SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

Release No. IA-3110; File No. S7-36-10

RIN 3235-AK82

Rules Implementing Amendments to the Investment Advisers Act of 1940

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing new rules and rule amendments under the Investment Advisers Act of 1940 to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules and rule amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act that, among other things, increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. In addition, we are proposing rule amendments, including amendments to the Commission's pay to play rule, that address a number of other changes to the Advisers Act made by the Dodd-Frank Act.

DATES: Comments must be received on or before [insert date 45 days after publication in Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-36-10 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-36-10. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Jennifer R. Porter, Attorney-Adviser, Daniele Marchesani, Senior Counsel, Melissa A. Roverts, Senior Counsel, Devin F. Sullivan, Senior Counsel, Matthew N. Goldin, Branch Chief, Daniel S. Kahl, Branch Chief, or Sarah A. Bessin, Assistant Director, at (202) 551-6787 or IArules@sec.gov, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing rules 203A-5 and 204-4 [17 CFR 275.203A-5 and 275.204-4] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act"),[1] amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 204-1, 204-2, 206(4)-5, 222-1, and 222-2 [17 CFR 275.0-7, 275.203A-1, 275.203A-2, 275.203A-3 , 275.204-1, 275.204-2, 275.206(4)-5, 275. 222-1, and 275.222-2] under the Advisers Act, and amendments to Form ADV, Form ADV-H, and Form ADV-NR [17 CFR 279.1, 279.3, and 279.4] under the Advisers Act. The Commission is also proposing to rescind rule 203A-4 [17 CFR 275.203A-4] under the Advisers Act.

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[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rule 0-7, rule 202(a)(11)-1, rule 203(b)(3)-1, rule 203(b)(3)-2, rule 203A-1, rule 203A-2, rule 203A-3, rule 203A-4, rule 203A-5, rule 204-1, rule 204-2, rule 204-4, rule 206(4)-5, rule 222-1, or rule 222-2, or any paragraph of these rules, we are referring to 17 CFR 275.0-7, 17 CFR 275.202(a)(11)-1, 17 CFR 275.203(b)(3)-1, 17 CFR 275.203(b)(3)-2, 17 CFR 275.203A-1, 17 CFR 275.203A-2, 17 CFR 275.203A-3, 17 CFR 275.203A-4, 17 CFR 275.203A-5, 17 CFR 275.204-1, 17 CFR 275.204-2, 17 CFR 275.204-4, 17 CFR 275.206(4)-5, 17 CFR 275.222-1, or 17 CFR 275.222-2, respectively, of the Code of Federal Regulations, in which these rules are published, or would be published, if adopted.

I. BACKGROUND

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") which, among other things, amends certain provisions of the Advisers Act.[2] Title IV of the Dodd-Frank Act includes most of the amendments to the Advisers Act. These amendments include provisions that reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers, *i.e.*, those that have between $25 and $100 million of assets under management.[3] This provision will require a significant number of advisers currently registered with the Commission to withdraw their registrations with the Commission

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[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[3] *See* section 410 of the Dodd-Frank Act; Advisers Act section 203A. *See also* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, § 303 (1996) ("NSMIA") (allocating to states responsibility for small investment advisers with less than $25 million in assets under management).

and to switch to registration with one or more state securities authorities. In addition, Title IV repeals the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act under which advisers, including those to many hedge funds, private equity funds and venture capital funds, had relied in order to avoid registration under the Act and our oversight.[4] In eliminating this provision, Congress created, or directed us to adopt other, in some ways narrower, exemptions for advisers to certain types of private funds – *e.g.*, venture capital funds – which provide that the Commission shall require such advisers to submit reports "as the Commission determines necessary or appropriate in the public interest."[5] These provisions in Title IV of the Dodd-Frank Act will be effective on July 21, 2011.[6]

We are proposing to adopt new rules and amend existing rules and forms to give effect to these provisions. In addition, we are proposing rule amendments, including amendments to the

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4 *See* section 403 of the Dodd-Frank Act. Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("Investment Company Act"), or a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act (15 U.S.C. 80a-54). Section 403 of the Dodd-Frank Act eliminates this "private adviser" exemption from section 203(b)(3) and replaces it with a new exemption for "foreign private advisers." We are proposing a rule to clarify the definition of a "foreign private adviser" in a separate release. *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3111, published elsewhere in this issue of the Federal Register ("Exemptions Release"). Commenters wishing to address issues related to foreign private advisers should submit comments on the Exemptions Release.

5 *See* sections 407 and 408 of the Dodd-Frank Act ("The Commission shall require [such advisers to] provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors"). Section 407 of the Dodd-Frank Act, which adds section 203(l) to the Advisers Act, exempts advisers solely to one or more venture capital funds. Section 408, which added section 203(m) to the Advisers Act, exempts advisers solely to private funds with assets under management in the United States of less than $150 million.

6 *See* section 419 of the Dodd-Frank Act. For purposes of this Release, when we refer to the effective date of the Dodd-Frank Act, we are referring to the effective date of Title IV, which is July 21, 2011, unless we indicate otherwise.

Commission's "pay to play" rule, that address a number of other changes to the Advisers Act made by the Dodd-Frank Act. Also, in light of our increased responsibility for oversight of private funds, we are proposing to require advisers to those funds to provide us with additional information about the operation of those funds. As discussed in more detail below, this information would permit us to provide better oversight of these advisers by focusing our examination and enforcement resources on those advisers to private funds that appear to present greater compliance risks. Finally, we are proposing additional changes to Form ADV that we believe would enhance our oversight of advisers and also will enable us to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.[7]

II. DISCUSSION

A. Eligibility for Registration with the Commission: Section 410

Section 203A of the Advisers Act generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the Commission unless it has at least $25 million of assets under management,[8] and preempts certain state laws regulating advisers that are registered with the Commission.[9] This provision, enacted

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7 *See* section 956 of the Dodd-Frank Act.

8 Advisers Act section 203A(a)(1). The prohibition does not apply if the investment adviser is an adviser to an investment company registered under the Investment Company Act, or the adviser is eligible for one of six exemptions the Commission has adopted. *See id.*; rule 203A-2; *infra* section II.A.5. of this Release. Section 403 of the Dodd-Frank Act also added exemptions to Section 203 of the Advisers Act for: (i) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund; and (ii) any investment adviser, other than a business development company, that solely advises certain small business investment companies.

9 An investment adviser must register with the Commission unless it is prohibited from registering under section 203A of the Advisers Act or is exempt from registration under section 203(b). Advisers Act section 203(a). Investment advisers that are prohibited from registering with the Commission are subject to regulation by the states, but the anti-fraud provisions of the Advisers Act continue to apply to them. *See* Advisers Act sections 203A(b), 206. For SEC-registered

in 1996 as part of the National Securities Markets Improvement Act ("NSMIA"), eliminated the duplicative regulation of advisers by the Commission and state securities authorities, making the states the primary regulators of smaller advisers and the Commission the primary regulator of larger advisers.[10]

Section 410 of the Dodd-Frank Act creates a new group of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the state securities authorities. It does this by prohibiting from registering with the Commission an investment adviser that is registered as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between $25 million and $100 million.[11] Unlike a small adviser, a mid-sized adviser is not prohibited from registering with the Commission: (i) if the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser would not be subject to examination as an investment adviser by that securities commissioner; or (iii) if the adviser is required to register in 15 or more states.[12] Section 203A(c) of the Advisers Act, which

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investment advisers, state laws requiring registration, licensing and qualification are preempted, but states may investigate and bring enforcement actions alleging fraud or deceit, may require notice filings of documents filed with the Commission, and may require investment advisers to pay state notice filing fees. *See* Advisers Act section 203A(b); NSMIA, *supra* note 3, at sections 307(a) and (b). The Dodd-Frank Act did not amend sections 203A(a)(1) or 203(a) of the Advisers Act. *See* section 410 of the Dodd-Frank Act.

10 *See* S. REP. NO. 104-293, at 4 (1996). *See also Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1633, section I (May 15, 1997) [62 FR 28112 (May 22, 1997)] ("NSMIA Adopting Release").

11 *See* section 410 of the Dodd-Frank Act. This amendment increases the threshold above which all investment advisers must register with the Commission from $25 million to $100 million. *See* S. REP. NO. 111-176, at 76 (2010) ("Senate Committee Report").

12 *See* section 410 of the Dodd-Frank Act. A mid-sized adviser also will be required to register with the Commission if it is an adviser to a registered investment company or business development company under the Investment Company Act. *Id*. As a result, mid-sized advisers to registered investment companies and business development companies will not have to withdraw their

was not amended by the Dodd-Frank Act, permits the Commission to exempt advisers from the prohibition on Commission registration, including small and mid-sized advisers, if the application of the prohibition from registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of section 203A.[13] Under this authority, we have adopted six exemptions from the prohibition on registration.[14]

As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 4,100 SEC-registered advisers will be required to withdraw their registrations and register with one or more state securities authorities.[15] We are working closely with the state securities authorities to assure an orderly transition of investment adviser registrants to state regulation. In addition, we are today proposing rules and rule amendments that would provide us a means of identifying advisers that must transition to state regulation, clarify the application of new statutory provisions, and modify certain of the exemptions from the prohibition on registration that we have adopted under section 203A of the Act.

1. Transition to State Registration

Commission registrations. *Compare* section 410 of the Dodd-Frank Act *with* Advisers Act section 203A(a)(1).

13 The Commission's exercise of this authority would not only permit registration with the Commission, but would result in the preemption of state law with respect to the advisers that register with us as a result of the exemption. *See* Advisers Act sections 203(a), 203A(b) and (c).

14 *See* rule 203A-2 (permitting the following types of advisers to register with the Commission: (i) nationally recognized statistical rating organizations ("NRSROs"); (ii) pension consultants; (iii) investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) multi-state investment advisers; and (vi) internet advisers).

15 According to data from the Investment Adviser Registration Depository ("IARD") as of September 1, 2010, 4,136 SEC-registered advisers either: (i) had assets under management between $25 million and $100 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $100 million and are not relying on an exemption.

We are proposing a new rule, rule 203A-5, which would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011, 30 days after the July 21, 2011 effective date of the amendments to section 203A, and to report the market value of its assets under management determined within 30 days of the filing.[16] This filing would be the first step by which an adviser no longer eligible for Commission registration would transition to state registration. It would require each investment adviser to determine whether it meets the revised eligibility criteria for Commission registration, and would provide the Commission and the state regulatory authorities with information necessary to identify those advisers required to transition to state registration and to understand the reason for the transition or basis for continued Commission registration.[17] An adviser no longer eligible for Commission registration would have to withdraw its Commission registration by filing Form ADV-W no later than October 19, 2011 (60 days after the required refiling of Form ADV).[18] We would expect to cancel the registration of advisers that fail to file an amendment or withdraw their registrations in accordance with the rule.[19] Finally, the proposed

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16 Proposed rule 203A-5(a). We propose to give advisers 30 days from the effective date of the Dodd-Frank Act to prepare and submit the amended Form ADV. This approach would avoid requiring an adviser to respond to items about its eligibility to register with the Commission *before* the statutory changes affecting that eligibility will be effective on July 21, 2011. The additional 30 days would provide an adviser with the opportunity to evaluate the effect of the legislation (and our rules) on its eligibility and seek the advice of legal counsel, if necessary, before submitting an amendment. By permitting a 30-day period we also seek to avoid a large volume of filings on a single day (*i.e.*, July 21).

17 Proposed amended Item 2.A. of Form ADV, Part 1A would reflect the requirements of the Advisers Act (as amended by the Dodd-Frank Act) and the related rules, and would require an investment adviser to mark Item 2.A.(13) if the adviser is no longer eligible to remain registered with the Commission. For a discussion of the proposed rules, see *infra* sections II.A.5. and II.A.7. of this Release, and for a discussion of Item 2.A, see *infra* section II.A.2. of this Release.

18 Proposed rule 203A-5(b).

19 *See* Advisers Act section 203(h). As provided in the Advisers Act, an adviser would be given appropriate notice and opportunity for hearing to show why its registration should not be cancelled. Advisers Act section 211(c).

rule would permit us to postpone the effectiveness of, and impose additional terms and conditions on, an adviser's withdrawal from SEC registration if we institute certain proceedings before the adviser files Form ADV-W.[20]

We propose to use our exemptive authority under section 203A(c)[21] to provide for a transitional process with two "grace periods," the first providing 30 days from the July 21, 2011 effective date of the Dodd-Frank Act for an adviser to determine whether it is eligible for Commission registration and to file an amended Form ADV, and the second providing an additional 60 days (following the end of the first 30-day period) for an adviser to register in the states and to arrange for its associated persons to qualify for investment adviser representative registration, which may include preparing for and passing an examination, before withdrawing from Commission registration.[22] We are proposing a 90-day transition process, which is shorter than the 180-day transition period that our rules currently provide for advisers switching from SEC to state registration, in order to promptly implement this Congressional mandate and accommodate the processing of renewals and fees for state registration and licensing via the IARD system, while allowing for an orderly transition.[23]

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[20] Proposed rule 203A-5(c) ("If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the Commission has instituted a proceeding pursuant to section 203(e)…to suspend or revoke registration, or pursuant to section 203(h)…to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors."). This language largely is consistent with rule 203A-5 adopted after NSMIA. *See* NSMIA Adopting Release, *supra* note 10.

[21] *See supra* note 13 and accompanying text.

[22] Proposed rule 203A-5. We would also amend the instructions on Form ADV to explain this process. *See* proposed Form ADV: General Instructions (special one-time instruction for Dodd-Frank transition filing for SEC-registered advisers).

[23] Our current rule provides an SEC-registered adviser that has to switch to state registration a period of 180 days after its fiscal year end to file an annual amendment to Form ADV and to withdraw its SEC registration after reporting to us that it is no longer eligible to remain registered

We request comment on proposed rule 203A-5. Specifically, we request comment on the proposed transition process, including the amount of time we propose for advisers to transition to state registration by filing an amended Form ADV within 30 days after July 21, 2011 and withdrawing from Commission registration within 60 days after the required Form ADV filing. We request comment on whether a transition process is necessary (*e.g.*, whether we should require advisers that do not meet the new eligibility requirements to withdraw from Commission registration as of July 21, 2011), whether two grace periods are necessary (*e.g.*, whether we should require the Form ADV filing and withdrawal of an adviser's registration to occur within the same period), or whether we should provide for a longer period (*e.g.*, whether we should provide 180 days to parallel our current switching rule).[24] Further, should the rule permit us to postpone the effectiveness of, and impose additional terms and conditions on, an adviser's withdrawal from SEC registration?

Our ability to effect the timely transition to state regulation of advisers no longer eligible to register with the Commission may also be affected by our need to re-program the IARD system, through which advisers will file their amendments to Form ADV. We are working closely with the Financial Industry Regulatory Authority ("FINRA"), our IARD contractor, to make the needed modifications, but the programming may not be completed until after we adopt these rules. If IARD is unable to accept filings of Form ADV, including the proposed revisions discussed below to Item 2 of Part 1A, we may need to use our exemptive authority to further delay implementation of the increased threshold for mid-sized adviser registration until the system can accept electronic filing of the revised form. Should we instead require an alternative

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with us. *See* rule 203A-1(b)(2) ; *cf.* rule 204-1(a) (requiring an adviser to file an annual amendment 90 days after its fiscal year end).

[24] *See* rule 203A-1(b)(2); *cf.* 204-1(a).

procedure, such as a paper filing, for advisers to indicate their eligibility for registration or lack thereof?[25]

Since the enactment of the Dodd-Frank Act, our staff has received inquiries from state-registered advisers and advisers registering for the first time expressing concern that they might be required to register with the Commission (because their assets under management are more than $30 million) only to have to withdraw their registration next year when we implement section 410 of the Dodd-Frank Act (raising the threshold for Commission registration to $100 million of assets under management). To avoid such regulatory burdens, we will not object if any state-registered or newly registering adviser is not registered with us if, on or after January 1, 2011 until the end of the transition process (which would be October 19, 2011 under proposed rule 203A-5), the adviser reports on its Form ADV that it has between $30 million and $100 million of assets under management, provided that the adviser is registered as an investment adviser in the state in which it maintains its principal office and place of business, and it has a reasonable belief that it is required to be registered with, and is subject to examination as an investment adviser by, that state.[26] Such advisers should remain registered with, or in the case of a newly registering adviser, apply for registration with, the state securities authorities.[27]

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[25] *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968, n. 53 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)] (requiring paper filing of Form ADV-E until IARD was upgraded to accept the form electronically); NSMIA Adopting Release at section II.A. (requiring advisers to file a separate paper form (Form ADV-T) to indicate whether they were eligible for SEC registration).

[26] For a discussion of these requirements, see *infra* section II.A.7. of this Release.

[27] As discussed above, the Dodd-Frank Act amendments to Advisers Act section 203A(a) will not be effective until July 21, 2011. *See supra* note 6 and accompanying text. Until that date, section 203A continues to apply, and all investment advisers registered with the Commission that remain eligible for registration under the current requirements must maintain their registrations and comply with the Advisers Act.

2. Amendments to Form ADV

Item 2 of Part 1A of Form ADV requires each investment adviser applying for registration to indicate its basis for registration with the Commission and to report annually whether it is eligible to remain registered. Item 2 reflects the current statutory threshold for registration with the Commission as well as our current rules. We propose to revise Item 2 to reflect the new statutory threshold and the revisions we propose to make to related rules as a result of the Dodd-Frank Act.[28] More specifically, we propose to amend Item 2 to require each adviser registered with us (and each applicant for registration) to identify whether, under section 203A, as amended, it is eligible to register with the Commission because it: (i) is a large adviser (having $100 million or more of regulatory assets under management);[29] (ii) is a mid-sized adviser that does not meet the criteria for state registration and examination;[30] (iii) has its principal office and place of business in Wyoming (which does not regulate advisers) or outside the United States;[31] (iv) meets the requirements for one or more of the exemptive rules under section 203A of the Act (as we propose to amend and discuss below);[32] (v) is an adviser (or subadviser) to a registered investment company;[33] (vi) is an adviser to a business development

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28 We also propose to revise the terms used in the rules and Form ADV to refer to the securities authorities in each state with a single defined term, "state securities authority." *Compare* proposed rules 203A-1, 203A-2(c) and (d), 203A-3(e); proposed Form ADV: Glossary *with* rules 203A-1(b)(1), 203A-2(e)(1), 203A-4; Form ADV: Glossary. *See generally* section 410 of the Dodd-Frank Act.

29 Proposed Form ADV, Part 1A, Item 2.A.(1). We are proposing to revise Form ADV to use the term "regulatory assets under management" instead of "assets under management." For a discussion of regulatory assets under management, see *infra* section II.A.3. of this Release.

30 Proposed Form ADV, Part 1A, Item 2.A.(2). For a discussion of the criteria for state registration and examination for mid-sized advisers, see *infra* section II.A.7. of this Release.

31 Proposed Form ADV, Part 1A, Items 2.A.(3), 2.A.(4).

32 Proposed Form ADV, Part 1A, Items 2.A.(7)-2.A.(11). For a discussion of the exemptive rules, see *infra* section II.A.5. of this Release.

33 Proposed Form ADV, Part 1A, Item 2.A.(5).

company and has at least $25 million of regulatory assets under management;[34] or (vii) has some other basis for registering with the Commission.[35] We also expect to modify IARD to prevent an applicant from registering with us, and an adviser from continuing to be registered with us, unless it represents that it meets the eligibility criteria set forth in the Advisers Act and our rules.[36] We request comment on each of the changes we propose to make to Item 2. Are the requirements clearly stated? Do the proposed changes fairly reflect the new eligibility requirements under the Dodd-Frank Act and the amendments we are proposing to make to our rules?

3. Assets Under Management

In most cases, the amount of assets an adviser has under management will determine whether the adviser must be registered with the Commission or the states. Section 203A(a)(2) of the Act defines "assets under management" as the "securities portfolios" with respect to which an adviser provides "continuous and regular supervisory or management services."[37] Instructions to Form ADV provide advisers with guidance in applying this provision, including a list of certain types of assets that advisers may (but are not required to) include.[38] Today, we are proposing revisions to these instructions in order to implement a uniform method to calculate

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34 Proposed Form ADV, Part 1A, Item 2.A.(6).

35 Proposed Form ADV, Part 1A, Item 2.A.(12). We also propose to delete current Item 2.A.(5) for NRSROs. For a discussion of NRSROs, see *infra* section II.A.5.a. of this Release.

36 We would also amend Item 2.A and the related items in Schedule D to reflect proposed revisions to rule 203A-2, which provides exemptions from the prohibition on registration with the Commission. *See* proposed Form ADV Items 2.A.(7), (10) and Section 2.A.(10) of proposed Schedule D; *infra* section II.A.5. of this Release. Additionally, we propose to make conforming changes to the instructions for Form ADV. *See* proposed Form ADV: Instructions for Part 1A, instr. 2.

37 Advisers Act section 203A(a)(2). The Dodd-Frank Act renumbered current paragraph 203A(a)(2) as 203A(a)(3), but did not amend this definition. *See* section 410 of the Dodd-Frank Act.

38 *See* Form ADV: Instructions for Part 1A, instr. 5.b. These assets include proprietary assets, assets an adviser manages without receiving compensation, and assets of foreign clients.

assets under management that can be used under the Act for purposes in addition to assessing whether an adviser is eligible to register with the Commission.[39] We also propose to amend rule 203A-3 to continue to require that the calculation of "assets under management" for purposes of Section 203A be the calculation of the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services, as reported on the investment adviser's Form ADV.[40]

We provided the current instructions on calculating assets under management in 1997 as part of our implementation of the $25 million of assets threshold for registering with the Commission provided for in NSMIA.[41] In that limited context, we provided some options for advisers in determining what assets must be included, and which are not mandated by the Advisers Act. In light of the additional uses of the term "assets under management" by the Dodd-Frank Act[42] and any new regulatory requirements related to systemic risk that might be triggered by registration with the Commission,[43] we are proposing to eliminate the choices we

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39 *Compare* Form ADV: Instructions for Part 1A, instr. 5.b *with* proposed Form ADV: Instructions for Part 1A, instr. 5.b.

40 *See* proposed rule 203A-3(d).

41 *See* NSMIA Adopting Release at section II.B.

42 *See* sections 402(a) and 408 of the Dodd-Frank Act (adding section 202(a)(30) of the Act defining a foreign private adviser as having "assets under management" attributable to U.S. clients and private fund investors of less than $25 million, and section 203(m) directing the Commission to provide for an exemption for advisers solely to private funds with assets under management in the United States of less than $150 million).

43 Section 404 of the Dodd-Frank Act gives the Commission authority to impose on investment advisers registered with the Commission reporting and recordkeeping requirements for systemic risk assessment purposes. The Commission could require registered advisers that meet a certain threshold of assets under management to submit systemic risk data pursuant to our authority in section 404 of the Dodd-Frank Act. *See also* section 203(n) of the Advisers Act, as amended by section 408 of the Dodd-Frank Act ("In prescribing regulations to carry out the requirements of [Section 203 of the Act] with respect to investment advisers acting as investment advisers to mid-sized private funds, the Commission shall take into account the size . . . of such funds to determine whether they pose systemic risk, and shall provide for registration and examination

have given advisers in the Form ADV instructions.[44] Our proposed change would eliminate an adviser's ability to opt into or out of state or federal regulation (by including or excluding a class of assets such as proprietary assets) and any such regulatory requirements. We also would provide additional guidance to advisers on how to count assets managed through private funds.[45] Finally, we propose to alter the terminology we use in Part 1A of Form ADV to refer to an adviser's "regulatory assets under management" in order to acknowledge the distinction from the amount of assets under management the adviser discloses to clients in Part 2 of Form ADV, which need not necessarily meet the requirements of section 203A.[46]

More specifically, we propose to require all advisers to include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without receiving compensation, or assets of foreign clients, all of which an adviser currently may (but is not required to) exclude.[47] In addition, we would not allow an adviser to subtract outstanding indebtedness and other accrued but unpaid liabilities, which remain in a client's account and are managed by the adviser.[48]

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procedures with respect to the investment advisers of such funds which reflect the level of systemic risk posed by such funds.").

44 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

45 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1), (4). *See also* section 402 of the Dodd-Frank Act (defining private fund as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act"); Exemptions Release at section II.A.8. (discussing when a fund qualifies as a private fund) and at section II (providing additional descriptions of the proposed rules and their application for purposes of the new exemptions available to private fund advisers).

46 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.; *Amendments to Form ADV*, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49234 (Aug. 12, 2010)] ("Part 2 Release").

47 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

48 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(2). Accordingly, an adviser would not be able to deduct accrued fees, expenses, or the amount of any borrowing.

We are proposing these changes in order to preclude some advisers from excluding certain assets from their calculation and thus remaining below the new assets threshold for registration with the Commission. The changes would result in some advisers reporting greater assets under management than they do today, but the assets we would require advisers to include in their assets under management are, in fact, assets managed by the adviser and allowing advisers to exclude such assets may have substantially more significant regulatory consequences than in 1997. The management of such assets, for example, may suggest that the adviser's activities are of national concern or have implications regarding the reporting for the assessment of systemic risk, a matter Congress considered important in enacting amendments to the Advisers Act in the Dodd-Frank Act.[49] The Commission, moreover, is proposing that advisers be required to include these assets so that the calculations would be more consistent among advisers. The Commission also believes that requiring that these assets be included in the calculation would better achieve the objective of the Dodd-Frank Act regarding which advisers must register with the Commission, which advisers must register with the states, and which advisers are exempt from Commission registration.

We also propose, as discussed below, to provide guidance regarding how an adviser that advises private funds determines the amount of assets it has under management. Form ADV currently provides no specific instructions applicable to this circumstance. We have designed our proposed instructions both to provide advisers with greater certainty in their calculation of regulatory assets under management, which they would also use as a basis to determine their eligibility for certain exemptions that we are proposing today in the Exemptions Release,[50] as

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[49] *See supra* note 43. Congress did not address these systemic risk implications when it adopted NSMIA.

[50] *See* Exemptions Release at sections II.B.2. and II.C.5.

well as to prevent advisers from understating those assets to avoid registration. First, we would require an adviser to include in its regulatory assets under management the value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund.[51] As would be required for any other securities portfolio, a sub-adviser to a private fund would include in its assets under management only that portion of the value of the portfolio for which it provides sub-advisory services.

Second, we propose to require such adviser to include in its calculation of regulatory assets under management the amount of any uncalled capital commitments made to the fund.[52] Private funds, such as venture capital and private equity funds, typically make investments following capital calls on their investors, who are contractually obligated to fund their committed capital amounts.[53] Advisers to these types of private funds provide supervisory or management services to the funds in anticipation of all investors fully funding their capital commitments, describe the size of their funds on the basis of these capital commitments and, in the early years of a fund's life, typically earn fees based on the total amount of capital committed.[54]

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51 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

52 *Id.* A capital commitment is a contractual obligation of an investor to acquire an interest in, or provide the total commitment amount over time to, a private fund, when called by the fund.

53 *See, e.g.*, JAMES SCHELL, PRIVATE EQUITY FUNDS: BUSINESS STRUCTURE AND OPERATIONS §1.01 (2010) ("SCHELL") (typical private equity fund partnership agreement requires investors to commit to make capital contributions to the fund, which would be paid as needed rather than upfront and would be used to pay expenses and make investments); STEPHANIE BRESLOW & PHYLLIS SCHWARTZ, PRIVATE EQUITY FUNDS, FORMATION AND OPERATION 2010, at § 2:5.6 (discussing the various remedies that may be imposed in the event an investor fails to fund its contractual capital commitment, including, but not limited to, "the ability to draw additional capital from non-defaulting investors;" "the right to force a sale of the defaulting partner's interests at a price determined by the general partner;" and "the right to take any other action permitted at law or in equity").

54 *See, e.g.*, SCHELL, *supra* note 53 at §1.01 (noting that capital contributions made by the investors are used to "make investments in a manner consistent with the investment strategy or guidelines for the Fund.") and at §1.03 ("Management fees in a Venture Capital Fund are usually an annual amount equal to a fixed percentage of total Capital Commitments.").

Third, we propose to add an instruction to require advisers to use the fair value of private fund assets in order to ensure that advisers value private fund assets on a more meaningful and consistent basis.[55] Use of the cost basis (*i.e.*, the value at which the assets were originally acquired), for example, could under certain circumstances grossly understate the value of appreciated assets, and thus result in advisers avoiding registration with the Commission. Use of the fair valuation method by all advisers, moreover, would result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Act's regulatory requirements and of our staff's risk assessment program. We understand that many, but not all, private funds value assets based on their fair value in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards.[56] We acknowledge some private funds do not use fair value methodologies, which may be more difficult to apply when the fund holds illiquid or other types of assets that are not traded on organized markets.[57] We believe, however, that for the reasons stated above it is

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55 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(4). A fund's governing documents may provide for a specific process for calculating fair value (*e.g.*, that the general partner, rather than the board of directors, determines the fair value of the fund's assets). An adviser would be able to rely on such a process also for purposes of calculating its "regulatory assets under management."

56 *See, e.g.*, Comment Letter of National Venture Capital Association, dated July 28, 2009, at 2, commenting on the Commission's proposed custody rule (Investment Advisers Act Release No. 2876) (the "vast majority of venture capital funds provide their LPs [*i.e.*, investors] quarterly and audited annual financial reports. These reports are prepared under generally accepted accounting principles, or GAAP, and audited under the standards established for all investment companies, including the largest mutual fund complexes."); Comment Letter of Managed Funds Association, dated July 28, 2009, at 3 (a "substantial proportion of hedge fund managers, whether or not they are registered with the Commission, provide independently audited financial statements of the [hedge] fund to investors."). Furthermore, advisers to private funds that prepare and distribute financial statements prepared in accordance with GAAP may be deemed to satisfy certain requirements of our custody rule. *See* rule 206(4)-2(b)(4) under the Advisers Act.

57 Those assets include, for example, "distressed debt" (such as securities of companies or government entities that are either already in default, under bankruptcy protection, or in distress and heading toward such a condition) or certain types of emerging market securities that are not readily marketable. *See* GERALD T. LINS *et al.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS: REG

important for all advisers to use the fair valuation method to calculate their private fund assets under management.

Advisers, as discussed below, would apply this revised method to calculate assets under management for various purposes under the Advisers Act. As they do today, advisers would calculate their assets under management for purposes of assessing whether they are eligible to register with the Commission. As a result of the proposed amendments to rule 203A-1, which would remove the requirement that an adviser determine its eligibility for registration by the assets under management reported on Form ADV, we are proposing a new provision, rule 203A-3(d), to retain the requirement that the calculation of "assets under management" under section 203A and the related rules be made in accordance with the Form ADV calculation.[58] Advisers would also apply the method for purposes of the new exemptions for foreign private advisers and with respect to certain private fund advisers, which we address in the Exemptions Release. For purposes of calculating the assets under management relevant under the exemptions, our proposed rules cross-reference the method for calculating "regulatory assets under management" under Form ADV.[59] A uniform method of calculating assets under management for purposes of determining eligibility for SEC registration, reporting assets under management on Form ADV, and the new exemptions from registration under the Advisers Act would result in a more

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AND COMP § 5:22 (2009) ("At any given time, some portion of a hedge fund's portfolio holdings may be illiquid and/or difficult to value. This is particularly the case for certain types of hedge funds, such as those focusing on distressed securities, activist investing, etc.").

58 *See* proposed rule 203A-3(d) (requiring advisers to determine "assets under management" by calculating the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services as reported on the investment adviser's Form ADV). This new provision reflects the current requirement in subsection (a) of rule 203A-1 that we propose to eliminate to remove the $5 million buffer, which also requires advisers to determine their eligibility to register with the Commission based on the amount of assets under management reported on Form ADV. *See* rule 203A-1(a).

59 *See* Exemptions Release at sections II.B.2. and II.C.5.; proposed rules 202(a)(30)-1 (definitions of foreign private adviser exemption terms) and 203(m)-1 (private fund adviser exemption).

coherent application of the Act's regulatory requirements and more consistent reporting across the industry.

We request comment on our proposed changes to the instructions relating to the calculation of "regulatory assets under management." Are changes to the rule and instructions necessary? Should we instead consider different changes? If so, in what way should we amend them? In particular, is our understanding that most private funds prepare financial statements using fair value accounting correct? Would the proposed approach result in advisers valuing their private fund assets in a generally uniform manner and in comparability of the valuations? We are not proposing to require advisers to determine fair value in accordance with GAAP. Should we adopt such a requirement? If not, should we specify that advisers may only determine the fair value of private fund assets in accordance with a body of accounting principles used in preparing financial statements? We understand that GAAP does not require some funds to fair value certain investments. Should we provide for an exception from the proposed fair valuation requirement with respect to any of those investments?

Should we adopt a different approach altogether and allow advisers to use a method other than fair value? Are there other methods that would not understate the value of fund assets? Should the instructions permit advisers to rely on the method set forth in a fund's governing documents, or the method used to report the value of assets to investors or to calculate fees (or other compensation) for investment advisory services? What method should apply if a fund uses different methods for different purposes? Should we modify the proposed rule to require that the valuation be derived from audited financial statements or be subject to review by auditors or another independent third party?

Advisers are currently only required to update their assets under management reported on Form ADV annually.[60] Should we require more frequent updating? For instance, should we require an adviser to update its regulatory assets under management quarterly or any time the adviser files an other-than-annual amendment?[61]

4. Switching Between State and Commission Registration

Rule 203A-1 currently contains two means of preventing an adviser from having to switch frequently between state and Commission registration as a result of changes in the value of its assets under management or the departure of one or more clients.[62] First, the rule provides for a $5 million buffer that permits an investment adviser having between $25 million and $30 million of assets under management to remain registered with the states and does not subject the adviser to cancellation of its Commission registration until its assets under management fall below $25 million.[63] Second, the rule permits an adviser to rely on the firm's assets under management reported annually in the firm's annual updating amendments for purposes of determining its eligibility to register with the Commission, allowing an adviser to avoid the need to change registration status based upon fluctuations that occur during the course of the year.[64] If

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60 *See* General Instruction 4 to Form ADV.

