

**SUPPORTING STATEMENT**  
**Rule 12d1-1**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Under current law, an investment company (“fund”) is limited in the amount of securities the fund (“acquiring fund”) can acquire from another fund (“acquired fund”). In general under the Investment Company Act of 1940 (the “Investment Company Act” or “Act”),<sup>1</sup> a registered fund (and companies it controls) cannot:

- acquire more than three percent of another fund’s securities;
- invest more than five percent of its own assets in another fund; or
- invest more than ten percent of its own assets in other funds in the aggregate.<sup>2</sup>

In addition, a registered open-end fund, its principal underwriter, and any registered broker or dealer cannot sell that fund’s shares to another fund if, as a result:

- the acquiring fund (and any companies it controls) owns more than three percent of the acquired fund’s stock; or
- all acquiring funds (and companies they control) in the aggregate own more than ten percent of the acquired fund’s stock.<sup>3</sup>

Rule 12d1-1 under the Act provides an exemption from these limitations for “cash sweep” arrangements in which a fund invests all or a portion of its available cash in a money market fund rather than directly in short-term instruments.<sup>4</sup> Acquiring funds relying on the exemption may not pay a sales load, distribution fee, or service fee on acquired fund shares, or if it does, the acquiring fund’s investment adviser must waive a sufficient amount of its advisory

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<sup>1</sup> See 15 U.S.C. 80a.

<sup>2</sup> See 15 U.S.C. 80a-12(d)(1)(A). If an acquiring fund is not registered, these limitations apply only with respect to the acquiring fund’s acquisition of registered funds.

<sup>3</sup> See 15 U.S.C. 80a-12(d)(1)(B).

<sup>4</sup> See 17 CFR 270.12d1-1.

fee to offset the cost of the loads or distribution fees.<sup>5</sup> The acquired fund may be a fund in the same fund complex or in a different fund complex. In addition to providing an exemption from section 12(d)(1) of the Act, the rule provides exemptions from section 17(a) and rule 17d-1, which restrict a fund's ability to enter into transactions and joint arrangements with affiliated persons.<sup>6</sup> These provisions would otherwise prohibit an acquiring fund from investing in a money market fund in the same fund complex,<sup>7</sup> or prohibit a fund that acquires five percent or more of the securities of a money market fund in another fund complex from making any additional investments in the money market fund.<sup>8</sup>

The rule also permits a registered fund to rely on the exemption to invest in an unregistered money market fund that limits its investments to those in which a registered money market fund may invest under rule 2a-7 under the Act, and undertakes to comply with all the other provisions of rule 2a-7.<sup>9</sup> In addition, the acquiring fund must reasonably believe that the unregistered money market fund (i) operates in compliance with rule 2a-7, (ii) complies with sections 17(a), (d), (e), 18, and 22(e) of the Act<sup>10</sup> as if it were a registered open-end fund, (iii) has

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<sup>5</sup> See Rule 12d1-1(b)(1).

<sup>6</sup> See 15 U.S.C. 80a-17(a), 15 U.S.C. 80a-17(d); 17 CFR 270.17d-1.

<sup>7</sup> An affiliated person of a fund includes any person directly or indirectly controlling, controlled by, or under common control with such other person. See 15 U.S.C. 80a-2(a)(3)(C) (definition of "affiliated person"). Most funds today are organized by an investment adviser that advises or provides administrative services to other funds in the same complex. Funds in a fund complex are generally under common control of an investment adviser or other person exercising a controlling influence over the management or policies of the funds. See 15 U.S.C. 80a-2(a)(9). Not all advisers control funds they advise. The determination of whether a fund is under the control of its adviser, officers, or directors depends on all the relevant facts and circumstances. See Investment Company Mergers, Investment Company Act Release No. 25259 (Nov. 8, 2001) [66 FR 57602 (Nov. 15, 2001)], at n.11. To the extent that an acquiring fund in a fund complex is under common control with a money market fund in the same complex, the funds would rely on the rule's exemptions from section 17(a) and rule 17d-1.

