 16 hours in preparing the

⁴⁶ This estimate is based on the following calculation: 5 hours (for adoption of policies and procedures) x \$530 (rate for a chief compliance officer). The hourly wages used are from 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.

⁴⁷ We estimate that the average investment adviser will have an average annual burden of 3.3 hours (5 hours for adoption of policies and procedures + 20 advertisements X 0.25 hours = 10 hours).

⁴⁸ We estimate that 10 burden hours on average per year X 6,732 advisers presenting performance results (*i.e.*, 50% of 13,463 total advisers).

⁴⁹ This estimate is based on the following calculation: 67,320 hours per advisers in the aggregate per year X \$530 per hour.

information sufficient to understand the criteria used and assumptions made in calculating, as well as risks and limitations in using, the hypothetical performance (the “underlying information”), in order to provide such information, which may in certain circumstances be upon

request.⁵⁰ There would therefore be an initial cost of \$5,384 for each adviser to prepare such information.⁵¹

We estimate that after initially preparing the underlying information, investment advisers will incur a burden of 3 hours to update the information for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update their hypothetical performance, and thus the underlying information, 3.5 times each year.

Accordingly, we estimate that the amortized average annual burden would be 8.5 hours for each of the first three years for each investment adviser to prepare the underlying information.⁵² The estimated amortized aggregate annual burden with respect to the “underlying

⁵⁰ This estimate includes the time spent by an adviser in preparing the information. The time spent calculating the hypothetical performance that is based on such information is not accounted for in this estimate, as the proposed rule has no requirement that an advertisement present hypothetical performance.

⁵¹ This estimate is based on the following calculation: 15.0 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) + 1 hour (to explain the assumptions used in creating the hypothetical performance) x \$329 (senior portfolio manager) = \$5,384. The hourly wages used are from 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.

⁵² We estimate that the average investment adviser will make 4.5 presentations of hypothetical performance, and thus underlying information to meet this requirement, in three years, for an amortized average annual burden of 8.5 hours (1 initial presentation X 15 hours + 3.5 subsequent presentations X 3 hours = 25.5 hours; and 25.5 hours ÷ 3 years = 8.5 hours).

information” requirement is 57,222 hours per year for each of the first three years,⁵³ and the aggregate internal cost burden is estimated to be \$19,283,814 per year.⁵⁴

We estimate that registered investment advisers may incur external costs in connection with the requirement to provide this underlying information upon the request of a client or prospective client. We estimate that the average annual costs associated with printing and mailing this underlying information upon request would be collectively \$500 for all documents associated with a single registered investment adviser.⁵⁵ Accordingly, we estimate that the aggregate annual external costs associated with printing and mailing these documents in connection with hypothetical performance presented in advertisements would be \$3,366,000.⁵⁶

d. Additional Conditions related to Performance Results in Retail Advertisements

The proposed rule would impose certain additional conditions on the presentation of performance results in Retail Advertisements. The proposed rule requires that Retail

⁵³ We estimate that 8.5 burden hours on average per year x 6,732 advisers presenting hypothetical performance (*i.e.*, 50% of 13,463 advisers).

⁵⁴ This estimate is based on the following calculation: 57,222 hours per advisers in the aggregate per year X \$337 per hour.

⁵⁵ We do not have specific data regarding how the cost of printing and mailing the underlying information would differ, nor are we able to specifically identify how the cost of printing and mailing the underlying information might be affected by the proposed rule. For these reasons, we estimate \$500 per year to collectively print and mail upon request the underlying information associated with hypothetical performance for purposes of our analysis. However, we are requesting comment on this estimate. In addition, investors may also request to receive the underlying information electronically. We estimate that there would be negligible external costs associated with emailing electronic copies of the underlying information.

⁵⁶ This estimate is based upon the following calculations: \$500 per adviser x 6,732 advisers presenting hypothetical performance = \$3,366,000. For purposes of this Paperwork Reduction Act analysis, based upon our experience, we assume that the burden of printing and mailing the underlying information would be outsourced to third-party service providers rather than handled internally, and therefore would be included within these external cost estimates.