61 *See, e.g.*, Exemptions Release at section II.B.2. (proposed rule 203(m)-1 would require quarterly evaluation of private fund assets); Part 2 Release, *supra* note 46, at nn.46-48 and accompanying text (requiring advisers to update the amount of assets under management reported in Part 2 annually and when there are material changes if the adviser files an interim amendment for a separate reason).

62 *See* rule 203A-1(a), (b); NSMIA Adopting Release, *supra* note 10, at section II.C.; *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1601, section II.C. (Dec. 20, 1996) [61 FR 68480 (Dec. 27, 1996)] ("NSMIA Proposing Release").

63 Rule 203A-1(a).

64 Rule 203A-1(b). *See also* rule 204-1(a) (requiring annual amendment to Form ADV within 90 days of fiscal year end); General Instruction 4 (annual amendment to Form ADV must update amount of assets under management reported). Other criteria to determine an adviser's eligibility to register with the Commission must also be determined annually. *See* rule 203A-1(b)(2).

an adviser is no longer eligible for Commission registration, the rule provides a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.[65]

We propose to amend rule 203A-1 to eliminate the $5 million buffer for advisers having between $25 million and $30 million of assets under management, but to retain the ability of an adviser to avoid the need to change registration status based upon intra-year fluctuations in its assets under management for purposes of determining its eligibility to register with the Commission.[66] The current buffer seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states.[67] Moreover, at this time, we believe it is not necessary to increase the $100 million threshold in order to provide a similar buffer for advisers crossing that threshold and becoming registered with the Commission under the amended statutory provisions. We believe that the requirement that advisers only assess their eligibility for registration annually and the grace periods provided to switch to and from state registration will be sufficient to address the concern that an investment adviser with assets under management approaching $100 million or affected by changes in other eligibility requirements will frequently have to switch between state and federal registration.[68]

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65 Rule 203A-1(b)(2).

66 *See* proposed rule 203A-1. In addition, the proposed rule would permit an adviser to rely on an affirmation of other criteria reported in its annual updating amendments for purposes of determining its eligibility to register with the Commission. *See* proposed rule 203A-1(b) (continuing to require an adviser filing an annual updating amendment to its Form ADV reporting that it is not eligible for Commission registration to withdraw its registration within 180 days of its fiscal year end).

67 *See* H.R. REP. NO. 111-517, at 867 (2010) ("Conference Committee Report") (discussing fact that legislation "raise[d] the assets threshold for federal regulation of investment advisers from $30 million to $100 million.").

68 If during the 180-day grace period to switch to state registration an adviser's assets under management increase, making the adviser eligible for Commission registration again, the adviser could amend its Form ADV to indicate the new amount of assets under management and continue

We request comment on our proposed elimination of the $5 million buffer. Do many advisers currently use this buffer? Should we retain the buffer given the new provisions regarding mid-sized advisers? Should we adopt a similar buffer for the new $100 million dollar threshold in amended section 203A? If so, what should be the amount of the buffer? Should it be $5 million, or higher or lower, and why? Do Item 2.A of Form ADV, Part 1A and the related instructions provide sufficient information to advisers about their eligibility to register with the Commission, or is additional guidance necessary?

5. Exemptions from the Prohibition on Registration with the Commission

Section 203A(c) of the Advisers Act provides the Commission with the authority to permit investment advisers to register with the Commission even though they would be prohibited from doing so otherwise.[69] As also noted above, under this authority, we have adopted six exemptions in rule 203A-2 from the prohibition on registration.[70] Our authority under this provision was unchanged by the Dodd-Frank Act and therefore extends to the new mid-sized adviser category in section 203A(a)(2) of the Act, as amended.[71] As a result, as

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to remain registered with the Commission. *See* proposed rule 203A-1(b) (adviser must withdraw from SEC registration within 180 days of its fiscal year end unless it then is eligible for registration).

69 *See* Advisers Act section 203A(c). An investment adviser exempted from the prohibition on registration must register with the Commission, unless it otherwise qualifies for an exemption from registration under section 203(b) of the Advisers Act. Advisers Act section 203(a).

70 *See supra* note 14 and accompanying text. The Commission has permitted six types of investment advisers to register with the Commission under rule 203A-2: (i) NRSROs; (ii) pension consultants; (iii) investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) multi-state investment advisers; and (vi) internet advisers.

71 Today, rule 203A-2 provides that advisers meeting the criteria for a category of advisers under the rule will not be prohibited from registering with us by Advisers Act section 203A(a). *See* rule 203A-2; NSMIA Adopting Release at section II.D. We are not proposing to amend this part of rule 203A-2. The new prohibition on mid-sized advisers registering with the Commission also is established under Advisers Act section 203A(a); therefore, mid-sized advisers meeting the requirements for a category of exempt advisers under rule 203A-2 would be eligible to register with us. *See* section 410 of the Dodd-Frank Act; proposed rule 203A-2.

currently drafted, each of these exemptions would, by its terms, apply to mid-sized advisers–exempting them from the prohibition on registering with the Commission if they meet the requirements of rule 203A-2. We are proposing amendments to three of the exemptions to reflect developments since their adoption, including the enactment of the Dodd-Frank Act. We request comment on whether we should amend the rules so that some, or all, of the exemptions should not be available to mid-sized advisers.[72]

a. NRSROs

We propose an amendment to eliminate the exemption in rule 203A-2(a) from the prohibition on Commission registration for nationally recognized statistical rating organizations ("NRSROs"). Since we adopted this exemption, Congress amended the Act to exclude NRSROs from the Act[73] and provided for a separate regulatory regime for NRSROs under the Securities Exchange Act of 1934 ("Exchange Act").[74] Only one NRSRO remains registered as an investment adviser under the Act and reports that it has more than $100 million of assets under management and thus would not rely on the exemption.[75] Should we retain this exemption? If so, why?

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72 We are also renumbering and making minor conforming changes to, rule 203A-2(c), (d) and (f) regarding investment advisers affiliated with an SEC-registered adviser, newly formed advisers expecting to be eligible for Commission registration within 120 days, and internet advisers. *See* proposed rule 203A-2(b), (c) and (e).

73 Credit Rating Agency Reform Act of 2006, P.L. 109-291, 120 Stat. 1327, § 4(b)(3)(B) (2006) ("Credit Rating Agency Reform Act"). *See also* Advisers Act section 202(a)(11)(F) (excluding an NRSRO from the definition of investment adviser unless it issues recommendations about purchasing, selling, or holding securities or engages in managing assets that include securities).

74 Credit Rating Agency Reform Act, *supra* note 73, at sections 4(a), 5.

75 Based on IARD data as of September 1, 2010.

b. Pension Consultants

We propose to amend the exemption available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million.[76] Pension consultants typically do not have "assets under management," but we have required these advisers to register with us because their activities have a direct effect on the management of large amounts of pension plan assets.[77] We had set the threshold at $50 million of plan assets for these advisers to ensure that, in order to register with us, a pension consultant's activities are significant enough to have an effect on national markets.[78] We propose to increase this threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of "assets under management" that requires all advisers to register with the Commission.[79] This threshold would maintain a ratio to the statutory threshold that is the same as the ratio of the $50 million plan asset threshold and $25 million assets under management threshold currently in place. As a result, advisers currently relying on the pension consultant

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76 *See* proposed rule 203A-2(a).

77 *See* NSMIA Adopting Release at section II.D.2.; NSMIA Proposing Release at section II.D.2. Pension consultants provide services to pension and employee benefit plans and their fiduciaries, including assisting them to select investment advisers that manage plan assets. *See* rule 203A-2(b)(2), (3); NSMIA Adopting Release at section II.D.2. The exemption does not apply to pension consultants that solely provide services to plan participants. *See* NSMIA Adopting Release at section II.D.2.

78 *See* NSMIA Adopting Release at n. 60 (the $50 million "higher threshold is necessary to demonstrate that a pension consultant's activities have an effect on national markets."). The higher asset requirement also reflects that a pension consultant has substantially less control over client assets than an adviser that has "assets under management." *Id.* To determine the aggregate value of plan assets, a pension consultant may only include the portion of the plan's assets for which the consultant provided investment advice. Rule 203A-2(b)(3).

79 *See* section 410 of the Dodd-Frank Act.

exemption advising plan assets of less than $200 million may be required to register with one or more states.[80]

We request comment on our proposed amendment. Does an adviser advising plan assets of $200 million or more have an impact on national markets? Should we use another amount instead? Does an adviser advising a smaller amount of plan assets also have an impact on national markets? Should we instead increase the threshold by the same amount that Congress increased the statutory threshold of assets under management, which would be $125 million of plan assets?

c. Multi-state Advisers

We propose to amend the multi-state adviser exemption to align the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act.[81] Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register in 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register in at least 25 states.[82] The Dodd-Frank

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80 We note, however, that a pension consultant required to register in 15 or more states would be eligible to register with the SEC pursuant to proposed rule 203A-2(d). *See infra* section II.A.5.c. of this Release.

81 *See* proposed rule 203A-2(d).

82 Rule 203A-2(e)(1). An investment adviser relying on this exemption also must: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with the required number of states; (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that it would be required by the laws of fewer than 25 states to register as an investment adviser with the state; and (iii) maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. Rule 203A-2(e)(2)-(4). Advisers relying on rule 203A-2(e) may not include in the number of states those in which they are not required to register because of applicable state laws or the national *de minimis* standard of section 222(d) of the Advisers Act. *See Exemption for Investment Advisers Operating in Multiple States; Revisions to Rules Implementing Amendments to the Investment Advisers Act of 1940; Investment Advisers with Principal Offices and Places of Business in*

Act provides that a mid-sized adviser that otherwise would be prohibited may register with the Commission if it would be required to register with 15 or more states.[83]

We believe that this provision of the Dodd-Frank Act reflects a Congressional view on the number of states with which an adviser must be required to be registered before the regulatory burdens associated with such regulation warrant registration solely with the Commission and application of the preemption provision.[84] Thus, we are reconsidering the threshold of our multi-state exemption, and propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.[85] We also propose to eliminate the provision in the rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not proposing a similar cushion for the 15-state threshold.[86] The Dodd-Frank Act contains no such cushion for mid-sized advisers.[87] We also believe that the requirement that advisers only assess their eligibility for registration annually and the grace periods provided to switch to and from state

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Colorado or Iowa, Investment Advisers Act Release No. 1733, n. 17 (July 17, 1998) [63 FR 39708 (July 24, 1998)] ("Multi-State Adviser Adopting Release").

83 *See* section 410 of the Dodd-Frank Act ("…if by effect of this paragraph an investment adviser would be required to register with 15 or more States, then the adviser may register under section 203."). Section 203A(a)(1) of the Advisers Act does not include a similar exemption from the prohibition on Commission registration for small advisers required to register in a particular number of states.

84 *See* Conference Committee Report, *supra* note 67, at 867 (bill "raises the assets threshold for federal regulation of investment advisers from $30 million to $100 million. Those advisers who qualify to register with their home state must register with the SEC should the adviser operate in more than 15 states.").

85 *See* proposed rule 203A-2(d)(1).

86 *See* proposed rule 203A-2(d)

87 *See* section 410 of the Dodd-Frank Act.

registration may be sufficient to address the concern that an investment adviser required to register in 15 states would frequently have to switch between state and federal registration.[88]

We request comment on whether the 15-state threshold should be applied to small advisers as well as mid-sized advisers. If not, should the threshold of 30 or more states continue to apply to small advisers? Should we, as proposed, eliminate the "cushion" that permits advisers to remain registered with us even if they are no longer registered in five of the states in which they were initially registered? Should we retain that provision or, alternatively, include a different number of states? Does the grace period currently provided in rule 203A-1 prevent the transient registration problems that the five-state cushion was designed to address?[89]

6. Elimination of Safe Harbor

Rule 203A-4 provides a safe harbor from Commission registration for an investment adviser that is registered with the state securities authority of the state in which it has its principal office and place of business, based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[90] Advisers have not, in our experience, asserted, as a defense, the availability of this safe harbor, which protects only against enforcement actions by us and not any private actions, and we are not proposing to extend it to the higher threshold established by the Dodd-Frank Act. This rule was designed for smaller advisory businesses with assets under management of less than $30

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88 *See supra* notes 66-68 and related text. We also note that proposed rule 203A-2(d) would permit an adviser to choose to maintain its state registrations and not switch to SEC registration. *See* proposed rule 203A-2(d)(2) (adviser elects to rely on the exemption by making the required representations on Form ADV).

89 *See* proposed rule 203A-1; *supra* notes 66-68 and related text; Multi-State Adviser Adopting Release at section II.A. (five-state provision creates a cushion to prevent an adviser from having to de-register and then re-register with the Commission frequently as a result of a change in registration obligations in one or a few states).

90 Rule 203A-4.

million,[91] which may not employ the same tools or otherwise have a need to calculate assets as precisely as advisers with greater assets under management. We view it as unlikely that an adviser would be reasonably unaware that it has more than $100 million of regulatory assets under management when it is required to report its regulatory assets under management on Form ADV.[92] Commenters are requested to address whether advisers do, in fact, rely on this safe harbor today. We also request comment on whether we should, as we propose, rescind this safe harbor or, alternatively, extend its availability to the higher registration threshold of the Dodd-Frank Act.

7. Mid-Sized Advisers

As discussed above, section 203A(a)(2) of the Advisers Act, as amended by the Dodd-Frank Act, will prohibit mid-sized advisers from registering with the Commission, but only if: (i) the adviser is required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; and (ii) if registered, the adviser would be subject to examination as an investment adviser by such commissioner, agency, or office.[93] The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority.[94] We propose to incorporate into Form ADV an explanation of how we construe these provisions.[95]

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91 *See* rule 203A-4; NSMIA Adopting Release at section II.B.3.

92 We believe that whether an adviser has $100 million of assets under management is unlikely to be determined by whether non-discretionary assets could be treated as assets under management or whether the adviser provides continuous and regular supervisory or management services with respect to certain assets, which was the basis for the safe harbor. *See* NSMIA Adopting Release at section II.B.3.; NSMIA Proposing Release at section II.B.4.

93 *See* section 410 of the Dodd-Frank Act.

94 The Advisers Act defines the term "state" to include any U.S. state, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Advisers Act

a. Required to be Registered

Under section 203A(a)(1) of the Act, an adviser that is not regulated or required to be regulated as an investment adviser in the state in which it has its principal office and place of business must register with the Commission regardless of the amount of assets it has under management.[96] We have interpreted "regulated or required to be regulated" to mean that a state has enacted an investment adviser statute, regardless of whether the adviser is actually registered in that state.[97] This interpretation has two relevant consequences. First, advisers with a principal office and place of business in Wyoming, or in foreign countries, must register with the Commission regardless of whether they have assets under management and would not otherwise be eligible for one of our exemptive rules.[98] Second, some smaller advisers exempt from state registration are not subject to registration with either the Commission or any of the states.[99]

We believe that Congress was concerned with the latter consequence when it passed this provision of the Dodd-Frank Act. The bills originally introduced and passed in the House and Senate increased up to $100 million the threshold for Commission registration under the

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section 202(a)(19). For purposes of section 203A of the Advisers Act and the rules thereunder, rule 203A-3(c) defines "principal office and place of business" to mean the executive office of the investment adviser from which its officers, partners, or managers direct, control, and coordinate its activities. We are not proposing changes to this definition. *See* rule 203A-3(c). For a discussion of amendments we propose to make to the calculation of assets under management, see *supra* section II.A.3. of this Release.

95 *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b.

96 Advisers Act section 203A(a)(1). *See also* Advisers Act section 203(a).

97 *See* NSMIA Adopting Release at section II.E.1.

98 *See* NSMIA Adopting Release at section II.E.; NSMIA Proposing Release at section II.E. Currently, all U.S. states except Wyoming require certain investment advisers to register. *See Transition Rule for Ohio Investment Advisers*, Investment Advisers Act Release No. 1794, n. 4 (Mar. 25, 1999) [64 FR 15680 (Apr. 1, 1999)].

99 *See, e.g.*, Advisers Act section 203A(a)(1); Uniform Securities Act §§ 102(15), 403(b) (2002) ("Uniform Securities Act") (defining "investment adviser" and providing exemptions from state registration as an investment adviser).

"regulated or required to be regulated" standard that is used today in section 203A(a)(1).[100] Accordingly, some advisers with a significant amount (more than $25 million) of assets under management could have escaped oversight by either the Commission or any of the states by taking advantage of state registration exemptions. Perhaps to avoid this possibility, the Conference Committee included a provision to prohibit a mid-sized adviser from registering with the Commission if, among other things, it is "required to be registered" as an adviser with the state securities authority where it maintains its principal office and place of business.[101] A mid-sized adviser that can and does rely on an exemption under the law of the state in which it has its principal office and place of business such that it is "not required to be registered" with the state securities authority[102] must register with the Commission, unless an exemption from registration with the Commission otherwise is available.[103] An adviser not registered under a state adviser statute in contravention of the statute, however, would not be eligible for registration with the Commission.

We are proposing changes to Form ADV to require a mid-sized adviser filing with us to affirm, upon application and annually thereafter, that it is not required to be registered as an adviser with the state securities authority in the state where it maintains its principal office and

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100 *See* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 7418 (2009) (requiring an adviser with between $25 million and $100 million of assets under management that "is regulated and examined, or required to be regulated and examined, by a State" to register with and be subject to examination by such state); Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 410 (2010) (prohibiting an investment adviser with assets under management of less than $100 million from registering with the Commission if the adviser "is regulated or required to be regulated as an investment adviser" in the state where it maintains its principal office and place of business).

101 *See* section 410 of the Dodd-Frank Act.

102 *See, e.g.*, Uniform Securities Act, *supra* note 99, at sections 102(15), 403(b).

103 *See, e.g.*, Advisers Act sections 203(a) and (b), 203A(b); rule 203A-2. Such an adviser could not voluntarily register with the state securities authorities to avoid SEC registration.

place of business.[104] An adviser reporting that it is no longer able to make such an affirmation thereafter would have 180 days from its fiscal year end to withdraw from Commission registration.[105] Thus, the rule would operate to permit an adviser to rely on this affirmation reported in its annual updating amendments for purposes of determining its eligibility to register with the Commission.[106] Should these requirements apply to mid-sized advisers? Are there alternative interpretations of "required to be registered" that we should consider and why?

b. Subject to Examination

Not all state securities authorities conduct compliance examinations of advisers registered with them.[107] Congress therefore determined to require a mid-sized adviser to register with the Commission if the adviser is not subject to examination as an investment adviser by the state in which the adviser has its principal office and place of business.[108]

The Commission does not intend either to review or evaluate each state's investment adviser examination program.[109] Instead, we will correspond with each state securities commissioner (or official with similar authority) and request that each advise us whether an

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104 *See* proposed Form ADV, Part 1A, Item 2.A.(2)(a). For a discussion of proposed changes to Form ADV, Part 1A, Item 2, see *supra* section II.A.2. of this Release.

105 *See* proposed rule 203A-1(b).

106 This would allow an adviser to change registration status based upon a change during the course of the year regarding whether it is required to be registered with a state.

107 *See, e.g.*, North American Securities Administrators Association, Inc., *State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers*, 7 (2010) ("NASAA Report"). The NASAA Report was submitted in connection with the Commission's study regarding obligations of brokers, dealers, and investment advisers, and is available on the Commission's website at http://www.sec.gov/comments/4-606/4606-2789.pdf.

108 *See* section 410 of the Dodd-Frank Act.

109 The bill introduced in the House included a requirement that we publish a list of the states that regulate and examine, or require regulation and examination of, investment advisers. *See* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 7418 (2009). Congress did not include this requirement in the Dodd-Frank Act. *See* section 410 of the Dodd-Frank Act.

investment adviser registered in the state would be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority).[110] We believe that the states, being most familiar with their own circumstances, are in the best position to determine whether advisers in their state are subject to examination. Using the responses that we receive, we will identify for advisers filing on IARD the states in which the securities commissioner did not certify that advisers are subject to examination and incorporate that list into IARD to ensure that only mid-sized advisers with their principal office and place of business in one of those states (or, as discussed above, mid-sized advisers that are not registered with the states where they maintain their principal office and place of business) will register with the Commission.[111] We request comment on whether the Commission should take additional steps to determine whether an investment adviser would be subject to examination in a state, as well as any alternatives the Commission may adopt. We also request comment on the steps the Commission should take if a state determines not to respond to our request.

B. Exempt Reporting Advisers: Sections 407 and 408

As discussed above, the Dodd-Frank Act, effective July 21, 2011, also repealed the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act on which advisers to many hedge funds and other pooled investment vehicles had relied in order to avoid registration under the Act.[112] In eliminating this provision, Congress amended the Act to create,

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110 We also will request that each state notify the Commission promptly if advisers in the state will begin to be subject to examination or will no longer be subject to examination.

111 *See* proposed Form ADV, Part 1A, Item 2.A.(2)(b). We will also make the list available on our website at http://www.sec.gov.

112 Section 403 of the Dodd-Frank Act. Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act, or a company which has elected to be a business development company pursuant to Section 54 of the Investment Company Act (15 U.S.C. 80a-53).

or direct us to adopt, other, in many ways narrower, exemptions for advisers to certain types of "private funds." Both section 203(l) of the Advisers Act (which provides an exemption for an adviser that advises solely one or more "venture capital funds") and section 203(m) of the Advisers Act (which instructs the Commission to exempt any adviser that acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million) provide that the Commission shall require such advisers to maintain such records, which we have the authority to examine,[113] and to submit reports "as the Commission determines necessary or appropriate in the public interest."[114] We refer to these advisers in this release as "exempt reporting advisers."

To implement sections 203(l) and 203(m), we are proposing a new rule to require exempt reporting advisers to submit, and to periodically update, reports to us by completing a limited subset of items on Form ADV.[115] We are also proposing amendments to Form ADV to permit the form to serve as a reporting, as well as a registration, form and to specify the seven items exempt reporting advisers must complete.[116]

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113 Under section 204(a) of the Advisers Act, the Commission has the authority to examine records, unless the adviser is "specifically exempted" from the requirement to register pursuant to section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on section 203(l) or 203(m) of the Advisers Act are not "specifically exempted" from the requirement to register pursuant to section 203(b).

114 *See* sections 407 and 408 of the Dodd-Frank Act, adding Advisers Act sections 203(l) and (m). See *supra* note 45 for a discussion of the term "private fund." *See also* Exemptions Release at section II. *See also* current section 204(a) of the Advisers Act and section 204(b)(5), as added by section 404 of the Dodd-Frank Act.

115 Recordkeeping requirements for exempt reporting advisers will be addressed in a future release. *See* sections 407 and 408 (providing that the Commission shall require investment advisers exempt from registration under either section 407 or 408 to maintain such records as the Commission determines necessary or appropriate in the public interest or for the protection of investors.).

116 For a discussion of additional amendments we are proposing to Part 1 of Form ADV, see *infra* section II.C. of this Release.

1. Reporting Required

We are proposing a new rule, rule 204-4, to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[117] Rule 204-4 would require these advisers to submit their reports through the IARD using the same process as registered investment advisers.[118] Each Form ADV would be considered filed with the Commission upon acceptance by the IARD,[119] and advisers filing the form would be required to pay a filing fee.[120] As we do for IARD filings by registered advisers, we would approve, by order, the amount of the filing fee charged by FINRA.[121] We anticipate that filing fees would be the same as those for registered investment advisers, which currently range from $40 to $200, based on the amount of assets an adviser has under management.[122] The filing fees would be set at amounts that are designed to pay the reasonable costs associated with the filing and the maintenance of the IARD.

The reports filed by exempt reporting advisers would be publicly available on our website.[123] Exempt reporting advisers unable to file electronically as a result of unanticipated technical difficulties may qualify for a temporary hardship exemption.[124] We also are proposing

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117 Proposed rule 204-4(a).

118 Proposed rule 204-4(b). *See* General Instructions 6, 7, 8 and 9 (providing guidance about the IARD entitlement process, signing the form, and submitting it for filing).

119 Proposed rule 204-4(c). *Cf.* rule 0-4(a)(2) ("All filings required to be made electronically with the . . . [IARD] shall, unless otherwise provided by the rules and regulations in this part, be deemed to have been filed with the Commission upon acceptance by the IARD.").

120 Proposed rule 204-4(d).

121 *See* section 204(b) of the Advisers Act.

122 The current fee schedule may be found on our website at http://www.sec.gov/divisions/investment/iard/iardfee.shtml.

123 The Investment Adviser Public Disclosure System ("IAPD") allows the public to access the most recent Form ADV filing made by an investment adviser and is available at http://www.adviserinfo.sec.gov. We would, however, make it clear to the public viewing reports filed by an exempt reporting adviser on IAPD that the adviser is not registered with us.

124 *See* proposed rule 204-4(e) (providing a temporary hardship exemption for an adviser having unanticipated technical difficulties that prevent submission of a filing to IARD). The temporary

technical amendments to Form ADV-H, the form advisers use to request a hardship exemption from electronic filing, and Form ADV-NR, used to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers.[125]

We are proposing to require reporting on Form ADV through the IARD to avoid the expense and delay of developing a new form and because the IARD already has the capacity to accept electronic filing of the form. Moreover, much of the information we propose that exempt reporting advisers would provide is required by Form ADV. Because exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities,[126] use of the existing form and filing system would also permit exempt reporting advisers to satisfy both state and Commission requirements with a single electronic filing.[127] Our proposed approach

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hardship exemption is based on a similar exemption for registered advisers contained in rule 203-3(a) under the Act [17 CFR 275.203-3(a)], which provides an exemption of no more than seven business days after the filing was due.

125 *See* proposed amended Form ADV-H, proposed amended Form ADV-NR, and proposed General Instruction 18. The amendments to Form ADV-H and Form ADV-NR would reflect that exempt reporting advisers would be filing on IARD and the forms would be used in the same way and for the same purpose as they are currently used by registered investment advisers.

126 The Dodd-Frank Act exempts exempt reporting advisers from registration with the Commission. *See* sections 407 and 408 of the Dodd-Frank Act. It does not, however, exempt these advisers from registering or filing reports with state securities regulators. *See also* section 410 of the Dodd-Frank Act (re-allocating SEC and state jurisdiction over investment advisers); proposed rule 203A-1 (proposing the process for switching to or from state or SEC registration); and proposed General Instruction 13 to Form ADV (noting that exempt reporting advisers who file reports with the SEC may continue to be subject to state registration, reporting, or other obligations).

127 Form ADV is used by advisers both to register with the Commission and with state securities authorities. At the request of the state securities authorities, we expect to add to Form ADV a check box and instructions that would permit exempt reporting advisers to direct the filing of reports filed with the Commission to the state securities authorities. Because these revisions to Form ADV and the obligation to file the report with the state securities authorities would not arise from a federal law or Commission rule, we are not proposing them for comment. We urge interested persons to submit comments directly to the North American Securities Administrators Association, Inc. ("NASAA") for consideration by the state securities authorities at the following e-mail address: advcomments@nasaa.org. In addition, we understand that NASAA may propose a model rule that would exempt certain exempt reporting advisers from state registration but would require these advisers to submit to the states a report identical to the report an exempt

would permit an adviser to transition from filing reports with us to applying for registration under the Act by simply amending its Form ADV; the adviser would check the box to indicate it is filing an initial application for registration, complete the items it did not have to answer as an exempt reporting adviser, and update the pre-populated items that it already has on file.[128]

We request comment on proposed rule 204-4 and its requirement that exempt reporting advisers file reports by responding to a subset of items on Form ADV and filing the report through IARD. Should we instead create a new form and/or a new filing system for exempt reporting advisers? Rather than use IARD or a new system, should we instead require exempt reporting advisers to use EDGAR? Should we not make this information available to the public on our website? Are there alternative approaches to reporting by exempt reporting advisers that we should consider? If so, please explain. Are there additional ways the Commission could distinguish between registered advisers and exempt reporting advisers?

2. Information in Reports

We are proposing several amendments to Form ADV to facilitate filings by exempt reporting advisers. First, we would re-title the form to reflect its dual purpose as both the "Uniform Application for Investment Adviser Registration," as well as the "Report by Exempt Reporting Advisers." Second, we are proposing to amend the cover page so that exempt reporting advisers would indicate the type of report they are filing.[129] Finally, we propose to amend Item 2 of Part 1A, which requires advisers to indicate their eligibility for SEC

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reporting adviser would be required to submit to the SEC. Interested persons should visit the NASAA website at http://www.nasaa.org for the full text of any proposed rule and to respond to any request for comment.

128 See proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also infra* note 140.

129 An adviser would indicate whether it is submitting an initial report, an annual updating amendment, an other-than-annual-amendment, or a final report. We also propose corresponding changes to General Instruction 2.

registration, by adding a new subsection C that would require an exempt reporting adviser to identify the exemption(s) that it is relying on to report, rather than register, with the Commission.[130]

Form ADV is today designed to obtain information from registered advisers that provide a wide variety of types of advisory services, including providing advice to private funds. Therefore, the information that we propose to collect from exempt reporting advisers is for the most part currently required by Form ADV.[131] We would provide an instruction to these advisers to complete only certain items in the form, but we do not propose to change the content of the items for exempt reporting advisers.[132] As noted above, we propose to require exempt reporting advisers to complete a limited subset of Form ADV items, which would provide us and the public with some basic information about the adviser and its business, but is not all of the information we require registered advisers to submit to us, and which is designed to support our regulatory program. We propose to require exempt reporting advisers to complete the following items in Part 1A of Form ADV: Items 1 (Identifying Information), 2.C. (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons), and 11

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130 An adviser would check that it qualifies for an exemption from registration: (i) as an adviser solely to one or more venture capital funds; and/or (ii) because it acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million. *See* proposed Form ADV, Part 1A, Item 2.C. An adviser relying on the latter exemption, for private fund advisers, would also be required to indicate the amount of private fund assets it manages in Section 2.C. of Schedule D to Form ADV, Part 1A. Investment advisers who have their principal office and place of business outside of the United States, however, would need only to include private fund assets that they manage from a place of business in the United States. *See* Exemptions Release at section II.B.2.

131 Some of the amendments we propose to Form ADV would apply to both registered and exempt reporting advisers. *See infra* section II.C. of this Release.

132 We propose amending General Instruction 3 to explain which portions of Form ADV are applicable to exempt reporting advisers.

(Disclosure Information). In addition, exempt reporting advisers would have to complete corresponding sections of Schedules A, B, C, and D. We would not require exempt reporting advisers to complete and file with us other Items in Part 1A or prepare a client brochure (Part 2).[133]

Congress gave us broad authority to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[134] The Dodd-Frank Act neither specifies the types of information we could require in the reports nor specifies the purpose for which we would use the information.[135] We have sought information that we believe would assist us to identify the advisers, their owners, and their business models. The items that we have proposed would also provide us with information as to whether these advisers or their activities might present sufficient concerns as to warrant our further attention in order to protect their clients, investors, and other market participants. We have also considered the broader public interest in making this information generally available and believe there may be benefits of providing information about their activities to the public. We acknowledge that there may be costs associated with providing this information to us, and that the adviser may provide some or all of this information to private fund investors or prospective investors, however we believe there will be benefits, which we describe in more detail below.

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133 Part 2 of Form ADV, which requires advisers to prepare a narrative, plain English client brochure, contains 18 items including information on the adviser's business practices, conflicts of interest, and background. Part 2 also requires advisers to prepare brochure supplements that include information about advisory personnel on whom clients rely for investment advice. Currently, only a *registered* adviser must deliver a brochure under rule 204-3, and only an adviser that must deliver a brochure must prepare and file one as part of its Form ADV. *See* rule 203-1.

134 *See* sections 407 and 408 of the Dodd-Frank Act.

135 The Dodd-Frank Act does, however, specify that the reports are those "the Commission determines necessary or appropriate in the public interest or for the protection of investors." *Id.*

Items 1, 3, and 10 would elicit basic identification details about an exempt reporting adviser such as name, address, contact information, form of organization, and who owns the adviser. Items 6 and 7.A. would provide us with details regarding other business activities that the adviser and its affiliates are engaged in, which would permit us to identify conflicts that the adviser may have with its clients that may suggest significant risks to those clients. Item 11 would require advisers to disclose the disciplinary history for the adviser and its employees. An exempt reporting adviser that has, for example, an officer that has been found guilty of fraud or other crimes or has committed substantial regulatory infractions would be of concern to us and to investors and prospective investors in funds advised by the exempt reporting adviser.

Because exempt reporting advisers manage private funds, we also propose to require them to complete Item 7.B. and Section 7.B of Schedule D for the private funds they advise. As discussed in more detail in Section II.C. below, we are proposing significant amendments to Section 7.B.1. of Schedule D that are designed to provide us with a comprehensive overview, or census, of private funds.[136] Exempt reporting advisers' responses to Item 7.B., and Section 7.B.1. of Schedule D, in conjunction with information provided by registered advisers, would provide us with important data about these funds that we would use to identify risks to their investors.

Do commenters agree with our judgments regarding the items applicable to exempt reporting advisers? We have not proposed to require exempt reporting advisers to complete Items 4, 5, 8, 9, or 12 of Part 1 of Form ADV. We request comment on whether we should

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[136] For instance, advisers who complete section 7.B.1. of Schedule D would have to provide identifying information about each private fund, such as its name and domicile, as well as information about its ownership, service providers, and its total and net assets. *See* proposed Form ADV, Part 1A, Schedule D, Section 7.B.1.

require exempt reporting advisers to complete any of these items to provide us and investors with the information required by those items.

Part 2 of Form ADV, the client brochure, is required of registered advisers to provide clients and potential clients with detailed information about their qualifications, investment strategies, and business practices. Our proposal would not require exempt reporting advisers to prepare Part 2 of Form ADV. Should we require exempt reporting advisers to complete Part 2 of Form ADV, file it with us on IARD, and make it available to the public on our website? Would some or all of this information be helpful to clients and potential clients of these advisers? Should we not require exempt reporting advisers to complete certain items of Part 2? For example, should we exclude those items that would require information similar to those items of Part 1 that we are not proposing to require exempt reporting advisers to complete? Are there other items we should include or not include? Should we require these advisers to complete brochure supplements? Would the information in the brochure supplements be helpful to the clients of these advisers? Do investors currently receive this type of information as a result of their investment in a private fund?

