

## SUPPORTING STATEMENT

### FOR THE PAPERWORK REDUCTION ACT SUBMISSION FOR A CURRENT INFORMATION COLLECTION

#### “Rule 19b-1”

#### A. JUSTIFICATION

##### 1. Necessity for the Information Collection

Section 19(b) of the Investment Company Act of 1940 (the “Act”) (15 U.S.C. 80a-19(b)) authorizes the Commission to regulate registered investment company (“fund”) distributions of long-term capital gains made more frequently than once every twelve months. Rule 19b-1 under the Act<sup>1</sup> prohibits funds from distributing long-term capital gains more than once every twelve months unless certain conditions are met. Rule 19b-1(c) permits unit investment trusts (“UITs”) engaged exclusively in the business of investing in certain eligible fixed-income securities to distribute long-term capital gains more than once every twelve months, if: (i) the capital gains distribution falls within one of several categories specified in the rule<sup>2</sup> and (ii) the distribution is accompanied by a report to the unitholder that clearly describes the distribution as a capital gains distribution (the “notice requirement”).<sup>3</sup> Rule 19b-1(e) permits a fund to apply to the Commission for permission to distribute long-term capital gains more than once a year if the fund did not foresee the circumstances that created the need for the distribution. The application must set forth the pertinent facts and explain the

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<sup>1</sup> 17 CFR 270.19b-1.

<sup>2</sup> 17 CFR 270.19b-1(c)(1).

<sup>3</sup> The notice requirement in rule 19b-1(c)(2) supplements the notice requirement of section 19(a) [15 U.S.C. 80a-19(a)] and rule 19a-1 [17 CFR 270.19a-1], which requires any distribution in the nature of a dividend payment made by a fund to its investors to be accompanied by a notice disclosing the source of the distribution.

circumstances that justify the distribution.<sup>4</sup> An application that meets those requirements is deemed to be granted unless the Commission denies the request within 15 days after the Commission receives the application.

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

Section 19(b) of the Act reflects Congress's concern that investors could confuse regular distributions of capital gains with distributions of investment income.<sup>5</sup> The purpose of the notice requirement in rule 19b-1(c)(2) is to ensure that investors are aware that a distribution consists of long-term capital gains.

Paragraph (e) of rule 19b-1 allows a fund, in unforeseen circumstances, to request timely authorization to make a distribution that would not otherwise be permitted by the rule.<sup>6</sup> The Commission uses the information required by paragraph (e) to determine whether a request should be granted under this paragraph.

## **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. Effective

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<sup>4</sup> Rule 19b-1(e) also requires that the application comply with rule 0-2 [17 CFR 270.02], which sets forth the general requirements for papers and applications filed with the Commission.

<sup>5</sup> See Report of the Committee on Banking and Currency, S. Rep. No. 184, 91st Cong., 1st Sess. 29 (May 21, 1969); see also SEC, Public Policy Implications of Investment Company Growth, H. Rep. No. 2337, 89th Cong., 2d Sess. 191-96 (Dec. 2, 1966); Rule Proposal for Unit Investment Trusts Start-Up Exemptions and Proposed Revision of Rule Regarding Pricing of Investment Company Shares Generally, Investment Company Act Release No. 10545 (Jan. 8, 1979) [44 FR 3376, 3379 (Jan. 16, 1979)].

<sup>6</sup> See Adoption of Rule 19b-1 Under the Investment Company Act of 1940 Limiting the Frequency of Distributions of Capital Gains by Registered Investment Companies, Investment Company Act Release No. 6834 (Nov. 23, 1971) [36 FR 232 (Dec. 2, 1971)].

January 1, 2009 applications for orders under any section of the Investment Company Act are required to be filed electronically on EDGAR.

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

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates those requirements whenever it proposes a rule or form, or a change in either. Rule 19b-1 does not require duplicative reporting.