Advertisements that present gross performance must also present net performance: (a) with at least equal prominence to, and in a format designed to facilitate comparison with, gross performance, and (b) calculated over the same time period, and using the same type of return and methodology as, the gross performance.⁵⁷ In addition, the proposed rule requires that Retail Advertisements that present performance results of any portfolio or any composite aggregation of related portfolios must include performance results of the same portfolio or composite aggregation for 1-, 5-, and 10-year periods, each presented with equal prominence and ending on the most recent practicable date; except that if the relevant portfolio did not exist for a particular prescribed period, then the life of the portfolio must be substituted for that period.⁵⁸ As a result of these conditions, the proposed rule would include additional “collection of information” requirements within the meaning of the PRA for investment advisers presenting performance results in any Retail Advertisements.

Based on Form ADV data, approximately 62 percent, or 8,396 investment advisers registered with the Commission have some portion of their business dedicated to retail clients, including either individual high net worth clients or individual non-high net worth clients.⁵⁹

⁵⁷ Proposed rule 206(4)-1(c)(2)(i).

⁵⁸ Proposed rule 206(4)-1(c)(2)(ii).

⁵⁹ See Release No. IA-5407 *supra* footnote 1, at footnote **Error! Bookmark not defined.** The number of advisers that have retail investors as clients is based on the number of advisers that report high net worth and non-high net worth clients, determined by responses to Item 5.D.(1)(a or b), or advisers who do not report individual clients per Item 5.D.(1)(a or b), but do report regulatory assets under management attributable to retail clients as per Item 5.D.(3)(a or b). If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to a client that would be a “retail investor” for purposes of the proposed rule. The data on individual clients obtained from Form ADV may not be exactly the same as who would be a “retail investor” for purposes of the proposed rule because Form ADV allows advisers to treat as a “high net worth individual” an individual who is a “qualified client” for purposes of rule 205-3 or a “qualified purchaser” as defined in section 2(a)(51)(A) of the Investment Company Act. In contrast, the proposed rule would treat any individual client who meets the definition of “qualified

Estimating the number of advisers servicing retail investors based on a review of individual clients reported on Form ADV entails certain limitations, and this estimate is only being used for purposes of this PRA analysis.

i. Presentation of Net Performance in Retail Advertisements

We estimate that an investment adviser that elects to present gross performance in a Retail Advertisement will incur an initial burden of 10 hours in preparing net performance for each portfolio, including the time spent determining and deducting the relevant fees and expenses to apply in calculating the net performance and then actually running the calculations. Based on staff experience, we estimate that the average investment adviser will present performance for three portfolios over the course of a year. Accordingly, we estimate that the initial burden, on a per-adviser basis, will be 30 hours. There would therefore be an initial estimated cost of \$10,110 for the average adviser to comply with this proposed requirement to present net performance in a Retail Advertisement.⁶⁰

We expect that the calculation of net performance may be modified every time an adviser

purchaser” or “knowledge employee” as a non-retail investor. *See also* 2018 Investment Management Compliance Testing Survey, Investment Adviser Association and ACA Compliance Group, at 67 (Jun. 14, 2018) (indicating that 60% of 454 survey respondents “provide services to individual clients (e.g. retail, high net worth, trusts)”), *available at*: https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843c-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/2018-Investment-Management_Compliance-Testing-Survey-Results-Webcast_pptx.pdf.

The figure representing advisers with non-retail clients or investors is the number of advisers that have advisory clients that are retail clients subtracted from the total number of registered investment advisers. These figures do not reflect investors in pooled investment vehicles.

⁶⁰ This estimate is based on the following calculation: 30.0 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) = \$10,110. *See* Release No. IA-5407, *supra* footnote 1, at footnote 624 (discussing the blended hourly rate for a compliance manager and a compliance attorney).

chooses to update the advertised performance. We estimate that after initially preparing net performance for each portfolio, investment advisers will incur a burden of 2 hours to update the net performance for each subsequent presentation. Accordingly, for each presentation of net performance after the initial presentation, we estimate that the burden, on a per-portfolio basis, will entail an estimated cost of \$674.⁶¹

For purposes of this analysis, we estimate that advisers will update the relevant performance of each portfolio 3.5 times each year.⁶² Accordingly, we estimate that the amortized average annual burden would be 17 hours for each of the first three years for each investment adviser to prepare net performance.⁶³ The estimated amortized aggregate annual internal burden with respect to Retail Advertisements is 135,592 hours per year for each of the first three years,⁶⁴ and the aggregate internal cost burden is estimated to be \$45,694,504 per year.⁶⁵

⁶¹ This estimate is based on the following calculation: 2 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) = 674. *See* Release No. IA-5407, *supra* footnote 1, at footnote 624 (discussing the blended hourly rate for a compliance manager and a compliance attorney).