Should the reporting requirements be identical for exempt reporting advisers as they are for registered advisers? Are there items that we have proposed to apply to exempt reporting advisers that we should not apply or are unnecessary, and why? Is any of the information we propose to require not readily available to an exempt reporting adviser? Would any of the items require disclosure of proprietary or competitively sensitive information? If so, which items, and if competitively sensitive, describe the competitive impact. Would any of these disclosure requirements, either individually or cumulatively, impose a significant burden? Would they require disclosure of proprietary or competitively sensitive information such that they could

impact or influence business or other decisions by these advisers? Would they materially affect a decision by an adviser whether to form a private fund? If so, why?

3. Updating Requirements

We are also proposing to amend rule 204-1 under the Advisers Act, which requires advisers to update their Form ADV filings, to require exempt reporting advisers to file updating amendments to reports filed on Form ADV.[137] Proposed rule 204-1(a) would require an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Consequently, we are proposing to amend General Instruction 4 to Form ADV to require an exempt reporting adviser to update Items 1 (Identification Information), 3 (Form of Organization), or 11 (Disciplinary Information) promptly if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[138] We are proposing the same updating requirements with respect to these Items as are applicable to registered advisers because we believe it is equally important for exempt reporting advisers to report information on a timely basis. We also believe it could create confusion to apply different updating standards *within* each item of the form depending on who completes the item. Consequently, we are proposing to require exempt reporting advisers to follow the same instructions applicable to the items they must complete, although they are required to complete fewer items than a registered adviser.

We request comment on the proposed amendments to rule 204-1 to extend its requirements to exempt reporting advisers. Should exempt reporting advisers be permitted to

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137 Proposed rule 204-1. We also propose to amend the title of the rule to be "Amendments to Form ADV," rather than "Amendments to application for registration," to reflect use of the Form by exempt reporting advisers.

138 *See* General Instruction 4 to Form ADV.

update Form ADV, or certain items, less frequently? If so, what should be the updating requirements, and should we be concerned that, as a result, an exempt reporting adviser that is also registered with a state securities regulator would have to update its Form ADV on a different schedule than an exempt reporting adviser that is not also registered with a state? Would less frequent reporting result in information that is less useful or materially inaccurate? Should exempt reporting advisers be required to update other items more frequently than annually?

We propose to include a provision in rule 204-4 to require an exempt reporting adviser to file an amendment to its Form ADV when it ceases to be an exempt reporting adviser.[139] The exempt reporting adviser would indicate in this amendment that it is filing a final report pursuant to rule 204-4 in order to alert us that the adviser no longer will be filing reports, and allow us to distinguish such a filer from one that is inattentive to its filing obligations.[140] We request comment on this proposed final report requirement. Is there an alternative approach we could take?

Finally, we propose amending the instructions to Form ADV to provide guidance to exempt reporting advisers who file final reports because they must register with the Commission. Such a transition may occur, for example, if an adviser relying on the "venture capital exemption" in section 203(l) of the Advisers Act accepts a client that is not a venture capital fund,[141] or the value of the assets under management in the United States of an adviser relying on the "private fund exemption" in section 203(m) of the Advisers Act meets or exceeds $150 million.[142] A transitioning adviser would file an amendment to its Form ADV simultaneously

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139 *See* proposed rule 204-4(f).

140 Proposed rule 204-4(f). Advisers filing a final report would not be required to pay a filing fee. We note that failure to file a final report would result in a violation of the rule.

141 *See* section 407 of the Dodd-Frank Act.

142 *See* section 408 of the Dodd-Frank Act.

indicating that the filing will be its final "report" on Form ADV and applying for registration with the Commission.[143] We request comment on this proposed guidance.

4. Transition

We propose requiring each exempt reporting adviser to file its initial report with us on Form ADV no later than August 20, 2011, 30 days after the July 21, 2011 effective date of the Dodd-Frank Act.[144] We believe this would provide sufficient time to enable an adviser to determine whether it must report to us and to take the steps necessary to complete and submit its initial filing. We request comment on our proposed transition, including the amount of time we propose for exempt reporting advisers to submit their initial reports.

As discussed above, our ability to effect this transition may be affected by our need to re-program IARD.[145] We are working closely with FINRA, our IARD contractor, to make the needed modifications, but the programming may not be completed until after we adopt these rules. If IARD is unable to accept filings of amended Form ADV by that time, we may want to delay the reporting deadline until the system can accept electronic filing of the revised form. Should we instead require an alternative procedure, such as a paper filing, for advisers to indicate their eligibility for this exemption from registration and to satisfy their reporting requirements?

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143 *See* proposed General Instruction 14. In the Exemptions Release we propose that an adviser relying on the private fund adviser exemption would have three months from the end of a calendar quarter at which it failed to qualify for the exemption because of a fluctuation in private fund assets to apply to the Commission for registration unless it qualifies for another exemption. *See* proposed rule 203(m)-1(d).

144 *See* sections 403, 407, 408, and 419 of the Dodd Frank Act.

145 *See supra* section II.A.1. of this Release.

C. Form ADV

Data collected from Form ADV is of critical importance to our regulatory program and our ability to protect investors. We use information reported to us on Form ADV for a number of purposes, one of which is to efficiently allocate our examination resources based on the risks we discern or the identification of common business activities from information provided by advisers. The information is used to create risk profiles of investment advisers and permits our examiners to better prepare for, and more efficiently conduct, their on-site examinations. Moreover, the information in Form ADV allows us to better understand the investment advisory industry and evaluate the implications of policy choices we must make in administering the Advisers Act.

To enhance our ability to oversee investment advisers, we are proposing to require advisers to provide us additional information about three areas of their operations.[146] First, we are proposing to require advisers to provide information regarding private funds they advise. Second, we are proposing to expand the data advisers provide about their advisory business, (including data about the types of clients they have, their employees, and their advisory activities), as well as about their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals). Third, we are proposing to require additional information about advisers' non-advisory activities and their financial industry affiliations. We are also proposing certain additional changes intended to improve our ability to assess compliance risks and also to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-

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146 In addition, we are proposing several clarifying or technical amendments based on frequently asked questions we receive from advisers as well as in our experience administering the form. *See infra* section II.C.6. of this release.

based compensation arrangements.[147] We understand that advisers would have ready access to all of the new information as part of their normal operations or compliance programs, and thus these new requirements should impose few additional regulatory burdens. We request comment on whether our understanding is correct. In addition to (or instead of) these three areas of operations, are there other areas about which we should require advisers to report additional information?

1. Private Fund Reporting: Item 7.B.

We propose to expand the information we require advisers to provide us about the private funds they advise in response to Item 7.B., and Schedule D. Both registered and exempt reporting advisers would complete this Item. The information would provide us with a more complete understanding of the private funds advised by advisers and would permit us to enhance our assessment of private fund advisers for purposes of targeting our examinations. The information also would help us identify particular practices that may harm investors. We have been concerned that unregistered funds have been used as a vehicle for perpetrating fraud on investors.[148] The private fund reporting requirements we are proposing would provide a level of transparency that we believe would help us to identify practices that may harm investors,[149] and would deter advisers' fraud and facilitate earlier discovery of potential misconduct.[150]

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147 *See* section 956 of the Dodd-Frank Act.

148 For example, since January 2009, the Commission has brought more than 50 enforcement cases in which we assert hedge fund advisers have defrauded hedge fund investors or used the fund to defraud others.

149 For instance, census data about a private fund's gatekeepers, including administrators and auditors, would be available on proposed Section 7.B.1. of Schedule D and would be verifiable by investors and the Commission. Recent enforcement actions suggest that the availability of such information could be helpful. *See, e.g., SEC v. Grant Ivan Grieve, et al.*, Litigation Release No. 21402 (Feb. 2, 2010) (default judgment against hedge fund adviser that was alleged to have fabricated and disseminated false financial information for the fund that was "certified" by a sham independent back-office administrator and phony accounting firm); *See In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled

Currently, Item 7 requires each adviser to complete Section 7.B. of Schedule D for any "investment-related limited partnership" that the adviser or a related person advises. A separate Schedule D must be completed for each partnership. We propose to modify the scope of Item 7 by requiring completion of Section 7.B. only for a private fund that the adviser (and not a related person) advises. This amendment would incorporate the new term "private fund," defined in section 202(a)(29) of the Act, the primary effect of which would be to require advisers to report pooled investment vehicles regardless of whether they are organized as limited partnerships.[151] We would no longer require an adviser to report to us funds that are advised by affiliates, which in many cases would now be reported to us by an affiliate that is either registered under the Act or is now an exempt reporting adviser.[152]

To avoid multiple reporting for each private fund, we propose to permit a sub-adviser to exclude private funds for which an adviser is reporting on another Schedule D,[153] and would

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action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not).

150 *See, e.g.*, Second Amended Complaint, *SEC v. Hoover*, Civil Action No. 01-10751-RGS, (D. Mass. Mar. 20, 2002) *available at* http://www.sec.gov/litigation/complaints/complr17487.htm (adviser allegedly participated in a scheme to defraud clients of his advisory firm by, among other things, misappropriating assets and overbilling expenses. When he became aware that the Commission staff was investigating his firm, he established a separate, unregistered advisory firm and perpetuated his fraud through use of a hedge fund he created and controlled.); *SEC v. Hoover*, Litigation Release No. 17981 (Feb. 11, 2003) (announcing final judgment by consent).

151 *See supra* note 45 (discussing the definition of private fund). In 2004, the Commission adopted amendments to Form ADV to require reporting of "private fund" information, including a similar amendment to Item 7. A federal appeals court vacated the 2004 amendments to Item 7 that we had adopted for private funds. *See Registration under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)] ("Hedge Fund Adviser Registration Release"); *Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. June 23, 2006) ("*Goldstein*"). The amendments we propose would, in part, reinstate these amendments we adopted in 2004.

152 Currently, a related person may be able to rely on the private adviser exemption from registration, which, as discussed above, was repealed by the Dodd Frank Act effective July 21, 2011. *See supra* at sections I, II.B. of this Release.

153 If an investment adviser completes section 7.B.1. of Schedule D for a private fund, other advisers to that fund (most of which are likely to be sub-advisers) would not have to complete section

permit an adviser sponsoring a master-feeder arrangement to submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data.[154] Finally, we propose to permit an adviser with a principal office and place of business outside the United States to omit a Schedule D for a private fund that is not organized in the United States and that is not offered to, or owned by, "United States persons."[155] This approach is designed to limit the reporting burden imposed on foreign advisers with respect to funds in which U.S. investors have no direct interest.

We request comment on the scope of the Schedule D filing requirements about private funds. Should we, as proposed, require exempt reporting advisers to file Section 7.B of Schedule D? Would the disclosure of private fund information by exempt reporting advisers impact or influence business or other decisions by these advisers, such as whether to form additional private funds or discourage entry into management of private funds all together?

7.B.1. for that private fund. *See* proposed Form ADV, Part 1A, Note to Item 7.B.; proposed Section 7.B.2. of Schedule D. When filing Section 7.B.1. of Schedule D for a private fund, an adviser would acquire a unique identification number to the fund. The adviser would be required to continue to use the same identification number whenever it amends Section 7.B.1. for that fund. Any adviser that files a Section 7.B.1. for a private fund for which an identification number has already been acquired by another adviser would not be permitted to acquire a new identification number, but would be required to instead utilize the existing number. *See* proposed Form ADV: Instructions for Part 1A, instr. 6.b.

154 *See* proposed Form ADV: Instructions for Part 1A, instr. 6. In a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). Advisers would report on a single Schedule D if their responses to certain questions of Section 7.B.1. of Schedule D would be identical for each master and feeder fund. Our staff estimates that most master-feeder arrangements involving private funds would meet this condition. An adviser filing a single Schedule D for a master-feeder arrangement would complete its Schedule D under the name of the master fund, following our proposed instructions for Section 7.B.

155 *Id. See also* proposed Form ADV: Glossary. We propose to define "United States person" by reference to the definition in proposed rule 203(m)-1(e)(8), which tracks the definition of a "U.S. person" under Regulation S, except that it contains a special rule for discretionary accounts maintained for the benefit of United States persons. *See* Exemptions Release at section II.B.4. As discussed in the Exemptions Release, our proposed use of the Regulation S definition for various purposes under the Advisers Act would lessen the burden imposed on advisers, which are familiar with the definition because they apply it for other purposes under the securities laws.

Should we require advisers to report information also about other pooled investment vehicles they may advise, such as foreign funds not offered to U.S. persons? Specifically, are there sufficient investor protection or other concerns that the Commission should seek to require this information? Is information about these funds important to understand conduct that directly involves U.S. investors? Are the instructions eliminating multiple filing of Section 7.B. by advisers helpful? Are there different approaches we might take to achieve our intended goals? We request that commenters review our proposed instructions and identify any ambiguities that we should address.

We propose to amend Section 7.B. of Schedule D, which currently requires very limited information about limited partnerships established by an adviser, and which provides us with little data about the operations of the many large hedge funds and other types of private funds advised by a growing number of advisers registered with the Commission.[156] New Section 7.B.1. would expand on the identifying information currently required to be reported in order to provide us with basic organizational, operational and investment characteristics of the fund; the amount of assets held by the fund; the nature of the investors in the fund; and the fund's service providers.[157] Although we are proposing several new items of information that would be reported to us, much of the information should be readily available to private fund advisers (*e.g.*,

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156 Today, Section 7.B. of Schedule D requires an adviser to a private fund that is a limited partnership or limited liability company to identify: (1) the name of the fund; (2) the name of the general partner or manager; (3) whether the adviser's clients are solicited to invest in the fund; (4) the approximate percentage of the adviser's clients that have invested in the fund; (5) the minimum investment commitment; and (6) the current value of the total assets of the fund.

157 We have considered the potential application of section 210(c) of the Advisers Act (which precludes us from requiring advisers to disclose to us the "identity, investments, or affairs" of any of its clients) to the information about private fund clients of advisers and have concluded that the Dodd-Frank Act permits us to require this information in Form ADV. *See, e.g.*, section 404(2) of the Dodd-Frank Act, adding Advisers Act section 204(b)(1)(A) (authorizing the Commission to require any investment adviser registered under the Act "to maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors…").

the amount of fund assets) and the responses to many of the items are unlikely to change from year to year (*e.g.*, on which exclusion from the Investment Company Act the fund relies) and thus the additional reporting should not involve a significant reporting burden. As discussed in more detail below, the information will help us identify potential compliance risks and inform our regulatory activities.

Part A of the Section would require identifying information, including the name of the private fund. We propose to add an instruction to the item to permit an adviser that seeks to preserve the anonymity of a private fund client by maintaining its identity in code in its records to identify the private fund in Schedule D using the same code.[158] We request comment on this new instruction.

We also propose to revise Part A to require an adviser to identify the state or country where the private fund is organized, and the name of its general partner, directors, trustees or persons occupying similar positions.[159] The item would ask information about the organization of the fund, including whether it is a master or a feeder fund, and some information about the regulatory status of the fund and its adviser, including the exclusion from the Investment Company Act on which it relies, whether the adviser is subject to a foreign regulatory authority, and whether the fund relies on an exemption from registration of its securities under the

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158 Rule 204-2(d) permits any books and records required to be maintained by the rule "in such manner that the identity of any client to whom such investment adviser renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation." We included the provision in the rule in 1961 to reconcile our then new examination authority (the exercise of which has required us to examine client records) with section 210(c) of the Act. *See Notice of Proposed Rule to Require Investment Advisers to Maintain Specified Books and Records Under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 111 (Jan. 25, 1961) [26 FR 987 (Feb. 1, 1961)]. We are proposing to add the instruction to permit the few advisers that in our experience have sought to encode the identity of their clients to do so.

159 *See* proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, questions 2-3.

Securities Act of 1933.[160] The Item also would contain questions regarding whether the adviser is a subadviser to the private fund and would require the adviser to identify by name and SEC file number any other advisers to the fund.[161] We are proposing several questions to help us better understand the private fund's investment activities and other areas of potential investor protection concerns. For example, we would ask about the size of the fund, including both its gross and net assets, from which we could better understand the scope of its operations and the extent of leverage it employs.[162] We would ask the adviser to identify within seven broad categories (which the applicable instruction would define) the type of investment strategy employed by the adviser,[163] and to break down the assets and liabilities held by the fund by class and categorization in the fair value hierarchy established under U.S. generally accepted accounting principles (GAAP).[164] Many private funds managed by investment advisers that would be reporting to us prepare financial statements in accordance with GAAP.[165] Others may use international accounting standards requiring substantially similar information. Their adviser, therefore, should have access to this information from such financial statements. We would ask about both the number and the types of investors in the fund, as well as the minimum amounts

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160 *Id.* questions 4-7 and questions 23-24 (asking whether the fund relies on Regulation D and what is the fund's Form D file number, if any).

161 *Id*. questions 19-20.

162 *Id.* question 11.

163 *Id.* question 10. The categories include: (i) hedge fund; (ii) liquidity fund; (iii) private equity fund; (iv) real estate fund; (v) securitized asset fund; (vi) venture capital fund; and (vii) other private fund.

164 *Id.* question 12. *See* FASB ASC 820-10-50-2b. We also propose to ask whether the fund invests in securities of registered investment companies, which is relevant to evaluating compliance with the fund of funds provision of the Investment Company Act, section 12(d)(1). *See* section 12(d)(1) of the Investment Company Act; proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, question 9.

165 *See supra* note 56. In addition, advisers to private funds that prepare and distribute financial statements prepared in accordance with GAAP may be deemed to satisfy certain requirements of our custody rule. *See* Advisers Act rule 206(4)-2(b)(4).

required to be invested by fund investors to get a better idea of the types of investors the fund is intended to serve and to get a sense of the extent to which investors may themselves be in a position to exercise oversight of the adviser.[166] Finally, some items would ask information about characteristics of the fund that may present the fund manager with conflicts of interest with fund investors of the sort that may implicate the adviser's fiduciary obligations to the fund and, in some cases, create risks for the fund investors. Thus we would continue to ask whether clients of the adviser are solicited to invest in the fund and what percentage of the other clients has invested in the fund.[167]

In Part B of the Section, we propose to require advisers to report information concerning five types of service providers that generally perform important roles as "gatekeepers" for private funds (*i.e.*, auditors, prime brokers, custodians, administrators and marketers).[168] We would require that an adviser identify them, provide their location, and state whether they are related persons. For each of these service providers, we would also require specific information that would clarify the services they provide and include certain identifying information such as registration status. This information includes the following for each service provider. For the auditors, whether they are independent, registered with the Public Company Accounting Oversight Board (PCAOB) and subject to its regular inspection, and whether audited statements are distributed to fund investors.[169] For the prime broker, whether it is SEC-registered and

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166 *See* proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, questions 13-18.

167 *Id.* questions 21-22.

168 *See* proposed Form ADV, Part 1A, Section 7.B.1.B. of Schedule D.

169 *See* proposed Form ADV, Part 1A, Section 7.B.1.B. of Schedule D, question 25. We are also proposing amendments to the instructions contained in Item 9 to avoid having advisers reporting overlapping information (relevant to compliance with rule 206(4)-2, the "custody rule") under Section 9 and Section 7.B. of Schedule D.

whether it acts as custodian for the private fund.[170] For the custodian, whether it is a related person of the adviser.[171] For the administrator, whether it prepares and sends to investors account statements and what percentage of the fund's assets are valued by the administrator or another person that is not a related person of the adviser.[172] Finally, for marketers, whether they are related persons of the adviser, their SEC file number (if any), and the address of any website they use to market the fund.[173] The questions in Part B are generally designed to improve our ability to assess conflicts and potential risks, identify funds with service provider arrangements that raise a "red flag," and identify firms for examination. For instance, it would be relevant to us to know that a private fund is using a service provider that we are separately investigating for alleged misconduct.

The information we propose to require advisers to report on private funds is similar to (although less extensive than) the information that we understand investors in hedge funds and other private funds commonly seek in their due diligence questionnaires.[174] Professional investors use information acquired as part of their vetting process before they invest. We likewise are seeking to acquire the information to help us identify private fund advisers that present investors with greater compliance or other risks. Each particular item of information may not itself indicate an elevated risk of a compliance failure, but could serve as an input to the risk metrics by which our staff identifies potential risk and allocates examination resources. The

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170 *See id.* question 26.

171 *See id.* question 27. "Related Person" is defined in Form ADV: Glossary.

172 *See id.* question 28.

173 *See id.* question 29. For purposes of this question, marketers include placement agents, consultants, finders, introducers, municipal advisors or other solicitors, or similar persons.

174 *See, e.g.*, AIMA's Illustrative Questionnaire For Due Diligence of Hedge Fund Managers, *available at* (registration required) http://www.aima.org/en/knowledge_centre/index.cfm.

staff conducts similar analyses today, but have limited inputs, which constrains their effectiveness.

The information would be publicly available as is other information on Form ADV, and we expect it would be used by investors to supplement their due diligence efforts. We expect the use of these data could further help investors and other industry participants protect against fraud. For example, using the IARD data, auditors would be able to compare their list of funds they audit with those whose advisers report them as auditor in order to uncover false representations.[175] Investors (and their consultants) would be able to compare representations made on Schedule D with those made in private offering documents or other material provided to prospective investors.

We request comment on our proposed amendments to Section 7.B. of Schedule D. Should we modify our requests for information? Is there information requested in due diligence questionnaires that would yield additional or more relevant risk information and that we should require? For instance, should we require advisers to report information regarding their legal counsel? If so, what information? Is the information we request readily available to fund managers, and in particular to sub-advisers? If not, is there information that is readily available that could serve the same purpose?

In crafting these new disclosure items, we have sought to avoid requiring disclosure of proprietary information that could harm the interests of the fund or fund investors. Have we succeeded? Commenters asserting that information not be reported should identify the specific harm asserted. Do commenters agree with our belief that reporting and disclosure of private

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[175] *See In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not.)

fund information will be beneficial to investors (although they may currently receive some or all of this information) as well as prospective investors and other market participants?

Will it be burdensome for registered or exempt reporting advisers to use for purposes of Question 12 the valuation hierarchy established under GAAP with respect to those funds that do not have financial statements prepared in accordance with GAAP? If we require all advisers to fair value their private fund assets under management as proposed,[176] would advisers be able to rely on such a valuation for purposes of Question 12? Should we require that the information provided in response to Question 12 be part of audited financial statements or be subject to review by auditors or another independent third party? Are there additions, deletions, or changes to the definitions of the seven categories of private fund we would require advisers to use to identify a private fund that we should consider? Should some of the items apply only to certain types of private funds (*e.g.*, hedge funds)? If so, which items and why?

2. Advisory Business Information: Employees, Clients and Advisory Activities: Item 5

Item 5 of Part 1A requires an adviser to provide basic information regarding the business of the adviser that allows us to identify the scope of the adviser's business, the types of services it provides, and the types of clients to whom it provides those services. The item requires information from the adviser about the number of its employees, the amount of assets it manages, the number and types of its clients, and the types of advisory services provided. The modifications we are proposing today, which primarily refine or expand existing questions, would help us better understand the operations of advisers.

First, we propose to seek additional information about the adviser's employees. Currently, Item 5 asks for the number of employees that are registered representatives of a

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176 *See supra* section II.A.3.

broker-dealer, which we would expand to ask for the number of employees that are registered as investment adviser representatives or insurance agents.[177] In order to obtain more precise data, we also propose that advisers provide a single numerical approximate response to the questions about employees, instead of checking a box corresponding to a range of numbers, as is currently required.[178] This additional employee data would, for instance, permit us to develop ratios (*e.g.*, number of employees to assets under management of clients) that we can use to identify advisers to inform our risk-based examination program.

Second, we propose to add some questions to help us better understand an adviser's business by reference to the types of clients the adviser services. Items 5.C. and D. currently require an adviser to report how many clients it has (in ranges) and to indicate the types of clients, *e.g*. high net worth individuals, investment companies. We propose to expand the list of types of clients provided in Item 5.D., to include business development companies, insurance companies, and other investment advisers, as well as to distinguish pension and profit-sharing plans subject to ERISA[179] from those that are not. As amended, this Item also would require an adviser to indicate the approximate amount of its regulatory assets under management attributable to each client type.[180] We also propose to ask approximately what percentage of the adviser's clients are not United States persons.[181] This additional information would allow us to better understand the focus of an adviser's business.

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177 Proposed Form ADV, Part 1A, Items 5.B.(3) and (5).

178 For instance, proposed Item 5.B.(1) asks how many of an adviser's employees perform advisory functions. Under the current Form, an adviser with seven such employees would check a box for "6-10." We propose the adviser simply fill in a blank with the number "7."

179 Employee Retirement Income Security Act of 1974 (29 U.S.C. 18).

180 Proposed Form ADV, Part 1A, Item 5.D. We are also proposing amendments to the calculation of an adviser's regulatory assets under management. *See supra* section II.A.3. of this Release.

181 Proposed Form ADV, Part 1A, Item 5.C.(2). *See supra* note 155 (discussing the definition of "United States person"). We also propose to add an instruction to Item 5.C., 5.D. and 5.H. to

Third, we are proposing two amendments related to the advisory activities that are reported in Item 5. Item 5.G. requires an adviser to select from a list the advisory services that it provides, such as financial planning or portfolio management. We propose to expand the list of advisory activities to include portfolio management for pooled investment vehicles, *other* than registered investment companies, and educational seminars or workshops.[182] We would also require advisers to provide the SEC file number for a registered investment company if they check the box for portfolio management for an investment company, which would permit our examination staff to link information reported on Form ADV to information reported on forms filed through our EDGAR system by investment companies managed by these advisers.[183] We are proposing new Item 5.J. that would require advisers to select from a list the types of investments about which they provided advice during the fiscal year for which they are reporting.[184] These changes would provide us with more details regarding the services an adviser provides, allowing us to better identify candidates if, for instance, we choose to do a risk-targeted examination of advisers based on the nature of the advice they provide.

We request comment on our proposed amendments to Item 5. Would advisers readily have access to the additional data we request? Does the switch from ranges to a single approximate number of employees in Items 5.A. and 5.B. pose any significant problems or burdens for advisers? If so, would providing an instruction to permit an adviser to round its

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clarify that advisers should not count as clients the investors in a private fund they advise unless they have a separate advisory relationship with them.

182 Proposed Form ADV, Part 1A, Item 5.G.

183 Proposed Form ADV, Part 1A, Schedule D, Section 5.G.(3).

184 Advisers would also be required to indicate the types of investments, such as various types of swaps and variable life insurance, about which they provided advice. Proposed Form ADV, Part 1A, Item 5.J.

responses up or down help? Are there additional types of clients, advisory activities, and investments we should add to our proposed lists in Items 5.D., 5.G., and 5.J., respectively?

3. Other Business Activities and Financial Industry Affiliations: Items 6 and 7

Items 6 and 7 of Part 1A require advisers, including exempt reporting advisers, to report those financial services the adviser or a related person is actively engaged in providing from lists of financial services set forth in the items. We are proposing several changes to these Items that would provide us with a more complete picture of the activities of an adviser and its related persons, which would better allow us to assess the conflicts of interest and risks that may be created by those relationships and to identify affiliated financial service businesses. We propose to expand the lists in both Items 6 and 7 to include business as a trust company, registered municipal advisor, registered security-based swap dealer, and major security-based swap participant, the latter three of which are new SEC-registrants under the Dodd-Frank Act's amendments to the Exchange Act.[185] We also propose to add accountants (or accounting firms) and lawyers (or law firms) to the list in Item 6, to parallel current Item 7. We are also proposing to move from Item 7.B. to Item 7.A. the question that asks whether a related person is a sponsor or the general partner or managing member of a pooled investment vehicle.[186] Finally, we would

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185 Proposed Form ADV, Part 1A, Items 6.A. and 7.A. Section 975 of the Dodd-Frank Act amends the Exchange Act to require "municipal advisors" to register with the Commission, Section 761 of that Act amends the Exchange Act to define the terms "security-based swap dealer" and "major security-based swap participant," and section 764 amends the Exchange Act to require these entities to register with the Commission.

186 The question we propose to ask in Item 7.A. would, therefore, retain information about related persons that would otherwise not be required as a result of our proposed changes to Item 7.B. As discussed above, we are proposing to require advisers to report in Item 7.B. and section 7.B.1. of Schedule D private fund information only about funds they advise, not funds advised by a related person. *See supra* section II.C.1. of this Release. We would also delete "investment company" from the list in Item 7 as duplicative of information we obtain in Item 5. *See, e.g.*, Form ADV, Part 1A, Items 5.D., 5.G., and proposed Form ADV, Part 1A, Section 5.G.(3) of Schedule D. *See also supra* note 183 and accompanying text.

clarify in the instruction to Item 7 that advisers are to include related persons that are foreign affiliates.

We are also proposing to require additional reporting in the corresponding sections of Schedule D for Items 6 and 7. First, we propose a new Section 6.A. of Schedule D that would require an adviser that checks the box that it is engaged in another business under a different name to list those other business names and the other lines of business in which the adviser engages using that name.[187] Second, we propose a similar modification to Item 6.B. to require advisers primarily engaged in another business under a different name to also provide that name in Section 6.B. of Schedule D. Third, we propose to amend Section 7.A. of Schedule D, which currently requires that advisers provide identifying information for related persons that are investment advisers or broker-dealers. We propose to require advisers to provide this same information with respect to *any* type of related person listed in Item 7.A. We also propose to expand the information we collect regarding these related persons to include more details about the relationship between the adviser and the related person, whether the related person is registered with a foreign financial regulatory authority, and how they share personnel and confidential information.[188] This additional information on related persons would allow us to link disparate pieces of information that we have access to concerning an adviser and its affiliates as well as identifying whether the adviser controls the related person or vice versa. It would also provide us with a tool to identify where there may be advisory activities by unregistered affiliates. Finally, we propose to relocate to this section a question currently under

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187 For example, an adviser registered with us under the name "Adam Bob Charlie Advisers LLC" that is also actively engaged in business as an insurance agent under the name "ABC Insurance LLC" would put the name "ABC Insurance LLC" in Section 6.A. of Schedule D and would check the box for "Insurance broker or agent."

188 Proposed Form ADV, Part 1A, Section 7.A., questions 1, 2, 5 and 6.

Section 9 that requires reporting of whether a related person bank or futures commission merchant is a qualified custodian for client assets under the adviser custody rule, and to ask, if the adviser is reporting a related person investment adviser, whether the related person is exempt from registration.[189]

We request comment on these proposed amendments. Should we request additional information about advisers' and their related persons' other business? Should we request less information? Are there other types of financial services providers we should include in the lists contained in Items 6 and 7? Are there other questions in Section 7.A. that we should ask to determine additional conflicts of interest advisers face through related persons? Is the information advisers need to complete the proposed additional questions contained in Section 7.A. readily available?

4. Participation in Client Transactions: Item 8

Item 8 requires an adviser to report information about its transactions, if any, with clients, including whether the adviser or a related person engages in transactions with clients as a principal, sells securities to clients, or has discretionary authority over client assets. This item also currently requires an adviser to indicate if it has discretionary authority to determine the brokers or dealers for client transactions and if it recommends brokers or dealers to clients.[190] We propose to further ask whether any of the brokers or dealers are related persons of the adviser.[191] An adviser that indicates that it receives "soft dollar benefits" would also report whether all those benefits qualify for the safe harbor under section 28(e) of the Exchange Act for

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189 Proposed Form ADV, Part 1A, Section 7.A., questions 3 and 4. We are also proposing a technical change to remove the same question in section 9.D. of Schedule D.

190 Form ADV, Part 1A, Items 8.C.3. and 8.E.

191 Proposed Form ADV, Part 1A, Items 8.F.

eligible research or brokerage services.[192] Finally, we would add a new question requiring an adviser to indicate whether it or its related person *receives* direct or indirect compensation for client referrals to complement the existing question concerning whether the adviser compensates any person for client referrals.[193] The amendments we are proposing would enhance our ability to identify additional conflicts of interest that advisers may face that we have identified through our experience administering the Advisers Act.

We request comment on our proposed amendments. Should we request additional information about advisers' receipt of soft dollar benefits, such as requiring advisers to quantify the benefits they receive or disclose the names of the brokers or dealers from whom the adviser receives soft dollar benefits? Is there other information that would assist us in identifying conflicts of interest?

5. Reporting $1 Billion in Assets: Item 1

Section 956 of the Dodd-Frank Act requires us, jointly with certain other federal regulators, to adopt rules or guidelines addressing certain excessive incentive-based compensation arrangements, including those of investment advisers with $1 billion or more in assets.[194] To enable us to identify those advisers that would be subject to section 956, we propose to require each adviser to indicate in Item 1 whether or not the adviser had $1 billion or

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192 Proposed Form ADV, Part 1A, Item 8.G.(2). *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165 (July 18, 2006) [71 FR 41978 (July 24, 2006)].

193 Proposed Form ADV, Part 1A, Item 8.I.

194 *See* sections 956(a)-(c), (e)(2)(D), (f) of the Dodd-Frank Act. The other federal regulators include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, and the Federal Housing Finance Agency.

more in assets as of the last day of the adviser's most recent fiscal year.[195] We propose that for purposes of this reporting requirement, the amount of assets would be the adviser's total assets determined in the same manner as the amount of "total assets" is determined on the adviser's balance sheet for its most recent fiscal year end.[196] We request comment on whether Form ADV generally, and the proposed requirement in particular, is the appropriate method to identify these investment advisers. Should we identify these advisers by other means, and if so, what other means? We also request comment on the proposed method that advisers must use to determine the amount of their assets.

