

**SUPPORTING STATEMENT**  
**RULE 12b-2**

**A. JUSTIFICATION**

**1. Necessity for the Collection of Information**

Section 12(b) of the Investment Company Act of 1940 (“the Act”) (15 U.S.C. 80a-12(b)) prohibits a registered open-end investment company (“fund” or “mutual fund”) from acting as a distributor of securities that it has issued, except through an underwriter, in contravention of Commission rules.

On July 21, 2010, the Commission issued a release proposing to replace rule 12b-1 under the Act (17 CFR 270.12b-1) with new rule 12b-2 (17 CFR 270.12b-2).<sup>1</sup> New rule 12b-2 would permit a mutual fund to bear expenses associated with the distribution of its shares, provided that the fund complies with certain requirements. Among other things, new rule 12b-2 would require that a fund (and its board of directors) approve policies and procedures designed to prevent: (i) the persons responsible for selecting brokers and dealers to effect the fund's portfolio securities transactions from taking into account the brokers' and dealers' promotion or sale of shares issued by the fund or any other registered investment company; and (ii) the

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<sup>1</sup> See Mutual Fund Distribution Fees; Confirmations, Release Nos. 33-9128; 34-62544; IC-29367 (July 21, 2010).

fund, or any investment adviser or principal underwriter of the fund, from entering into any agreement or other understanding under which the fund directs portfolio securities transactions to a broker or dealer to pay for the distribution of fund shares. The requirement to adopt these policies and procedures would be a collection of information under the PRA, and would be mandatory in order to direct brokerage transactions to a broker or dealer that distributes fund shares.

New rule 12b-2 is a recordkeeping rule. It requires funds to create (and record) policies and procedures that prevent fund personnel from choosing which brokers they will use to perform their portfolio transactions based on what that broker does in terms of distributing fund shares. This is necessary to protect against the inappropriate use of fund assets to finance distribution. The Commission has determined that this collection of information would be

necessary to protect against the inappropriate use of fund assets to finance distribution, and

would be used by the Commission and its examination staff to monitor these activities.

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

New rule 12b-2 would enable funds to use their own assets to pay for distribution of fund shares. The requirement is for mutual funds, or their advisers, to implement and their boards approve policies and procedures to prevent persons responsible for the fund from taking distribution efforts into account. It is designed to ensure that the funds' selection of brokers that will participate in the fund's portfolio securities transactions is not influenced by considerations regarding the sale of fund shares.

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

The Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") provides for the automated filing, processing and dissemination of full disclosure filings. The automation provides for speed, accuracy and public availability of information, generating benefits to investors and financial markets. Although new rule 12b-2 would not require the filing of any documents with the Commission, the Commission may use its EDGAR facility in the future to improve the examination of records funds must keep under the rule. The Electronic Signatures in Global and National

Commerce Act and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

#### **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 form, or a change in either. New rule 12b-2 would not require duplicative reporting or recordkeeping. Although new rule 12b-2 and existing rule 12b-1 have identical collections of information, the Commission proposes to rescind rule 12b-1 upon adoption of new rule 12b-2. Furthermore, although the requirement for policies and procedures is encompassed by the more general requirement for compliance policies and procedures contained in rule 38a-1 under the Investment Company Act,<sup>2</sup> the requirement is intended to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute the fund's shares.

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

The recordkeeping requirements of new rule 12b-2 are the same for all funds that choose to rely on the rule, including small entities. New rule 12b-2 would not be mandatory, and funds may choose other distribution arrangements. All funds that use their selling brokers to execute fund

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<sup>2</sup>

17 CFR 270.38a-1.

portfolio securities transactions are required to adopt policies and procedures. The Commission does not believe that compliance with new rule 12b-2 would be unduly burdensome for small entities.

**6. Consequences of Less Frequent Collection**

New rule 12b-2 would require that funds implement (and their boards approve) policies and procedures to prevent distribution efforts from being a factor in the selection of executing brokers before using a broker that sells fund shares to execute portfolio transactions. This requirement is necessary to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute the fund's shares.

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

Not applicable.

**8. Consultation Outside the Agency**

The collection of information in new rule 12b-2 is identical to one of the collections of information in rule 12b-1. The Commission has sought and received public comments on rule 12b-1 and each rule amendment before its adoption.<sup>3</sup> In addition, before submitting this request for approval of the

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See, e.g., Investment Company Act Release No. 26356 (Feb. 24, 2004)

information collections under new rule 12b-2, the Commission requested public comment on those information collections. In addition, the Commission and the staff of the Division of Investment Management continue to participate in an ongoing dialogue with representatives of the mutual fund industry through public conferences, meetings and informal exchanges. These various forums assist the Commission and its staff to ascertain the magnitude of 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**

Based on our experience with rule 12b-1, which contains the same collection of information as new rule 12b-2, we understand that funds (if they intend to pay brokerage commissions to brokers and dealers who distribute

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(69 FR 9726 (Mar. 1, 2004)).

their shares) generally adopt these policies and procedures when the fund is created, and incur any burden associated with this collection of information at that time. We assume that all funds that are currently operating have already adopted these policies and procedures (if relevant), and therefore only new funds that begin to operate in the future will incur this burden.