⁶² *Id.* at footnote 641 (discussing the Commission’s experiences with portfolio performance advertising in the context of rule 482 under the Securities Act of 1933, 17 CFR § 230.482).

⁶³ We estimate that the average investment adviser will make 13.5 presentations of net performance in three years, for an amortized average annual burden of 17 hours (1 initial presentation X 10 hours + 3.5 subsequent presentations X 2 hours = 17 hours X 3 portfolios = 51 hours per adviser; and 51 hours ÷ 3 years = 17 hours).

⁶⁴ We estimate that 17 burden hours on average per year X 7,976 “retail advisers” presenting performance results (*i.e.*, 95% of 8,396 “retail advisers”).

⁶⁵ This estimate is based on the following calculation: 135,592 hours per advisers in the aggregate per year x \$337 per hour.

ii. Time Period Requirements in Retail Advertisements

We estimate that an investment adviser that elects to present performance results in a Retail Advertisement will incur an initial burden of 35 hours in preparing performance results of the same portfolio for 1-, 5-, and 10-year periods, taking into account that these results must be prepared on a net basis (and may also be prepared and presented on a gross basis). This estimate reflects that many advisers currently prepare and present GIPS-compliant performance information, and also that many advisers, particularly private fund advisers, currently prepare annual performance for investors. There would therefore be an initial cost of \$11,795 for each adviser to comply with this proposed time period requirement in a Retail Advertisement.⁶⁶

Advisers may vary in the frequency with which they calculate performance in order to satisfy this proposed time period requirement, though presumably advisers will do so every time they choose to update the advertised performance. We estimate that after initially preparing 1-, 5-, and 10-year performance for each portfolio, investment advisers will incur a burden of 8 hours to update the performance for these time periods for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant performance 3.5 times each year.

Accordingly, we estimate that the amortized average annual burden would be 21 hours for each of the first three years for each investment adviser to prepare performance in compliance with this time period requirement.⁶⁷ The estimated amortized aggregate annual

⁶⁶ This estimate is based on the following calculation: 35 hours (for review of disclosures) x \$337 (blended rate for a compliance manager (\$309) and a compliance attorney (\$365)) = \$11,795. *See* Release No. IA-5407, *supra* footnote 1, at footnote 624 (discussing the blended hourly rate for a compliance manager and a compliance attorney).

⁶⁷ We estimate that the average investment adviser will make 4.5 presentations of performance to meet this

burden with respect to Retail Advertisements is 167,496 hours per year for each of the first three years,⁶⁸ and the aggregate internal cost burden is estimated to be \$56,446,152 per year.⁶⁹

e. Review and Approval of Advertisements

The proposed rule would require that any advertisement be reviewed and approved in writing by a designated employee.⁷⁰ As noted above, the use of advertisements is not mandatory, but given that advertising is an essential part of retaining and attracting clients, and that advertising may be disseminated easily through the internet and social media, we estimate that all investment advisers will disseminate at least one communication meeting the proposed rule's definition of "advertisement".⁷¹

Based on staff experience, we expect 80% of investment advisers, or 10,770, are light advertisers and 20%, or 2,693, are heavy advertisers.⁷² We estimate that investment advisers that are light advertisers and heavy advertisers would create new advertisements approximately 10 and 50 times, respectively, per year. We also estimate that investment advisers that are light

time period requirement (*i.e.*, 1-, 5-, and 10-year performance calculations) in three years, for an amortized average annual burden of 22.7 hours (1 initial presentation X 35 hours + 3.5 subsequent presentations X 8 hours = 63 hours per adviser; and 63 hours ÷ 3 years = 21 hours).

⁶⁸ We estimate that 21 burden hours on average per year X 7,976 "retail advisers" presenting performance results in a Retail Advertisement (*i.e.*, 95% of all 8,396 advisers that have retail clients).

⁶⁹ This estimate is based on the following calculation: 167,496 hours per advisers in the aggregate per year X \$337 per hour.

⁷⁰ Proposed rule 206(4)-1(d).