6. Other Amendments to Form ADV

The proposed amendments also include a number of additional changes unrelated to the Dodd-Frank Act that are intended to improve our ability to assess compliance risks. First, we propose changes to improve certain identifying information we obtain from other items of Part 1A of Form ADV. Item 1 currently requires an adviser to provide contact information for an employee designated to handle inquiries regarding the adviser's Form ADV. We propose instead to require an adviser to provide contact information for its chief compliance officer to give us direct access to the person designated to be in charge of its compliance program.[197] Advisers

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195 *See* proposed Form ADV, Part 1A, Item 1.O. (adviser would mark "yes" or "no" to indicate whether it had $1 billion or more in assets).

196 *See* proposed Form ADV: Instructions for Part 1A, instr. 1.b. We construe section 956 as specifying, and thus propose to define "assets" to mean, the total assets of the advisory firm rather than the total "assets under management," *i.e.*, assets managed on behalf of clients.

197 Proposed Form ADV, Part 1A, Item 1.J. An adviser is currently required to provide the name of its chief compliance officer on Schedule A of Form ADV, but not other identifying information. *See also* 17 CFR 275.206(4)-7; *Compliance Programs of Investment Companies and Investment Advisers*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (adopting rule 206(4)-7 requiring registered investment advisers to designate a chief compliance officer). An exempt reporting adviser that does not have a chief compliance officer would instead provide a designated person's contact information in Item 1.K. Proposed Form ADV, Part 1A, Item 1.K. Likewise, we would not require an exempt reporting adviser to provide the name of a chief compliance officer on Schedule A of Form ADV.

would have the option, in Item 1.K., to provide an additional regulatory contact for Form ADV, neither of which would be viewable by the public on our website.[198] We also propose to amend Item 1 to require an adviser to indicate whether it or any of its control persons is a public reporting company under the Exchange Act.[199] This would provide a signal, not only to us, but to investors and to prospective investors, that additional public information is available about the adviser and/or its control persons. In addition, we propose to add "Limited Partnership" as another choice advisers may select to indicate how their organization is legally formed.[200]

We are also proposing to add an additional custody question to Item 9 to require advisers to indicate the *total* number of persons that act as qualified custodians for the adviser's clients in connection with advisory services the adviser provides to its clients.[201] We recently modified Item 9 to elicit information about the adviser or its related person(s) acting as qualified custodian.[202] We did not, however, request information about *other* qualified custodians. We expect this discrete piece of additional data to provide us with a more complete picture of an adviser's custodial practices.[203]

Finally, we are proposing three technical changes with respect to the reporting of disciplinary events. First, we propose to add a box to Item 11 for advisers to check if any disciplinary information reported in that item and the corresponding disclosure reporting pages is

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198 Proposed Form ADV, Part 1A, Item 1.K. We note that clients will be provided with a supervisory contact in brochure supplements. *See* Part 2 Release, *supra* note 46.

199 Proposed Form ADV, Part 1A, Items 1.N., 10.B., and Section 10.B. of Schedule D.

200 Proposed Form ADV, Part 1A, Item 3.A.

201 Proposed Form ADV, Part 1A, Item 9.F.

202 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)].

203 Consistent with the updating requirements for Items 9.A.(2), 9.B.(2), and 9.E., we propose requiring new Item 9.F. to be updated only annually. *See* proposed General Instruction 4.

being reported about the adviser or any of its supervised persons.[204] This would enable us to easily determine if an adviser is only reporting disciplinary events for its affiliates, and would facilitate our ability to focus examination and enforcement resources on those advisers that appear to present the greatest compliance risks. Second, we propose to add a third reason to each disclosure reporting page (DRP) that permits an adviser to remove the DRP from its filing by adding a box an adviser could check if it was filed in error. Third, we propose to amend Item 3.D. of Part 2B, the brochure supplement, to correct a drafting error regarding when a brochure supplement would need to include disclosure regarding the revocation or suspension of a professional attainment, designation, or license. The amendment would replace "proceeding" in that item with "hearing or formal adjudication."[205] By using the term "proceeding," which is defined in the Form ADV Glossary, this item limits the required disclosure to actions initiated by a government agency, self-regulatory organization or foreign financial regulatory authority. The item was intended to require disclosure of actions taken by the designating authority to revoke or suspend the use of the attainment, designation, or license that it administers, and not actions taken by regulatory authorities who are unlikely to bring an action to revoke or suspend a professional designation.

We request comment on these proposed changes. Are there additional items we should consider amending, and why? We are considering whether to add an additional reporting requirement to Item 1 that would require advisers to provide a unique identification code to

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204 Proposed Form ADV, Part 1A, Item 11.

205 If adopted, the revised item would state "[A]ny other hearing or formal adjudication in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished the attainment, designation, or license) in anticipation of such a hearing or formal adjudication (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event."

provide additional uses for the data that we collect. For example, the Office of Financial Research (OFR) is required to publish a financial company reference database as part of its role in assisting the Financial Stability Oversight Council (FSOC) under the Dodd-Frank Act.[206] Would a unique identification code assigned by, on behalf of, or otherwise used by FSOC or OFR that is reported on Form ADV permit cross-referencing of the data we collect with this future database? Is there a reason why we should not require an adviser to report such an identifier on Form ADV if one is provided?

Should we consider accelerating any of the updating requirements for Form ADV to improve the usefulness of the form to the Commission and to investors? For instance, while we have accelerated filing deadlines in for other types of reports,[207] since 1979, advisers have had 90 days from their fiscal year ends to provide an annual update to Form ADV.[208] To provide more timely information to us and the public, should advisers be required to file their annual amendments to Form ADV within 60 days of the end of the adviser's fiscal year or some other shorter time period?

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206 *See* sections 154(b)(2)(A) and 201(a)(11) of the Dodd Frank Act.

207 *See, e.g., Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports*, Exchange Act Release No. 46464 (Sept. 5, 2002) [67 FR 58480 (Sept. 16, 2002)], at nn. 22-24 and accompanying text (noting that the deadline to file Form 10-K within 90 days after a company's fiscal year end had not been changed in 32 years and accelerating it to 60 days for "large accelerated filers" and 75 days for "accelerated filers," each as defined in rule 12b-2 under the Exchange Act, in order to modernize the periodic reporting system and improve the usefulness of periodic reports to investors).

208 *See Investment Adviser Requirements Concerning Disclosure, Recordkeeping, Applications for Registration and Annual Filings,* Investment Advisers Act Release No. 664 (Jan. 30, 1979) [44 FR 7870 (Feb. 7, 1979)] (adopting rule 204-1).

D. Other Amendments

1. Amendments to "Pay to Play" Rule

Adopted last July, rule 206(4)-5, generally prohibits registered and certain unregistered advisers from engaging directly or indirectly in pay to play practices identified in the rule.[209] We are proposing three amendments to the rule that we believe are needed as a result of the enactment of the Dodd-Frank Act.

First, we propose to amend the scope of the rule to make it apply to exempt reporting advisers and foreign private advisers.[210] Rule 206(4)-5 currently applies to advisers that are either registered with the Commission, or unregistered in reliance on the exemption under section 203(b)(3) of the Advisers Act.[211] As a consequence of the repeal of the private adviser exemption in section 203(b)(3), many unregistered advisers will register under the Act and will be subject to rule 206(4)-5 (albeit pursuant to a different clause of the rule).[212] In addition, the Dodd-Frank Act has added an exemption for "foreign private advisers" in section 203(b)(3) of the Act, which will result in these advisers being subject to the pay to play rule.[213] However,

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209 *Political Contributions by Certain Investment Advisers*, Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018, 41024 (July 14, 2010)] ("Pay to Play Release"). The rule prohibits covered advisers from (i) providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees makes certain political contributions; (ii) paying any third party to solicit advisory business from any government entity unless the person is a "regulated person," subject to similar pay to play restrictions; and (iii) soliciting others, or coordinating, contributions to certain elected officials or candidates or payments to political parties where the adviser is providing or seeking government business. *See id*.

210 Proposed rule 206(4)-5(a).

211 *See* rule 206(4)-5(a)(1) and (2).

212 Instead of being subject to the rule as advisers "unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act," they will be subject to the rule as advisers "registered (or required to be registered)" under the Act. Rule 206(4)-5(a)(1) and (2).

213 *See* section 402 of the Dodd-Frank Act (defining "foreign private adviser"); section 403 of the Dodd-Frank Act (amending section 203(b)(3) of the Advisers Act to strike the current language

some unregistered advisers to which the rule currently applies because of section 203(b)(3) will remain exempt from registration because of the new exemptions for exempt reporting advisers, which we did not contemplate when we adopted rule 206(4)-5, and will no longer be subject to the rule. To prevent unintended narrowing of the application of the rule as a result of the amendments to the Advisers Act, we are proposing to extend the rule to apply it to exempt reporting advisers, as well as foreign private advisers.

We request comment on our proposal to make rule 206(4)-5 applicable to exempt reporting advisers and foreign private advisers. Should either of these types of unregistered advisers be excluded from the rule? If so, what protections should apply instead? We are not proposing to require advisers that will become subject to state registration as a result of the Dodd-Frank Act to comply with the pay to play rule.[214] Should we?

Second, we propose to amend the provision of rule 206(4)-5 that prohibits advisers from paying persons (*e.g.*, "solicitors" or "placement agents") to solicit government entities unless such persons are "regulated persons" (*i.e.*, registered investment advisers or broker-dealers subject to rules of a registered national securities association, such as the Financial Industry Regulatory Authority ("FINRA"), that restricts its members from engaging in pay to play activities).[215] Instead, we would permit an adviser to pay any "regulated municipal advisor" to solicit government entities on its behalf. A regulated municipal advisor under the proposed rule

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exempting certain "private advisers" from registration and inserting language exempting "foreign private advisers" from registration).

Applying rule 206(4)-5 to foreign private advisers, unlike exempt reporting advisers, does not require any amendment of the rule specifically regarding these advisers because the rule currently cross-references section 203(b)(3) of the Advisers Act.

214 For a discussion of the Dodd-Frank Act's reallocation of responsibility for regulation of investment advisers between the Commission and the states, see *supra* section II.A. of this Release.

215 Rule 206(4)-5(a)(2)(i). FINRA is currently the only national securities association registered under section 19(a) of the Exchange Act (15 U.S.C. 78s(a)).

would be a person that is registered under section 15B of the Securities Exchange Act and subject to pay to play rules adopted by the MSRB.[216]

The Dodd-Frank Act creates a new category of person known as a "municipal advisor," which it defines to include persons that undertake "a solicitation of a municipal entity."[217] These persons include, among others, any third-party solicitor, including registered investment advisers and broker-dealers, seeking business on behalf of an investment adviser from a municipal entity, including a pension fund.[218] These municipal advisors are subject to MSRB rules, and we understand that the MSRB intends to consider subjecting municipal advisors to pay to play rules

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216 Proposed rule 206(4)-5(a)(2), (f)(9). As provided in the proposed rule, these pay to play rules must prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made. In addition, the Commission must find that they both impose substantially equivalent or more stringent restrictions on municipal advisors than rule 206(4)-5 imposes on investment advisers and that they are consistent with the objectives of rule 206(4)-5.

217 Section 975 of the Dodd-Frank Act. In creating this new municipal advisor category, Congress expressed its intent that municipal advisors be permitted to solicit government clients. *See* Senate Committee Report, *supra* note 11, at 148 ("The SEC recently proposed new rules under the Investment Advisers Act of 1940 relating to the provision by registered investment advisers of investment advisory services to municipal entities in which, among other things, the SEC proposed prohibiting investment advisers from making payments to unrelated persons for solicitation of municipal entities for investment advisory services on behalf of investment advisers. Rather than effectively prohibiting such third-party solicitation for investment advisory services, [section 975] would provide that activities of a municipal advisor, broker, dealer or municipal securities dealer to solicit a municipal entity to engage an unrelated investment adviser to provide investment advisory services to a municipal entity or to engage to undertake underwriting, financial advisory or other activities for a municipal entity in connection with the issuance of municipal securities would be subject to regulation by the MSRB...").

218 *See* Section 975(e) of the Dodd-Frank Act (defining: (i) "municipal advisor," in relevant part, as "a person . . . that . . . undertakes a solicitation of a municipal entity;" (ii) "municipal entity," in relevant part, as "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including . . . any plan, program, or pool of assets sponsored or established by the State, political subdivision . . . or any agency, authority or instrumentality thereof. . . .;" and (iii) "solicitation of a municipal entity or obligated person," in relevant part, as "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of . . . an investment adviser (as defined in section 202 of the Investment Advisers Act of 1940) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person . . . of an investment adviser to provide investment advisory services to or on behalf of a municipal entity.").

similar to its rules governing municipal securities dealers.[219] Broker-dealers acting as placement agents or solicitors and investment advisers acting as solicitors of municipal entities and obligated persons generally meet the statutory definition of a municipal advisor and thus would be subject to MSRB rules.[220] Our proposed amendment would, like the current rule, permit advisers to pay persons to solicit government entities on their behalf only if such third parties are registered with us and subject to pay to play rules.[221] Given the new regulatory regime applicable to municipal advisors, including solicitors of government entities that meet the definition of "regulated person" under rule 206(4)-5,[222] broker-dealer solicitors are expected to be subject to MSRB's pay to play rules, rendering it unnecessary at this time for FINRA to adopt

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219 *See* MSRB, *Municipal Securities Rulemaking Board Issues Statement on Financial Reform Legislation*, Press Release, July 15, 2010, *available at* http://www.msrb.org/News-and-Events/Press-Releases/2010/MSRB-Issues-Statement-on-Financial-Reform-Legislation.aspx ("The transition [to a majority public governing board] will be coordinated with a rulemaking program designed to ensure careful but prompt development of rules fulfilling the MSRB's expanded mission. The MSRB will develop rules in the areas of fair practice and fiduciary duties, pay to play and other conflicts of interest, gifts, disclosures, professional qualifications, continuing education and other areas identified by the new governing board."); MSRB rule G-37. MSRB rule G-37 is available on the MSRB's website at http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-37.aspx.

220 *See supra* note 218. While section 15B(e)(4)(C) of the Exchange Act excludes from the definition of municipal advisor "a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933)," we interpret this exclusion to apply solely to a broker, dealer, or municipal securities dealer serving as an underwriter on behalf of a municipal issuer in connection with the issuance of municipal securities. Congress enacted section 975 of the Dodd-Frank Act, which added the definition of "municipal advisor" to Section 15B of the Exchange Act, to subject the relationship between a municipal advisor and a municipal entity to regulation by the MSRB. *See* Senate Committee Report, *supra* note 11, at 148 (noting the need to subject activities such as solicitation of a municipal entity to engage an investment adviser to MSRB regulation). The Commission expects to consider a proposal for a permanent municipal advisor registration program, including requirements for the registration of municipal advisors. *See Temporary Registration of Municipal Advisors*, Exchange Act Release No. 62824 (Sept. 1, 2010) [75 FR 54465 (Sept. 8, 2010)].

221 *See* Pay to Play Release at section II.B.2.(b). We note that a person that solicits investors to invest in investment interests that are securities also may need to consider whether that person is acting as a broker. *See* Pay to Play Release at n. 326.

222 *See* rule 206(4)-5(f)(9)(ii) (defining "regulated person" to include a broker-dealer that is registered with the Commission and is a member of a national securities association registered under section 15A of the Exchange Act (currently limited to FINRA)).

a pay to play rule that would satisfy rule 206(4)-5(f)(9)(ii). We are proposing, therefore, to replace references in rule 206(4)-5 to FINRA's pay to play rules with references to MSRB rules that we find are consistent with the objectives of rule 206(4)-5 and impose substantially equivalent or more stringent pay to play restrictions.

We are not proposing to amend the compliance date of rule 206(4)-5's limitation on payments to third-party solicitors, which is September 13, 2011. MSRB staff has informed our staff that the pay to play rules it expects to consider would likely be in effect by that date.[223] If rule 206(4)-5 is amended as proposed, an investment adviser subject to the rule would be prohibited from paying any third party to solicit government entities on its behalf that is not registered with us under Section 15B of the Securities Exchange Act and thus not subject to the MSRB's pay to play rules.

We request comment on our proposal to permit investment advisers to hire registered municipal advisors to solicit government entities on their behalf, if those registered municipal advisors are subject to pay to play restrictions under MSRB rules. Could our proposal result in rule 206(4)-5's solicitation limitations applying to certain solicitors affiliated with an investment adviser?[224] Should we amend rule 206(4)-5 expressly to allow advisers to pay these investment adviser-affiliated solicitors? Should we amend rule 206(4)-5 to provide that any person that

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223 If it appears that the MSRB will not be able to adopt pay to play rules for municipal advisors by September 13, 2011 that would meet the requirements of rule 206(4)-5, we will consider whether to take alternative action.

224 *See* section 15B(e)(4) of the Exchange Act (defining "municipal advisor" to include "a person (who is not a municipal entity or an employee of a municipal entity) that…undertakes a solicitation of a municipal entity"); section 15B(e)(9) of the Exchange Act (defining "solicitation of a municipal entity or obligated person" to mean "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of… [an] investment adviser… *that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation* for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person…of an investment adviser to provide investment advisory services to or on behalf of a municipal entity" (emphasis added)).

controls, is controlled by, or is under common control with an investment adviser (and, if that person is an entity, its personnel) would be deemed to be a "covered associate" of the investment adviser if the investment adviser pays or agrees to pay such person (or such personnel) to solicit a government entity on its behalf?

Finally, we are proposing a minor amendment to rule 206(4)-5's definition of a "covered associate"[225] of an investment adviser to clarify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition. Under the rule as adopted, "covered associate" includes any owner and personnel of an adviser and political action committees the owner, personnel, or adviser control for purposes of the rule's restrictions. Currently, the owners of an adviser included in the definition of "covered associate" are: "[a]ny general partner, managing member . . . or other individual with a similar status or function."[226] We are proposing to replace the word "individual" with the word "person." Unlike the other proposed amendments to rule 206(4)-5, this proposed amendment is not related to the Dodd-Frank Act, but instead is meant to clarify the rule and the Commission's original intent that "covered associate" include legal entities as well as natural persons, and to respond to interpretive questions our staff has received.

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225 *See* rule 206(4)-5(f)(2) (defining a "covered associate" of an investment adviser as: "(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by [any other covered associate].").

226 *See id.*

2. Technical and Conforming Amendments

a. Rules 203(b)(3)-1 and 203(b)(3)-2

We intend, at the adoption of rule and form amendments to implement provisions of the Dodd-Frank Act, to rescind rules 203(b)(3)-1[227] and 203(b)(3)-2,[228] which specify how advisers "count clients" for purposes of determining whether the adviser is eligible for the private adviser exemption of section 203(b)(3) of the Advisers Act (which, as discussed above, Congress repealed in section 403 of the Dodd-Frank Act). In the Exemptions Release, we are proposing a new client counting rule, rule 202(a)(30)-1, for purposes of the new foreign private adviser exemption.[229]

b. Rule 204-2

We are proposing to amend rule 204-2 under the Advisers Act, the "books and records" rule, to update the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register when the Dodd-Frank Act's elimination of the "private adviser" exemption becomes effective on July 21, 2011. At that time, these advisers would become subject to the recordkeeping requirements of the Act, including the requirement to keep certain records relating to performance.[230] We propose that these advisers would not be obligated to keep certain performance-related records so long as they did not actually register when they were eligible for the "private adviser" exemption; however, to the extent that these advisers preserved these

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227 Rule 203(b)(3)-1.

228 Rule 203(b)(3)-2. We adopted rule 203(b)(3)-2 in 2004 in order to require certain hedge fund advisers to register under the Act. *See* Hedge Fund Adviser Registration Release. That rule, and certain amendments to rule 203(b)(3)-1 and other rules, were vacated by a federal appeals court in *Goldstein*, but have remained in the Code of Federal Regulations.

229 *See* Exemptions Release at section II.C.1.

230 *See* rule 204-2(a)(16).

performance-related records without being required to do so by current rule 204-2, the proposed grandfathering provision would require them to continue to preserve them.[231] In addition, we are proposing to amend rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added to the Dodd-Frank Act.[232] Finally, we expect to rescind rule 204-2(l)[233] because it was vacated by the federal appeals court in *Goldstein* and because the Dodd-Frank Act's addition of section 204(b)(2) to the Advisers Act codifies this concept in the statute itself.[234]

c. Rule 0-7

Rule 0-7(a)(1) under the Advisers Act, which defines "small entities" under the Advisers Act for purposes of the Regulatory Flexibility Act, cross-references section 203A(a)(2) of the Advisers Act.[235] The Dodd-Frank Act has renumbered section 203A(a)(2) of the Advisers Act to

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231 *See* proposed amendment to rule 204-2(e)(3)(ii) (stating, "[i]f you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, [this rule] does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under [certain sections of this rule] to the extent those books and records pertain to the performance or rate of return of such private fund (*as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)*), or other account you advise for any period ended prior to July 21, 2011, *provided that* you were not registered with the Commission as an investment adviser during such period, and *provided further* that you continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period." (emphasis added)). Advisers to private funds that registered with the Commission based on adoption of rule 203(b)(3)-2 in the Hedge Fund Adviser Registration Release and then withdrew their registration based upon the *Goldstein* decision would be permitted to rely on the proposed grandfathering provision.

232 *See* rule 204-2(e)(3)(ii) (using the term private fund without reference to a definition). We are proposing to add a parenthetical noting that the term is defined in section 202(a)(29) of the Advisers Act.

233 Rule 204-2(l) states that books and records of a private fund are, under certain circumstances, treated as books and records of its adviser.

234 Section 404 of the Dodd-Frank Act (adding section 204(b)(2) to the Advisers Act, which states, "The records and reports of any private fund to which an investment adviser registered under this title provides investment advice shall be deemed to be the records and reports of the investment adviser.").

235 Rule 0-7(a)(1) (stating that the term "small business" or "small organization" for purposes of the Advisers Act means an investment advisers that: "Has assets under management, as defined under Section 203(a)(2) of the Act (15 U.S.C. 80b-3a(a)(2)) and reported on its annual updating

203A(a)(3)), and thus we are proposing to amend rule 0-7(a)(1) to cross-reference section 203A(a)(3) rather than section 203A(a)(2).[236]

d. Rule 222-1

We are proposing to replace the term "principal place of business" in rule 222-1(b)[237] under the Advisers Act, which contains definitions relevant to section 222 of the Advisers Act's provisions regarding state regulation of investment advisers, with the term "principal office and place of business" to conform to the Dodd-Frank Act's amendments to that section.[238] We are not proposing to modify the definition.

e. Rule 222-2

We are proposing technical amendments to rule 222-2 to define "client" for purposes of the national *de minimis* standard by cross-referencing the definition of "client" in proposed rule 202(a)(30)-1 rather than the definition in rule 203(b)(3)-1 because we expect to rescind rule 203(b)(3)-1.[239] We also propose to change a cross-reference to paragraph (b)(6) of existing rule 203(b)(3)-1 to paragraph (b)(4) of proposed rule 202(a)(30)-1 to account for the changed location of that particular provision. Finally, because proposed rule 202(a)(30)-1, unlike rule 203(b)(3)-1, does not include a "special rule" specifying that an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without

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amendment to Form ADV [17 CFR 279.1], of less than $25 million, or such higher amount as the Commission may by rule deem appropriate . . . .").

236 Proposed amendment to rule 0-7(a)(1).

237 Rule 222-1(b) (defining "principal place of business" of an investment adviser as "the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.").

238 *See* section 985 of the Dodd-Frank Act (replacing the term "principal place of business" each time it appears – *i.e.*, six times – with the term "principal office and place of business" in section 222 of the Advisers Act).

239 *See supra* section II.D.2.a. of this Release (discussing rescinding rule 203(b)(3)-1); Exemptions Release at section II.C.1. (discussing the definition of "client" in proposed rule 202(a)(30)-1).

compensation, we are proposing to include this instruction in rule 222-2. We request comment on our proposed amendments to rule 222-2. Should we preserve the instruction that an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without compensation for purposes of the national *de minimis* standard?

f. Rule 202(a)(11)-1

We intend, at the adoption of rule and form amendments to implement the Dodd-Frank Act, to rescind rule 202(a)(11)-1.[240] Although the rule was vacated by a federal appeals court (and is therefore not in effect),[241] it has remained in the CFR.

III. GENERAL REQUEST FOR COMMENT

The Commission requests comment on the rules, and rule and form amendments proposed in this Release, suggestions for additional changes to the existing rules and comment on other matters that might have an effect on the proposals contained in this Release. Commenters should provide empirical data to support their views.

IV. COST-BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits of its rules. The new rules and rule and form amendments we are proposing would give effect to provisions in Title IV of the Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting by advisers to certain types of private funds that are exempt from registration. As part of these amendments, we are also proposing amendments to the Advisers Act pay to play rule, rule 206(4)-5. Additionally, we propose to identify the advisers that are subject to the Dodd-

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240 Rule 202(a)(11)-1.

241 *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

Frank Act's requirements concerning certain incentive-based compensation arrangements. Because many of our proposals would implement or clarify provisions of the Dodd-Frank Act, they would not create benefits and costs separate from the benefits and costs considered by Congress in passing the Dodd-Frank Act.[242] However, certain of our proposals, if adopted, would generate costs and benefits independent of those generated by the Dodd-Frank Act itself. These costs and benefits are discussed below.

A. Benefits

1. Eligibility to Register with the Commission: Section 410

Section 410 of the Dodd-Frank Act amends section 203A of the Advisers Act to create a new group of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the state securities authorities.[243] It does this by prohibiting from registering with the Commission an investment adviser that is required to be registered and subject to examination as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between $25 million and $100 million.[244] We are proposing rules and rule amendments that would provide us a means of identifying advisers that must transition to state regulation, clarify the application of new statutory provisions, and modify certain of the exemptions we have adopted under section 203A of the Act.

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242 *See* Dodd-Frank Act, *supra* note 2; Conference Committee Report, *supra* note 67; Senate Committee Report, *supra* note 11; *supra* section I. of this Release. Proposals not generating costs and benefits independent of those generated by the Dodd-Frank Act include the proposed amendments to rules 0-7, 204-2, 222-1, 222-2 and our proposal to rescind rule 203(b)(3)-1.

243 *See supra* section II.A.7. of this Release.

244 *See supra* notes 11-12 and accompanying text (discussing section 410 of the Dodd-Frank Act, which amends Section 203A of the Advisers Act to increase the threshold above which all investment advisers must register with the Commission from $25 million to $100 million).

Transition to State Registration

We are proposing a new rule, rule 203A-5, which would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011 (30 days after the July 21, 2011 effective date of the amendments to section 203A), and withdraw from Commission registration by October 19, 2011 (60 days after the required filing of Form ADV), if no longer eligible.[245] As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 4,100 advisers currently registered with the Commission will be required to withdraw their registration and register with one or more state securities authorities.[246] Given this significant re-alignment of regulatory authority over numerous advisers, our proposed rule would allow us to easily and efficiently identify the advisers that are subject to our regulatory authority after the Dodd-Frank Act's amendment to section 203A becomes effective, and which advisers have switched to state registration due to the amendment to section 203A. The proposed rule would confer this same benefit on state securities authorities. This would promptly implement the Congressional mandate, and accommodate the IARD processing of renewals and fees for state registration and licensing, while allowing for an orderly transition. It would also help minimize any potential uncertainty about the effects of the Dodd-Frank Act on the registration status of a particular adviser among investors and other market participants by providing a simple, efficient means of determining the adviser's post-Dodd-Frank registration status through the IARD system as of a specific date. To the extent that rule 203A-5 would minimize uncertainty among investors and other market participants, it could help minimize any disruption in advisory business that such uncertainty could provoke, and

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245 Proposed rule 203A-5(a), (b). *See supra* section II.A.1. of this Release.

246 *See supra* note 15 and accompanying text.

investors would know clearly whether an adviser that advises them is subject to state or Commission registration and regulation.

Switching Between State and Commission Registration

Rule 203A-1 currently contains two means of preventing an adviser from having to switch frequently between state and Commission registration as a result of changes in its assets under management or the departure of one or more clients.[247] We propose to amend rule 203A-1 to eliminate the $5 million buffer that permits an investment adviser having between $25 million and $30 million of assets under management to remain registered with the states and that does not subject the adviser to cancellation of its Commission registration until its assets under management fall below $25 million.[248] We are proposing to eliminate the current $5 million buffer because it seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states.[249] Elimination of this portion of the rule also promotes efficiency and competition by making the registration requirements for advisers with assets under management between $25 million and $30 million consistent with the requirements for advisers with assets under management between $30 million and $100 million. Moreover, we are proposing to retain the 180-day grace period from the adviser's fiscal year end to address concerns about advisers frequently having to register and then de-register with the Commission as a result of changes in their eligibility to register.[250]

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247 *See supra* note 62-65 and accompanying text.

248 *See supra* note 66.

249 *See supra* note 67.

250 *See* proposed rule 203A-1(b); *supra* notes 66-68 and accompanying text.

Exemptions from the Prohibition on Registration with the Commission

We are proposing amendments to three exemptions from the prohibition on registration in rule 203A-2 to reflect developments since their initial adoption, including the enactment of the Dodd-Frank Act.[251] First, we are proposing to eliminate the exemption in rule 203A-2(a) from the prohibition on Commission registration for NRSROs.[252] Since we adopted this exemption, Congress amended the Act to exclude NRSROs from the Act and provided for a separate regulatory regime for NRSROs under the Exchange Act.[253] Only one NRSRO remains registered as an investment adviser under the Act and reports that it has more than $100 million of assets under management and thus would not need to rely on the exemption.[254] Given that NRSROs do not currently rely on the exemption and that Congress has excluded NRSROs from the Act, we do not believe that our proposed amendment would generate any benefits or costs and would not impact efficiency, competition or capital formation, separate from the benefit of simplifying our rules by eliminating an unused exemption.

Second, we are proposing to amend the exemption available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million.[255] We had set the threshold at $50 million of plan assets for these advisers to ensure that a pension consultant's activities are significant enough to have an effect on national markets.[256] We propose to increase this threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of "assets under management" that

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251 *See* proposed rule 203A-2; *supra* section II.A.5. of this Release. We would also make conforming amendments to renumber rule 203A-2(b) through (f).

252 *See supra* section II.A.5.a. of this Release.

253 *See supra* notes 73-74.

254 Based on IARD data as of September 1, 2010.

255 *See* proposed rule 203A-2(a); *supra* section II.A.5.b. of this Release.

256 *See supra* note 78.

requires advisers to register with the Commission without regard to state regulatory requirements.[257] This amendment would maintain the same ratio of plan assets to the statutory assets under management requirements currently in place, and would provide the regulatory benefit of allowing the Commission to focus its resources on oversight of those pension consultants that are more likely to have an effect on national markets.

Finally, we propose to amend the multi-state adviser exemption in rule 203A-2(e) to align the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act.[258] Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register in 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register in at least 25 states.[259] We propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.[260] We believe this reflects a Congressional view on the number of states with which an adviser must be required to be registered before the regulatory burdens associated with such regulation warrants registration with the Commission and application of the preemption provision.[261] This amendment reduces the regulatory burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator — the Commission. Additionally, the amendment promotes efficiency and reduces the effect on competition between small and mid-sized investment advisers by imposing a consistent multi-

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257 *See supra* note 79.

258 *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

259 *See supra* note 82.

260 *See* proposed rule 203A-1(d)(1).

261 *See supra* note 84.

state exemption standard. We also propose to eliminate the provision in the rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not proposing a similar cushion for the 15-state threshold.[262] We do not see any significant benefit of retaining the buffer and believe it is unnecessary as a result of our proposal to lower the number of states from 30 to 15 and because advisers elect to rely on the exemption.

Elimination of Safe Harbor

We are proposing to eliminate the safe harbor in rule 203A-4 from Commission registration for an investment adviser that is registered with a state securities authority of the state in which it has its principal office and place of business, based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[263] Advisers have not, in our experience, asserted the availability of this safe harbor as a defense, which protects only against enforcement actions by us and not any private actions, and we view it as unlikely that an adviser would be reasonably unaware that it has more than $100 million of regulatory assets under management when it is required to report its regulatory assets under management on Form ADV.[264] We do not believe that rescinding the safe harbor would generate any significant benefits, other than simplifying our rules in general and thereby marginally reducing costs of compliance, and we believe it would have little, if any, other effect on efficiency, competition or capital formation.

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262 *See supra* note 85-86.

263 Rule 203A-4. *See supra* section II.A.6. of this Release.

264 *See supra* notes 91-92 and accompanying text.

Mid-Sized Advisers

The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers registering with the Commission.[265] We propose to incorporate into Form ADV an explanation of how we construe these provisions.[266] Our instructions are intended to clarify the meaning of these provisions, which would benefit advisers by promoting efficiency and competition. For example, as a result of our proposal to identify to advisers filing on IARD the states that do not subject advisers to examination, a mid-sized adviser would not be required to determine whether it is subject to examination in a particular state. Simplifying the process for mid-sized advisers to determine whether they are required to register with us would decrease any competitive disadvantages compared to smaller advisers. Our proposed changes to IARD also would ensure that only mid-sized advisers with a principal office and place of business in those states (or mid-sized advisers that are not registered with the states where they maintain a principal office and place of business) will register with the Commission, which would also make the registration process more efficient.

2. Exempt Reporting Advisers: Sections 407 and 408

Congress gave us broad authority to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[267] We have sought information that we believe would be useful to us to be able to identify the advisers, their owners, and their business models and, in addition, whether they might present sufficient

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265 *See supra* note 94.

266 *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b. *See also supra* section II.A.7. of this Release (discussing these instructions in detail).

267 *See* sections 407 and 408 of the Dodd-Frank Act.

concerns as to warrant our further attention in order to protect their clients and fulfill our regulatory responsibilities. We have also considered the broader public interest in making this information generally available and believe there may be benefits of providing information about their activities to the public. We acknowledge that there may be costs associated with providing this information to us, and that the adviser may provide some or all of this information to private fund investors or prospective investors, however, we believe these investors would benefit from the proposed reporting requirements.

