

**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 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.

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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.

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 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

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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.

<sup>4</sup> The sponsor also must provide a means by which clients can contact the sponsor (or its designee).

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 mailed, physically or electronically, to clients, and quarterly notices must be provided in writing. In addition, 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>

### **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

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<sup>5</sup> See Adopting Release, *supra* note 1, at n.33 and text following n.36.

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 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 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

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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.

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.

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 following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act of 1995<sup>7</sup> and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.

**Table 1: Rule 3a-4 burden of Information collection for certain investment advisory programs**

	<b>Estimated Responses</b>	<b>Estimated Burden Hours</b>	<b>Estimated Cost Burdens<sup>8</sup></b>
<b>Prepare, conduct, and/or review initial interviews with new clients annually</b>	3,073,796 <sup>9</sup>	1.3 annual hours x 3,073,796 = 3,995,934.8 annual hours for an operations specialist  .2 hours x 3,073,796 support staff time = 614,759.2 annual hours for a general clerk  <b>3,995,934.8 + 614,759 = 4,610,694</b>	3,995,934 annual hours x \$168 per hour = \$671,316,912 annual costs for an operations specialist  614,759 annual hours x \$57 per hour = \$35,041,263 annual costs for a general clerk  <b>\$671,316,912 + \$35,041,263 = \$706,358,175</b>
<b>Totals</b>	3,073,796 total annual estimated responses	4,610,694 total annual estimated burden hours <sup>10</sup>	\$706,358,175 total annual estimated costs
<b>Prepare, conduct, and/or review annual</b>	31,208,571 (estimated existing clients) <sup>11</sup>	.83 annual hours x 31,208,571 = 25,903,113.9 annual hours for an operations specialist  .17 x 31,208,571	25,903,113.9 annual hours x \$168 per hour = \$4,351,723,135.26 annual costs for an operations specialist

<sup>8</sup> The Commission’s estimate concerning the wage rate is based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The cost burdens for professional personnel are based on SIFMA’s *Management & Professional Earnings in the Securities Industry 2013*, modified for 2020 by the Commission staff 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 and the cost burdens for clerical personnel are based on SIFMA’s *Office Salaries in the Securities Industry 2013*, modified for 2021 by Commission staff 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.

<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 9%) 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.

<sup>11</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%.

<b>interviews with continuing clients</b>		support staff time = 5,305,457.07 annual hours for a general clerk  <b>25,903,113.9 + 5,305,457.07 = 31,208,571</b>	5,305,457.07 annual hours x \$57 per hour = \$302,411,052.99 annual costs for a general clerk  <b>\$4,351,723,135.2 + \$302,411,052.99 = \$4,654,134,188.19</b>
<b>Totals</b>	31,208,571 total annual estimated responses	31,208,571 total annual estimated burden hours <sup>12</sup>	\$3,965,985,198.48 total annual estimated costs
<b>Prepare and mail each quarterly client account statement, including the notice to update information, annually</b>	34,282,367 total clients x 4 statements = 137,129,468	137,129,468 x .25 hours = 34,282,367 hours for a general clerk	34,282,367 burden hours x \$57 = \$1,954,094,919 annual costs for a general clerk
<b>Total</b>	137,129,468 estimated annual responses	34,282,367 estimated annual hours	\$1,954,094,9198 estimated annual costs
<b>TOTALS</b>	3,073,796 +31,208,571+137,129,367=  <b>171,411,744 total estimated annual responses</b>	4,610,694 + 31,208,571 + 34,282,367 =  <b>70,101,632 total estimated annual burden hours</b>	\$706,358,175 + \$4,654,134,188.19 + \$1,954,094,919 =  <b>\$7,314,587,282 total estimated annual costs</b>

<sup>12</sup> See, supra n.10.

**Table 2: Change in Burden Estimates**

	<b>Annual No. of Responses (in thousands)</b>			<b>Annual Time Burden (thousands of hours)</b>		
	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>
<b>Interview new clients</b>	3,531	3,074	-457	5,297	4,611	-686
<b>Interview continuing clients</b>	16,087	31,208	15,121	16,087	31,208	15,121
<b>Prepare and mail quarterly account statements</b>	78,475	137,129	58,654	19,619	34,282	14,663
<b>Totals</b>	98,094	171,412	73,318	41,003	70,102	29,099

**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 70,101,632 hours represents an increase of 29,098,484 hours from the prior estimate of 41,003,148 hours. This increase is a result of the increase in the estimated number of clients.



**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 Submissions**

Not applicable.

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

Not applicable.