

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
Rule 206(4)-10 under the Investment Advisers Act of 1940

A. JUSTIFICATION

1. Necessity for the Information Collection

On February 9, 2022, the Commission proposed rules related to private fund transparency and conflicts of interest as well as amendments to certain rules that govern investment adviser and fund disclosures under the Investment Advisers Act of 1940 (the “Advisers Act”).¹ The proposed rules and amendments are designed protect those who directly or indirectly invest in private funds by increasing visibility into certain practices, establishing requirements to address certain practices that have the potential to lead to investor harm, and prohibiting adviser activity that is contrary to the public interest and the protection of investors.

The Commission proposed new rule 206(4)-10² to require an adviser registered or required to be registered with the Commission to cause each private fund they advise, directly or indirectly, to undergo a financial statement audit at least annually and upon liquidation and to distribute the fund’s audited financial statements to current investors promptly after completion of the audit. The rule would also require an adviser to enter into a written agreement between the adviser or the private fund, on one hand, and the auditor, on the other hand, under which the auditor would be required to notify the Division of Examinations upon the auditor’s termination or issuance of a modified opinion. This information bolsters the Commission’s efforts to prevent fraudulent, deceptive, and manipulative activity and aids the oversight of private fund advisers.

2. Purpose and Use of the Information Collection

The purpose of new rule 206(4)-10 is to protect investors against misappropriation of client assets and the overcharging of client fees because of inflated valuations by requiring private fund advisers to cause each private fund they advise to undergo a financial statement audit.

3. Consideration Given to Information Technology

Rule 206(4)-10 would not require the adviser to report any information or file any documents with the Commission. Rule 206(4)-10 would, however, require the auditor to notify the Commission by electronic means directed to the Division of Examinations: (i) promptly upon issuing an audit report to the private fund that contains a modified opinion and (ii) within four

¹ 15 U.S.C. 80b-1 *et seq.*; Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews Release No. IA-5955 (Feb. 9, 2022) available at <https://www.sec.gov/rules/proposed/2022/ia-5955.pdf> (“Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews”).

² 17 CFR 275.206(4)-10.

business days of resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed.

4. Duplication

The collection of information requirements are not duplicated elsewhere.

5. Effect on Small Entities

Rule 206(4)-10 would not affect most investment advisers that are small entities (“small advisers”) because the rule applies only to advisers that are registered with the Commission and small advisers are generally unregistered or are registered with one or more state securities authorities and not with the Commission. In fact, under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators. Based on IARD data, we estimate that as of November 30, 2021, approximately 594 Commission-registered advisers are small advisers. Of these 594 advisers, approximately 29 advise private funds, and we estimate that all of these 29 advisers would be subject to rule 206(4)-10. As discussed below, rule 206(4)-10 under the Advisers Act would create a new annual burden of approximately 18.36 hours per adviser, or 532.44 hours in aggregate for small advisers. We therefore expect the annual monetized aggregate cost to small advisers associated with our proposed amendments would be \$15,819,118.65.

6. Consequences of Not Conducting Collection

The collection of information would bolster the Commission’s efforts at preventing fraudulent, deceptive, and manipulative activity and would aid oversight of private fund advisers. The consequences of not collecting this information would be that the Commission may not have information when an auditor issues an audit report to a private fund containing a modified opinion or when an auditor has been terminated by an adviser to a private fund, which may hinder the Commission’s ability to identify advisers potentially engaged in harmful misconduct and that have other compliance issues.

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

This collection is not inconsistent with 5 CFR 1320.5(d)(2).

8. Consultation Outside the Agency

The Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment management industry 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 rule 206(4)-10. Before adopting rule 206(4)-10, the Commission will receive and evaluate public comments on the proposed rule and its associated collection of information requirements.

9. Payment or Gift

No payment or gift to respondents was provided.

10. Confidentiality

The information collected pursuant to rule 206(4)-10 would be by electronic means to a dedicated email address established by the Division of Examinations. These transmissions would be kept confidential.

11. Sensitive Questions

Not applicable.

12. Burden of Information Collection

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act of 1995³ and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.

Based on IARD data, as of November 30, 2021, there were 14,832 investment advisers registered with the Commission. According to this data, 5,037 registered advisers provide advice to private funds. We estimate that these advisers would, on average, each provide advice to 9 private funds. We further estimate that these private funds would, on average, each have a total of 67 investors. As a result, an average private fund adviser would have a total of 603 investors across all private funds it advises.