To meet the Dodd-Frank Act's reporting provisions for "exempt reporting advisers," we are proposing a new rule, rule 204-4, to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[268] We are also proposing amendments to Form ADV so that it could serve the dual purpose of both an SEC reporting form for exempt advisers and, as it is used today, a registration form for both state and SEC-registered firms.[269] In addition to requiring that exempt reporting advisers use Form ADV, proposed rule 204-4 would require these advisers to submit reports through the IARD and to pay a filing fee.[270]

We believe that using Form ADV and IARD for exempt reporting adviser reports would yield several benefits. For instance, using Form ADV and IARD would create efficiencies that benefit both us and filers by taking advantage of an established and proven adviser filing system, while avoiding the expense and delay of developing a new form and filing system. Additionally, the IARD contains many time-saving features, like the ability to pre-populate prior responses and drop-down boxes for common responses. In addition, because exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities, use of the

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268 Proposed rule 204-4(a). *See supra* section II.B. of this Release.

269 *See supra* section II.B.1. of this Release.

270 Proposed rule 204-4(b), (d).

existing form and filing system (which is shared with the states) should reduce regulatory burdens for them because they can satisfy multiple filing obligations through a uniform form.[271] Similarly, regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[272] Finally, certain items in Form ADV Part 1 are also linked to Form BD, which would create efficiencies if the exempt reporting adviser ever applies for broker-dealer registration.

Requiring that exempt reporting advisers file their reports through the IARD would also benefit clients, prospective clients, and members of the public who could readily access the information, without cost, through the Commission's website on the Investment Adviser Public Disclosure (IAPD) system. Investors would have access to some information that may have been previously unavailable or not easily attainable, such as whether a prospective exempt reporting adviser has certain disciplinary events and whether its affiliates present conflicts of interest or broader access to other financial services. As a result, investors would be in a better position to make informed decisions. As a secondary benefit, the easy availability of information about these advisers and their advisory affiliates may discourage advisers from engaging in certain practices (such as maintaining client assets with a related person custodian) or hiring certain persons (such as those with disciplinary history). Investors' access to information may also facilitate greater competition among advisers, which may in turn benefit clients.

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271 *See supra* note 126-127 and accompanying text.

272 *See* proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also supra* note 128.

Electronic reporting by exempt reporting advisers of certain Items within Form ADV would give us better access to information about these advisers to administer our regulatory programs and to identify advisers whose activities suggest a need for closer scrutiny. We can easily use the IARD to generate reports on the industry, its characteristics and trends. These reports would help us anticipate regulatory problems, allocate and reallocate our resources, and more fully evaluate and anticipate the implications of various regulatory actions we may consider taking, which should increase both the efficiency and effectiveness of our programs and thus increase investor protection. In addition, requiring exempt reporting advisers to complete Section 7.B of Schedule D for each private fund they manage should result in many of the same benefits that this information produces with respect to registered advisers that we address in the discussion of the proposed amendments to Form ADV below.

We are also proposing to amend rule 204-1 under the Advisers Act, which addresses when and how advisers must amend their Form ADV, to require that exempt reporting advisers file updating amendments to reports filed on Form ADV.[273] Proposed rule 204-1(a) would require an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Consequently, we are proposing to amend General Instruction 4 to Form ADV to require an exempt reporting adviser to update Items 1 (identification information), 3 (Form of Organization), or 11 (disciplinary information) promptly if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[274]

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273 Proposed rule 204-1. *See supra* section II.B.3. of this Release.

274 Registered advisers are subject to the same updating requirements with respect to these Items. *See* General Instruction 4 to Form ADV.

Requiring advisers to amend their reports on Form ADV at least annually, and more frequently if identification or disciplinary information becomes inaccurate in any way, would assure that we have access to updated information such as knowing when an exempt reporting adviser has added or no longer has a private fund client, which will provide us with the information necessary to assess whether they might present sufficient concerns to warrant our further inquiry. Updated information would also benefit clients, prospective clients, and other members of the public that could use this information in evaluating, for example, whether to make an investment in a venture capital fund managed by an exempt reporting adviser.

To accommodate their use by exempt reporting advisers, we also are proposing technical amendments to Form ADV-H, the form advisers use to request a hardship exemption from electronic filing,[275] and Form ADV-NR, used to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers.[276] Proposed rule 204-4(e) and the proposed amendments to Form ADV-H would benefit exempt reporting advisers by allowing them to avoid non-compliance with reporting requirements based purely on unanticipated technical difficulties. The proposed amendments to Form ADV-NR would benefit investors by allowing us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws.

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275 Proposed rule 204-4(e) would allow exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD systems to request a temporary hardship exemption from electronic filing requirements.

276 *See* proposed amended Form ADV-H, proposed amended Form ADV-NR, and proposed General Instruction 18. The amendments to Form ADV-H and Form ADV-NR would reflect that exempt reporting advisers use the forms in the same way and for the same purpose as they are currently used by registered investment advisers.

3. Form ADV Amendments

As discussed above, we are proposing to require advisers to provide us on Form ADV additional information about (1) private funds they advise, (2) their advisory business and conflicts of interest, and (3) their non-advisory activities and financial industry affiliations.[277] We are also proposing certain additional changes intended to improve our ability to assess compliance risks and to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

Private Fund Reporting Requirements

The private fund reporting requirements we are proposing would provide us with information designed to help us better understand private fund investment activities and the scope and potential impact of those activities on investors and our markets. The information would assist us in identifying particular practices that may harm investors and would allow us to conduct targeted examinations of private fund advisers based on these practices or other criteria. In addition the proposed items are designed to improve our ability to assess risk, identify funds with service provider arrangements that raise a "red flag," identify firms for examination, and allow us to more efficiently conduct examinations. For instance, it would be relevant to us to know that a private fund is using a service provider that we are separately investigating for alleged misconduct. We propose to ask about both the number and the types of investors in the fund to get a better idea of the investors the fund is intended to serve and to get a sense of the extent to which investors may themselves be in a position to evaluate the adviser. We would ask about the size of the fund, including both its gross and net assets, to better understand the scope of its operations and the extent of leverage it employs. Responses to the service provider

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277 *See supra* section II.C. of this Release.

questions would, for example, allow us to identify those funds that do not make use of independent service providers, which may indicate a higher level of risk, and provide other key information regarding the identity and role of these private fund gatekeepers. Each particular item of information may not itself indicate an elevated risk of a compliance failure, but is designed to serve as an input to the risk metrics by which our staff identifies potential risk and allocates examination resources. The staff conducts similar analyses today, but with fewer inputs.

Form ADV information that private fund advisers would report to us also would benefit private fund investors in evaluating potential managers. As amended, Form ADV would require private fund advisers to disclose information about their business, affiliates and owners, gatekeepers, and disciplinary history. This would create a publicly accessible foundation of basic information that could aid investors, to the extent they were not otherwise timely given the information, in conducting due diligence and could further help investors and other industry participants protect against fraud. For example, using the IARD data, auditors would be able to compare their list of funds they audit with those whose advisers report them as auditor. Investors (and their consultants) would be able to compare representations made on Schedule D with those made in private offering documents or other material provided to prospective investors.

Private fund reporting would benefit investors and market participants by providing us and other policy makers with better data. Better data would enhance our ability to form and frame regulatory policies regarding the private fund industry and its advisers, and to evaluate the effect of our policies and programs on this sector, including for the protection of private fund investors. Today we frequently have to rely on data from other sources, when available. Private

fund reporting would provide us with important information about this rapidly growing segment of the U.S. financial system.

Other Proposed Amendments to Form ADV

Other amendments we are proposing today to Form ADV would refine or expand existing questions, which would give us a more complete picture of an adviser's practices, help us better understand each adviser's operations, business and services, and provide us with more information to determine advisers' risk profiles and prepare for examinations. The amendments would provide us with critical information to identify practices that may harm clients, which would assist us in identifying candidates for risk-targeted examinations, detecting data or patterns that suggest further inquiry may be warranted about a particular issue, and distinguishing additional conflicts of interest that advisers may face. For example, the additional information we propose to require about related persons would allow us to link disparate pieces of information that we have access to concerning an adviser and its affiliates to identify whether those relationships present conflicts of interest that create higher risks for advisory clients. Another example is the proposed switch from ranges to approximate numbers of employees and assets by client type. Although these changes would refine data we already receive, it would provide significant benefits in developing risk-based profiles of advisers. Our proposal to expand the list of the types of advisory activities an adviser might engage in and to include a list of the types of investments about which they provide advice would help us better understand the operations of advisers. Additionally, our proposal to require advisers to report whether they have $1 billion or more in assets would help us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements. Overall,

the information proposed to be collected on Form ADV is designed to improve our risk-assessment capabilities and help us best allocate our examination resources.

Further, advisory clients and prospective clients would also benefit from these proposed amendments. The additional information that registered advisers would report to us would be publicly available, which would aid investors in evaluating potential managers and understanding their practices. For example, requiring an adviser to indicate whether it or any of its control persons is a public reporting company under the Exchange Act would provide a signal, not only to us, but to clients and to prospective clients, that additional public information is available about the adviser and/or its control persons. Requiring an adviser to report whether it has $1 billion or more of assets would help inform the adviser, its clients and the public whether or not the adviser is subject to section 956 of the Dodd-Frank Act and any rules or guidelines thereunder. The additional information about the adviser's related persons would assist clients to compare business practices, strategies, and conflicts of a number of advisers, which may help them to select the most appropriate adviser for them. Clients may also benefit indirectly because advisers may be incentivized to implement stronger controls and practices, particularly related to any conflicts of interest or business practices that may result in additional risks because of enhanced client awareness. Third parties would also be able to access the new information reported in filings of the amended form, which would allow academics, businesses, and others to access additional information about registered investment advisers and exempt reporting advisers, which they can use to study the industry.

We anticipate that the proposed amendments to the Form ADV instructions would assist investment advisers in determining their regulatory assets under management and whether they are eligible to register with us, which may result in cost savings for some advisers because they

may more readily be able to make this determination.[278] Eliminating the choices we have given advisers in the Form ADV instructions for calculating assets under management would, for example, provide for a uniform method of determining assets under management for purposes of the form and the new exemptions from registration under the Advisers Act, which we expect would promote competition, would result in advisers' greater certainty in choosing to rely on an exemption from registration, and would result in consistent reporting across the industry.[279] Our proposed amendments to the instructions relating to calculation of assets under management would also clarify how an adviser would determine the amount of private fund assets it has under management, as there are currently no specific instructions on this point. We expect this may provide advisers with greater certainty in their calculation of regulatory assets under management and would provide greater certainty in determining their eligibility for the exemptions from registration available to certain private fund advisers.[280]

4. Amendments to Pay to Play Rule

We are proposing two amendments to rule 206(4)-5 that we believe are appropriate as a result of the enactment of the Dodd-Frank Act, and one minor amendment to clarify the rule.[281] First, we propose to amend the rule to make it continue to apply to all private advisers, including exempt reporting advisers and foreign private advisers.[282] We are proposing this amendment to prevent the narrowing of the application of the rule as a result of the amendments

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278 *See* section II.A.3.

279 *See id. See also* Exemptions Release at section II.C. (discussing exemption for foreign private advisers).

280 *See* Exemptions Release at sections II.B.2. and II.C.5.

281 *See supra* section II.D.1. of this Release.

282 Proposed rule 206(4)-5(a). *See supra* section II.B. of this Release (discussing the definitions of exempt reporting advisers and foreign private advisers).

to the Act made by the Dodd-Frank Act.[283] We do not believe that this amendment would create any benefits (or costs) beyond those created by the rule as originally adopted,[284] but rather would merely assure that the rule continues to apply to the same advisers as we intended when we adopted the rule.[285]

Second, we propose to amend the provision of rule 206(4)-5 that prohibits advisers from paying persons (*e.g.*, "solicitors" or "placement agents") to solicit government entities unless such persons are "regulated persons" (*i.e.*, registered investment advisers or broker-dealers subject to rules of a registered national securities association, such as FINRA, that restrict its members from engaging in pay to play activities).[286] Instead, the proposed amendments would permit an adviser to pay any "regulated municipal advisor" to solicit government entities on its behalf. A regulated municipal advisor under the proposed rule would be a municipal advisor that is registered under section 15B of the Exchange Act and subject to pay to play rules adopted by the MSRB.[287] We understand that the MSRB intends to consider subjecting municipal advisors to pay to play rules similar to its rules governing municipal securities dealers. Broker-dealers acting as placement agents or solicitors and investment advisers acting as solicitors of

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283 *See supra* section II.D.1. of this Release.

284 *See* section IV of the Pay to Play Release.

285 Rule 206(4)-5 currently applies to "private advisers" exempt from registration with the Commission under section 203(b)(3) of the Advisers Act. As discussed in section II.B. of this Release, the Dodd-Frank Act has eliminated the "private adviser" exemption from registration with the Commission in section 203(b)(3), but has created new exemptions for exempt reporting advisers and foreign private advisers. Advisers that qualify for these new exemptions generally are subsets of the advisers that qualify for the existing section 203(b)(3) "private adviser" exemption.

286 Rule 206(4)-5(a)(2)(i). FINRA is currently the only national securities association registered under section 19(a) of the Exchange Act (15 U.S.C. 78s(b)).

287 Proposed rule 206(4)-5(a)(2), (f)(9). These pay to play rules must prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made. In addition, the Commission must find that they both impose substantially equivalent or more stringent restrictions on municipal advisors than rule 206(4)-5 imposes on investment advisers and that they are consistent with the objectives of rule 206(4)-5.

government entities meet the statutory definition of a municipal advisor and thus would be subject to MSRB rules. Our proposed amendment would, like the current rule, permit advisers to pay persons to solicit government entities on their behalf only if such third parties are registered with us and subject to pay to play rules of their own.[288] Given the new regulatory regime applicable to municipal advisors, including solicitors of municipal entities that meet the definition of "regulated person" under rule 206(4)-5, broker-dealer solicitors are expected to be subject to MSRB's pay to play rules, rendering it unnecessary at this time for FINRA to adopt a pay to play rule that would satisfy rule 206(4)-5(f)(9)(ii). We are proposing, therefore, to replace references in rule 206(4)-5 to FINRA's pay to play rules with references to MSRB rules that we find are consistent with the objectives of rule 206(4)-5 and impose substantially equivalent or more stringent pay to play restrictions. To the extent that our proposed amendment would eliminate the need to subject certain solicitors to multiple pay to play rules, it would reduce the regulatory burdens on such placement agents.

In addition, due to the fact that the definition of a municipal advisor includes certain registered investment advisers and broker dealers—the two categories of regulated persons that an adviser may currently use as placement agents under rule 206(4)-5—our amendment may increase the number of placement agents that an adviser potentially could hire.[289] This could

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288 Pay to Play Release at section II.B.2.(b).

289 Our current "regulated person" definition does not include, for example, advisers prohibited from registering with the Commission under section 203A of the Advisers Act (15 U.S.C. 80b-3A), such as state-registered advisers, or advisers unregistered in reliance on an exemption other than section 203(b)(3) of the Act. (15 U.S.C. 80b-3(b)(3)). The definition of "municipal advisor" does not exclude these advisers. *See* section 975 of the Dodd-Frank Act.

We adopted the third party solicitor ban to prevent advisers from circumventing the rule through third parties. *See* section II.B.2.(b) of the Pay to Play Release. Given the Dodd-Frank Act's creation of the "municipal advisor" category, and given that it requires these persons to register with the Commission and subjects them to MSRB rulemaking authority, we believe that expanding the current "regulated person" exception to the third party solicitor ban to include registered municipal advisors subject to pay to play rules would not undermine the ban's purpose.

benefit advisers by increasing competition in the market for placement agent services and reducing the cost of such services. It could also benefit those placement agents that are not "regulated persons" under rule 206(4)-5, but may meet the municipal advisor definition, by allowing advisers to hire them.

Finally, we are proposing a minor amendment to rule 206(4)-5's definition of a "covered associate"[290] of an investment adviser to specify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition.[291] Because the minor amendment would not change the meaning of the rule, we do not believe that it would generate any additional benefits (or costs).

B. Costs

1. Eligibility to Register with the Commission: Section 410

Transition to State Registration

Proposed Rule 203A-5 would impose one-time costs on investment advisers registered with us by requiring them to file an amendment to Form ADV, and on advisers that are no longer eligible to remain registered with us by requiring them to file Form ADV-W to withdraw from Commission registration.[292] According to IARD data, approximately 11,850 investment advisers

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By potentially allowing advisers to choose from a broader set of potential third party solicitors, we believe our proposed amendments may promote efficiency and competition in the market for advisory services to the extent third party solicitors that are not regulated persons participate.

290 *See* rule 206(4)-5(f)(2) (defining a "covered associate" of an investment adviser as: "(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by [any other covered associate].").

291 *See* proposed rule 206(4)-5(f)(2); *supra* section II.D.1. of this Release.

292 *See* proposed rule 203A-5; *supra* section II.A.1. of this Release.

are registered with us and would be required to file an amended Form ADV,[293] and we estimate that approximately 4,100 of those advisers will be required to withdraw their registration and register with one or more state securities authorities.[294] We believe that the proposed rule would have little impact on competition among advisers registered with us because they would all be subject to these requirements, but the rule could have a limited impact on competition between SEC-registered advisers who are subject to the rule and state-registered advisers who are not. We also believe that the rule would have little, if any, effect on capital formation.

For purposes of calculating the currently approved Paperwork Reduction Act ("PRA") burden for Form ADV, we estimated that an annual updating amendment would take each adviser approximately 6 hours per amendment,[295] and we estimate the one-time transition amendment would have similar burden. In addition, for purposes of the increased PRA burden for Form ADV, we estimate that the proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete.[296] As a result, we estimate a total average time burden of 10.5 hours for each respondent completing the amendment to Form ADV required by proposed rule 203A-5 (excluding private fund information which is addressed below).[297] We estimate that each adviser would incur average costs of approximately $2,646,[298]

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293 Based on IARD data as of September 1, 2010, 11,867 investment advisers are registered with the Commission. We have rounded this number to 11,850 for purposes of our analysis.

294 According to data from the IARD as of September 1, 2010, 4,136 Commission-registered advisers, which we are rounding to 4,100 for our analysis, either: (i) had assets under management between $25 million and $100 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $100 million and are not relying on an exemption.

295 *See infra* section V.B.2.a.3. of this Release.

296 *See infra* sections V.B.1.a. and V.B.2.a.3. of this Release.

297 6 hours (Form ADV amendment) + 4.5 hours (new Form ADV items) = 10.5 hours.

for a total aggregate of $31,355,100.[299] In addition, of these 11,850 registered advisers, we estimate that 3,500 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[300] We expect this would take 33,350 hours,[301] in the aggregate, for a total cost of $8,404,200.[302] As a result, the total estimated costs associated with filing amended Form ADV as required by proposed rule 203A-5 would be $39,759,300.[303]

For the estimated 4,100 advisers that will be required to withdraw their registrations, we estimate that the average burden for each respondent is 0.25 hours for filing a partial withdrawal on Form ADV-W.[304] An adviser would likely use compliance clerks to prepare the filings and

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298 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the Securities Industry Financial Markets Association's *Management & Professional Earnings in the Securities Industry 2009* ("SIFMA Management and Earnings Report"), modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for a senior compliance examiner and a compliance manager are $210 and $294 per hour, respectively. [5.25 hours x $210 = $1,102.50] + [5.25 hours x $294 = $1,543.50] = $2,646.

299 11,850 advisers x $2,646 = $31,355,100.

300 *See infra* note 400.

301 *See infra* note 403.

302 [16,675 hours x $210 = $3,501,750] + [16,675 hours x $294 = $4,902,450] = $8,404,200. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 298.

303 $31,355,100+ $8,404,200 = $39,759,300.

304 Form ADV-W is designed to accommodate the different types of withdrawals an investment advisers may file. An investment adviser ceasing operations would complete the entire form to withdraw from all jurisdictions in which it is registered (full withdrawal), while an adviser withdrawing from some, but not all, of the jurisdictions in which it is registered would omit certain items that we do not need from an adviser continuing in business as a state-registered adviser. We expect that advisers that would be required to file Form ADV-W if proposed rule 203A-5 is adopted would file only a partial withdrawal because switching to state registration only requires a partial withdrawal. Compliance with the requirement to complete Form ADV-W imposes an average burden of 0.25 hours for an adviser filing for partial withdrawal.

review the prepared Form ADV-W.[305] We estimate that each adviser would incur average costs of approximately $14.75[306] to comply with the Form ADV-W filing requirements, for a total one-time cost of $60,475.[307] As a result, proposed rule 203A-5 would result in a total one-time cost of $39,819,775.[308]

Switching Between State and Commission Registration

The proposed amendment to rule 203A-1 may impose costs on advisers by eliminating the $5 million buffer in current rule 203A-1(a), which permits but does not require an adviser to register with the Commission if the adviser has between $25 million and $30 million of assets under management.[309] Specifically, the proposed amendment may require advisers with between $25 million and $30 million in assets under management that are still eligible for registration with the Commission despite the Dodd-Frank Act's amendments to section 203A of the Advisers Act to switch their registration between the Commission and the states when they otherwise would not do so if the rule continued to include the buffer.[310] As of September 1, 2010,

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305 We have assumed for purposes of the current approved PRA burden for rule 203-2 and Form ADV-W that advisers would use clerical staff to file for a partial withdrawal. Data from the Securities Industry Financial Markets Association's *Office Salaries in the Securities Industry 2009* ("SIFMA Office Salaries Report") modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the hourly rate for a compliance clerk is $59.

306 0.25 hours x $59 (hourly wage for clerk) = $14.75 (total cost for Form ADV-W filing).

307 $14.75 x 4,100 = $60,475.

308 $39,759,300 (total cost for Form ADV filing) + $60,475 (total cost for Form ADV-W filing) = $39,819,775 (total cost for proposed rule 203A-5).

309 *See* proposed rule 203A-1; *supra* section II.A.4. of this Release.

310 *See supra* section II.A.4. of this Release. Under the Dodd-Frank Act, a mid-sized adviser is not prohibited from registering with the Commission if: (i) the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser would not be subject to examination as an investment adviser by that securities commissioner; or (iii) the adviser is required to register in 15 or more states. *See* section 410 of the Dodd-Frank Act; *supra* section II.A. of this Release.

approximately 530 advisers registered with the Commission had between $25 million and $30 million of assets under management.[311] Because the Dodd-Frank Act has amended section 203A to prohibit most of these advisers from registering with the Commission,[312] we believe that all of these advisers could see increased costs as a result of our proposed amendment.[313] These costs include those associated with withdrawing their registration with the Commission and registering with the states, including filing a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act. We have estimated for purposes of our current approved hour burden under the PRA for rule 203-2 and Form ADV that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser, and the filing (and costs associated with the filing) by these 530 advisers are included in our discussion above of the Form ADV-W filing requirement under rule 203A-5.[314] These advisers also would incur the costs of state registration and of compliance with state laws and regulations, which we expect would vary widely depending on the number of, and which, states with which each adviser is required to register. For example, individual state registration fees range from approximately $60 to $400

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311 Based on IARD data as of September 1, 2010.

312 *See supra* section II.A. of this Release (discussing new section 203A(a)(2) of the Advisers Act, which prohibits certain mid-sized advisers from registering with the Commission).

313 For purposes of this analysis, we assume that all of these advisers would not remain eligible to register with the Commission because they would be required to be registered and subject to examination by securities authorities in the states where they maintain their respective principal offices and places of business. *See* Section 203A(a)(2); *supra* section II.A.7.b. of this Release (discussing the fact that we are writing a letter to each state securities commissioner (or official with similar authority) to request that each advise us whether investment advisers registered in the state would be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority)). *See also* NASAA Report at 7.

314 *See supra* notes 304-308 and accompanying text addressing the costs of filing Form ADV-W for advisers that will be required to withdraw their registrations.

annually and some states require advisers to submit documentation in addition to Form ADV.[315] We believe these amendments would have little, if any, effect on capital formation.

Exemptions from the Prohibition on Registration with the Commission

Amending the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million[316] may impose costs on some of the approximately 350 advisers that currently rely on the exemption.[317] These costs, which include those associated with withdrawing their registration with the Commission and registering with the states, if required, would have a negative impact on competition for the advisers that no longer qualify for the exemption and potentially must register as an adviser with more than one state securities authority. We estimate that 50 of the 350 advisers relying on the exemption would have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their

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315 *See, e.g.*, OHIO REV. CODE § 1707.17(B)(3) (2010) ($100 registration fee); ARK. CODE § 23-42-304(a)(3) (2010) ($300 registration fee); Colorado Division of Securities Fee Schedule ($60 registration fee), *available at* http://www.dora.state.co.us/securities/feeschedule.htm; Illinois Secretary of State, Securities Fees ($400 registration fee), *available at* http://www.sos.state.il.us/departments/securities/investment_advisers/fees.html; Texas State Securities Board, Check Sheet For a Sole Proprietor Corporation LLC or Partnership Applying For Registration as an Investment Adviser (requiring copies of adviser's organizational documents, balance sheet, fee schedule, advisory contract, and brochure or disclosure document delivered to clients), *available at* http://www.ssb.state.tx.us/Dealer_And_Investment_Adviser_Registration/Check_Sheet_For_a_Sole_Proprieter_Corporation_LLC_or_Partnership_Applying_For_Registration_as_an_Investment_Adviser.php; NASAA Report at 7 (among other things, states review registrants' disclosure history, financial status, business practices, and provisions in client contracts).

316 *See* proposed rule 203A-2(a). *See also supra* section II.A.5.b. of this Release.

317 Based on IARD data as of September 1, 2010, 353 SEC-registered advisers, which we rounded to 350, indicated that they rely on the exemption for pension consultants by marking Item 2.A.(6) on Form ADV Part 1A. These advisers do not report the amount of plan assets for which they provide investment advice, so we are unable to determine how many have between $50 million and $200 million of plan assets and may have to register with the state securities authorities as a result of the proposed amendment. It is also difficult to determine whether such advisers would be prohibited from registering with the Commission because they are required to register with and are subject to examination by the state securities authority where they maintain a principal office and place of business under the Dodd-Frank Act.

registration based on the proposed amendment.[318] We have estimated that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[319] Thus, we estimate that the proposed amendment to rule 203A-2(b) associated with filing Form ADV-W would generate a burden of 12.5 hours[320] at a cost of $738.[321] These advisers will incur the costs of state registration, which we expect will vary widely depending on the number of, and which, states with which an adviser is required to register.[322] We believe the amendment would have little, if any, effect on capital formation.

As discussed above, the proposed amendment to the multi-state adviser exemption in rule 203A-2(e) would reduce costs for advisers in the aggregate because more advisers would be permitted to register with one securities regulator—the Commission—rather than being required to register with multiple states.[323] Advisers relying on the exemption, however, would incur costs of complying with the Advisers Act and our rules, and would incur the costs associated with keeping records sufficient to demonstrate that they would be required to register with 15 or more states. We estimate that, in addition to the approximately 40 advisers that rely on the

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318 Based on IARD data as of September 1, 2010, approximately 225 pension consultants reported assets under management of less than $100 million, and 202 of those advisers reported assets under management of less than $25 million. We believe that most pension consultants relying on the exemption provide advice regarding a large amount of plan assets, so we expect the number of advisers affected by the proposed amendment to be one quarter of the advisers with less than $25 million of assets under management. We expect that advisers that would be required to file Form ADV-W if our proposed amendment to rule 203A-2(b) is adopted would file only a partial withdrawal because they would be registering with the states. *See supra* note 304. Compliance with the requirement to complete Form ADV-W imposes an average burden of approximately 0.25 hours for an adviser filing for partial withdrawal. *See id.*

319 *See supra* note 304.

320 50 responses on Form ADV-W x 0.25 hours = 12.5 hours.

321 12.5 hours x $59 = $738.

322 *See, e.g., supra* note 315.

323 *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

exemption currently, approximately 110 would rely on the exemption if amended as proposed.[324] For purposes of the PRA, we have estimated that these advisers would incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold.[325] We further estimate that a senior operations manager would maintain the records at an hourly rate of $311, resulting in average initial and annual recordkeeping costs associated with our proposed amendments to rule 203A-2(e) of $2,488 per adviser,[326] and total increased costs of approximately $273,680 per year.[327] Advisers newly relying on the proposed amended exemption would also incur costs associated with completing and filing Form ADV for purposes of registration with the Commission. For purposes of the increase in our PRA burden for Form ADV, we have estimated that advisers newly registering with the Commission would incur a burden of approximately 13.58 hours per year,[328] resulting in costs of approximately $3,422 per

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324 Based on IARD data as of September 1, 2010, of the approximately 11,850 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule. Of the advisers that have less than $100 million of assets under management, 94 currently file notice filings with 15 or more states. However, state notice filing requirements for SEC-registered advisers may differ from registration requirements because Form ADV does not distinguish between states where the registration is mandatory and where registration is voluntary. In addition, we estimate that 15 advisers currently registered with the states that are registered with 15 or more states could rely on the proposed exemption and register with us. Thus, we estimate that approximately 150 advisers will rely on the proposed exemption (40 currently relying on it + estimated 95 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

325 These estimates are based on an estimate that each year an investment adviser would spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain the record, for a total of 8 hours. *See infra* note 383 and accompanying text.

326 8 hours x $311 = $2,488. The $311 compensation rate used is the rate for a senior operations manager in the SIFMA Management and Earnings Report, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

327 110 new advisers relying on the exemption x $2,488 = $273,680.

328 *See infra* note 399 and accompanying text.

adviser[329] and total increased costs of approximately $376,420 per year.[330] Additionally, we estimate that 40 of the newly registering advisers would use outside legal services, and 50 would use outside compliance consulting services, to assist them in preparing their Part 2 brochures, for a total cost of $176,000, and $250,000, respectively, resulting in a total non-labor cost among the newly registering advisers of $426,000.[331] If adopted, the proposal could also impact competition between advisers who rely on the exemption and are subject to our full regulatory program, including examinations and our rules, and state-registered advisers who do not rely on the exemption. We believe these amendments would have little, if any, effect on capital formation.

Mid-Sized Advisers

As discussed above, the Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers registering with the Commission, and we propose to incorporate into Form ADV an explanation of how we construe these provisions.[332] We do not, however, believe that they would generate costs independent of any costs associated with Congress' enactment of section 203A(a)(2), and would have little, if any, effect on capital formation.

2. Exempt Reporting Advisers: Sections 407 and 408

While we believe that our proposed approach to implementing the Dodd-Frank Act's

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329 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner at $210 per hour and a compliance manager at $294 per hour. *See infra* note 338. [6.79 hours x $210 = $1,425.90] + [6.79 hours x $294 = $1,996.26] = $3,422.

330 110 advisers relying on the exemption x $3,422 = $376,420.

331 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. *See infra* notes 420-421 and accompanying text.

332 *See supra* notes 265-266 and accompanying text.

reporting provisions applicable to exempt reporting advisers would minimize costs inherent in such reporting, we acknowledge that it would impose some costs on these advisers.[333] Although not significant, these costs would include paying a filing fee to FINRA to support the IARD. We anticipate that filing fees for exempt reporting advisers would be the same as those for registered investment advisers, which currently range from $40 to $200, based on the amount of assets an adviser has under management.[334] In order to estimate the costs associated with paying filing fees, we will assume for purposes of this cost-benefit analysis that exempt reporting advisers will pay a fee of $200 per report filed on Form ADV. We estimate that approximately 2,000 advisers would qualify as exempt reporting advisers pursuant to sections 407 and 408 of the Dodd-Frank Act and would have to file Form ADV on the IARD,[335] which would result in total annual costs consisting of filing fees of approximately $400,000.[336]

In addition to filing fees, our proposals would result in internal costs to exempt reporting advisers associated with collecting, reviewing, reporting, and updating a limited subset of Form ADV items in Part 1A, as we propose to amend it, including Items 1, 2.C., 3, 6, 7, 10, 11 and corresponding schedules, but exempt reporting advisers would not be required to complete the remainder of Part 1A or Part 2. The costs of completing these items would vary from one adviser to the next, depending in large part on the number of private funds these advisers

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333 *See* proposed rules 204-1 and 204-4; proposed Form ADV, Part 1A; *supra* section II.B. of this Release.

334 *See supra* note 122 and accompanying text.

335 *See infra* note 422. While this is an estimate of the total number of advisers that may file reports rather than register with the Commission, a number of these advisers may choose to register with the Commission rather than file reports. We cannot determine *ex ante* the number of these advisers that will choose to register rather than report. Therefore, in order to avoid under-estimating the costs of our proposals, we are using the total number of potential exempt reporting advisers in our estimates.

336 2,000 exempt reporting advisers x $200 per year = $400,000. Advisers pay for initial Form ADV submissions and for annual amendments; there is no charge for an interim amendment.

manage. We believe the information required by these items should be readily available to any adviser, particularly the identifying data and control person information required by Items 1, 3, and 10. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep the average completion time for these advisers to a minimum. For purposes of the PRA, we estimate that exempt reporting advisers, in the aggregate, would spend 14,000 hours to prepare and submit their initial reports on Form ADV.[337] Based on this estimate, we expect that exempt reporting advisers would incur costs of approximately $3,528,000 to prepare and submit their initial report on Form ADV.[338] Additionally, for PRA purposes, we estimate that exempt reporting advisers in the aggregate would spend 2,200 hours per year on amendments to their filings.[339] Based on this estimate, we expect that exempt reporting advisers would incur costs of approximately $554,400 to prepare and submit annual amendments to their reports on Form ADV.[340]

Completing and filing Form ADV-H and Form ADV-NR would also impose costs on exempt reporting advisers. For purposes of the PRA, we estimate that approximately 2 exempt reporting advisers would file Form ADV-H annually and that it would impose an average burden per response of 1 hour on exempt reporting advisers.[341] Thus, proposed rule 204-4 would result

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337 *See infra* note 425; *infra* section V. of this Release.