⁷¹ Additionally, if an adviser includes in any legal or regulatory document information beyond what is required under applicable law, and such additional information "offers or promotes" the adviser's services, then that information would be considered an "advertisement" for purposes of the proposed rule, and therefore would be subject to the employee review and approval requirement. *See* Release No. IA-5407, *supra* footnote 1, at footnote 111 and accompanying text.

⁷² 0.80 X 13,463 (total investment advisers) = 10,770 light advisers. 0.20 X 13,463 (total investment advisers) = 2,693 heavy advisers.

advertisers and heavy advertisers would update existing advertisements approximately 50 and 250 times, respectively, per year. These estimates account for the proposed rule's expanded definition of "advertisement" relative to the current rule. We further estimate that an investment adviser would incur an average burden of 1.5 and 0.5 hours to review each new advertisement and review each update of an existing advertisement, respectively. Since each advertisement requiring employee review would likely be different, we believe this burden would remain the same each year. Although the proposed rule permits advisers to designate any employee to review and approve advertisements, we would anticipate many investment advisers to designate their chief compliance officers with this task. In addition, a compliance attorney would review any revisions that occur during the course of review. There would therefore be an annual cost to each respondent of this hour burden of \$671.25 and \$223.75 to review and approve each new or updated advertisement, respectively, that is subject to the review requirement.⁷³ Therefore, we estimate that the yearly total burden of reviewing and approving advertisements would be 430,800 hours and 538,600 hours for advisers that are light and heavy advertisers, respectively, or 969,400 hours across all advisers.⁷⁴ Thus, the aggregate internal cost of the hour burden for

⁷³ This estimate for new advertisements is based on the following calculation: 0.75 hour (for review and approval) x \$530 (hourly rate for a chief compliance officer) + 0.75 hour (for revisions) x \$365 (hourly rate for a compliance attorney) = \$671.25. This estimate for updates to existing advertisements is based on the following calculation: 0.25 hour (for review and approval) x \$530 (hourly rate for a chief compliance officer) + 0.25 hour (for revisions) x \$365 (hourly rate for a compliance attorney) = \$223.75. The hourly wages used are from 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.

⁷⁴ This estimate for light advisers is based on the following calculation: [1.5 hours per adviser x 10 new advertisements per year + 0.5 hours per adviser x 50 updated advertisements per year] x 10,770 light advisers = 430,800 hours. This estimate for heavy advisers is based on the following calculation: [1.5 hours per adviser x 50 new advertisements per year + 0.5 hours per adviser x 250 updated advertisements per year] x 2,693 heavy advisers = 538,600 hours. 430,800 + 538,600 = 969,400.

all investment advisers is estimated to be \$448,347,500 per year.⁷⁵

We estimate that light advertisers and heavy advertisers would utilize 10 and 50 hours, respectively, of external legal services per year to review advertisements. Therefore, we estimate that the average annual costs associated with external legal review of advertisements would be \$4,000 for a light advertiser and \$20,000 for a heavy advertiser, or \$24,000 across all advisers.⁷⁶

f. Total Hour Burden

Accordingly, we estimate the total annual hour burden for investment advisers registered or required to be registered with the Commission under proposed rule 206(4)-1 to prepare testimonials and endorsements, third-party ratings, and performance results disclosures, as well as review and approve advertisements, would be 1,832,281 hours,⁷⁷ at a time cost of \$736,001,832.⁷⁸

A chart summarizing the various components of the total annual burden for investment advisers is below.

⁷⁵ This estimate is based on the following calculation: 969,400 hours for advisers in the aggregate per year x \$462.5 per hour (blended rate of a chief compliance officer and a compliance attorney).

⁷⁶ The estimated \$4,000 figure for light advertisers has been calculated as follows: \$400 per hour cost for outside legal services x 10 hours = \$4,000. The estimated \$4,000 figure for heavy advertisers has been calculated as follows: \$400 per hour cost for outside legal services x 50 hours = \$20,000.

These estimates are based on an estimated \$400 per hour cost for external legal services. We do not have specific data regarding these external legal costs. However, we are requesting comment on this estimate.

⁷⁷ This estimate is based upon the following calculations: 6,732 + 10,098 + 2,524.5 + 131,098 + 277,866 + 6,932 + 67,320 + 57,222 + 135,592 + 167,496 + 969,400 hours = 1,832,281 hours.

