

**SUPPORTING STATEMENT  
RULE 17J-1**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Conflicts of interest between investment company personnel (such as portfolio managers) and their funds can arise when these persons buy and sell securities for their own accounts (“personal investment activities”). These conflicts arise because fund personnel have the opportunity to profit from information about fund transactions, often to the detriment of fund investors. Beginning in the early 1960s, Congress and the Securities and Exchange Commission (“Commission”) sought to devise a regulatory scheme to effectively address these potential conflicts. These efforts culminated in the addition of section 17(j) to the Investment Company Act of 1940 (the “Investment Company Act”) (15 U.S.C. 80a-17(j)) in 1970 and the adoption by the Commission of rule 17j-1 (17 CFR 270.17j-1) in 1980.<sup>1</sup> The Commission proposed amendments to rule 17j-1 in 1995 in response to recommendations made in the first detailed study of fund policies concerning personal investment activities by the Commission’s Division of Investment Management since rule 17j-1 was adopted. Amendments to rule 17j-1, which were adopted in 1999, enhanced fund oversight of personal investment activities and the board’s role in carrying out that oversight.<sup>2</sup> Additional amendments to rule 17j-1 were made in 2004, conforming rule 17j-1 to rule 204A-1 under the Investment Advisers Act of 1940 (15 U.S.C. 80b), avoiding duplicative reporting, and modifying certain definitions and time restrictions.<sup>3</sup>

Section 17(j) makes it unlawful for persons affiliated with a registered investment company (“fund”) or with the fund’s investment adviser or principal underwriter (each a “17j-1

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<sup>1</sup> Prevention of Certain Unlawful Activities with Respect to Registered Investment Companies, Investment Company Act Release No. 11421 (Oct. 31, 1980) (45 FR 73915 (Nov. 7, 1980)).

<sup>2</sup> Personal Investment Activities of Investment Company Personnel, Investment Company Act Release No. 23958 (Aug. 20, 1999) (64 FR 46821-01 (Aug. 27, 1999)).

<sup>3</sup> Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (Jul. 2, 2004) (66 FR 41696 (Jul. 9, 2004)).

organization”), in connection with the purchase or sale of securities held or to be acquired by the investment company, to engage in any fraudulent, deceptive, or manipulative act or practice in contravention of the Commission’s rules and regulations. Section 17(j) also authorizes the Commission to promulgate rules requiring 17j-1 organizations to adopt codes of ethics.

In order to implement section 17(j), rule 17j-1 imposes certain requirements on 17j-1 organizations and “Access Persons”<sup>4</sup> of those organizations. The rule prohibits fraudulent, deceptive or manipulative acts by persons affiliated with a 17j-1 organization in connection with their personal securities transactions in securities held or to be acquired by the fund. The rule requires each 17j-1 organization, unless it is a money market fund or a fund that does not invest in Covered Securities,<sup>5</sup> to: (i) adopt a written codes of ethics, (ii) submit the code and any material changes to the code, along with a certification that it has adopted procedures reasonably necessary to prevent Access Persons from violating the code of ethics, to the fund board for approval, (iii) use reasonable diligence and institute procedures reasonably necessary to prevent violations of the code, (iv) submit a written report to the fund describing any issues arising under the code and procedures and certifying that the 17j-1 entity has adopted procedures reasonably necessary to prevent Access Persons form violating the code, (v) identify Access Persons and notify them of their reporting obligations, and (vi) maintain and make available to the

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<sup>4</sup> Rule 17j-1(a)(1) defines an “access person” as “Any advisory person of a Fund or of a Fund's investment adviser. If an investment adviser's primary business is advising Funds or other advisory clients, all of the investment adviser's directors, officers, and general partners are presumed to be Access Persons of any Fund advised by the investment adviser. All of a Fund's directors, officers, and general partners are presumed to be Access Persons of the Fund.” The definition of Access Person also includes “Any director, officer or general partner of a principal underwriter who, in the ordinary course of business, makes, participates in or obtains information regarding, the purchase or sale of Covered Securities by the Fund for which the principal underwriter acts, or whose functions or duties in the ordinary course of business relate to the making of any recommendation to the Fund regarding the purchase or sale of Covered Securities.” Rule 17j-1(a)(1).