338 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. [7,000 hours x $210 = $1,470,000] + [7,000 hours x $294 = 2,058,000] = $3,528,000. For an exempt reporting adviser that does not already have a senior compliance examiner or a compliance manager, we expect that a person performing a similar function would have similar hourly costs.

339 *See infra* note 430.

340 [1,100 hours x $210 = $231,000] + [1,100 hours x $294 = 323,400] = $554,400.

341 *See infra* section V.F. of this Release.

in an increase in the total hour burden associated with Form ADV-H of 2 hours.[342] We further estimate that for each hour required by the Form, professional staff time would comprise 0.625 hours, and clerical staff time would comprise 0.375 hours. The Commission staff estimates the hourly wage for compliance professionals to be $294 per hour,[343] and the hourly wage for general clerks to be $52 per hour.[344] Accordingly, we estimate the average cost per response imposed on exempt reporting advisers by proposed rule 204-4 and amended Form ADV-H would be $203,[345] for a total annual cost of $406.[346] With regard to Form ADV-NR, we estimate that exempt reporting advisers would file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[347] Thus, we estimate that the amendments would increase the total annual hour burden associated with Form ADV-NR by 1 hour.[348] We further estimate that for each hour required by the Form, compliance clerk time comprises 0.75 hours and general clerk time comprises 0.25 hours.[349] Therefore, we estimate that the proposed amendments to Form ADV-NR would impose approximately $57 in total additional annual costs for advisers.[350]

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342 2 responses x 1 hour = 2 hours.

343 Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a Compliance Manager is approximately $294 per hour.

344 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a general clerk is approximately $52 per hour.

345 (0.625 hours x $294) + (0.375 hours x $52) = approximately $203.

346 $203 per response x 2 responses annually = $406.

347 *See infra* note 450.

348 0.17% (rate of filing) x (9,150 estimated registered investment advisers + 2,000 estimated exempt reporting advisers) x 1 hour per ADV-NR filing = 19.

349 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a general clerk is approximately $52 per hour and cost for a compliance clerk is approximately $59 per hour.

350 1 hour x ((0.75 hours x $59) + (0.25 hours x $52)) = approximately $57.

If adopted, our proposed reporting requirement would also result in other costs for exempt reporting advisers. For example, some of the information these advisers would report (and that we would make publicly available), such as the identification of owners of the adviser or disciplinary information, could impose costs on the advisers and, in some cases their supervised persons or owners, including the potential loss of business to competitors, as this information, today, is not typically made available to others. In addition, there may be other costs associated with the reporting requirements, including the possibility that the proposed disclosure requirements could influence business or other decisions by exempt reporting advisers, such as whether to form additional private funds or discourage entry into management of funds all together.

3. Form ADV Amendments

The costs of completing these new and amended items would vary among advisers. We believe that the information required by these items, however, should be readily available to any adviser. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep costs down by reducing the average completion time.

One-time monetary costs we expect to be borne by current registrants to complete the proposed amendments to Form ADV in connection with the transition filing are discussed above, but that discussion does not take into account costs we expect to be borne by newly registering advisers.[351] For purposes of the PRA, we estimate that 650 advisers will register with us within the next year as a result of normal annual growth of our population of registered advisers[352] and would spend, on average, 4.5 hours to respond to the new and amended questions we are

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351 *See supra* section IV.B.1. of this release.

352 *See infra* note 376 and accompanying text.

proposing today, other than the private fund reporting requirements.[353] We expect the aggregate cost associated with this process would be $737,100.[354] In our PRA analysis, we also project that 750 new advisers would register with us as a result of the Dodd-Frank Act's elimination of the private adviser exemption, and this group of advisers would be required to complete and submit to us the entire form.[355] We expect these newly registering advisers would spend, in the aggregate, 30,555 hours to complete the form (Part 1 except for the private fund reporting requirements, and Part 2) as well as to periodically amend the form, prepare brochure supplements and deliver codes of ethics to clients,[356] for a total cost of $7,699,860.[357] In addition, of these 1,400 newly registering advisers,[358] we estimate that 950 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[359] We expect this would take 4,750 hours,[360] in the aggregate, for a total cost

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353 *See infra* section V.B.1.a. of this Release. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments we are proposing today would neither increase the burden associated with the other items on Form ADV, nor would they increase the external costs associated with certain Part 2 requirements.

354 We expect that the performance of this function would most likely be equally allocated between a Senior Compliance Examiner and a Compliance Manager. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. 650 advisers x 4.5 hours = 2,925 hours. [1,462.5 hours x $210 = $307,125] + [1,462.5 hours x $294 = $429,975] = $737,100.

355 *See infra* note 396.

356 750 advisers x 40.74 hours per adviser to complete entire form (except private fund reporting requirements) = 30,555 hours. *See infra* note 388.

357 [15,277.5 hours x $210 = $3,208,275] + [15,277.5 hours x $294 = $4,491,585] = $7,699,860. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

358 650 advisers expected to register with us within the next year + 750 advisers expected to register with us as a result of the elimination of the private adviser exemption = 1,400.

359 *See infra* text preceding note 405.

360 *See infra* notes 407 and 408.

of $1,197,000.[361] The total estimated costs associated with our amendments for newly registering advisers, therefore, are $9,633,960.[362]

Additionally, we estimate that a quarter (or 188) of the 750 new registered advisers no longer able to rely on the private adviser exemption would use outside legal services, and half (or 375) would use outside compliance consulting services, to assist them in preparing their Part 2 brochures, for a total cost of $827,200, and $1,875,000, respectively, resulting in a total non-labor cost among all newly registering advisers of $2,702,200.[363]

If adopted, our proposed amendments to Form ADV would also result in other costs. For instance, our proposed changes to the instructions on calculating regulatory assets under management, and proposed rule 203A-3(d), would result in some advisers reporting greater assets under management than they do today, and would preclude some advisers from excluding certain assets from their calculation in order to remain below the new asset threshold for registration with the Commission. The impact of these changes may result in a limited number of state-registered advisers that report assets under management of less than $30 million under the current Form ADV reporting requirements to register with us if under the proposed revised instructions they would report $100 million or more in assets under management.[364]

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361 [2,375 hours x $210 = $498,750] + [2,375 hours x $294 = $698,250] = $1,197,000. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

362 $737,100 + $7,699,860 + $1,197,000 = $9,633,960.

363 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants, and it already accounts for a percentage of annual growth in our population of registered advisers. *See also infra* text following note 421.

364 A registered investment adviser that reports more than $30 million in assets under management under the current instructions to Item 5 of Form ADV would be required to register with the Commission. These advisers would not have additional costs associated with registration as they would already be incurring those costs.

We have also proposed to require advisers to private funds to use fair value of private fund assets for determining regulatory assets under management.[365] We understand that many, but not all, private funds value assets based on their fair value in accordance with U.S. generally accepted accounting principles (GAAP) or other international accounting standards.[366] The advisers to private funds that do not use fair value methodologies would likely incur costs to comply with this proposed requirement. These costs would vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or would rely on a third party for valuation services. We do not believe, however, that these costs would be significant. We understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a matter of business practice.[367] Commission staff estimates that such an adviser would incur $1,224 in internal costs to conform its internal valuations to a fair value standard.[368] In the event a fund does not have an internal capability for valuing specific illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service provider.

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365 *See* proposed Form ADV: Instructions for Part 1A, inst. 5.b.(4).

366 *See supra* note 56.

367 For example, a hedge fund adviser may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to private equity funds may obtain valuation of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement we propose with respect to private fund assets.

368 This estimate is based upon the following calculation: 8 hours x $153/hour = $1,224. The hourly wage is based on data for a fund senior accountant from the SIFMA Management and Earnings Report, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

Staff estimates that the cost of such a service would range from $250 to $75,000 annually.[369] We request comment on these estimates. Do advisers that do not use fair value methodologies for reporting purposes have the ability to fair value private fund assets internally? If not, what would be the costs to retain a third party valuation service? Are there certain types of advisers (*e.g.*, advisers to real estate private funds) that would experience special difficulties in performing fair value analyses? If so, why?

Requiring advisers to report whether they have $1 billion or more in assets also may have costs for advisers that are not publicly traded or otherwise do not publicly disclose the amount of their own assets as it would be easy to identify the very largest advisers in terms of assets. These proposals may provide limited efficiency improvements as a result of the uniformity in calculating and reporting managed assets, and there may also be, as discussed below, competitive effects of these changes and other proposed amendments to Form ADV. We believe these proposals would have little, if any, effect on capital formation.

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369 These estimates are based on conversations with providers of valuation services. We understand that the cost of valuation for illiquid fixed income securities generally ranges from $1.00 and $5.00 per security, depending on the difficulty of valuation, and is performed for clients on weekly or monthly basis. Appraisals of privately placed equity securities may cost from $3,000 to $5,000 (with updates to such values at much lower prices). As proposed, an adviser only has to calculate regulatory assets under management for purposes of reporting on Form ADV annually. For purposes of this cost benefit analysis, we are estimating the range of costs for (i) a private fund that holds 50 illiquid fixed income securities at a cost of $5.00 to price and (ii) a private fund that holds privately placed securities of 15 issuers that each cost $5,000 to value. We believe that costs for funds that hold both fixed-income and privately placed equity securities would fall within the maximum of our estimated range. We note that funds that have significant positions in illiquid securities are likely to have the in-house capacity to value those securities or already subscribe to a third party service to value them. We note that many private funds are likely to have many fewer fixed income illiquid securities in their portfolios, some or all of which may cost less than $5.00 to value. Finally, we note that obtaining valuation services for a small number of fixed income positions on an annual basis may result in a higher cost for each security or require a subscription to the valuation service for those that do not already purchase such services. The staff's estimate is based on the following calculations: (50 x $5.00 = $250; 15 x $5,000 = $75,000).

In addition, some of the proposed amendments also could impose costs including potential competitive effects with other advisers as certain information we are proposing to be disclosed may not typically be provided to others. This would be the case, for example, for advisers that currently disclose only to certain clients and prospective clients, or only upon request, such information as census data about the private funds and the amount of private fund assets that the adviser manages, information about the state registrations of the adviser's employees, the types of investments about which the adviser provides advice, and the service providers to each private fund that the adviser manages. This could create benefits as well as costs. While exempt reporting advisers may be subject to a lower regulatory burden, investors may have greater confidence in advisers that provide more fulsome disclosure and are subject to our oversight.

4. Amendments to Pay to Play Rule

Our proposal to permit an adviser to pay any municipal advisor that is registered with the Commission under section 15B of the Exchange Act[370] and subject to pay to play rules adopted by the MSRB to solicit government entities on its behalf may result in limited additional costs to comply with rule 206(4)-5.[371] Specifically, advisers that have created compliance programs in anticipation of rule 206(4)-5's compliance date may have to make adjustments to those programs to account for the fact that our proposed amendment would permit them to hire placement agents

370 15 U.S.C. 78o-4.

371 *See* proposed rule 206(4)-5(a)(2), (f)(9). As discussed in section II.D.1. of this Release, we believe that our proposed amendment to rule 206(4)-5 to make it apply to exempt reporting advisers and foreign private advisers and our proposed technical amendment to the definition of "covered associate" would not generate new costs.

that are registered municipal advisors.[372] But, as explained above, our proposed amendments would allow them greater latitude in hiring placement agents.

C. Request for Comment

- The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this release, as well as any other costs or benefits that may result from the proposals.
- We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits.

V. PAPERWORK REDUCTION ACT ANALYSIS

Certain provisions of our proposal contain "collection of information" requirements within the meaning of the PRA, and we are submitting the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The titles for the collections of information we are proposing or proposing to amend are: (i) "Form ADV"; (ii) "Rule 203-2 and Form ADV-W under the Investment Advisers Act of 1940;" (iii) "Rule 204-2 under the Investment Advisers Act of 1940;" (iv) "Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(e));" (v) "Rule 203A-5;" (vi) "Form ADV-H;"[373] and (vii) "Rule 0-2 and Form ADV-NR under the Investment Advisers

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372 *See* section III.B of the Pay to Play Release (requiring advisers to comply with the rule's prohibition on making payments to third parties to solicit government entities for investment advisory services on September 13, 2011).

373 The current title for the collection of information on Form ADV-H is "Rule 203-3 and Form ADV-H under the Investment Advisers Act of 1940" because currently only registered advisers file Form ADV-H under rule 203-3. However, because we are proposing to amend Form ADV-H to allow exempt reporting advisers to apply for a temporary hardship exemption on Form ADV-H under rule 204-4, we are proposing to re-title the collection of information simply "Form ADV-H."

Act of 1940." 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 control number.

While our proposed rules and rule and form amendments would impose new collection of information burdens for certain advisers and change existing burdens on advisers under our rules, the Dodd-Frank Act also will impact our total burden estimates for certain of our rules, principally by changing the numbers of advisers subject to these rules. Specifically, we estimate the Dodd-Frank Act's amendments to section 203A to reallocate regulatory responsibility over numerous registered advisers to the states will result in about 4,100 registered advisers switching from Commission to state registration.[374] At the same time, we estimate that the Dodd-Frank Act's elimination of the private adviser exemption in section 203(b)(3) of the Advisers Act will result in approximately 750 additional private fund advisers registering with the Commission.[375] Based on IARD data as of September 1, 2010, we estimate that approximately 11,850 advisers are currently registered with the Commission. We further estimate that approximately 650 additional advisers register with the Commission each year.[376] Therefore, for purposes of calculating the burdens of our proposed rules and amendments under the PRA, we estimate that

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374 *See supra* section II.A. of this Release (discussing the Dodd-Frank Act's amendments to section 203A). Based on IARD data as of September 1, 2010, we estimate that approximately 4,050 will switch registration because they have assets under management of less than $100 million. We also estimate that approximately 50 additional advisers will switch to state registration because they are relying on the registration of an affiliated adviser with the same principal office and place of business that will be switching to state registration.

375 *See* Exemptions Release at section I. (discussing elimination of the private adviser exemption in section 203(b)(3)).

376 Over the past several years, approximately 1,000 new advisers have registered with us annually. Due to the Dodd-Frank Act's reallocation of regulatory responsibility for advisers with assets under management of less than $100 million, we estimate that about 650 new advisers will register with us annually based on reducing the current growth rates by the gross reduction in the number of advisers due to the Dodd-Frank Act. (4,100 (SEC advisers withdrawing) / 11,850 (total SEC advisers)) x 1000 (number of new advisers each year) = 0.35 x 1000 = 350 (number of additional new advisers registering with the states, not the SEC). 1000 - 350 = 650.

the number of advisers registering with the Commission after the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) become effective will be approximately 9,150.[377]

A. Rule 203A-2(e)

Rule 203A-2(e) exempts certain multi-state investment advisers from section 203A's prohibition on registration with the Commission. We are proposing to renumber and amend rule 203A-2(e) to permit investment advisers required to register as an investment adviser with 15 or more states, instead of 30 or more states under the current rule, to register with the Commission.[378] An investment adviser relying on this exemption would be required to maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register.[379] We have submitted this collection of information to OMB for review.

Respondents to this collection of information would be investment advisers who are required to register in 15 or more states absent the exemption from the prohibition on Commission registration. This collection of information is mandatory for those advisers relying on the exemption provided by rule 203A-2(e) (proposed rule 203A-2(d)). The records kept by investment advisers in compliance with the rule would be necessary for the Commission staff to

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377 11,850 (total SEC advisers) - 4,100 (SEC advisers withdrawing) + 750 (private advisers registering with the SEC) + 650 (new SEC advisers each year) = 9,150.

378 *See* proposed rule 203A-2(d). Under rule 203A-2(e) an adviser, once registered with the Commission, is not required to withdraw its registration as long as it would be required to register with at least 25 states.

379 *See* proposed rule 203A-2(d)(3). An investment adviser relying on this exemption also would continue to be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has reviewed applicable law and concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake on Schedule D to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 states to register as an investment adviser with the state. *See* proposed rule 203A-2(d)(2). The proposed increase in the PRA burden for Form ADV reflects these requirements. *See infra* section V.B. of this Release.

use in its examination and oversight program, and the information in these records generally would be kept confidential.[380]

As of September 1, 2010, there were approximately 40 advisers relying on the exemption under rule 203A-2(e).[381] Although it is difficult to estimate the number of advisers that would rely on the exemption if amended as proposed because such reliance is entirely voluntary, we estimate that approximately 150 advisers would rely on the exemption.[382] These advisers would incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold. These estimates are based on an estimate that each year an investment adviser would spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain these records.[383]

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380 *See* section 210(b) of the Advisers Act.

381 Based on IARD data as of September 1, 2010, of the approximately 11,850 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule.

382 Based on IARD data as of September 1, 2010, 94 of the advisers that have less than $100 million of assets under management currently file notice filings with 15 or more states. This number may overestimate the number of advisers required to be registered with 15 or more states, and therefore eligible for the proposed multi-state exemption, because notice filing requirements may differ from registration requirements. In addition, we are unable to determine the number of advisers currently registered with the states that are registered with 15 or more states that may rely on the proposed exemption and register with us. We expect this number to be small based on the scope of business of an adviser that has less than $25 million in assets under management and because section 222(d) of the Advisers Act provides a de minimis exemption for limited state operations without registration. For purposes of this analysis, we estimate the number is 15. As a result, we estimate that approximately 150 advisers would rely on the proposed exemption (40 currently relying on it + estimated 95 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

383 0.5 hours x 15 states = 7.5 hours + 0.5 hours = 8 hours.

B. Form ADV

Form ADV (OMB Control No. 3235-0049) is the two-part investment adviser registration form. Part 1 of Form ADV contains information designed for use by Commission staff, and Part 2 is the client brochure. We use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or retain an adviser. Rule 203-1 requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-1 requires each registered adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through the IARD. These collections of information are found at 17 CFR 275.203-1, 275.204-1, and 279.1 and are mandatory, although the paperwork burdens associated with rules 203-1 and 204-1 are included in the approved annual burden associated with Form ADV and thus do not entail separate collections of information. Responses are not kept confidential. The respondents to this information collection are investment advisers registered or applying for registration with us, and as discussed below, would include exempt reporting advisers.

The current total annual burden for all advisers completing, amending, and filing Form ADV (Part 1 and Part 2) with the Commission, approved recently in connection with amendments we adopted to Part 2,[384] is 268,457 hours.[385] This burden is based on an average

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384 *See* section VI of Part 2 Release, *supra* note 46 at nn. 341 and 342 and accompanying text. This estimate includes the annual burden associated with advisers' obligations to deliver to clients copies of their codes of ethics upon request.

385 The approved burden is comprised of 11,658 advisers preparing an initial filing of Form ADV at 36.24 hours, which is amortized over a three-year period (the estimated period that advisers are expected to use Form ADV) for an annual burden of 152,909 hours. The burden also includes two amendments to Form ADV annually, one annual amendment and one other than annual amendment, for an annual burden of 87,435 hours; an annual burden of 11,658 hours to account for new brochure supplements that advisers are required to prepare; and 16,455 hours attributable to the obligation to deliver to clients codes of ethics upon request.

total collection of information burden of 36.24 hours per adviser for the first year that an adviser completes Form ADV. The currently approved burden also includes a total annual cost burden of $22,775,400, which includes costs associated with outside legal assistance and outside consulting services that vary based on the size of the adviser.[386]

As discussed above, in order to give effect to provisions in Title IV of the Dodd-Frank Act, we are proposing amendments to Part 1A of Form ADV to reflect the new statutory threshold for registration with the Commission and to restructure it to accommodate filings by exempt reporting advisers. Additionally, to enhance our ability to oversee investment advisers, we are proposing amendments to Part 1A of Form ADV to require advisers to provide us additional information regarding: (i) private funds they advise; (ii) their advisory business and business practices that may present significant conflicts of interest; and (iii) advisers' non-advisory activities and their financial industry affiliations.[387] We are also proposing certain additional changes intended to improve our ability to assess compliance risks and to enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

We expect that an increase in the information requested in Form ADV Part 1A as a result of these amendments would increase the currently approved collection of information associated with Form ADV. In addition, the annual burden also would increase as a result of an increase in the number of respondents attributable to new investment adviser registrations and the proposed

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386 For outside legal services, ($4,400 x 535 medium advisers) + ($3,200 x 2,370 small advisers)) + ($10,400 x 36 large advisers) = $ 10,312,400. For compliance consulting services, ($3,000 x 2,371 small advisers) + ($5,000 x 1,070 medium advisers) = $12,463,000. $10,312,400+$12,463,000 = $22,775,400. *See* Part 2 Release, *supra* note 46, for a discussion of these estimates.

387 *See supra* section II.C of this Release. In addition, we are proposing several clarifying or minor amendments based on frequently asked questions we receive from advisers as well as in our experience administering the form.

use of the form for reporting by exempt reporting advisers. We discuss below, in three sub-sections, the estimated revised collection of information requirements for Form ADV: first, we address the change to the collection as a result of our proposed amendments to Part 1A of Form ADV excluding those related to private fund reporting for registered advisers; second, we discuss the proposed amendments related to private fund reporting for registered advisers; and third, we address the proposed amendments to Part 1A of Form ADV for its use as a reporting form by exempt reporting advisers.

1. Changes in Average Burden Estimates and New Burden Estimates

a. Estimated Change in Burden Related to Proposed Part 1A Amendments (Not Including Private Fund Reporting)

We are proposing amendments to many Items in Part 1A, some that are merely technical changes or very simple in nature, and others that would require more of an adviser's time to respond. The paperwork burdens of filing an amended Form ADV, Part 1A would, however, vary among advisers, depending on factors such as the size of the adviser, the complexity of its operations, and the number or extent of its affiliations. Although burdens would vary among advisers, we believe that the proposed revisions to Part 1A would impose few additional burdens on advisers in collecting information as advisers should have ready access to all the information necessary to respond to the proposed items in their normal course of operations. We also are working with FINRA, as our IARD contractor, to implement measures intended to minimize the burden for advisers filing proposed amended Form ADV on IARD (*e.g.*, pre-populating fields and drop-down boxes for common responses). We anticipate, moreover, that the responses to many of the questions are unlikely to change from year to year, minimizing the ongoing reporting burden associated with these questions.

In large part, the amendments we propose to Form ADV, Part 1A, including those to account for the statutory changes in the threshold for SEC registration, primarily refine or expand existing questions or request information advisers already have for compliance purposes. For instance, some of the proposed changes to Item 5 would require advisers to provide numerical responses to certain questions about their employees. An adviser would likely already have this information in order to respond to those questions today by checking boxes that correspond to a range of numbers. Likewise, the proposed amendments to Item 8 require advisers to expand on information they provide in response to existing Item 8, such as whether the broker-dealers that advisers recommend or have discretion to select for client transactions are related persons of the adviser. Other questions expand upon existing requirements to elicit information advisers would already have available for compliance purposes, such as whether the soft dollar benefits they currently report receiving under Item 8 qualify for the safe harbor under section 28(e) of the Exchange Act for eligible research or brokerage services. As amended, Item 2 would require an adviser to report to us its basis for registration or reporting, as already determined for compliance purposes. Other proposed amendments to Items 5, 6 and 7 expand existing lists of information advisers already provide to us on Form ADV, such as types of advisory activities the advisers perform and other types of business engaged in by advisers and their related persons. We believe several of the new questions we propose would merely require advisers to provide readily available or easily accessible information, such as Chief Compliance Officer contact information and whether the adviser has $1 billion or more in assets in Item 1, form of organization in Item 3, or types of investments about which they provided advice during the fiscal year for which they are reporting in Item 5.

We anticipate other proposed questions may take longer for advisers to complete, even with readily available information, such as calculating regulatory assets under management according to our revised instruction. Other proposed new items may present greater burdens for some advisers, but not others, depending on the nature and complexity of their businesses, such as the proposed requirement to provide a list of the SEC file numbers of investment companies they advise, or providing expanded information about related person financial industry affiliates.

We estimate these proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete. We have based this estimate, in part, by comparing the relative complexity and availability of the information elicited by the proposed items and the nature of the response required (*i.e.*, checking a box as opposed to providing a narrative response) to the current form and its approved burden. As a result, we estimate the average total collection of information burden would increase to 40.74 hours per adviser for the first year that an adviser completes Form ADV (Part 1 and Part 2).[388]

b. New Estimated Burden Related to Proposed Private Fund Reporting Requirements

The amendments that we propose to Item 7.B. and Section 7.B. of Schedule D to collect new data on private funds managed by advisers would provide us with basic census data on private funds and would permit us to conduct a more robust risk assessment of private fund advisers for purposes of targeting our examinations. The information would include fund data such as basic organizational, operational, and investment characteristics of the fund; the amount of assets held by the fund; and the fund's service providers or gatekeepers. We believe much of the information we are proposing to be reported to us should be readily available to private fund advisers because, among other things, it is information that private fund investors commonly

388 Current approved per adviser total (36.24) + estimated per adviser increase (4.5) = 40.74.

seek in their due diligence questionnaires or it is information that would often be included in a private placement memorandum offering fund shares.

Although we understand that the information we are proposing to require for private funds typically would be readily available to advisers to these funds, we expect that these amendments could require advisers, particularly those with many private funds, to be subject to a significantly increased paperwork burden. We are proposing certain measures to minimize the increase in burden associated with this proposed reporting requirement. We propose to permit a sub-adviser to exclude private funds for which an adviser is reporting on another Schedule D, and would permit an adviser sponsoring a master-feeder arrangement to submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data.[389] We also propose to permit an adviser with a principal office and place of business outside the United States to omit a Schedule D for a private fund that is not organized in the United States and that does not have any investors who are "United States persons."[390] And as discussed above, we are working with FINRA to implement measures intended to minimize the burden for advisers filing proposed amended Form ADV, such as the ability to automatically populate private fund service provider information provided for other funds advised by the same adviser. Finally, we note that as proposed, Item 7.B. would no longer require advisers to report the funds that their related persons advise on Schedule D, which we expect would decrease the burden on private fund advisers. Taking into account, as discussed above, the scope of the information we propose to request and our understanding that much of the information is readily available, as well as the technology upgrades we expect to be incorporated into the IARD, we

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389 *See supra* notes 153-154 and accompanying text.

390 *See supra* note 155 and accompanying text.

estimate advisers to private funds would each spend, on average, one hour per private fund to complete these questions.

c. New Estimated Burden Related to Proposed Exempt Reporting Adviser Reporting Requirements

Exempt reporting advisers would be required to complete a limited number of items in Part 1A of Form ADV (consisting of Items 1, 2.C., 3, 6, 7, 10, 11 and corresponding schedules), and are not required to complete Part 2. We believe the information required by these items should be readily available to any adviser, particularly the identifying data and control person information required by Items 1, 3, and 10. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep the average completion time for these advisers to a minimum. Moreover, in our staff's experience, the types of advisers that would meet the criteria for exempt reporting advisers are unlikely to have significantly large numbers of affiliations, nor do we expect them to have to report disciplinary events at a greater rate than currently registered advisers.[391] We estimate that these items, other than Item 7.B., would take each exempt reporting adviser approximately two hours to complete. We anticipate that, like registered advisers, exempt reporting advisers would each spend an additional hour per private fund to complete Item 7.B. and Schedule 7.B.

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391 As of September 1, 2010, approximately 13% of SEC-registered investment advisers reported a disclosure in Item 11 of Form ADV.

2. Annual Burden Estimates

a. Estimated Annual Burden Applicable to All Registered Investment Advisers

i. Estimated Initial Hour Burden (Not Including Burden Applicable to Private Funds)

As a result of the transition filing discussed above,[392] we expect the total number of registered adviser respondents to this collection of information would be 9,150.[393] Approximately 11,850 investment advisers are currently registered with the Commission.[394] We expect 4,100 will withdraw from registration.[395] We expect about 750 advisers who currently rely on the private adviser exemption to apply for registration with us, and we estimate that approximately 650 new advisers will register with us each year beginning in 2011.[396]

The estimated total annual burden applicable to these advisers, including new registrants, but excluding private fund reporting requirements, is 372,771 hours.[397] We believe that most of the paperwork burden would be incurred in advisers' initial submission of the new and amended items of Form ADV Part 1A, and that over time this burden would decrease substantially because the paperwork burden will be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form would result in an average burden of an estimated

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392 *See supra* section IV.B.1. of this Release.

393 *See supra* note 377.

394 Based on IARD data as of September 1, 2010.

395 *See supra* section IV.B.1. of this Release.

396 (4,100 (SEC advisers expected to withdraw from registration) / 11,850 (total SEC advisers)) x 1000 (average number of new advisers registered with the Commission each year) = 0.35 x 1000 = 350 (number of additional new advisers registering with the states, not the SEC). 1000 - 350 = 650. *See also infra* note 422.

397 40.74 per-adviser burden x 9,150 = 372,771 hours.

124,257 hours per year,[398] or 13.58 hours per year for each new applicant[399] and for each adviser currently registered with the Commission that would re-file through the IARD.

ii. Estimated Initial Hour Burden Applicable to All Registered Advisers to Private Funds

The amount of time each of the registered advisers to private funds would incur to complete Item 7.B. and Section 7.B. of Schedule D would vary depending on the number of funds the advisers manage. Of the 9,150 advisers currently registered with us, approximately 3,500 indicate that they are advisers to private funds.[400] Due to the assets under management these advisers report on Form ADV,[401] and considering that today these advisers either do not qualify for the private adviser exemption or choose not to rely on it, we expect these advisers to remain registered with us. Based on Form ADV filings by these advisers, we estimate that 50% of these advisers, or 1,800, currently advise an average of 3 private funds each; 45%, or 1,550 advisers, currently advise an average of 10 private funds each, and the remaining 5%, or 150 advisers, manage an average of 83 private funds each.[402] As we discussed above, we estimate that private fund advisers would spend, on average, one hour per private fund to complete Item 7.B. and Section 7.B. of Schedule D. As a result, the private fund reporting requirements that

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398 372,771 / 3 = 124,257.

399 124,257 / 9,150 = 13.58.

400 3,500 advisers indicate by reporting a fund in Schedule D, Section 7.B. that they, or a related person, advise private funds or investment related funds. Based on IARD data as of September 1, 2010.

401 Approximately 71% of the advisers to private funds or investment related funds report assets under management over $100 million.

402 Based on IARD data as of September 1, 2010. Form ADV currently asks for an adviser to report about investment-related partnerships and limited liability companies advised by the adviser *and* its related persons. As a result, the data we have obtained from IARD over-estimates the average number of funds as a result of reporting of the same fund multiple times by affiliated registered advisers.

would be applicable to registered investment advisers would add 33,350 hours to the overall annual burden applicable to registered advisers.[403]

In addition to the registered advisers that advise private funds today, we estimate that about 200 of the 650 new advisers that will register with us annually will manage private funds,[404] and an estimated 750 new private fund advisers will register with us that previously relied on the private adviser exemption. We believe that these 950 advisers that would be required to register will generally be similar to the 50% of our current registrants that advise, on average, 3 private funds, but believe that some portion of them may advise a greater number of funds, as the estimated 750 currently exempt private advisers rely on the private adviser exemption, which permits up to 14 private fund clients.[405] In addition, with respect to the 650 new registrants we estimate annually, the elimination of the private adviser exemption will require them, unless they are eligible for another exemption, to register even if they have only a single private fund client. To account for the addition of these two groups of advisers to the registrant pool, but taking into account the demographics of our current registrant pool (with 50% having on average 3 private fund clients), we estimate that each registered private fund adviser, on average, will advise five private funds.[406] Accordingly, private fund reporting requirements attributable to the estimated 750 new registrants because of the elimination of the

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403 (1,800 advisers x 3 hours (3 funds x 1 hour per fund)) + (1,550 advisers x 10 hours (10 funds x 1 hour per fund)) + (150 advisers x 83 hours x 1 hour per fund)) = 5,400 + 15,500 + 12,450 = 33,350.

404 About 30% of current registrants report that they advise one or more private funds. (3,500 advisers to private funds / 11,850 registered advisers). Applying the same proportion to new registrants results in approximately 200 additional advisers to private funds each year. (650 x .30 = 195).

405 Section 203(b)(3).

406 Approximately 65% of advisers that reported a fund in Schedule D, Section 7.B. listed five or fewer funds and 72% of advisers that registered since September 1, 2009 and reported a fund reported five or fewer private funds. The average number of private funds reported is about five funds for the new registrants in the past year.

private adviser exemption would add 3,750 hours to the overall annual burden applicable to registered advisers.[407] We also estimate that private fund reporting requirements applicable to new registered investment advisers would add 1,000 hours to the overall annual burden applicable to registered advisers.[408]

The total annual burden related to private fund reporting that is applicable to registered advisers would be 38,100 hours.[409] We believe that most of the paperwork burden would be incurred in connection with advisers' initial submission of private fund data, and that over time this burden would decrease substantially because the paperwork burden will be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the initial filing or re-filing of the rest of the form, would result in an average burden of an estimated 12,700 hours per year,[410] or 2.85 hours per year for each new private fund adviser[411] and for each private fund adviser currently registered with the Commission.

iii. Estimated Annual Burden Associated with Amendments, New Brochure Supplements and Delivery Obligations

The current approved collection of information burden for Form ADV has three additional elements: (1) the annual burden associated with annual and other amendments to Form ADV, (2) the annual burden associated with creating new Part 2 brochure supplements for advisory employees throughout the year, and (3) the annual burden associated with delivering codes of ethics to clients as a result of the offer of such codes contained in the brochure.

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407 750 newly registering advisers x 5 private funds on average x 1 hour/private fund = 3,750.

408 200 new advisers x 5 private funds on average x 1 hour/private fund = 1,000.

409 33,350 for existing registered advisers + 3,750 for no longer exempt advisers + 1,000 for estimated new registrants due to growth = 38,100.

410 38,100 / 3 = 12,700.

411 12,700 / [3,500 + 200 + 750] = 2.85.

