

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**Amendments to Rule 204-2 under the Investment Advisers Act of 1940**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 204 of the Investment Advisers Act of 1940 (the “Advisers Act”) provides that investment advisers required to register with the Securities and Exchange Commission (the “Commission” or “SEC”) must make and keep certain records for prescribed periods, and make and disseminate certain reports.<sup>1</sup> Advisers Act rule 204-2 sets forth mandatory requirements for maintaining and preserving specified books and records.<sup>2</sup> The majority of records that an adviser must keep in accordance with rule 204-2 must generally be retained for not less than five years, and in some cases longer.<sup>3</sup> These requirements constitute a mandatory “collection of information,” within the meaning of the Paperwork Reduction Act.

On October 26, 2022, the Commission proposed a new rule 206(4)-11 under the Advisers Act to prohibit investment advisers registered with the Commission from outsourcing certain services or functions without first meeting minimum requirements.<sup>4</sup> The proposal also includes amendments to Rule 204-2, including new subsection 204-2(a)(24) requiring advisers that outsource a covered function to a service provider to make and keep certain records<sup>5</sup>. Another provision also requires similar records for advisers that rely on a third party to make and/or keep the adviser’s books and records.<sup>6</sup> Specifically, the proposed amendments would require advisers to make and retain: (1) a list or other record of covered functions that the adviser has outsourced to a service provider, along with a record of the factors that led the adviser to list each function<sup>7</sup>; (2) records documenting the due diligence assessment conducted pursuant to proposed rule 206(4)-11, including any policies and procedures or other documentation as to how the adviser will mitigate and manage the risks of outsourcing a covered function<sup>8</sup>; (3) a copy of any written

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<sup>1</sup> 15 U.S.C. 80b-4.

<sup>2</sup> 17 CFR 275.204-2.

<sup>3</sup> 17 CFR 275.204-2(e). The retention period required for the majority of books and records requirements under rule 204-2 is five years, in an easily accessible place, the first two years in an appropriate office of the investment adviser.

<sup>4</sup> Outsourcing by Investment Advisers, Release No. IA-6176 (Oct. 26, 2022) *available at* <https://www.sec.gov/rules/proposed/2022/ia-6176.pdf>.

<sup>5</sup> See proposed rule 204-2(a)(24), (e)(4).

<sup>6</sup> See proposed rule 204-2(l).

<sup>7</sup> See proposed rule 204-2(a)(24)(i).

<sup>8</sup> See proposed rule 204-2(a)(24)(ii).

agreement, including amendments, appendices, exhibits, and attachments, entered into pursuant to proposed rule 206(4)-11<sup>9</sup>; and (4) records documenting the periodic monitoring of a service provider of a covered function.<sup>10</sup> Each of these records would be maintained and preserved consistent with proposed Advisers Act Rule 204-2(e)(4) in an easily accessible place throughout the time period during which the adviser has outsourced a covered function to a service provider and for a period of five years thereafter.<sup>11</sup> These proposed amendments would help facilitate the Commission's inspection and enforcement capabilities.

The collection has been previously approved and subsequently extended under Office of Management and Budget ("OMB") control number 3235- 0278 (expiring October 31, 2024), and it is found at 17 CFR 275.204-2. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB number.

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

The purpose of the information collection in rule 204-2 is to assist the Commission's examination and oversight program. Requiring the creation, maintenance and retention of the above records as part of rule 204-2 would facilitate the Commission's ability to inspect for and enforce compliance with firms' obligations with respect to the proposed new rule 206(4)-11 to enhance investment adviser oversight when a covered function is outsourced to a service provider.

The respondents to the rule are investment advisers registered with the Commission. The likely respondents for the amendments to the rule will be all investment advisers registered with the Commission. Responses provided to the Commission in the context of its examination and oversight program are generally kept confidential subject to the applicable law.<sup>12</sup> This collection of information is found at 17 CFR 275.204-2 and is mandatory.

## **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. The Commission currently permits advisers to maintain records required by the rule through electronic media.<sup>13</sup>

## **4. Duplication**

The collection of information requirements of the rule, including the amendments, are not duplicated elsewhere. The Commission periodically evaluates rule-based reporting and

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<sup>9</sup> See proposed rule 204-2(a)(24)(iii).

<sup>10</sup> See proposed rule 204-2(a)(24)(iv).

<sup>11</sup> See proposed rule 204-2(e)(4).

<sup>12</sup> See section 210(b) of the Advisers Act [15 U.S.C. 80b-10(b)].

<sup>13</sup> See Electronic Recordkeeping by Investment Companies and Investment Advisers, Investment Advisers Act Release No. 1945 (May 24, 2001) 66 FR 29224 (May 30, 2001).

recordkeeping requirements for duplication, and reevaluates these requirements whenever it adopts amendments to its rules.

