

will have to arrange for qualified custodians to deliver account statements directly to their advisory clients, and the qualified custodians may pass any new costs on to the advisers. These costs are necessary for the protection of advisory clients and we estimated in the Proposing Release that they should be no greater, at an aggregate level, than the costs incurred under the current account statement delivery requirement. We received no specific comments on these assumption and estimates, and we believe they remain accurate.

VI. Paperwork Reduction Act

As set forth in the Proposing Release, the amendments contain several "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.⁶⁵ The titles for the collections of information are "Rule 206(4)–2, Custody of Funds or Securities of Clients by Investment Advisers" and "Form ADV, Financial Information" under the Advisers Act. The Commission submitted the amendments to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The collection of information for the rule and the form has been approved by OMB under control numbers 3235–0241 and 3235–0049, respectively (both expire on September 30, 2005). 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 control number.

The collections of information under rule 206(4)–2 are necessary to ensure that clients' funds and securities in the custody of advisers are safeguarded, and information contained in the collections is used by staff of the Commission in its enforcement, regulatory, and examination programs. The respondents are investment advisers registered with us that have custody of clients' funds or securities. The collections of information under Form ADV are necessary for use by staff of the Commission in its examination and oversight program. The respondents are investment advisers seeking to register with the Commission or to update their registration. Responses provided to the Commission are not kept confidential.

A. Rule 206(4)–2

We are adopting the amendments substantially as proposed. The

pooled investment vehicles) do not receive account statements directly from custodians. Many commenters indicated that their custodians do deliver account statements to their clients directly.

⁶⁵ 44 U.S.C. 3501 to 3520.

amendments require advisers with client funds and securities to maintain those funds and securities in custodial accounts with banks, broker-dealers, or other "qualified custodians." The amendments exempt advisers with custody of client assets from the current requirements of sending their clients quarterly account statements and undergoing an annual surprise examination if qualified custodians send account statements directly to the advisory clients at least quarterly.⁶⁶ The amendments exempt advisers from the rule with respect to accounts of registered investment companies, and exempt advisers from the reporting requirement with respect to pooled investment vehicles that are audited annually and have the audit results distributed to their investors.⁶⁷ We received no comments on the collection of information burden of the amendments.

We estimated in our Proposing Release that the amendments would generally reduce the paperwork burden for advisers. We estimated the aggregate burden under the current rule at 1,246,200 hours, and the aggregate cost under the current rule at \$5,952,000, assuming that an adviser would pay an independent public accountant \$8,000 to conduct an annual surprise examination.

For purposes of calculating the burden hours under the amendments, we estimated in the Proposing Release that (i) of the 867 advisers reporting that they had custody of clients' assets, 156 would be fully exempted from the requirements of sending quarterly advisory account statements and undergoing an annual surprise examination,⁶⁸ (ii) 95 percent (675

⁶⁶ We proposed that qualified custodians send account statements to clients monthly. A number of commenters noted that some custodial accounts are on quarterly rather than monthly reporting cycles and that moving to a monthly cycle would increase expenses. In response to these comments, the amended rule requires only quarterly account statements. This revision will not affect our original estimate of information collection burden, which was based on an assumption that the amendments would not result in any change in qualified custodians' reporting cycles.

⁶⁷ We had proposed a complete exemption for advisers to audited pooled investment vehicles, but are adopting an exemption from the account statement delivery requirements only. Exempting audited investment pools from the account statement delivery requirement will eliminate both the adviser's burden of sending account statements and its burden in undergoing an annual surprise examination. This modification does not affect estimate of the information collection burden.

⁶⁸ Advisers that are registered broker-dealers (123 firms) or banks (33 firms) will be "qualified custodians" under the amended rule and may keep custody of their own (and other advisers') clients' assets. We understand that broker-dealers and banks generally send account statements at least

advisers) of the remaining 711 advisers would be eligible for the exemption from these two requirements with respect to 99 percent of their clients, and (iii) 5 percent (36 advisers) of the remaining 711 advisers would continue to be subject to both requirements with respect to all of their clients. Assuming an average of 670 clients per adviser registered with us, we estimated that the aggregate annual burden that advisers would face under the amended rule would be 72,113 hours rather than the estimated 1,246,200 hours under the current rule.⁶⁹

We further estimated in the Proposing Release that (i) the aggregate cost for accounting fees for the annual surprise examination would be \$288,000 for the 36 advisers who would be subject to the collection of information for all of their clients;⁷⁰ and (ii) the accounting fees for the 675 advisers who would be subject to the collection of information for 1 percent of their clients would decrease to \$1,000 per adviser, for an aggregate of \$675,000. The aggregate cost for information collection burden under the amended rule would therefore be \$963,000 rather than the estimated \$5,952,000 under the current rule.⁷¹ We received no comments on these estimates and assumptions.

As stated above, we are adopting the amendments substantially as proposed. Accordingly, our estimate of the annual aggregate burden of collection for the amended rule remains 72,113 hours and our estimate of the aggregate cost remains \$963,000. This collection of information is mandatory, and responses are not kept confidential.

B. Form ADV

The amended rule eliminates the requirement set forth in Part II, Item 14 of Form ADV that an adviser with custody must include in its brochure a balance sheet audited by an independent public accountant.⁷² This will reduce paperwork burden for

quarterly. These advisers will therefore be in compliance with the amended rule without incurring any additional burden under the rule.

⁶⁹ The 675 advisers facing this burden with respect to 1% of their clients will spend 2.5 hours per client for 7 clients annually. 675 advisers \times 7 clients \times 2.5 hours = 11,812.5 hours. The 36 advisers facing this burden with respect to all of their clients will spend 2.5 hours per client for 670 clients annually. 36 advisers \times 670 clients \times 2.5 hours = 60,300 hours. 11,812.5 hours + 60,300 hours = a total hour burden of 72,112.5 (rounded to 72,113) hours annually for all advisers in the aggregate.

⁷⁰ These 36 advisers would be subject to a surprise examination. Based on our experience examining investment advisers, we estimated that each surprise examination would cost \$8,000. 36 advisers \times \$8,000 = \$288,000.

⁷¹ \$288,000 + \$675,000 = \$963,000.

⁷² See *supra* Section II.E. of this Release.