<sup>5</sup> A “Covered Security” is any security that falls within the definition in section 2(a)(36) of the Act, except for direct obligations of the U.S. Government, bankers’ acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements, and shares issued by open-end funds. Rule 17j-1(a)(4).

Commission for review certain records related to the code of ethics and transaction reporting by Access Persons.

The rule requires each Access Person of a fund (other than a money market fund or a fund that does not invest in Covered Securities) and of an investment adviser or principal underwriter of the fund, who is not subject to an exception,<sup>6</sup> to file: (i) within 10 days of becoming an Access Person, a dated initial holdings report that sets forth certain information with respect to the access person's securities and accounts; (ii) dated quarterly transaction reports within 30 days of the end of each calendar quarter providing certain information with respect to any securities transactions during the quarter and any account established by the Access Person in which any securities were held during the quarter; and (iii) dated annual holding reports providing information with respect to each Covered Security the Access Person beneficially owns and accounts in which securities are held for his or her benefit. In addition, rule 17j-1 requires investment personnel of a fund or its investment adviser, before acquiring beneficial ownership in securities through an initial public offering (IPO) or in a private placement, to obtain approval from the fund or the fund's investment adviser.

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<sup>6</sup> Rule 17j-1(d)(2) contains the following exceptions: (i) an Access Person need not file a report for transactions effected for, and securities held in, any account over which the Access Person does not have control; (ii) an independent director of the fund, who would otherwise not need to report and who does not have information with respect to the fund's transactions in a particular security, does not have to file an initial holdings report or a quarterly transaction report; (iii) an Access Person of a principal underwriter of the fund does not have to file reports if the principal underwriter is not affiliated with the fund (unless the fund is a unit investment trust) or any investment adviser of the fund and the principal underwriter of the fund does not have any officer, director, or general partner who serves in one of those capacities for the fund or any investment adviser of the fund; (iv) an Access Person to an investment adviser need not make quarterly reports if the report would duplicate information provided under the reporting provisions of the Investment Adviser's Act; and (v) an Access Person need not make quarterly transaction reports if the information provided in the report would duplicate information received by the 17j-1 organization in the form of broker trade confirmations or account statements or information otherwise in the records of the 17j-1 organization.

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

Rule 17j-1 provides for oversight by a fund's board of the codes of ethics and procedures employed by the fund, its investment advisers and underwriters to prevent fraudulent, deceptive, or manipulative acts in connection with the purchase or sale by persons associated with those entities of securities held or to be acquired by the fund. Without the rule, fund boards and the Commission would be hampered in their ability to monitor fully the conduct of such persons for activities that are fraudulent, deceptive or manipulative.

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

Some 17j-1 entities employ computerized transaction reporting and recordkeeping systems to reduce the burden in connection with rule 17j-1. Although these systems can impose substantial start-up and maintenance costs, they can help to reduce the information collection burdens arising under rule 17j-1. The Commission permits the use of such technologies to comply with rule 17j-1.

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

The Commission is not aware of any duplicate reporting or recordkeeping requirements. Rule 17j-1(d)(2)(iv) under the Investment Company Act relieves an access person of the duty to file reports if those reports would duplicate reports required by rules under the Investment Advisers Act of 1940.<sup>7</sup> Rule 17j-1(d)(2)(v) under the Act exempts an Access Person from filing the quarterly transaction report if it would duplicate information already received by the 17j-1 organization in the form of broker trade confirmations or account statements or information otherwise in the records of the 17j-1 organization.

Information collected under the rule is intended to improve board oversight of personal investment activities of fund personnel. Similar information would not achieve that goal.

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Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (Jul. 2, 2004) (66 FR 41696 (Jul. 9, 2004)).

**5. Effect on Small Entities**

All rule 17j-1 organizations, regardless of size, must adopt a code of ethics and keep records of reports submitted by Access Persons. The reporting and recordkeeping requirements for small entities could not be reduced without risking harm to investors' interests.