## **5. Effect on Small Entities**

The requirements of the rule are the same for all investment advisers registered with the Commission, including those that are small entities. The requirements of the amendments to rule 204-2 will not distinguish between small entities and other investment advisers because the protections of the Advisers Act are intended to apply equally to retail investor clients of both large and small firms. OMB has previously approved the effect of this collection on all investment advisers in general, including advisers that are small entities. Moreover, it would defeat the purpose of the rule to exempt small entities from these requirements. The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small businesses.

## **6. Consequences of Not Conducting Collection**

Less frequent information collection will be incompatible with the objectives of the rule and would hinder the Commission's oversight and examination program for investment advisers and thereby reduce the protection to investors.

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

The collection requirements under rule 204-2 generally require advisers to maintain documents for five years, and in some cases longer. The retention period will not be affected by the amendments to the rule. Although this period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), OMB has previously approved the collection with this retention period. The retention periods in rule 204-2 are warranted because the recordkeeping requirements in rule 204-2 of the Advisers Act are designed to contribute to the effectiveness of the Commission's examination and inspection program. Because the period between examinations may be as long as five years, it is important that the Commission have access to records that cover the entire period between examinations.

## **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 the proposed amendments to rule 204-2, including the collection of information requirements resulting from the proposed amendments. Before adopting these amendments, the Commission will receive and evaluate public comments on the proposed amendments and their associated collection of information requirements.

## **9. Payment or Gift**

None.

## **10. Confidentiality**

Responses provided to the Commission pursuant to rule 204-2 in the context of the Commission's examination and oversight program are generally kept confidential subject to the applicable law.

## **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. Estimate of Hour and Cost 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>14</sup> and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.

The respondents to this collection of information are investment advisers registered or required to be registered with the Commission. All such advisers will be subject to the proposed amendments to rule 204-2. As of December 31, 2021, there were 14,756 advisers registered with the Commission. We estimate that all of them would be subject to these books and records requirements. In our most recent Paperwork Reduction Act submission for rule 204-2, we estimated for rule 204-2 a total annual aggregate hour burden of 2,764,563 hours, based on an estimate of 13,724 registered advisers, or 201.44 hours per registered adviser, with a total annual aggregate external cost burden of \$175,980,426.<sup>15</sup> The table below summarizes the initial and ongoing annual burden estimates associated with the proposed amendments to rule 204-2. We have made certain estimates of the burdens associated with the proposed amendments solely for the purpose of this PRA analysis. Based on staff experience, most advisers already conduct some level of oversight of service providers so as to fulfill the adviser's fiduciary duty, comply with the Federal securities laws, and protect clients from potential harm. Our burden estimates therefore presume that advisers are already making some records of due diligence and monitoring.

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<sup>14</sup> 44 U.S.C. 3501 *et seq.*

<sup>15</sup> Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Revisions to Rule 204-2, OMB Report, OMB 3235-0278 (Aug. 2021).

Table 1: Rule 204-2 PRA Estimates

	Internal Initial Hour Burden	Internal Annual Hour Burden	Wage Rate <sup>2</sup>	Annual Internal Time Costs	Annual External Cost Burden
<b>PROPOSED ESTIMATES</b>					
Make and Retain list of outsourced Covered Functions and factors <sup>5</sup>	6 hours <sup>1</sup>	2 hours	\$292.75 (blended rate for compliance manager, attorney, and senior business analyst)	\$585.50 (Internal Annual Hour Burden of 2 hours x Wage rate of 292.75)	\$0
Total burden per adviser	6 hours	2 hours		\$585.50	\$0
Total number of affected advisers	× 14,756 advisers	× 14,756 advisers		× 14,756	\$0
<b>Sub-total burden for aggregated advisers</b>	<b>88,536 hours</b>	<b>29,512 hours</b>		<b>\$8,639,638</b>	<b>\$0</b>
Make and retain records documenting due diligence assessment <sup>3</sup>	0	6 hours	\$292.75 (blended rate for compliance manager, attorney, and senior business analyst)	\$1,756.50	\$0
Total annual burden per adviser	0	6 hours		\$1,756.50	\$0
Total number of affected advisers	0	× 14,756		× 14,756	\$0
<b>Sub-total burden</b>	<b>0</b>	<b>88,536 hours</b>		<b>\$25,918,914</b>	<b>\$0</b>
Retention of written agreement with service provider <sup>4</sup>	0	1	\$72.50 (blended rate for general clerk and compliance clerk)	\$72.50	\$0
Total annual burden per adviser	0	1		\$72.50	\$0
Total number of affected advisers	0	× 14,756		× 14,756	\$0
<b>Sub-total burden</b>	<b>0</b>	<b>14,756 hours</b>		<b>\$1,069,810</b>	<b>\$0</b>
Make and retain records documenting monitoring of service providers of covered functions <sup>6</sup>	8 hours	6	\$292.75 (blended rate for general clerk and compliance clerk)	\$1,756.50	\$0
Total annual burden per adviser	8 hours	6		\$1,756.50	\$0