⁷⁸ This estimate is based upon the following calculations: \$2,268,684 + \$3,403,026 + \$850,756.50 + \$29,094,221 + \$93,640,842 + \$1,292,732 + \$35,679,600 + \$19,283,814 + \$45,694,504 + \$56,446,152 + \$448,347,500 = \$736,001,832.

Rule 206(4)-1 Description of Requirements	No. of Responses	Internal Burden Hours	External Burden Costs
Ongoing annual burden for testimonials and endorsements* * This is not broken up into initial and ongoing burden because the annual burden is estimated to be the same each year, as discussed above.	33,660 (5 per adviser)	6,732 (1 per response)	
Initial burden for third-party rating	6,732 (1 per adviser)	10,098 (1.5 per response)	
Ongoing annual burden for third-party rating	6,732 (1 per adviser)	2,525 (0.375 per response)	
Initial burden for advertisements presenting gross performance and providing a schedule of fees and expenses	38,370 (3 per adviser)	63,950 (5 per response)	\$500 per adviser
Ongoing annual burden for advertisements presenting gross performance and providing a schedule of fees and expenses	134,295 (10.5 per adviser)	6,395 (0.5 per response)	\$500 per adviser
Initial burden for advertisements presenting related performance	10,770 (1 per adviser presenting related performance)	269,250 (25 per response)	
Ongoing annual burden for advertisements presenting related performance	32,310 (3.5 per adviser presenting related performance)	64,620 (5 per response)	
Initial burden for advertisements	673 (1 per adviser)	6,730 (10 per response)	\$500 per

presenting extracted performance	presenting extracted performance)	response)	adviser
Ongoing annual burden for advertisements presenting extracted performance	2,356 (3.5 per adviser presenting extracted performance)	1,346 (2 per response)	\$500 per adviser
Initial burden for policies and procedures for hypothetical performance	6,732 (1 per adviser presenting hypothetical performance)	33,660 (5 per response)	
Ongoing annual burden for policies and procedures for hypothetical performance	134,640 (20 per adviser presenting hypothetical performance)	1,683 (0.25 per response)	
Initial burden for advertisements presenting underlying information for hypothetical performance	6,732(1 per adviser presenting hypothetical performance)	107,712 (16 hours per response)	\$500 per adviser
Ongoing annual burden for advertisements presenting underlying information for hypothetical performance	23,562 (3.5 per adviser presenting hypothetical performance)	20,196 (3 hours per response)	\$500 per adviser
Initial burden for Retail Advertisements presenting gross performance	7,976 (1 per adviser presenting gross	79,760 (10 hours per response)	

	performance)		
Ongoing burden for Retail Advertisements presenting gross performance	27,916 (3.5 per adviser presenting gross performance)	55,832 (2 hours per response)	
Initial burden for Retail Advertisements meeting “time period” requirement	7,976 (1 per retail adviser)	279,160 (35 per response)	
Ongoing annual burden for Retail Advertisements meeting “time period” requirement	27,916 (3.5 per retail adviser)	223,328 (8 per response)	
Annual burden for review of advertisements for light advertisers* * This is not broken up into initial and ongoing burden because the annual burden is estimated to be the same each year.	107,770 and 538,500 (10 new and 50 updated per each adviser)	161,655 and 269,250 (1.5 hours per response for new advertisements, 0.5 hours per response for updated advertisements)	\$4,000 per adviser
Annual burden for review of advertisements for heavy advertisers* * This is not broken up into initial and ongoing burden because the annual burden is estimated to be the same each year.	134,650 and 673,250 (50 new and 250 updated per each adviser)	201,975 and 336,625 (1.5 hours per response for new advertisements, 0.5 hours per response for updated advertisements)	\$20,000 per adviser

13. Cost to Respondents

In addition to the burden costs described above, and as described in the table, we estimate

the total external cost per adviser per year to be \$27,000.⁷⁹

14. Cost to the Federal Government

Rule 206(4)-1 does not impose any costs on the Federal government because there are no separate filing requirements with the Commission.

15. Changes in Burden

This is a new information collection.

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.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.

⁷⁹ This estimate is based upon the following calculations: \$500 + \$500 + \$500 + \$500 + \$500 + \$500 + \$24,000 = \$27,000.