Although we do not anticipate that our proposed amendments to Form ADV would affect the per adviser burden imposed by these three elements, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the number of advisers subject to them, which will result in a change to the total annual burden associated with these elements of the collection of information for Form ADV.[412]

We continue to estimate that, on average, each adviser filing Form ADV through the IARD will likely amend its form two times during the year.[413] We estimate, based on IARD data, that advisers, on average, make one interim updating amendment (at an estimated 0.5 hours per amendment) and one annual updating amendment (at an estimated 6 hours per amendment) each year. We also expect advisers, on average, to continue to incur one hour annually to prepare new brochure supplements as required by Part 2 of the form,[414] and to continue to spend 1.3 hours annually to meet obligations to deliver codes of ethics to clients.[415] These obligations would add 80,520 hours annually to the collection of information. These 80,520 hours consist of 59,475 hours attributable to amendments,[416] 9,150 hours attributable to the creation of new brochure supplements,[417] and 11,895 hours for delivery of codes of ethics.[418]

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412 We anticipate that the clarification we are proposing to make to the brochure supplement (Part 2B) would not affect this cost burden estimate. *See* note 205 and accompanying text for a discussion of this proposed clarifying amendment.

413 Based on IARD system data regarding the number of filings of Form ADV amendments.

414 *See* section VI of Part 2 Release, *supra* note 46.

415 *Id*.

416 (9,150 advisers x .5 hours/other than annual amendment) + (9,150 advisers x 6 hours/annual amendment) = 59,475.

417 9,150 advisers x 1 hour = 9,150.

418 9,150 advisers x 1.3 hours = 11,895.

iv. Estimated Annual Cost Burden

The current approved collection of information burden for Form ADV has a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV. Although we do not anticipate that our proposed amendments to Form ADV would affect the per adviser cost burden estimates, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) of the Adviser's Act will result in a significant change to our estimates of the number of advisers subject to these costs. The current approved collection is based on an estimate that 2,941 advisers will elect to obtain outside legal assistance and 3,441 advisers will elect to obtain outside consulting services, for a total cost among all respondents of $22,775,400 for a one-time initial cost to draft the new narrative brochure.

By the time the amendments to Form ADV that we are proposing today would become effective, substantially all SEC-registered advisers will have completed their initial filing of the narrative brochure required by our recent amendments to Part 2 of Form ADV and will have already incurred these estimated one-time costs.[419] As a result, the only respondents that we expect would incur legal and consulting costs for the initial drafting of Part 2 of Form ADV, subsequent to the effective date of the amendments to Part 2, would consist of the estimated 650 new advisers that we expect to register annually and the estimated 750 advisers that will have to register as a result of the elimination of the private adviser exemption.

The current approved burden estimates that the initial per adviser cost for legal services related to preparation of Part 2 of Form ADV would be $3,200 for small advisers, $4,400 for

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419 *See* section V. of Part 2 Release, *supra* note 46.

medium-sized advisers, and $10,400 for larger advisers.[420] The current approved burden also contains an initial per adviser cost for compliance consulting services related to initial preparation of the amended Form ADV that ranges from $3,000 for smaller advisers to $5,000 for medium-sized advisers.[421] We estimate that the 750 new registered advisers no longer able to rely on the private adviser exemption will be medium-sized. The current approved burden anticipates that a quarter of medium-sized advisers would seek the help of outside legal services and half would seek the help of compliance consulting services. Accordingly, we estimate that 188 of these advisers would use outside legal services, for a total cost burden of $827,200, and 375 advisers would use outside compliance consulting services, for a total cost burden of $1,875,000, resulting in a total cost burden among all respondents of $2,702,000.

b. Estimated Annual Burden Applicable to Exempt Reporting Advisers

i. Estimated Initial Hour Burden

Based on publications, reports, and general information publicly available from trade organizations, financial research companies, and news organizations as well as safe harbor filings with the SEC, we expect approximately 2,000 investment advisers will qualify for an exemption from registration, but will be required to submit reports to us on Form ADV.[422] The paperwork burden applicable to these new exempt reporting advisers would consist of the burden

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420 For purposes of this estimate, we categorize small advisers as advisers with 10 or fewer employees, medium advisers as having between 11 and 1,000 employees, and large advisers as those with 1,000 or more employees. *See* Part 2 Release, *supra* note 46, at nn. 301 and 324.

421 *Id.* at n. 325.

422 This estimate was collectively derived from various sources including the National Venture Capital Association's Yearbook 2010 (http://www.nvca.org), First Research reports (http://www.firstresearch.com), Preqin reports (http://www.preqin.com), Bloomberg (http://www.bloomberg.com), the Managed Funds Association (http://www.managedfunds.org), PerTrac data (http://www.pertrac.com), and Form D data. Specific data relevant to the number or types of advisers that would be exempt reporting advisers was not available, but the information located did inform the staff to the probable number of exempt reporting advisers.

attributable to completing a limited number of items in Part 1A as well as the burden attributable to the private fund reporting requirements of Item 7.B. and Section 7.B. of Schedule D. We estimated the burden to complete the subset of items in Part 1A applicable to exempt reporting advisers, above, to be two hours, which would result in an annual burden of approximately 4,000 hours.

As discussed above, we estimate the private fund reporting requirements of the form to be one hour per private fund. We assume that each exempt reporting adviser currently relies on the private adviser exemption and, therefore, has 14 or fewer private fund clients. Based on reporting by registered advisers to private funds and industry publications and reports, we expect each of these advisers, on average, advises five private funds.[423] Accordingly, we would attribute an additional 10,000 burden hours to exempt reporting advisers' private fund reporting requirements.[424]

The estimated total annual hour burden applicable to exempt reporting advisers is 14,000 hours.[425] We believe that most of the paperwork burden would be incurred in advisers' initial submission of private fund data, and that over time this burden would decrease substantially because the paperwork burden would be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the

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423 *Id*. Based upon the reported general number of private funds and the estimated number of advisers to these private funds, it is estimated that each adviser advises five private funds on average. (approximately 10,000 private funds / estimated 2,000 advisers = 5 private funds per adviser.

424 2,000 exempt reporting advisers x 5 private funds/adviser x 1 hour/private fund = 10,000. *See Id.* for 5 funds estimate.

425 4,000 + 10,000 = 14,000.

initial filing for registered advisers, would result in an average burden of an estimated 4,667 hours per year,[426] or 2.33 hours per year, on average, for each exempt reporting adviser.[427]

ii. Estimated Annual Burden Associated with Amendments

In addition to the burdens associated with initial completion and filing of the portion of the form that exempt reporting advisers would be required to prepare, we estimate that, on average, each exempt reporting adviser would prepare an annual updating amendment and 20% of these advisers would file an interim updating amendment.[428] With respect to an exempt reporting adviser's annual updating amendment of Form ADV, we expect that advisers would not have to spend a significant amount of time entering responses into the electronic version of the form to file their annual updating amendments because IARD will automatically pre-populate their prior responses. Based on this consideration, we estimate that the average exempt reporting adviser will spend 1 hour per year completing its annual updating amendment to Form ADV. This estimate is based on our estimate for registered advisers, but it is 85% shorter because exempt reporting advisers would be required to complete and update only a limited number of items in the form, not including Part 2. The other amendment that we estimate 20% of the exempt reporting advisers would file is an interim updating amendment to Items 1, 3, 10 or 11 of Form ADV,[429] and we estimate that this amendment would require 0.5 hours per amendment.

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426 14,000 / 3 = 4,667.

427 4,667 / 2,000 = 2.33.

428 Approximately 20% of advisers with a fiscal year end of December that filed an other-than-amendment changed Item 1 or 11 between April 1, 2009 and December 31, 2009 (period between annual amendment filing time).

429 *See* General Instruction 4 to Form ADV.

We therefore, estimate that the total paperwork burden on exempt reporting advisers of amendments to Form ADV would be 2,200 hours per year.[430]

3. Total Revised Burdens

The revised total annual collection of information burden for registered advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants, including private fund advisers, plus the burden associated with amendments to the form, preparing brochure supplements and delivering codes of ethics to clients is estimated to be approximately 217,477 hours per year.[431] This burden represents an decrease of 50,980 hours from the current approved burden.[432] This decrease is attributable primarily to the 4,100 advisers that we expect to withdraw from SEC registration.

Registered investment advisers are also expected to incur an annual cost burden of $2,702,000, a reduction from the current approved cost burden of $22,775,400. The decrease in annual cost burden is attributed to the nature of the costs, which are one-time initial costs to draft the narrative brochure. As the transition to the narrative brochure will have substantially been completed, the on-going costs arise from new registrants.

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430 [(2,000 advisers x .20) x 0.5 hours] = 200 hours per year for interim amendments. 2,000 advisers x 1 hour = 2,000 hours per year for annual amendments. 200 + 2,000 = 2,200 hours. Exempt reporting advisers would not incur any burden to prepare new brochure supplements, however, as is required of registered advisers; nor would they be required to meet obligations to deliver codes of ethics to clients, as is also required of registered advisers. Similarly, we have not prepared an estimated annual cost burden to be incurred by exempt reporting advisers because the cost burden attributed to registered advisers is associated with Part 2 obligations to which exempt reporting advisers are not subject.

431 124,257 hours per year attributable to initial preparation of Form ADV + 12,700 hours per year attributable to initial private fund reporting requirements + 59,475 hours per year for amendments to Form ADV + 9,150 hours per year for brochure supplements for new employees + 11,895 hours per year to meet code of ethics delivery obligations = 217,477 hours.

432 Current approved burden of 268,457 hours - revised burden 217,477 hours = 50,980 decrease in hours.

The total annual collection of information burden for exempt reporting advisers to file and complete the required Items of Part 1A of Form ADV, including the burden associated with amendments to the form, would be 6,867 hours.[433]

We estimate that, if the amendments to Form ADV are adopted, the total annual hour burden for the form would decrease by 44,113 hours to 224,344.[434] The resulting blended average per adviser amortized burden for Form ADV would be 20.12 hours,[435] which would consist of an average annual amortized burden of 23.77 hours for the estimated 9,150 registered advisers and 3.43 hours for the estimated 2,000 exempt reporting advisers.[436]

C. Rule 203A-5

Proposed rule 203A-5 would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011, and withdraw from Commission registration by October 19, 2011, if no longer eligible.[437] The amendment to Form ADV would, among other things, require each adviser to declare whether it remains eligible for Commission registration.[438] The likely respondents to this information collection are all investment advisers registered with the Commission on July 21, 2011, and the investment advisers that withdraw their registration. Compliance with this collection of information is mandatory, and the information collected on Form ADV and Form ADV-W is not kept confidential. We have submitted this collection of information to OMB for review.

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433 4,667 hours per year attributable to initial preparation of Form ADV + 2,200 hours per year for amendments = 6,867 hours.

434 217,477 + 6,867 = 224,344.

435 224,344 / 11,150 = 20.12.

436 Registered advisers (217,477 / 9,150 = 23.77), exempt reporting advisers (6,867/2,000 = 3.43).

437 Proposed rule 203A-5(a), (b). *See supra* section II.A.1. of this Release.

438 *See supra* section II.A.2. of this Release.

We estimate that there would be approximately 11,850 respondents to this collection of information filing an amendment to Form ADV[439] and 4,100 respondents filing Form ADV-W.[440] Each respondent would respond once. For purposes of the collection of information burden for Form ADV, we estimate that the amendment would take each adviser approximately 6 hours per amendment, on average,[441] and that the proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete.[442] We also estimate the average burden for each respondent to be 0.25 hours for filing Form ADV-W.[443]

We estimate that the burdens associated with the Form ADV amendment required by rule 203A-5 would be more like an annual amendment with respect to the burden to complete than an other-than-annual amendment, as a result of our proposed changes to Part 1A. Consequently, we estimate the total one-time burden for completing the Form ADV amendments to be 124,425 hours,[444] and for completing Form ADV-W to be 1,025 hours,[445] for a total one-time burden of 125,450 hours.[446]

D. Form ADV-NR

We are proposing minor amendments to Form ADV-NR (OMB Control No. 3235-0238), the form used to appoint the Secretary of the Commission as an agent for service of process for

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439 Based on IARD data as of September 1, 2010, 11,867 investment advisers are registered with the Commission. We have rounded this number to 11,850 for purposes of our analysis.

440 *See supra* note 294.

441 We anticipate that the hour burden for the refiling of Form ADV for purposes of rule 203A-5 would be the same as an adviser's annual amendment filing, which has an approved burden of 6 hours.

442 *See supra* sections V.B.1.a., V.B.2.a.3. of this Release.

443 *See supra* note 304.

444 [6 hours (annual amendment) + 4.5 hours (new items)] x 11,850 = 124,425.

445 0.25 hours x 4,100 = 1,025.

446 124,425 + 1,025 = 125,450.

certain non-resident advisers.[447] Non-resident general partners or managing agents of SEC-registered investment advisers must make a one-time filing of Form ADV-NR with the Commission. Form ADV-NR requires these non-resident general partners or managing agents to furnish us with a written irrevocable consent and power of attorney that designates the Commission as an agent for service of process, and that stipulates and agrees that any civil suit or action against such person may be commenced by service of process on the Commission. The amendments we are proposing reflect that exempt reporting advisers would be filing reports on IARD, and that they would use Form ADV-NR in the same way and for the same purpose as it is currently used by registered investment advisers. The collection of information is necessary for us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws. This collection of information is found at 17 CFR 279.4. The collection of information is mandatory, and the information provided in response to the collection is not kept confidential. The currently approved collection of information in Form ADV-NR is 18 hours.

We estimate that approximately 9,150[448] investment advisers will be registered with the Commission and that approximately 2,000[449] exempt reporting advisers would file reports with the Commission, and that these advisers would file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[450] Accordingly, we estimate that as a result of the amendments to Form ADV-NR and the change in the number of filers after the effectiveness of

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447 *See* proposed amended Form ADV-NR; proposed General Instruction 18.

448 *See supra* note 377 and accompanying text.

449 *See supra* note 422 and accompanying text.

450 From September 1, 2009 through September 1, 2010, 20 Form ADV-NRs were filed with us for an annual rate for all SEC-registered advisers of 0.17%. (20 Form ADV-NR filings/11,850 advisers registered as of Sept. 1, 2010)

the Dodd-Frank Act the annual aggregate information collection burden for Form ADV-NR would be 19 hours, an increase of 1 hour over the currently approved burden.[451]

E. Rule 203-2 and Form ADV-W

We are proposing amendments to rule 203A-2(b), the exemption from the prohibition on registration for certain pension consultants. The proposed amendments would raise the amount of plan assets that an adviser must consult on from $50 to $200 million annually.[452] If we adopt the proposed amendment to rule 203A-2(b), an investment adviser would have to be a pension consultant with respect to assets of plans having an aggregate value of $200 million or more to be able to register with the Commission. Those pension consultants providing consulting services to plans of less than $200 million would be required to file a notice of withdrawal of their registration in accordance with rule 203-2 on Form ADV-W (OMB Control No. 3235-0313). The collection of information on Form ADV-W is mandatory and is not kept confidential. The currently approved collection of information for Form ADV-W is 500 hours for 1,000 responses.

Based on IARD data as of September 1, 2010, there are 353 advisers relying on the pension consultant exemption from registration. We estimate that approximately 15%, or 50, of the current advisers relying on this exemption from the prohibition on registration would no longer be eligible to rely on the exemption if adopted as proposed. This estimate is based on our understanding that a typical pension consultant would have plan assets far in excess of the proposed higher threshold, in light of the fact that most pension plans contain a significant amount of assets.

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451 0.17% (rate of filing) x (9,150 estimated registered investment advisers + 2,000 estimated exempt reporting advisers) x 1 hour per ADV-NR filing = 19.

452 *See* proposed rule 203A-2(a)(1).

The estimated 50 advisers no longer eligible to rely on the exemption, however, would have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their registration based on the proposed amendment to rule 203A-2(b).[453] In addition, as noted above, we estimate that approximately 4,100 advisers also will have to withdraw their Commission registration as a result of the Dodd-Frank Act. Because these advisers are registered today, we further anticipate that these advisers will be switching from SEC to state registration, and as a result will be filing a "partial" Form ADV-W. We have estimated for purposes of our current approved burden under the PRA for rule 203-2 and Form ADV-W, that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[454] Thus, we estimate that the proposed amendment to rule 203A-2(b) associated with filing Form ADV-W would generate a burden of 1,038 additional hours[455] in addition to the approved burden of 500 hours for a total of 1,538 hours.

F. Form ADV-H

Proposed rule 204-4(e) would provide a temporary hardship exemption for an exempt reporting adviser having unanticipated technical difficulties that prevent submission of a filing to the IARD system.[456] Currently, rule 203-3(a) provides a similar temporary hardship exemption for registered advisers that file an application on Form ADV-H (OMB Control No. 3235-0538).[457] Like rule 203-3(a), proposed rule 204-4(e) would require advisers relying on the temporary hardship exemption to file an application on Form ADV-H in paper format no later

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453 *See supra* note 318 (discussing the fact that advisers filing Form ADV-W due to our proposed amendment to rule 203A-2(b) would likely file partial withdrawals).

454 *See supra* note 304.

455 (4,100 + 50) responses on Form ADV-W x 0.25 hours = 1,038 hours.

456 Proposed rule 204-4(e).

457 Rule 203-3(a); 17 CFR 279.3 (Form ADV-H). *See supra* note 125 and accompanying text.

than one business day after the filing that is the subject of the Form ADV-H was due, and submit the filing on Form ADV in electronic format with IARD no later than seven business days after the filing was due.[458] If rule 204-4 is adopted as proposed, respondents to the collection of information on Form ADV-H would be exempt reporting advisers, in addition to registered advisers, who are currently respondents to this collection of information. The collection of information on Form ADV-H is mandatory for registered advisers relying on a temporary hardship exemption and would be mandatory for exempt reporting advisers relying on a temporary hardship exemption if rule 204-4 is adopted as proposed. The information collected on Form ADV-H is not kept confidential.

To estimate the currently approved total burden associated with Form ADV-H, we estimated that registered advisers file approximately 11 responses to Form ADV-H per year, which, given the estimated 11,850 advisers currently registered with the Commission, means that approximately 1 response is filed per 1,000 advisers.[459] We further estimated that the average burden per response is approximately 1 hour. Therefore the total approved burden for Form ADV-H is approximately 11 hours per year.[460] Based on the proportion of annual responses to the number of registered advisers, we estimate that exempt reporting advisers would file approximately 2 responses to Form ADV-H annually if rule 204-4 is adopted.[461] We also estimate that Form ADV-H would impose the same average burden per response of 1 hour on

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458 Proposed rule 204-4(e).

459 11,850 registered advisers ÷ 11 responses = approximately 1 response per 1,000 registered advisers)

460 11 responses x 1 hour = 11 hours.

461 We estimate that approximately 2,000 exempt reporting advisers would file reports on Form ADV in accordance with proposed rule 204-4. Thus, we estimate 2 responses to Form ADV-H in accordance with proposed rule 204-4 (2,000 exempt reporting advisers x 1 response per 1000 advisers = 2 responses).

exempt reporting advisers. Thus, proposed rule 204-4 would result in an increase in the total hour burden associated with Form ADV-H of 2 hours.[462] However, as discussed above, the number of registered advisers will decrease due to the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) from 11,850 to 9,150.[463] Given the reduction in registered advisers, we estimate that Form ADV-H will receive 9 annual responses from registered advisers, for a total annual burden for registered advisers of 9 hours.[464] Thus, if rule 204-4 is adopted as proposed, the total burden associated with Form ADV-H would continue to be 11 hours.[465]

G. Rule 204-2

Rule 204-2 (OMB Control No. 3235-0278) requires investment advisers registered, or required to be registered under section 203 of the Act, to keep certain books and records relating to their advisory business.[466] The collection of information under rule 204-2 is necessary for the Commission staff to use in its examination and oversight program, and the information is generally kept confidential.[467] The collection of information is mandatory.

We are proposing to amend rule 204-2 to update the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register when the Dodd-Frank Act's elimination of the "private adviser" exemption becomes effective on July 21, 2011.[468] Under the proposed

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462 2 responses x 1 hour = 2 hours.

463 *See supra* note 377.

464 9,150 registered advisers x 1 response per 1,000 advisers = 9 responses. 9 responses x 1 hour = 9 hours.

465 9 hours for registered advisers + 2 hours for exempt reporting advisers = 11 hours.

466 Rule 204-2.

467 *See* section 210(b) of the Advisers Act.

468 *See* proposed rule 204-2(e)(3)(ii); *supra* section II.D.2.b of this Release. In addition, we are proposing to amend rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added to the Advisers Act by the Dodd-Frank Act where that term is used in rule 204-2.

amended grandfathering provision, an adviser that was exempt from registration under section 203(b)(3) of the Advisers Act prior to July 21, 2011 would not be required to maintain certain books and records concerning performance or rate of return of a private fund or other account for any period prior to July 21, 2011, provided the adviser was not registered with the Commission.[469] Most, if not all, advisers likely gather the records and documents necessary to support the calculation of performance or rate of return as those records or documents are produced or at the time a calculation is made. Thus, we do not believe that the proposed amendment to the grandfathering provision would reduce our current approved average annual hourly burden per adviser under rule 204-2.

Although we do not anticipate that our proposed amendments to rule 204-2 would affect the per adviser burden imposed by the rule, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the total annual burden associated with the rule.[470] The current approved burden for rule 204-2 is based an estimate of 11,607 registered advisers subject to rule 204-2 and an estimated average burden of 181.45 burden hours each year per

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However, this proposed amendment is technical, and would not increase or decrease the collection burden on advisers. We also intend to rescind rule 204-2(l) because that section was vacated by the federal appeals court in *Goldstein.*

469 Proposed rule 204-2(e)(3)(ii). Rule 204-2 requires registered advisers to make and keep books and records necessary to support the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons. Rule 204-2(a)(16). It requires that advisers maintain and preserve these records in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such records, the first two years in an appropriate office of the investment adviser. Rule 204-2(e)(1). Our proposed grandfathering provision would assure that advisers newly subject to the rule due to elimination of the "private adviser" exemption in existing section 203(b)(3) do not face a retroactively-imposed recordkeeping requirement. However, the proposed grandfathering provision would require these advisers to continue to preserve any books and records in their possession that pertain to the performance or rate of return of a private fund or other account for the two and five year periods.

470 Exempt reporting advisers are not subject to rule 204-2, and therefore there is no offsetting increase in the number of advisers subject to the rule.

adviser, for a total of 2,106,046 hours.[471] We estimate that the Dodd-Frank Act will reduce the number of registered advisers to 9,150.[472] Thus, we estimate that the total burden under rule 204-2 will be 1,660,268,[473] a reduction of 445,778 hours.[474]

The reduction in the number of advisers subject to the rule will also reduce the total non-labor cost burden of the rule. The current approved non-labor cost burden associated with rule 204-2 is $14,581,509, or an average of approximately $1,256 per adviser.[475] Due to the reduction in the number of advisers subject to rule 204-2, we estimate that the new total non-labor cost burden will be $11,492,400,[476] a reduction of $3,089,109. [477]

H. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed amendments to the collection of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

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471 In the Pay to Play Release, we estimated that the average burden for advisers imposed by rule 204-2 to be 181.45 hours. *See* section V.A. of the Pay to Play Release.

472 *See supra* note 377 and accompanying text.

473 9,150 registered advisers x 181.45 hours = approximately 1,660,268.

474 2,106,046 hours – 1,660,268 hours = 445,778 hours.

475 $14,581,509 ÷ 11,607 advisers = approximately $1,256.

476 9,150 x $1,256 = $11,492,400.

477 $14,581,509 - $11,492,400 = $3,089,109.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and also should send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-36-10. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-36-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release. A comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding our proposed rules and rule amendments to give effect to the Dodd-Frank Act's amendments to the Advisers Act in accordance with section 3(a) of the Regulatory Flexibility Act.[478] It relates to proposed new rules 203A-5 and 204-4, proposed amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 203A-4, 204-1, 204-2, 206(4)-5, 222-1, 222-2, and proposed amendments to Form ADV, Form ADV-NR and Form ADV-H under the Advisers Act.

A. Need for the New Rules and Rule Amendments

The proposed new rules and rule amendments are necessary to give effect to provisions of the Dodd-Frank Act which, among other things, amend certain provisions of the Advisers Act,

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478 5 U.S.C. 603(a).

and to respond to a number of other changes to the Advisers Act made by the Dodd-Frank Act, including the Commission's pay to play rule. In addition, in light of our increased responsibility for oversight of private fund advisers, we are proposing to require advisers to those funds to provide us with additional information about the operation of those funds, which would permit us to provide better oversight of these advisers by focusing our examination and enforcement resources on those advisers to private funds that appear to present greater compliance risks. We also are proposing to require all registered advisers to provide us with additional information on their operations to allow us to more efficiently allocate our examination resources, to better prepare for on-site examinations, and to provide us with a better understanding of the investment advisory industry to assist our evaluation of the implications of policy choices we must make in administering the Advisers Act.

B. Objectives and Legal Basis

The primary objective of the proposed new rules and rule amendments is to give effect to provisions of Title IV of the Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting from advisers to certain types of private funds that are exempt from registration.[479] Proposed new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 are intended to provide us a means of identifying advisers that must transition to state regulation, clarify the application of the new statutory provisions under the Dodd-Frank Act, and extend certain of the exemptions we have adopted under section 203A of the Act to mid-sized advisers. Proposed new rule 204-4 and amendments to rule 204-1 are

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479 *See supra* section I of this Release.

intended to require exempt reporting advisers to submit, and to periodically update, reports to us by completing several items on Form ADV. The proposed amendments to rule 204-2 are intended to account for the Dodd-Frank Act's elimination of the "private adviser" exemption under section 203(b)(3) of the Advisers Act and its addition of a definition of "private fund" to the Advisers Act.[480] The proposed amendments to Form ADV would permit the form to serve as a reporting, as well as a registration, form and to specify the seven items exempt reporting advisers must complete. The proposed amendments to Form ADV would also provide additional information on the operations of registered investment advisers. The proposed amendments to Forms ADV-NR and ADV-H would revise the forms for use by exempt reporting advisers. Additionally, we are proposing amendments to the Advisers Act pay to play rule, rule 206(4)-5.[481]

The Commission is proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 under the Advisers Act pursuant to the authority set forth in sections 203A(c), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3A(c) and 80b-11(a)]; new rule 204-4 and amendments to rules 204-1 and 204-2 pursuant to the authority set forth in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)]; amendments to rule 206(4)-5 pursuant to authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]; amendments to rules 0-7, 222-1, and 222-2 pursuant to authority set forth in section 211(a) of the Advisers Act [15 U.S.C. 80b-11(a)]; and to amend Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)],

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480 *See supra* section II.D.2.b. We also intend to rescind section 204-2(l), which was vacated by the federal appeals court in *Goldstein.*

481 *See* proposed rule 206(4)-5; *supra* section II.D.1. of this Release.

section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-NR under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], section 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; and Form ADV-H pursuant to the authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a)]. Section 203A(c) gives us authority to permit registration with the Commission of any person or class of persons to which the application of section 203A(a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A. Section 206(4) gives us authority to prescribe means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices. Section 211 gives us authority to classify, by rule, persons and matters within our jurisdiction and to prescribe different requirements for different classes of persons, as necessary or appropriate to the exercise of our authority under the Act. Section 204 gives us authority to prescribe, by rule, such records and reports that an adviser must make, keep for prescribed periods, or disseminate, as necessary or appropriate in the public interest or for the protection of investors.

C. Small Entities Subject to Rules and Rule Amendments

In developing these proposals, we have considered their potential impact on small entities that would be subject to the proposed rule and form amendments. The proposed rule and form amendments would affect all advisers registered with the Commission and exempt reporting

advisers, including small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[482]

Our rule and form amendments would not affect most advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with us. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators.[483] We estimate that as of September 1, 2010, approximately 620 advisers that were small entities were registered with the Commission.[484] Because these advisers are registered, they would be subject to proposed new rule 203A-5 and amendments to rules 0-7, 204-2, 203A-1, 203A-2, 203A-3, and 203A-4, and Forms ADV and ADV-NR. In addition, we estimate that due to the Dodd-Frank Act's elimination of the "private adviser" exemption in section 203(b)(3), an additional 2 advisers that are small entities will become subject to these rules.[485] Further, as a result of our

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482 Rule 0-7(a) [17 CFR 275.0-7(a)].

483 *See supra* section II.A.7.a.

484 Based on IARD data as of September 1, 2010.

485 We believe that the only small entities that would become subject to registration as a result of the elimination of the private adviser exemption in section 203(b)(3) would be advisers to private funds that maintain their principal office and place of business in Wyoming. Based on IARD data as of September 1, 2010, we estimate that 36 SEC-registered small entity advisers are required to be registered with us because they have a principal office and place of business in Wyoming, which is 0.3% of all SEC-registered advisers (36 ÷ 11,850 SEC-registered advisers = approximately 0.3%). We estimate that a similar proportion of the approximately 750 advisers to private funds that will register with the Commission due to the elimination of the private adviser

proposed amendments to rule 203A-2, we estimate that 15 additional multi-state advisers would register with us and be subject to these rules,[486] and 21 pension consultants that are small entity advisers would be required to withdraw from registration with us and would no longer be subject to these rules.[487] We estimate that 6 exempt reporting advisers that are small entities would be subject to proposed rule 204-4, and the proposed amendments to rule 204-1, Form ADV, Form ADV-NR and Form ADV-H to give effect to the Dodd-Frank Act's reporting requirements by exempt reporting advisers.[488] We also estimate that 6 exempt reporting advisers that are small entities would be subject to the proposed amendments to rule 206(4)-5. Finally, all investment advisers, whether they are small entities or not, would be subject to the proposed technical

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exemption in section 203(b)(3) would be small Wyoming-based advisers. As a result, we estimate that approximately 2 small entity advisers to private funds will register with the Commission (750 private fund advisers x 0.3% = approximately 2).

486 *See supra* note 324.

487 Based on IARD data as of September 1, 2010, 142 of the advisers that would be considered small entities rely on the pension consultant exemption from registration. We estimate that approximately 15%, or 21, of these advisers would no longer be eligible to rely on the exemption if adopted as proposed. This ratio is consistent with our estimate for the PRA burden. *See supra* section V.E. of this Release.

488 The only small entity exempt reporting advisers that would be subject to the proposed rule and proposed amendments would be exempt reporting advisers that maintain their principal office and place of business in Wyoming. As discussed *supra* in note 98 and accompanying and preceding text, the current practical effect of section 203A(a)(1) is to prohibit U.S. advisers with less than $25 million in assets under management from registering with the Commission *unless* they maintain their principal office or place of business in Wyoming. Proposed new rule 204-4 requires an adviser relying on an exemption under new sections 203(l) or (m) of the Advisers Act to complete and file reports on Form ADV. *See* proposed rule 204-4; *supra* section II.B.1. of this Release. The exemptions from registration in sections 203(l) and (m) apply to advisers solely to venture capital funds and advisers solely to private funds with less than $150 million in assets under management, respectively. Small Wyoming-based advisers to venture capital funds or private funds may be required to register with the Commission but for the exemptions in section 203(l) or (m). Thus, these advisers would be subject to proposed rule 204-4 and the proposed amendments to rule 204-1, Form ADV, and Form ADV-H to give effect to the Dodd-Frank Act's mandate for reporting by exempt reporting advisers. Assuming that the proportion of registered Wyoming-based small advisers to registered advisers is similar to the proportion of small Wyoming-based exempt reporting advisers to exempt reporting advisers generally, we estimate that approximately 6 exempt reporting advisers that are small entities would be subject to proposed rule 204-4 and the proposed amendments to rule 204-1, Form ADV, and Form ADV-H (2,000 exempt reporting advisers x 0.3% = 6 small Wyoming-based exempt reporting advisers).

amendments to rules 222-1 and 222-2. The small entities subject to these amendments include approximately 6 exempt reporting advisers and approximately 14,700 state-registered advisers.[489]

D. Reporting, Recordkeeping and Other Compliance Requirements

The proposed rules and rule and form amendments would impose certain reporting, recordkeeping, and compliance requirements on advisers, including small advisers. The proposals would require all of the small advisers registered with us to file an amended Form ADV, would require some to file Form ADV-W, and would require some to file reports as exempt reporting advisers. The amendments also would cause the adviser to be subject to the existing recordkeeping and compliance requirements for SEC-registered advisers. These requirements and the burdens on small advisers are discussed below.[490]

Transition to State Registration

Proposed rule 203A-5 would impose costs on all investment advisers, including small advisers, by requiring *each* investment adviser registered with us to file an amendment to its Form ADV no later than August 20, 2011 (30 days after the July 21, 2011 effective date of the amendments to section 203A), and withdraw from Commission registration by October 19, 2011 (60 days after the required filing of Form ADV), if no longer eligible.[491] We estimate that all of

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489 Based on IARD data as of July 1, 2010, we estimate that there were approximately 14,700 state-registered advisers. Because section 203A currently precludes most advisers with less than $25 million in assets under management from registering with the Commission, we assume that nearly all of the 14,700 state-registered advisers are small entities. Therefore, 14,700 small entities (registered with the states as of July 1, 2010) + 21 small entities (registering with the states due to the proposed amendment to the pension consultant exemption in rule 203A-2(b)) – 2 small entities (registering due to elimination of the private adviser exemption in section 203(b)(3)) – 15 small entities (de-registering with the states and registering with the Commission due to the proposed amendment to the multi-state adviser exemption in rule 203A-2(e)) = approximately 14,704 state-registered advisers that are small entities.

490 *Supra* sections I through II of this Release, describe these requirements in more detail.

491 Proposed rule 203A-5(a), (b). *See supra* section II.A.1. of this Release.

the 620 small advisers currently registered with the Commission would file Form ADV, but none would withdraw registration because the Dodd-Frank Act does not change the eligibility requirements for small advisers registered with us because they rely on one or more of the exemptions from the prohibition on registration.[492]

Switching Between State and Commission Registration

The proposed amendments to rule 203A-1 would eliminate the $5 million buffer in current rule 203A-1(a), which permits but does not require an adviser to register with the Commission if the adviser has between $25 million and $30 million of assets under management.[493] By definition, a small adviser under the Advisers Act has less than $25 million in assets under management, so elimination of this rule should have no impact on small advisers.[494]

Exemptions from the Prohibition on Registration with the Commission

The amendments we are proposing to two of the three exemptions from the prohibition on registration in rule 203A-2 would cause small advisers to be subject to new reporting, recordkeeping, and other compliance requirements.[495] The proposed amendment to the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) would increase the minimum value of plan assets from $50 million to $200 million.[496] We

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492 *See* section 410 of the Dodd-Frank Act.