**6. Consequences of Less Frequent Collection**

In order for fund boards to play a meaningful oversight role, it is necessary for them to receive no less frequently than annually reports from the fund, its investment advisers and underwriters regarding issues arising under the code of ethics. Rule 17j-1, by requiring Access Persons to provide initial holdings reports, quarterly transactions reports, and annual holdings reports, enables rule 17j-1 organizations to monitor the securities transactions of Access Persons to ensure compliance with their codes of ethics. Less frequent collection of such reports would hinder these organizations from enforcing their codes.

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

Not applicable.

**8. Consultation Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 17j-1 before it submitted this request for approval to the Office of Management and Budget. The Commission received no comments in response to this request.

More generally, the Commission and the staff participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon the paperwork burdens confronting the industry.

**9. Payment or Gift to Respondents**

Not applicable.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

The staff spoke with representatives of a number of 17j-1 entities. Based upon these conversations and its experience with the industry, the staff has made estimates with respect to the reporting burden. As noted above, Access Persons must file initial and annual holdings reports and quarterly transaction reports. Investment personnel must obtain approval before acquiring beneficial ownership in any securities through an IPO or private placement. In addition, rule 17j-1 organizations have a number of responsibilities, most of which are carried out at the fund complex level<sup>8</sup>, arising from information collection requirements under rule 17j-1. They must notify Access Persons of their reporting obligations, prepare an annual rule 17j-1 report and certification for the board, document their approval or rejection of IPO and private placement requests, maintain annual rule 17j-1 records, maintain electronic reporting and recordkeeping systems, amend their codes of ethics as necessary, and, for new fund complexes, adopt a code of ethics.

The estimated burdens associated with these information collections are set forth in the table below.

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<sup>8</sup> We estimate that there are approximately 550 fund complexes currently operating, with an average of 2 boards for each complex, for a total of 1,100 boards that give annual certifications.

<b>Information Collection</b>	<b>Annual Hours Per Person or Complex</b>	<b>Annual Aggregate Hours</b>	<b>Person Responsible</b>	<b>Hourly Rate (\$)<sup>9</sup></b>	<b>Annual Aggregate Cost (\$)</b>
Initial Holdings Report	¾	3,300 <sup>10</sup>	New Access Person	75 <sup>11</sup>	247,500 <sup>12</sup>
Quarterly Transaction Report	¼	6,250 <sup>13</sup>	Access Person	75	468,750 <sup>14</sup>
Annual Holdings Report	⅓	23,100 <sup>15</sup>	Access Person	75	1,732,500 <sup>16</sup>
IPO/Private Placement Preapproval Request	1	3,300 <sup>17</sup>	Investment Personnel	75	247,500 <sup>18</sup>
Informing Access Persons of Reporting Obligation	2½	1,375	Junior Compliance Officer	227	312,125 <sup>19</sup>

<sup>9</sup> All hourly rates used in this analysis (except for the “access person” rate of \$75 per hour) are derived from salaries reported in Securities Industry Association, Management and Professional Earnings in the Securities Industry (2005) and Securities Industry Association, Office Salaries in the Securities Industry (2005) modified to account for an 1800-hour work-year and multiplied by 2.93 or 5.95 to account for bonuses, firm size, employee benefits and overhead.

<sup>10</sup> We estimate that there are approximately 8 new access persons per fund complex each year and 4400 total new access persons each year (8 new access persons × 550 fund complexes = 4400 new access persons). In addition, we estimate that the total number of access persons remains approximately steady due to attrition.

<sup>11</sup> Although hourly rates of respondents differ, we estimate that, on average, the time for Access Persons required to complete initial holdings reports and other transaction reports costs \$75 per hour.

<sup>12</sup> This is based on the following calculations: (4400 new access persons × .75 hour = 3,300 hours; 3,300 hours × \$75 rate = \$247,500).

<sup>13</sup> We estimate that annually 25,000 quarterly transactions reports are filed. Access Persons do not have to file such reports in certain instances including, for example, when they have not engaged in any securities transactions during a particular quarter, or when the relevant information is contained in duplicate broker trade confirmations or account statements received by the firm.

<sup>14</sup> This is based on the following calculations: (25,000 quarterly reports × .25 hour = 6,250 hours; 6,250 hours × \$75 rate = \$468,750).