	Internal Initial Hour Burden	Internal Annual Hour Burden	Wage Rate <sup>2</sup>	Annual Internal Time Costs	Annual External Cost Burden
Total number of affected advisers	14,756	× 14,756		× 14,756	\$0
<b>Sub-total burden</b>	<b>118,048 hours</b>	<b>88,536 hours</b>		<b>\$25,918,914</b>	<b>\$0</b>
Total annual aggregate burden of rule 204-2 amendments	206,584 hours (initial burden hours)	221,340 hours		\$61,547,276	\$0
Current annual estimated aggregate burden of rule 204-2	NA	2,764,563 hours		\$175,980,426	\$0
<b>Total annual aggregate burden of rule 204-2</b>	<b>NA</b>	<b>2,985,903 hours</b>		<b>\$237,527,702</b>	<b>\$0</b>

1. We believe that the estimated internal hour burdens associated with the proposed amendment would include one-time initial burdens, and we then amortize these initial burdens over three years to determine the ongoing annual burden. Our estimate assumes that there would be required annual maintenance and review of the list of covered functions and factors. Taking into account the various sizes of SEC registered advisers with varying operational complexities, we estimate that each adviser would outsource an average of six covered functions.

2. 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. The rates used to create the blended rates are as follows: compliance manager - \$339; attorney - \$455; senior business analyst - \$300; compliance clerk - \$77; general clerk - \$68. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 ("SIFMA Report").

3. The proposed rule's due diligence requirements would apply before a service provider is retained to perform a covered function (note that monitoring would apply to existing engagements). For new advisers, we believe that the time, effort, and financial resources would be incurred in the normal course of activities and therefore there is no additional burden. Based on staff experience, most advisers already conduct some level of oversight of service providers so as to fulfill the adviser's fiduciary duty, comply with the Federal securities laws, and protect clients from potential harm. Our burden estimates therefore presume that advisers are already making some records of due diligence and monitoring. Our burden estimate addresses the making and retention of the due diligence records only. It is not an estimate of the time needed to conduct due diligence. This estimate also presumes that an adviser initiates the outsourcing, or amends an existing outsourcing agreement, for an average of two covered functions per year. In reaching our estimate, we considered that larger advisers, or advisers with more complex operations and strategies, may exceed this average, while smaller advisers or advisers with comparatively streamlined operations may outsource fewer covered functions than this average.

4. Because the proposed rule would not apply until a new covered function is outsourced, or existing outsourced covered function is amended, there should be no initial burden that differs from the annual burden. The proposed amendments would require the retention of a written agreement only if such agreement is made. Based on staff experience, it is customary business practice for advisers to enter into written agreements with service providers that are performing a covered function. We therefore estimate that the additional burden of retaining written agreements, if applicable, will be minimal.

5. Based on staff experience, and considering the varying sizes and complexities of advisers, we estimate that advisers will outsource an average of six covered functions. We anticipate that larger advisers, or advisers with more complex operations and strategies, may exceed this average, while smaller advisers or advisers with comparatively streamlined operations may outsource fewer covered functions than this average.

6. Because the monitoring obligations would apply to existing agreements as of the compliance date, we believe there would be an initial monitoring burden that differs from the annual burden in the first year that the rule becomes effective. This is because advisers may need to alter their existing monitoring practices resulting in collections of information that they did not previously develop. Our burden estimate addresses the making and retention of the monitoring records only. It is not an estimate of the time needed to conduct monitoring. This estimate assumes advisers monitor an average of six outsourced covered functions each year (this is in addition to our estimate of two new or amended outsourced functions that would be subject to initial due diligence each year). In reaching our estimate, we considered that larger advisers, or advisers with more complex operations and strategies, may exceed this average, while smaller advisers or advisers with comparatively streamlined operations may outsource fewer covered functions than this average.

### **13. Cost to Respondents**

Cost burden is the cost of goods and services purchased to meet the requirements of rule 204-2, 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 in Table 1 above, we estimate that the annual external cost associated with the proposed amendments to rule 204-2 is \$0.

### **14. Cost to Federal Government**

There are no additional costs to the federal government directly attributable to rule 204-2.

### **15. Change in Burden**

As noted above, the approved annual aggregate burden for rule 204-2 is currently 2,764,563 hours, based on an estimate of 13,724 registered advisers, or 201.44 hours per registered adviser, with a total monetized costs of \$175,980,426. We estimate that amendments to rule 204-2 will result in a revised annual aggregate burden of 2,985,903 hours per year, based on a revised estimate of 14,756 registered advisers, or 202.35 hours per registered adviser, with a monetized value of \$237,527,702. This would be an aggregate increase of 221,340 hours, or \$61,547,276 in the monetized value of the hour burden, from the currently approved annual aggregate burden estimates. The changes are due to proposed amendments and updated data. The external cost burden associated with rule 204-2 (\$0) has not changed.

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

None.

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

Not Applicable

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

Not Applicable.

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

The collection of information will not employ statistical methods.