<sup>8</sup> See 15 U.S.C. 80a-2(a)(3)(A), (B).

<sup>9</sup> See 17 CFR 270.2a-7.

<sup>10</sup> See 15 U.S.C. 80a-17(a), 15 U.S.C. 80a-17(d), 15 U.S.C. 80a-18, 15 U.S.C. 80a-22(e).

adopted procedures designed to ensure that it complies with these statutory provisions, (iv) maintains the records required by rules 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9);<sup>11</sup> and (v) preserves permanently, the first two years in an easily accessible place, all books and records required to be made under these rules.

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

Rule 2a-7 contains certain collection of information requirements. An unregistered money market fund that complies with rule 2a-7 would be subject to these collection of information requirements. In addition, the recordkeeping requirements under rule 31 with which the acquiring fund reasonably believes the unregistered money market fund complies are collections of information for the unregistered money market fund. By allowing funds to invest in registered and unregistered money market funds, rule 12d1-1 is intended to provide funds greater options for cash management. In order for a registered fund to rely on the exemption to invest in an unregistered money market fund, the unregistered money market fund must comply with certain collection of information requirements for registered money market funds. These requirements are intended to ensure that the unregistered money market fund has established procedures for collecting the information necessary to make adequate credit reviews of securities in its portfolio, as well as other recordkeeping requirements that will assist the acquiring fund in overseeing the unregistered money market fund (and Commission staff in its examination of the unregistered money market fund's adviser).

## **3. Role of Improved Information Technology**

Rule 31a-2(f) under the Act permits investment companies to maintain many types of records on micrographic and electronic storage media.

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<sup>11</sup> See 17 CFR 270.31a-1(b)(2)(ii), 17 CFR 270.31a-1(b)(2)(iv), 17 CFR 270.31a-1(b)(9).

#### **4. Efforts to Identify Duplication**

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or a change in a rule. The conditions in rule 12d1-1 are not duplicated elsewhere.

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

Rule 12d1-1 does not distinguish between small entities and other unregistered funds. The rule does not apply directly to unregistered money market funds, which are not regulated by the Commission. The Commission does not believe that to the extent an unregistered money market fund complies with the rule's requirements in order to sell its shares to a registered fund relying on the rule, the collection of information is unduly burdensome for large or small entities.

We review all Commission rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small entities.

#### **6. Consequences of Less Frequent Collection**

Rule 2a-7 requires a fund's board to adopt written procedures designed to stabilize the fund's net asset value and guidelines regarding the delegation of certain responsibilities. None of these is a recurring obligation. The rule also requires money market funds to perform periodic analyses of portfolio securities and reviews of the credit risks associated with those securities. The frequency of these reviews is within the fund's discretion. The reviews are necessary to ensure that securities that remain in a fund's portfolio continue to present minimal credit risks.

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

Unregistered money market funds that sell their shares to registered funds that rely on rule 12d1-1 would be required to keep certain records for more than three years. The

Commission believes that the long-term retention of records is necessary to carry out its examination and enforcement responsibilities, and its mandate to ensure that the Act's provisions are legally enforceable. Under the rule, in which registered funds would be investing in unregistered funds that operate like a registered money market fund, the Commission would examine the unregistered fund through the Commission staff's examination of the unregistered fund's adviser. Commission staff periodically inspects the operations of registered funds and registered investment advisers to ensure compliance with the rules and regulations under the Act and the Investment Advisers' Act. For those advisers who also advise an unregistered money market fund that sells shares to registered funds in reliance on rule 12d1-1, Commission staff would inspect for compliance with the conditions in the rule. Nevertheless, each fund or adviser may be inspected only at intervals of several years due to limits on the Commission's resources. For this reason, the Commission often needs information relating to events or transactions that occurred years ago. Computerized record storage has made long-term retention of records less burdensome.