<sup>15</sup> Each of the approximately 70,000 access persons must file an annual holdings report.

<sup>16</sup> This is based on the following calculations: (70,000 annual reports × .33 hour = 23,100 hours; 23,100 hours × \$75 rate = \$1,732,500).

<sup>17</sup> We estimate that each of the 550 fund complexes receives approximately 6 such requests each year, for a total of approximately 3,300 such requests filed each year.

<sup>18</sup> This is based on the following calculations: (3,300 IPO requests × 1 hour = 3,300 hours; 3,300 hours × \$75 rate = \$247,500).

<sup>19</sup> This is based on the following calculations: (550 fund complexes × 2.5 hours = 1,375 hours; 1,375 hours × \$227 rate = \$312,125).

Information Collection	Annual Hours Per Person or Complex	Annual Aggregate Hours	Person Responsible	Hourly Rate (\$)	Annual Aggregate Cost (\$)
Preparation of Annual Report to Board and Certification	5	2,750	Chief Compliance Officer (50%) <u>Attorney for Fund Complex (50%)</u>	433 <u>310</u>	1,021,625 <sup>20</sup>
Documentation of IPO/Private Placement Approval/Rejection	3 (½ hour per request)	1650	Chief Compliance Officer	433	714,450 <sup>21</sup>
Rule 17j-1 Recordkeeping	180	99,000	Chief Compliance Officer (5%) <u>Compliance Clerk (95%)</u>	433 <u>38</u>	5,717,250 <sup>22</sup>
Maintenance of Computer Systems for Use in 17j-1 Reporting and Recordkeeping	50	27,500	Chief Compliance Officer (20%) <u>Computer Programmer (80%)</u>	433 <u>199</u>	6,759,500 <sup>23</sup>

<sup>20</sup> This is based on the following calculations: (550 fund complexes × 5 hours = 2,750 hours; 2750 ÷ 2 = 1,375 hours (50% division between CCO and attorney); 1,375 hours × \$433 rate = \$595,375 CCO costs; 1,375 hours × \$310 rate = \$426,250 attorney costs; \$595,375 CCO costs + \$426,250 attorney costs = \$1,021,625 total costs).

<sup>21</sup> This is based on the following calculations: (3,300 IPO requests × .5 hour for processing each request = 1,650 hours; 1,650 hours × \$433 rate = \$714,450).

<sup>22</sup> This is based on the following calculations: (550 fund complexes × 180 hours = 99,000 hours; 99,000 × .95 = 94,050 hours clerk time (4,950 hours CCO time with a 95% and 5% division between clerk and CCO ); 4,950 CCO hours × \$433 rate = \$2,143,350 CCO costs; 94,050 clerk hours × \$38 rate = \$3,573,900 clerk costs; \$2,143,350 CCO costs + \$3,573,900 clerk costs = \$5,717,250 total costs).

<sup>23</sup> This is based on the following calculations: (550 fund complexes × 50 hours = 27,500 hours; 27,500 × .80 = 22,000 hours programmer time (5,500 hours CCO time with a 80% and 20% division between programmer and CCO ); 5,500 CCO hours × \$433 rate = \$2,381,500 CCO costs; 22,000 programmer hours × \$199 rate = \$4,378,000 programmer costs; \$2,381,500 CCO costs + \$4,378,000 programmer costs = \$6,759,500 total costs).



Information Collection	Annual Hours Per Person or Complex	Annual Aggregate Hours	Person Responsible	Hourly Rate (\$)	Annual Aggregate Cost (\$)
Preparation of New Code of Ethics for New Fund Complex	25	625 <sup>24</sup>	Chief Compliance Officer (50%) <u>Attorney for Fund Complex (50%)</u>	433 <u>310</u>	232,188 <sup>25</sup>
Preparation of Material Amendments to Existing Codes of Ethics	2 (4 hours every other year)	1,100	Chief Compliance Officer (50%) <u>Attorney for Fund Complex (50%)</u>	433 <u>310</u>	408,650 <sup>26</sup>
<b>TOTAL</b>		<b>169,950</b>			<b>17,862,038</b>

We estimate that annually there are approximately 75,363 respondents under rule 17j-1, of which 5,363 are rule 17j-1 organizations<sup>27</sup> and 70,000 are Access Persons.<sup>28</sup> In the aggregate, these respondents make approximately 113,970 responses annually.<sup>29</sup> As the table shows, we

<sup>24</sup> We estimate that there are approximately 25 new fund complexes formed each year.