We have made certain estimates of this data solely for the purpose of this analysis. The table below summarizes the initial and ongoing annual burden estimates associated with the rule.

³ 44 U.S.C. 3501 *et seq.*

Table 1: Rule 206(4)-10 Estimates

	Internal initial burden hours	Internal annual burden hours	Wage rate ¹	Internal time cost	Annual external cost burden
PROPOSED ESTIMATES					
Distribution of audited financial statements ²	0 hours	1.12 hours ³	\$153.33 (blended rate for intermediate accountant (\$175), general accounting supervisor (\$221), and general clerk (\$64))	\$171.73	\$60,000 ⁴
Preparation of the written agreement ⁵	1.25 hours ⁶	0.92 hours ⁷	\$476 (rate for assistant general counsel)	\$437.92	\$0
Total new annual burden per private fund		2.04 hours		\$609.65	\$60,000 ⁸
Avg. number of private funds per adviser		9 private funds		9 private funds	9 private funds
Number of advisers		5,037 advisers		5,037 advisers	5,037 advisers
Total new annual burden		92,479.32 hours		\$27,637,263.40	\$2,719,980,000

Notes:

1. The Commission's estimates of the relevant wage rates are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2013. The estimated figures are modified by firm size, employee benefits, overhead, and adjusted to account for the effects of inflation. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013.

2. The proposed audit provision would require an adviser to obtain an audit at least annually and upon an entity's liquidation. To the extent not prohibited, we anticipate that, in some cases, the fund will bear the audit expense, in other cases the adviser will bear it, and in other instances both the adviser and fund will share the expense. The liquidation audit would serve as the annual audit for the fiscal year in which it occurs. See proposed rule 206(4)-10.

3. This estimate takes into account that the financial statements must be distributed once annually under the proposed audit rule and that a liquidation audit would replace a final audit in a year. Based on our experience with similar requirements under the custody rule, we estimate the hour burden imposed on the adviser relating to the distribution of the audited financial statements with respect to the investors in each fund should be minimal, approximately one minute per investor. *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1455 (Jan. 11, 2010)] (“Custody Rule 2009 Adopting Release”), at 59-60. We estimate that the average private fund has 67 investors.

4. Based on our experience, we estimate that the party (or parties) that bears the audit expense would pay an average audit fee of \$60,000 per fund. We estimate that individual fund audit fees would tend to vary over an estimated range from \$15,000 to \$300,000, and that some fund audit fees would be higher or lower than this range. We understand that the price of the audit has many variables, such as whether it is a liquid fund or illiquid fund, the number of its holdings, availability of a PCAOB-registered and –inspected auditor, economies of scale, and the location and size of the auditor.

5. The proposed rule would require the adviser or the private fund to enter into an agreement with the independent public accountant. The agreement would require the independent public accountant that completes the audit to notify the Commission by electronic means directed to the Division of Examinations promptly upon certain events. *See* proposed rule 206(4)-10(e).

6. For purposes of this estimate we assume that, regardless of whether the adviser or the fund enters into the written agreement, the accountant would incur the hour burden of preparing the agreement. We also assume that, if the fund was party to the agreement, the fund would delegate the task of reviewing the agreement to the adviser. This estimate also assumes that the adviser would enter into a separate agreement for each private fund, even if multiple funds use the same auditor. We believe that written agreements are commonplace and reflect industry practice when a person retains the services of a professional such as an accountant, and they are typically prepared by the accountant in advance. We therefore estimate that each adviser would spend 1.25 hours to add the required provisions to, or confirm that the required provisions are in, the written agreement.

7. This includes the internal initial burden estimate annualized over a three-year period, plus 0.5 hours of ongoing annual burden hours, and it assumes annual reassessment and execution: $((1.25 \text{ initial hours} / 3 \text{ years}) + 0.5 \text{ hours of additional ongoing burden hours}) = 0.92 \text{ hours}$.

8. We assume the same frequency of these cost estimates as for the internal annual burden hours estimate.

13. Cost to Respondents

Cost burden is the cost of goods and services purchased to meet the requirements of rule 206(4)-10, such as for the services of outside counsel. The cost burden does not include the hour burden discussed in Item 12 above. Estimates are based on the Commission's experience.

As summarized above, Commission staff estimates that the annual cost of outside services associated with rule 206(4)-10 is approximately \$540,000 per adviser and the total annual external cost burden for rule 206(4)-10 is \$2,719,980,000.

14. Cost to the Federal Government

There are no costs to the government directly attributable to the rule.

15. Change in Burden

New 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.