The staff estimates that approximately 300 new funds would begin operations annually that would comply with new rule 12b-2(c) and adopt these policies and procedures. Based on information received during conversations with fund representatives, the staff estimates that adopting these policies and procedures would take a total of approximately 1 hour of the board of directors' time as a whole, at an internal time cost equivalent rate of \$4500 per hour.<sup>4</sup> The staff further estimates that preparing these policies and procedures for adoption would take approximately 3 hours of internal fund counsel time, at an internal time cost equivalent rate of \$316 per hour.<sup>5</sup>

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<sup>4</sup> The staff has estimated the average cost of board of director time as \$4500 per hour for the board as a whole, based on information received from funds, intermediaries, and their counsel.

<sup>5</sup> The staff estimates that the internal time cost equivalent for time

Therefore, the collection of information related to adopting directed brokerage policies and procedures pursuant to new rule 12b-2(c) would require a total annual burden of 300 hours of director time (at a total internal time cost equivalent of \$1,350,000),<sup>6</sup> 900 hours of inside counsel time (at a total internal time cost equivalent of \$284,400).<sup>7</sup> The total annual number of respondents would be 300, the total number of responses would also be 300, and the annual burden per respondent would be 4 hours.

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spent by internal counsel is \$316 per hour. This estimate, as well as all other internal time cost estimates made in this analysis (unless otherwise noted) is derived from SIFMA's Management & Professional Earnings in the Securities Industry 2009, 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 or from SIFMA's Office Salaries in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

<sup>6</sup> This estimate is based on the following calculations: (1 hour of directors time × 300 newly formed funds = 300 hours); (300 hours × \$4500 per hour = \$1,350,000).

<sup>7</sup> This estimate is based on the following calculation: (3 hours of inside counsel time × 300 newly formed funds = 900 hours); (900 hours × \$316 per hour = \$284,400).



Thus, the staff estimates that the aggregate burden to comply with new rule 12b-2 would be 1200 burden hours per year, at an internal time cost equivalent of \$1,634,400 per year.<sup>8</sup> These estimates are made solely for the purposes of the Paperwork Reduction Act. They are not derived from a comprehensive or even representative survey or study of the costs of Commission rules.

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

The staff estimates that it would cost each fund approximately \$800 in outside counsel time (2 hours multiplied by an estimated \$400 per hour for outside counsel time)<sup>9</sup> to adopt these policies and procedures. Thus, the total annual cost burden to all funds to adopt these policies and procedures would be \$240,000.<sup>10</sup>

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<sup>8</sup> These estimates are based on the following calculations: (300 hours) + (900 hours) = 1200 hours; \$284,400 + \$1,350,000 = \$1,634,400.

<sup>9</sup> The staff has estimated the average cost of outside counsel as \$400 per hour based on information received from funds, intermediaries, and their counsel.

<sup>10</sup> This estimate is based on the following calculation: (\$800 cost of outside counsel time × 300 newly formed funds = \$240,000).

In addition, if a currently operating fund seeks to materially increase the amount it spends for distribution, new rule 12b-2 would require that the fund obtain shareholder approval.<sup>11</sup> As a consequence, the fund will incur the cost of a proxy. Based on conversations with fund representatives, Commission staff estimates that approximately three funds per year would prepare a proxy in connection with the material increase of the amount it spends for distribution. Funds typically hire outside legal counsel and proxy solicitation firms to prepare, print, and mail such proxies. The staff further estimates that the cost of each fund's proxy would be \$30,000. Thus, the total annual cost burden to all funds to obtain shareholder approval would be \$90,000.<sup>12</sup>

Thus, the total annual cost burden of new rule 12b-2 to the fund industry would be \$330,000.<sup>13</sup>

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<sup>11</sup> Rule 12b-2 would not require the fund to obtain the approval of its public shareholders to institute or increase the amount it spends for distribution in a new class of fund shares.

<sup>12</sup> This estimate is based on the following calculation: (3 funds requiring a proxy x \$30,000 per proxy) = \$90,000.

<sup>13</sup> This estimate is based on the following calculation: \$90,000 + \$240,000 = \$330,000.

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

New rule 12b-2 would not impose any costs on the federal government. The rule would not require funds to file any documents with the Commission.

**15. Explanation of Changes in Burden**

Not applicable.

**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.