<sup>25</sup> This is based on the following calculations: (25 new fund complexes × 25 hours = 625 hours; 625 hours ÷ 2 = 312.5 hours (50% division between CCO and attorney); 312.5 hours × \$433 rate = \$135,313 CCO costs; 312.5 hours × \$310 rate = \$96,875 attorney costs; \$135,313 CCO costs + \$96,875 attorney costs = \$232,188 total costs).

<sup>26</sup> This is based on the following calculations: (550 fund complexes × 2 hours = 1,100 hours; 1,100 ÷ 2 = 550 hours (50% division between CCO and attorney); 550 hours × \$433 rate = \$238,150 CCO costs; 550 hours × \$310 rate = \$170,500 attorney costs; \$238,150 CCO costs + \$170,500 attorney costs = \$408,650 total costs).

<sup>27</sup> Currently, there are approximately 4,106 active funds, approximately 802 investment advisers to funds, and approximately 455 principal underwriters to funds, for a total of 5363 17j-1 organizations.

<sup>28</sup> This number is based on discussions with representatives of small, medium, and large fund complexes.

<sup>29</sup> This estimate is based on the following calculation: (4,400 initial holdings reports by access persons + 25,000 quarterly transaction reports by access persons + 70,000 annual holdings reports by access persons + 5,070 preapproval requests by access persons for purchases of initial public offerings and private placements + 1100 annual certifications by fund boards + 275 annual material amendments + 25 new codes of ethics for new fund complexes = 113,970 annual responses).

estimate that the total annual burden of complying with the information collection requirements in rule 17j-1 is approximately 169,950 hours and the cost of those hours is approximately \$17,862,038.

The estimate of average burden hours is made solely for the purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of Commission rules. Reporting burdens may differ substantially across respondents.

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

We estimate that there is an annual cost burden of approximately \$2,000 per fund complex, for a total of \$1,100,000<sup>30</sup>, associated with complying with the information collection requirements in rule 17j-1, aside from the cost of the burden hours discussed above.<sup>31</sup> This represents the costs of purchasing and maintaining computers and software to assist funds in carrying out rule 17j-1 recordkeeping. The estimate of average cost burden is made solely for the purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of Commission rules. Reporting burdens may differ substantially across respondents.

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

There is no cost to the federal government of administering the information collection requirements in rule 17j-1 under the Investment Company Act.

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<sup>30</sup> This estimate is based on the following calculation: (\$2000 software costs × 550 fund complexes = \$1,100,000 total costs).

<sup>31</sup> The cost burden associated with filing of new and amended codes of ethics on the Commission's Electronic Data Gathering, Analysis, and Retrieval system (EDGAR) is included in the Paperwork Reduction Act estimates for the relevant forms to which these codes must be appended.

**15. Explanation of Changes in Burden**

The decrease from 243,884 to 169,950 burden hours reflects a change in the estimated number of Access Persons and fund complexes. In addition, the decrease reflects adjustments we made in response to discussions with representatives of fund complexes about their experiences in complying with rule 17j-1. Some of the changes in the burden hours for particular requirements are attributable to increasing reliance on computers. However, the primary factor in the decrease is an adjustment in the estimated number of fund complexes currently operating.

The increase in costs associated with the collections of information from \$845,000 to \$1,100,000 is primarily attributable to an increase in the estimated costs of purchasing and maintaining computers and software to assist with 17j-1 recordkeeping. Fund complexes are relying increasingly on computers to assist them in complying with the information collection requirements under rule 17j-1 and must purchase and maintain the computer systems they develop for these purposes.

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

Not applicable.

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

Not applicable.

**18. Exception to Certification Statement**

Not applicable.

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

Not applicable.