#### **8. Consultation Outside the Agency**

Before adopting rule 12d1-1, the Commission received and evaluated public comments on the proposed rule and its collection of information requirements. The Commission received five comments on its proposal, including comments from a fund management company, a fund trade association, and an adviser to funds of hedge funds. In addition, the Commission and staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and informal exchanges. The Commission requested public comment on the collection of information requirements in rule 12d1-1 before it submitted this request for extension and approval to the

Office of Management and Budget. The Commission received no comments in response to its request.

**9. Payment or Gift to Respondents**

Not applicable.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

Not applicable.

**12. Estimates of Hour Burden**

The number of unregistered money market funds that would be affected by the proposal is an estimate based on the number of Commission exemptive orders that include relief to registered funds to purchase shares in an unregistered money market fund in excess of the section 12(d)(1) limits. The hour burden estimates for the condition that an unregistered money market fund comply with rule 2a-7 are based on the burden hours included in the Commission's most recent PRA submission regarding rule 2a-7 ("Rule 2a-7 submission").<sup>12</sup> The estimated average burden hours in this collection of information are made solely for purposes of the Paperwork Reduction Act and are not derived from a quantitative, comprehensive or even representative survey or study of the burdens associated with Commission rules and forms. In its most recent rule 2a-7 submission, Commission staff made the following estimates with respect to burdens for each registered money market fund:

Record of credit risk analyses, and determinations regarding adjustable rate securities, asset backed securities, and securities subject to a demand feature or guarantee:

162 responses  
1220 hours of professional time

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<sup>12</sup> Securities and Exchange Commission, Request for OMB Approval of Extension for Approved Collection for Rule 2a-7 under the Investment Company Act of 1940 (OMB Control No. 3235-0268) (approved April 21, 2006).

Cost: \$92,720.

Board procedures re: stabilizing the fund's net asset value and guidelines for delegating authority for determinations under the rule:

1 response  
21 hours of director, legal, and support staff  
Cost: \$250.

Board review of procedures and amendment of procedures:

1 response  
4.5 burden hours of the board of directors' time  
Cost: \$961

The staff estimates that registered funds currently invest in 40 unregistered money market funds in excess of the statutory limits under an exemptive order issued by the Commission, and will invest in approximately 6 new unregistered money market funds each year.<sup>13</sup> Each of these unregistered money market funds would perform the record of credit risk analysis and other determinations and, in the first year after the rule's adoption, would implement the board procedures.<sup>14</sup> Finally, consistent with the estimate in the Commission's 2a-7 submission, Commission staff estimates that approximately 1/4, or 10, unregistered money market funds would review and amend procedures annually. Accordingly, the estimated total of annual responses under proposed rule 12d1-1 is 7508,<sup>15</sup> the estimated burden hours associated with these responses is 57,131,<sup>16</sup> and the estimated cost to funds is \$4.3 million.<sup>17</sup>

<sup>13</sup> This estimate is based on the number of applications filed with the Commission in 2005. This estimate may be understated because applicants generally do not identify the name or number of unregistered money market funds in which registered funds intend to invest, and each application also applies to unregistered money market funds to be organized in the future.

<sup>14</sup> The Commission adopted rule 12d1-1 on June 20, 2006. See Fund of Funds Investments, Investment Company Act Release No.27399 (June 20, 2006).

<sup>15</sup> The estimate is based on the following calculation:  $(40 \times 162) + (6 \times 162) + (40 \times 1) + (6 \times 1) + (10 \times 1) = 7508$ .

<sup>16</sup> This estimate is based on the following calculation:  $(40 \times 1220) + (6 \times 1220) + (40 \times 21) + (6 \times 21) + (10 \times 4.5) = 57,131$ .