493 *See* proposed rule 203A-1; *supra* section II.A.4. of this Release.

494 *See* rule 0-7(a)(1).

495 *See* proposed rule 203A-2; *supra* section II.A.5. of this Release. The proposed elimination of the exemption from the prohibition on Commission registration for NRSROs in rule 203A-2(a) would not affect small advisers because based on IARD data as of September 1, 2010 only one NRSRO remains registered under the Act and it reports that it has more than $100 million of assets under management. Therefore, it would neither be a small adviser nor rely on the exemption.

496 We also propose to renumber the rule as rule 203A-2(a). *See* proposed rule 203A-2(a); *supra* section II.A.5.b. of this Release.

estimate that this may cause approximately 21 small adviser pension consultants to be required to withdraw from registration with us by filing Form ADV-W and thus no longer be subject to Commission rules.[497] These advisers would likely need to register with one or more states, and comply with the states' recordkeeping and other regulatory requirements. This would have a negative impact on competition for these advisers compared to pension consultants with more than $200 million of plan assets that would remain registered with the Commission.

The proposed amendment to the multi-state adviser exemption in rule 203A-2(e) would permit investment advisers required to register as an investment adviser with 15 or more states, instead of 30 or more states under the current rule, to register with the Commission.[498] An investment adviser relying on this exemption would continue to report certain information on Form ADV[499] and maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. This would promote efficiency and competition by making the standards for the multi-state exemption consistent for small and mid-sized advisers. We estimate that, in addition to the approximately 23 small advisers that rely on the exemption currently, approximately 15 would begin relying on the exemption if amended as proposed.[500] Advisers newly relying on the proposed amended exemption would incur costs associated with completing and filing Form ADV for purposes of registration with the Commission, and all of the advisers relying on the exemption will incur the costs associated with

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497 *See supra* notes 318-321 and accompanying text; *supra* note 487 and accompanying text.

498 We also propose to renumber the rule as rule 203A-2(d). *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

499 Advisers would be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 states to register as an investment adviser with those states. *See* proposed rule 203A-2(d)(2).

500 *See supra* note 324.

keeping records sufficient to demonstrate that they would be required to register with 15 or more states.[501] In addition, these advisers will incur costs of complying with the Advisers Act and our rules, but they may see an absolute reduction in compliance costs by registering with the Commission instead of 15 or more states.[502]

Elimination of Safe Harbor

The proposed elimination of rule 203A-4, which provides a safe harbor from Commission registration for an investment adviser based on a reasonable belief that it is prohibited from registering with the Commission because it does not have at least $30 million of assets under management, would not create new requirements for small advisers.[503] These advisers would not have at least $30 million of assets under management, and advisers have not, in our experience, asserted the availability of this safe harbor.

Mid-Sized Advisers

Our proposal to incorporate into Form ADV an explanation of how we construe the determination of whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers from registering with the Commission would not create new reporting requirements for small advisers.[504] The mid-sized adviser requirements would only apply to advisers with assets under management between $25 million and $100 million and would therefore not apply to small advisers.

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501 *See supra* notes 325-327 and accompanying text.

502 *See supra* note 323 and accompanying text.

503 Rule 203A-4. *See supra* section II.A.6. of this Release.

504 *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b.; *supra* section II.A.7. of this Release.

Exempt Reporting Advisers

Proposed rule 204-4 and the proposed amendments to rules 204-1, Form ADV, and Form ADV-H to require exempt reporting advisers to file reports with the Commission electronically on Form ADV would impose reporting requirements on an estimated 6 small advisers.[505] As discussed above, we estimate that completing and filing Form ADV will cost $1,764 for each exempt reporting adviser.[506] In addition, small exempt reporting advisers would be required to pay an estimated filing fee of $200 annually,[507] for a total of $1,200 for the estimated 6 small exempt reporting advisers.[508] Finally, under rule 204-4 exempt reporting advisers that seek a temporary hardship exemption from electronic filing would be required to complete and file Form ADV-H.[509] To the extent that either of the estimated two small exempt reporting advisers file Form ADV-H, we have estimated that it would require 1 burden hour at a total cost of $204.[510]

Amendments to Form ADV

Proposed amendments to Form ADV would require registered advisers to report different or additional information than what is currently required. Approximately 620 small advisers currently registered with us, and two advisers currently relying on the private adviser exemption that we expect will register with us, would be subject to these requirements.[511] We expect these 620 advisers would spend, on average, 4.5 hours to respond to the new and amended questions

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505 *See supra* note 488.

506 *See supra* note 338 and accompanying text. $3,528,000/2,000 = $1,764.

507 *See supra* section IV.B.2. of this Release (discussing the potential filing fee).

508 $200 x 6 small exempt reporting advisers = $1,200.

509 Proposed rule 204-4(e).

510 *See supra* section IV.B.2. of this Release.

511 *See supra* notes 484-485 and accompanying text.

we are proposing today, other than the private fund reporting requirements.[512] We expect the aggregate cost associated with this process would be $703,080.[513] The two anticipated newly registering advisers would spend, in the aggregate, about 82 hours total to complete the form (Part 1 except for the private fund reporting requirements, and Part 2) as well as to amend the form periodically, to prepare brochure supplements, and to deliver codes of ethics to clients,[514] for a total cost of $20,664.[515] In addition, of these approximately 620 registered advisers, we estimate that 200 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[516] We expect this will take 600 hours,[517] in the aggregate, for a total cost of $151,200.[518] The total estimated labor costs associated with our amendments that we expect will be borne by small advisers, therefore, are $874,944.

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512 *See supra* text preceding note 388. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments we are proposing today would increase neither the burden associated with these items on Form ADV, nor the external costs associated with certain Part 2 requirements.

513 We expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. 620 advisers x 4.5 hours = 2,790 hours. [1,395 hours x $210 = $292,950] + [1,395 hours x $294 = $410,130] = $703,080.

514 2 advisers x 40.74 hours per adviser to complete the entire form (except private fund reporting requirements) = 81.48 hours.

515 [41 hours x $210 = $8,610] + [41 hours x $294 = $12,054] = $20,664. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

516 *See supra* note 404.

517 We expect these advisers are likely to advise 3 funds each. *See* text accompanying note 405. We estimated above that private fund reporting would take an adviser approximately 1 hour per fund to complete. 200 advisers x 3 hours = 600 hours.

518 [300 hours x $210 = $63,000] + [300 hours x $294 = $88,200] = $151,200. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

Additionally, we estimate that one of the newly registering advisers would use outside legal services to assist them in preparing their Part 2 brochure, for a total non-labor cost of $3,200.[519]

Amendments to Pay to Play Rule

Our proposed amendment to rule 206(4)-5 to make it apply to exempt reporting advisers and foreign private advisers would not create new reporting, recordkeeping, or other compliance requirements on these advisers.[520] Rather, we are proposing this amendment to ensure that the rule continues to apply to these advisers and to prevent the unintended narrowing of the rule.[521] Our proposed amendment to permit an adviser to pay any registered municipal advisor subject to a pay to play rule adopted by MSRB to solicit government entities on its behalf may create new recordkeeping and compliance requirements on investment advisers that are small entities subject to the rule to the extent that they have to verify and document that placement agents that they hire to solicit government entities are indeed registered municipal advisors.[522] Finally, our technical amendment to rule 206(4)-5's definition of a "covered associate"[523] of an investment adviser to clarify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition, would not create any new reporting, recordkeeping, or other compliance requirements.[524]

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519 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. The non-labor costs for Form ADV are based on an estimate that 50% of small advisers will retain either legal services (at $3,200) or compliance consulting services (at $3,000) to assist in the preparation of Form ADV. *See supra* note 420 and accompanying text.

520 *See supra* section II.D.1 of this Release (discussing these amendments).

521 *See id.*

522 *See id.*

523 *See id.*

524 *See id.*

Other Amendments

Our proposed amendments to rule 204-2's grandfathering provision are meant to ensure that private fund advisers that are required to register as a result of the Dodd-Frank Act's elimination of the private fund exemption in section 203(b)(3) would not face a retroactive recordkeeping requirement.[525] Our proposed technical amendment to rule 204-2(e)(3)(ii) would add a cross-reference to the new definition of a private fund in section 202(a)(29) of the Advisers Act.[526] These amendments would not create reporting, recordkeeping, and other compliance requirements for small entities independent of the reporting, recordkeeping, and other compliance requirements imposed by current rule 204-2.[527]

We do not believe that our proposed technical amendments to rules 0-7, 222-1, and 222-2 would impose reporting, recordkeeping, and other compliance requirements on small advisers.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no proposed rules that duplicate, overlap, or conflict with the proposed rules and rule and form amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed rule amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting

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525 *See supra* note 231 and accompanying text.

526 *See supra* section II.D.2.b of this Release.

527 The Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3) may require additional small advisers to register with the Commission. Therefore these small entities would become subject to rule 204-2 with its reporting, recordkeeping, and other compliance burdens. However, subjecting these entities to rule 204-2 is a function of the Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3), not our proposed amendments to rule 204-2.

requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rules, or any part thereof, for such small entities.

Regarding the first and fourth alternatives, we do not believe that differing compliance or reporting requirements or an exemption from coverage of the new rules or rule amendments, or any part thereof, for small entities, would be appropriate or consistent with investor protection or with Congress's mandate in the Dodd-Frank Act, to the extent the new rule or amendment is being proposed due to a Congressional mandate. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small advisory firms, it would be inconsistent with the purposes of the Act to specify different requirements for small entities under the proposed rules and amendments unless expressly required to do so by Congress.

Regarding the second alternative, proposed rule 203A-5 would enable small advisers to easily and efficiently identify whether they are subject to our regulatory authority after the Dodd-Frank Act's amendment to section 203A becomes effective, and would also help minimize any potential uncertainty about the effects of the Dodd-Frank Act on their registration status by providing a simple, efficient means of determining their post-Dodd-Frank registration status as of a specific date. The proposed amendments to rule 203A-1 eliminate the $5 million buffer because it seems unnecessary in light of Congress's determination to require many (although not all) advisers having between $30 million and $100 million of assets under management to be registered with the states,[528] and makes the registration requirements for advisers with assets under management between $25 million and $30 million uniform with the requirements for

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528 *See supra* note 67.

advisers with assets under management between $30 million and $100 million. Our proposal to amend the multi-state adviser exemption in rule 203A-2(e) also would consolidate and simplify compliance for small advisers by aligning the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act and by requiring one standard for advisers relying on the exemption.[529] This amendment also would reduce the compliance burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator—the Commission. Furthermore, our proposal to use an existing form, Form ADV, and an existing filing system, IARD, for reporting and registration purposes will clarify and simplify the processes of registering and/or reporting for small entities because: (i) all of the information collection requirements for both registration and reporting would be consolidated in a single form; (ii) a small exempt reporting adviser would be able to use the same form and filing system both for reporting and for purposes of registering with one or more state securities authorities; and (iii) a small exempt reporting adviser may find that it can no longer rely on an exemption from registration with the Commission and would be able to register simply by filing an amendment to its current Form ADV to apply for registration.[530]

Regarding the third alternative, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection or with Congress's mandate in the Dodd-Frank Act.

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529 *See* proposed rule 203A-2(d); *supra* section IV.A.1. of this Release. Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register with 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register with at least 25 states. We propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.

530 *See supra* section II.C. of this Release.

G. Solicitation of Comments

We encourage written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on:

- the number of small entities subject to the proposed rules and rule and form amendments; and
- whether the effect of the proposed rules and rule and form amendments on small entities would be economically significant.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect.

VII. EFFECTS ON COMPETITION, EFFICIENCY AND CAPITAL FORMATION

The Commission is proposing to adopt certain new rules and to amend others pursuant to its authority under section 204(a) of the Advisers Act,[531] and sections 23(a) and 28(e)(2) of the Exchange Act.[532] Section 204(a) of the Advisers Act and section 28(e)(2) of the Exchange Act require the Commission, when engaging in rulemaking under the authority provided in those sections, to consider whether the rule is "necessary or appropriate in the public interest or for the protection of investors."[533] Section 202(c) of the Advisers Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[534] Section 3(f) of the Exchange Act requires the Commission, when engaging in rulemaking that requires it to

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531 15 U.S.C. 80b-4(a).

532 15 U.S.C. 78w(a) and 78bb(e)(2).

533 15 U.S.C. 80b-4(a) and 78bb(e)(2).

534 15 U.S.C. 80b-2(c).

consider or determine whether an action is necessary or appropriate in the public interest to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[535] Section 23(a) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[536]

The Commission is proposing to adopt rule 204-4 and to amend rules 204-1 and 204-2 and Forms ADV, ADV-NR, and ADV-H.[537] The proposed new rule and rule and form amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act.[538] We are proposing new rule 204-4 to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[539] We are also proposing amendments to Form ADV to improve our risk-assessment capabilities and so that it can serve the dual purpose of both an SEC reporting form for exempt reporting advisers and, as it is used today, a registration form for both state and SEC-registered firms.[540] In addition to requiring that exempt reporting advisers use Form ADV, proposed rule 204-4 would require these advisers to submit reports through the

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535 15 U.S.C. 78c(f).

536 15 U.S.C. 78w(a)(2).

537 In contrast, we are proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 pursuant to our authority set forth in sections 203A(c) and 211(a), amendments to rules 0-7, 222-1, and 222-2 pursuant to our authority set forth in section 211(a), and amendments to rule 206(4)-5 pursuant to our authority set forth in sections 206(4) and 211(a). For a discussion of the effects of this proposed new rule and rule amendments on competition, efficiency, and capital formation, see *supra* sections IV., V., and VI. of this Release.

538 For a discussion of the overall objectives of our proposals, see *supra* section I of this Release.

539 Proposed rule 204-4. *See supra* section II.B.1. of this Release.

540 *See supra* sections II.B. and II.C. of this Release.

IARD and to pay a filing fee.[541] We are also proposing to amend rule 204-1, which addresses when and how advisers must amend their Form ADV, to add a requirement that exempt reporting advisers file updating amendments to reports filed on Form ADV.[542]

A. Proposed Exempt Reporting Adviser Reporting Requirements

The Dodd-Frank Act provides that the Commission shall require reporting by exempt reporting advisers, but it does not indicate the information we should collect or the filing method by which it should be collected. Our choices, in proposing rule 204-4 to require these advisers to complete a sub-set of items contained in Form ADV and to file through the IARD, and in proposing to amend rule 204-1 to impose periodic updating requirements of those filings, would impose costs on exempt reporting advisers,[543] but would also create efficiencies that benefit both us and filers by taking advantage of an established and proven adviser filing system and avoiding the expense and delay of developing a new form and filing system. Additionally, we believe this proposal may create efficiencies to the extent exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities because they would be using the existing form and filing system that is also used by the states, which should reduce regulatory burdens.[544] Similarly, regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us

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541 Proposed rule 204-4(b). Proposed rule 204-4(e) would also allow exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD system to request a temporary hardship exemption from electronic filing requirements by filing Form ADV-H. We are also proposing technical amendments to Form ADV-H for this purpose.

542 *See* proposed rule 204-1; *supra* section II.B.3. of this Release.

543 For a discussion of the costs of the reporting obligations we are proposing to apply to exempt reporting advisers, see section IV.B.2, of this Release.

544 *See supra* section IV.A.2. of this Release.

because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[545]

Using Form ADV and IARD would also enable investors to access information on our website that may have previously been unavailable or not easily attainable, such as whether a prospective exempt reporting adviser has reported disciplinary events and whether its relationships with affiliates present conflicts of interest or potential efficiencies. Public access to this information, which may previously have been undisclosed, may promote competition to the extent that it would allow private fund investors to make informed decisions about these advisers, avoiding the burdens and costs associated with selling private funds to switch advisers at a later date, and thereby potentially creating efficiency gains in the marketplace and improving allocation of client assets among investment advisers. The availability of disciplinary information, in particular, about these advisers and their supervised persons may also enhance competition if, for example, firms and personnel with better disciplinary records outcompete those with worse records. Alternatively, the choices that we have made about the information these advisers would report (and that we would make publicly available), such as the identification of owners of the adviser or disciplinary information, could impose costs on advisers, including the potential loss of business to competitors (who may or may not report to us or be registered with us), as this information may not typically be made available to others.

Access to the information we propose to require exempt reporting advisers to report may also increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets.

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[545] *See* proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also supra* note 128 and accompanying text. Certain items in Form ADV Part 1 are also linked to Form B-D, which would create efficiencies if the exempt reporting adviser ever applies for broker-dealer registration.

This may enhance capital formation by making more funds available for investment and enhancing the allocation of capital generally. On the other hand, to the extent that the information we propose to collect and the filing method by which we propose to collect it imposes costs on exempt reporting advisers that are then passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

B. Proposed Risk-Assessment Amendments to Form ADV

The amendments to Form ADV we are proposing today are designed to improve advisers' disclosure of their business practices (particularly, those relating to advising private funds), non-advisory activities and financial industry affiliations, and other conflicts of interest. Private fund reporting, in particular, would benefit private fund investors and other market participants and would provide us and other policy makers with better data. Better data would enhance our ability to form and frame regulatory policies regarding the private fund industry and fund advisers, and to evaluate the effect of our policies and programs on this sector. Private fund reporting would provide us with important information about this rapidly growing segment of the U.S. financial system. Additionally, data about which advisers have $1 billion or more of assets would enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

As acknowledged above with respect to exempt reporting advisers, there may also be competitive impacts between registered investment advisers as a result of the collection of the proposed additional information on Form ADV. For instance, information regarding the amount of assets under management by specific types of clients could be used by competitors when marketing their own advisory services. Another example includes the information concerning

private funds that we propose to require registered and exempt reporting advisers to submit on Form ADV, which could assist private fund investors in assessing investment choices or screen funds based on certain parameters such as the identification of certain fund service providers or gatekeepers. Similarly, this information could be used by other financial service providers (such as banks or broker-dealers) that do not provide similar information publicly. Increased competition among investment advisers (both exempt reporting and registered) and other financial service providers may result in capital being allocated more efficiently, benefiting clients and certain advisers.

Better disclosure may increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets. This also may enhance capital formation by making more funds available for investment and enhancing the allocation of capital generally. On the other hand, if the rule amendments increase costs for investment advisers and these cost increases are passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

C. Other Proposed Amendments

Finally, we are proposing to amend rule 204-2 to cross-reference the new definition of private fund and add a grandfathering provision relieving firms that were exempt from registration prior to the effectiveness of the Dodd-Frank Act's elimination of the "private adviser" exemption from certain recordkeeping obligations applicable to registered advisers.[546] We also are amending Forms ADV-NR and Form ADV-H to provide for their use by exempt

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546 *See* proposed rule 204-2; *supra* section II.D.2.b of this Release. We also intend to rescind rule 204-2(l) because that section was vacated by the federal appeals court in *Goldstein.*

reporting advisers. The proposed amendments to rule 204-2, Form ADV-NR, and Form ADV-H are technical in nature. We do not anticipate that they would have any bearing on efficiency, competition, or capital formation.

D. Request for Comment

The Commission requests comment whether the proposed rule and rule amendments would, if adopted, promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data to support their views.

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[547] the Commission must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment, or innovation.

We request comment on the potential impact of the proposed new rule and proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

IX. STATUTORY AUTHORITY

The Commission is proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 under the Advisers Act pursuant to the authority set forth in sections 203A(c), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3A(c) and 80b-11(a)]; new rule 204-4 and amendments to rules 204-1 and 204-2 pursuant to the authority set

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547 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and 15 U.S.C., and as a note to 5 U.S.C. 601).

forth in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)]; amendments to rule 206(4)-5 pursuant to authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]; amendments to rules 0-7, 222-1, and 222-2 pursuant to authority set forth in section 211(a) of the Advisers Act [15 U.S.C. 80b-11(a)]; and to amend Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-NR under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], section 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; and Form ADV-H pursuant to the authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities.

TEXT OF RULE AND FORM AMENDMENTS

For the reasons set out in the preamble, Title 17 Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1-2. The authority citation for Part 275 is amended by revising the general authority and by adding authority for sections 275.203A-5, 275.204-1 and 275.204-4 to read as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

Section 275.203A-5 is also issued under 15 U.S.C. 80b-3a.

Section 275.204-1 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

Section 275.204-4 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

3. Section 275.0-7 is amended by revising the reference to "Section 203A(a)(2)" in paragraph (a)(1) to read "Section 203A(a)(3)."

4. Section 275.203A-1 is revised to read as follows:

§ 275.203A-1 Switching to or from SEC registration.

(a) *State-registered advisers—switching to SEC registration.* If you are registered with a state securities authority, you must apply for registration with the Commission within 90 days of filing an annual updating amendment to your Form ADV reporting that you are eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)).

(b) *SEC-registered advisers—switching to State registration.* If you are registered with the Commission and file an annual updating amendment to your Form ADV reporting that you are not eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)), you must file Form ADV-W (17 CFR 279.2) to withdraw your SEC registration within 180 days of your fiscal year end (unless you then are eligible for SEC registration). During this period while you are registered with both

the Commission and one or more state securities authorities, the Act and applicable State law will apply to your advisory activities.

5. Section 275.203A-2 is amended by:

a. Removing paragraph (a);

b. Redesignating paragraphs (b) through (f) as paragraphs (a) through (e);

c. Revising newly designated paragraph (a)(1);

d. Revising the reference to “paragraph (b) of this section” in newly designated paragraph (a)(2) to read “paragraph (a) of this section”;

e. Revising newly designated paragraph (c)(1);

f. Revising the reference in newly designated paragraph (c)(3) to “§275.203A-1(b)(2)” to read “§275.203A-1(b)”;

g. Revising newly designated paragraph (d)(1);

h. Further redesignating newly designated paragraphs (d)(2) and (d)(3) as paragraphs (d)(2)(i) and (d)(2)(ii);

i. Adding new introductory text to paragraph (d)(2) and revising newly designated paragraphs (d)(2)(i) and (d)(2)(ii);

j. Further redesignating newly designated paragraph (d)(4) as paragraph (d)(3);

k. Revising the reference to “paragraph (f) of this section” in newly designated paragraphs (e)(1)(ii), (e)(1)(iii), and (e)(2) to read “paragraph (e) of this section”;

l. Revising the reference to “paragraph (f)(1)(i) of this section” in newly designated paragraph (e)(1)(ii) to read “paragraph (e)(1)(i) of this section”;

m. Revising the reference “paragraph (c) of this section” in newly designated paragraph (e)(1)(iii) to read “paragraph (b) of this section”; and

n. Revising the reference "§ 275.203(b)(3)-1" in newly designated paragraph (e)(3) to read "§ 275.202(a)(30)-1".

The revisions and additions read as follows:

§ 275.203A-2 Exemptions from prohibition on Commission registration.

(a) *Pension Consultants.* (1) An investment adviser that is a "pension consultant," as defined in this section, with respect to assets of plans having an aggregate value of at least $200,000,000.

* * * * *

(c) * * *

(1) Immediately before it registers with the Commission, is not registered or required to be registered with the Commission or a state securities authority of any State and has a reasonable expectation that it would be eligible to register with the Commission within 120 days after the date the investment adviser's registration with the Commission becomes effective;

* * * * *

(d) * * *

(1) Upon submission of its application for registration with the Commission, is required by the laws of 15 or more States to register as an investment adviser with the state securities authority in the respective States, and thereafter would, but for this section, be required by the laws of at least 15 States to register as an investment adviser with the state securities authority in the respective States;

(2) Elects to rely on paragraph (d) of this section by:

(i) Indicating on Schedule D of its Form ADV that the investment adviser has reviewed the applicable State and federal laws and has concluded that, in the case of an application for

registration with the Commission, it is required by the laws of 15 or more States to register as an investment adviser with the state securities authorities in the respective States or, in the case of an amendment to Form ADV, it would be required by the laws of at least 15 States to register as an investment adviser with the state securities authorities in the respective States, within 90 days prior to the date of filing Form ADV; and

(ii) Undertaking on Schedule D of its Form ADV to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 States to register as an investment adviser with the state securities authority in the respective States, and that the investment adviser would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3a(a)) from registering with the Commission, by filing a completed Form ADV-W within 180 days of the adviser's fiscal year end (unless the adviser then has at least $100 million of assets under management or is otherwise eligible for SEC registration); and

* * * * *

6. Section 275.203A-3 is amended by revising paragraph (a)(4) and adding paragraphs (d) and (e) to read as follows:

§ 275.203A-3 Definitions.

* * * * *

(a) * * *

(4) Supervised persons may rely on the definition of “client” in §275.202(a)(30)–1 to identify clients for purposes of paragraph (a)(1) of this section, except that supervised persons need not count clients that are not residents of the United States.

* * * * *

(d) *Assets under management*. Determine "assets under management" by calculating the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services as reported on the investment adviser's Form ADV (17 CFR 279.1).

(e) *State securities authority*. "State securities authority" means the securities commissioner or commission (or any agency, office or officer performing like functions) of any State.

7. Section 275.203A-4 is removed and reserved.

8. Section 275.203A-5 is added to read as follows:

§ 275.203A-5 Transition rules.

(a) Every investment adviser registered with the Commission on July 21, 2011 shall file an other-than-annual amendment to Form ADV (17 CFR 279.1) no later than August 20, 2011 and shall determine its assets under management based on the current market value of the assets as determined within 30 days prior to the date of filing the Form ADV.

(b) If an investment adviser registered with the Commission on July 21, 2011 would be prohibited from registering with the Commission under section 203A(a)(2) of the Act (15 U.S.C. 80b-3a(a)(2)), and is not otherwise exempted by § 275.203A-2 from such prohibition, such investment adviser shall withdraw from registration with the Commission by filing Form ADV-W (17 CFR 279.2) no later than October 19, 2011. During this period while an investment adviser is registered with both the Commission and one or more state securities authorities, the Act and applicable State law will apply to the investment adviser's advisory activities.

(c) If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the Commission has instituted a proceeding pursuant to section 203(e) of the Act (15 U.S.C. 80b-3(e)) to suspend or revoke registration, or pursuant to section 203(h) of the Act (15 U.S.C. 80b-3(h)) to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

9. Section 275.204-1 is amended by revising the heading, paragraphs (b) and (c) to read as follows:

§ 275.204-1 Amendments to Form ADV.

* * * * *

(b) Electronic filing of amendments.

(1) Subject to paragraph (c), you must file all amendments to Part 1A of Form ADV and Part 2A of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under §275.203-3. You are not required to file with the Commission amendments to brochure supplements if required by Part 2B of Form ADV.

(2) If you have received a continuing hardship exemption under §275.203-3, you must, when you are required to amend your Form ADV, file a completed Part 1A and Part 2A of Form ADV on paper with the SEC by mailing it to FINRA.

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our website at www.sec.gov/iard. For the annual updating amendment: summaries of material changes that are not included in the adviser's brochure must be filed with the Commission as an exhibit to Part 2A in the same electronic file; and if you are not required to prepare a brochure, a

summary of material changes, or an annual updating amendment to your brochure, you are not required to file them with the Commission. See the instructions for Part 2A of Form ADV.

(c) Transition to electronic filing. If you are required to file a brochure and your fiscal year ends on or after December 31, 2010, you must amend your Form ADV by electronically filing with the IARD one or more brochures that satisfy the requirements of Part 2A of Form ADV (as amended effective October 12, 2010) as part of the next annual updating amendment that you are required to file.

* * * * *

10. Section 275.204-2 is amended by removing paragraph (l), and revising paragraph (e)(3)(ii) to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

* * * * *

(e) * * *

(3) * * *

(ii) *Transition rule.* If you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, paragraph (e)(3)(i) of this section does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under the provisions of paragraph (a)(16) of this section to the extent those books and records pertain to the performance or rate of return of such private fund (as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)), or other account you advise for any period ended prior to July 21, 2011, provided that you were not registered with the Commission as an investment adviser during such period, and provided further that you continue to preserve any books and records in

your possession that pertain to the performance or rate of return of such private fund or other account for such period.

* * * * *

11. Section 275.204-4 is added to read as follows:

§ 275.204-4 Reporting by exempt reporting advisers.

(a) *Exempt reporting advisers*. If you are an investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Act (15 U.S.C. 80b-3(l) or 80b-3(m)), you must complete and file reports on Form ADV (17 CFR 279.1) by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide.

(b) *Electronic filing.* You must file Form ADV electronically with the Investment Adviser Registration Depository (IARD) unless you have received a hardship exemption under paragraph (e) of this section.

Note to paragraph (b): Information on how to file with the IARD is available on the Commission's website at http://www.sec.gov/iard.

(c) *When filed*. Each Form ADV is considered filed with the Commission upon acceptance by the IARD.

(d) *Filing fees*. You must pay FINRA (the operator of the IARD) a filing fee. The Commission has approved the amount of the filing fee. No portion of the filing fee is refundable. Your completed Form ADV will not be accepted by FINRA, and thus will not be considered filed with the Commission, until you have paid the filing fee.

(e) *Temporary hardship exemption*.

(1) *Eligibility for exemption.* If you have unanticipated technical difficulties that prevent submission of a filing to the IARD system, you may request a temporary hardship exemption from the requirements of this chapter to file electronically.

(2) *Application procedures*. To request a temporary hardship exemption, you must:

(i) File Form ADV-H (17 CFR 279.3) in paper format no later than one business day after the filing that is the subject of the ADV-H was due; and

(ii) Submit the filing that is the subject of the Form ADV-H in electronic format with the IARD no later than seven business days after the filing was due.

(3) *Effective date – upon filing.* The temporary hardship exemption will be granted when you file a completed Form ADV-H.

(f) *Final report.* You must file a final report in accordance with instructions in Form ADV when:

(1) You cease operation as an investment adviser;

(2) You no longer meet the definition of exempt reporting adviser under paragraph (a); or

(3) You apply for registration with the Commission.

Note to paragraph (f): You do not have to pay a filing fee to file a final report on Form ADV through the IARD.

12. Section 275.206(4)-5 is amended by:

a. In paragraph (f)(2)(i), removing the term “individual” and adding in its place the term “person”; and

b. Revising paragraphs (a)(1), (a)(2) introductory text, (a)(2)(i), (d), and (f)(9) to read as follows:

§ 275.206(4)-5 Political contributions by certain investment advisers.

(a) * * *

(1) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, as defined in § 275.204-4(a), to provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made); and

(2) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates:

(i) To provide or agree to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is:

(A) A regulated municipal advisor; or

(B) An executive officer, general partner, managing member (or, in each case, a person with a similar status or function), or employee of the investment adviser; and

* * * * *

(d) Further prohibition. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts, practices, or courses of business within the meaning of section 206(4) of Advisers Act (15 U.S.C. 80b-6(4)), it shall be unlawful for any investment adviser

registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates to do anything indirectly which, if done directly, would result in a violation of this section.

* * * * *

(f) * * *

(9) Regulated municipal advisor means a municipal advisor registered with the Commission under section 15B of that Act and subject to rules of the Municipal Securities Rulemaking Board that:

(i) Prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made; and

(ii) The Commission, by order, finds:

(A) Impose substantially equivalent or more stringent restrictions on municipal advisors than this section imposes on investment advisers; and

(B) Are consistent with the objectives of this section.

* * * * *

13. Section 275.222-1 is amended by revising the phrase "Principal place of business" to read "Principal office and place of business" in both the heading and the first sentence of paragraph (b).

14. Section 275.222-2 is revised to read as follows:

§ 275.222-2 Definition of "client" for purposes of the national de minimis standard.

For purposes of section 222(d)(2) of the Act (15 U.S.C. 80b-18a(d)(2)), an investment adviser may rely upon the definition of "client" provided by § 275.202(a)(30)-1, without giving

regard to paragraph (b)(4) of that section, provided that an investment adviser is not required to count as a client any person for whom the investment adviser provides advisory services without compensation.

PART 279 -- FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

15. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

§ 279.1 [Amended]

16. Form ADV [referenced in § 279.1] is amended by:

a. In the instructions to the form, revising the section entitled "Form ADV: General Instructions." The revised version of Form ADV: General Instructions is attached as Appendix A;

b. In the instructions to the form, revising the section entitled "Form ADV: Instructions for Part 1A." The revised version of Form ADV: Instructions for Part 1A is attached as Appendix B;

c. In the instructions to the form, revising the section entitled "Form ADV: Glossary of Terms." The revised version of Form ADV: Glossary of Terms is attached as Appendix C;

d. In the form, revising Part 1A. The revised version of Form ADV, Part 1A is attached as Appendix D;

e. In the form, revising the reference to "proceeding" in Item 3.D. of Part 2B to read "hearing or formal adjudication"; and

f. In the form, revising the section entitled "Form ADV: Domestic Investment Adviser Execution Page." The revised version of Form ADV: Domestic Investment Adviser Execution Page is attached as Appendix E.

The revisions read as follows:

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

* * * * *

Form ADV: Part 2B

* * *

Item 3. * * *

D. Any other hearing or formal adjudication in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished the attainment, designation, or license) in anticipation of such a hearing or formal adjudication (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event.

* * * * *

§ 279.3 [Amended]

17. Form ADV-H [referenced in § 279.3] is amended by revising the form. The revised version of Form ADV-H is attached as Appendix F.

Note: The text of Form ADV-H does not and the amendments will not appear in the Code of Federal Regulations.

§ 279.4 [Amended]

18. Form ADV-NR [referenced in § 279.4] is amended by revising the form. The revised version of Form ADV-NR is attached as Appendix G.

Note: The text of Form ADV-NR does not and the amendments will not appear in the Code of Federal Regulations.

By the Commission.

Elizabeth M. Murphy
Secretary

November 19, 2010