Rules 31a-1(b)(1), 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9) require registered funds to keep certain records, which include journals and general and auxiliary ledgers, including ledgers for each portfolio security and each shareholder of record of the fund. Most of the records required to be maintained by the rule are the type that generally would be maintained as a matter of good business practice and to prepare the unregistered money market fund's financial statements. Accordingly, Commission staff estimates that the requirements under rules 31a-1(b)(1), 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9) would not impose any additional burden because the costs of maintaining these records would be incurred by unregistered money market funds in any case to keep books and records that are necessary to prepare financial statements for shareholders, to prepare the fund's annual income tax returns, and as a normal business custom.

### **13. Estimate of Total Annual Cost Burden**

Commission staff estimates that in addition to the costs described in section 12, unregistered money market funds will incur costs to preserve records, as required under rule 2a-7. These costs will vary significantly for individual funds, depending on the amount of assets under fund management and whether the fund preserves its records in a storage facility in hard copy or has developed and maintains a computer system to create and preserve compliance records. In its Rule 2a-7 submission, Commission staff estimated that the amount an individual money market fund may spend ranged from \$100 per year to \$300,000. We have no reason to believe the range would be different for unregistered money market funds. The Commission does not have specific information on the amount of assets managed by unregistered money

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<sup>17</sup> This estimate is based on the following calculation:  $(40 \times \$92,720) + (6 \times \$92,720) + (40 \times \$250) + (6 \times \$250) + (10 \times \$961) = \$4,286,230$ .

In addition, in its Rule 2a-7 submission, Commission staff estimated that in a year, 0.1% of registered money market funds spend 0.5 hours to record board determinations and actions in response to certain events of default or insolvency, and to notify the Commission of the event. We have not included this burden estimate in our estimate for unregistered funds because 0.1% of 40 unregistered money market funds is less than 1.



market funds. Accordingly, Commission staff has estimated that an unregistered money market fund in which registered funds would invest in reliance on proposed rule 12d1-1 would have, on average, \$357.7 million in assets under management.<sup>18</sup> Based on a cost of \$0.0000005 per dollar of assets under management for medium-sized funds, the staff estimates compliance with rule 2-7 would cost each of these unregistered money market funds \$179 annually for a total annual cost of \$8000.<sup>19</sup> Commission staff estimates that unregistered money market funds will not incur any capital costs to create computer programs for maintaining and preserving compliance records for rule 2a-7.<sup>20</sup>

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

There are no costs to the Federal Government associated with rule 12d1-1.

#### **15. Explanation of Changes in Burden**

The estimated total annual burden is being increased from 21,175 to 57,131 hours. The estimated total annual cost is being decreased from \$76,000 to \$8000 annually. The increase in hours is attributable to increased estimates of the number of funds investing in unregistered money market funds, updated information under the rule 2a-7 submission from money market funds regarding hourly burdens, and the significant differences in burden hours reported by the funds selected at random to be surveyed in different submission years. The significant decrease

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<sup>18</sup> This estimated average is based on the following calculation: \$165.6 billion (assets under management by medium-sized money market funds) ÷ 463 medium-sized registered money market funds (money market funds with \$50 million to \$999 million in assets under management) = \$357.7 million. These include registered money market funds and series of registered money market funds. The estimate is based on information from Lipper Inc.'s Lana database as of December 31, 2005.

<sup>19</sup> This estimate was based on the following calculation: 46 unregistered money market funds x \$357.7 million x \$0.0000005 = \$8227. The estimate of cost per dollar of assets is the same as that used for medium-sized funds in the Rule 2a-7 submission.

<sup>20</sup> This estimate is based on information Commission staff obtained in its survey for the 2a-7 submission. Of the funds surveyed, no medium-sized funds incurred this type of capital cost. The funds either maintained record systems using a program the fund would be likely to have in the ordinary course of business (such as Excel) or the records were maintained by the fund's custodian.

in costs is attributable to an error in calculating the costs in the previous submission. The annual cost in the previous submission should have been \$4403. The increase in costs from the correct estimate is attributable to differences in record preservation costs reported by the funds selected at random to be surveyed in different submission years.

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

Not applicable.

**17. Approval to not Display Expiration Date**

Not applicable

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.