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

The information collection requirements of rule 19b-1 apply to all funds that rely on paragraphs (c) or (e) of the rule to distribute long-term capital gains more than once a year. The notice requirement of rule 19b-1(c) is necessary to ensure that a unitholder of a UIT is aware that a distribution is a capital gains distribution. The paperwork burdens that rule 19b-1(e) imposes are essential to facilitate review by Commission staff of requests made pursuant to that paragraph. The Commission believes that compliance with these collection of information requirements is not unduly burdensome for either large or small entities, and that the shareholders of small entities, along with the shareholders of large entities, are entitled to the protections that give rise to the paperwork burdens.

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

Rule 19b-1(c)(2) requires each distribution of capital gains made pursuant to the rule to be accompanied by a notice explaining that the distribution contains capital gains. If the notice were not required to accompany each distribution made in reliance on paragraph (c)(2) of the rule, unitholders might not be aware of the source of the distribution.

Likewise, the collection of information requirements of rule 19b-1(e) occur only when a fund needs to request permission to distribute long-term capital gains due to unforeseen circumstances.

**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 19b-1 before it submitted this request for extension and approval to the Office of Management and Budget (“OMB”). The Commission received no comments in response to this request. The Commission and the 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. These forums provide the Commission and the staff useful means to identify and address paperwork burdens that may confront 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**

Commission staff estimates that, on average, each year six funds file an application under rule 19b-1(e). The staff understands that funds that file an application generally use outside counsel to prepare the application. The cost burden of using

outside counsel is discussed in Item 13 below. The staff estimates that, on average, the fund's investment adviser spends approximately 4 hours to review an application, including 3.5 hours by an assistant general counsel, at a cost of \$354 per hour, 0.5 hours by an administrative assistant, at a cost of \$66 per hour, and the fund's board of directors spends an additional 1 hour, at a cost of \$4,000 per hour, for a total of 5 hours.<sup>7</sup> Thus, the Commission staff estimates that the annual hour burden of the collection of information imposed by rule 19b-1 is approximately five hours per fund, at a cost of \$5,272, for a total burden of 30 hours at a cost of \$31,632.<sup>8</sup>

The Commission staff estimates that there is no hour burden associated with complying with the collection of information component of rule 19b-1(c).

The estimate of average burden hours is made solely for purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of the costs of Commission rules.

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

As noted above, the Commission staff understands that funds that file an application under rule 19b-1(e) generally use outside counsel to prepare the application.<sup>9</sup> The staff estimates that, on average, outside counsel spends 10 hours preparing a rule 19b-1(e) application, including eight hours by an associate and two hours by a partner.

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<sup>7</sup> Estimates for attorneys and administrative assistants are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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. The estimate of \$4000 per hour for the board of directors as a whole is based on a staff review and analysis and conversations with industry participants

<sup>8</sup> This estimate is based on the following calculations: \$1239 (3.5 hours × \$354 = \$1239) plus \$33 (0.5 hours × \$66 = \$33) plus \$4000 equals \$5272 (cost of one application); \$5272 × 6 applications = \$31,632 total cost.

<sup>9</sup> This understanding is based on conversations with representatives from the fund industry.

Outside counsel billing arrangements and rates vary based on numerous factors, but the staff has estimated the average cost of outside counsel as \$400 per hour, based on information received from funds, intermediaries, and their counsel. The staff therefore estimates that the average cost of outside counsel preparation of the 19b-(e) exemptive application is \$4,000.<sup>10</sup> Thus, the staff estimates that the total annual cost burden imposed by the exemptive application requirements of rule 19b-1(e) is \$24,000.<sup>11</sup>

The Commission staff estimates that there are approximately 3,759 UITs<sup>12</sup> that may rely on rule 19b-1(c) to make capital gains distributions. The staff estimates that, on average, these UITs rely on rule 19b-1(c) once a year to make a capital gains distribution.<sup>13</sup> In most cases, the trustee of the UIT is responsible for preparing and sending the notices that must accompany a capital gains distribution under rule 19b-1(c)(2). These notices require limited preparation, the cost of which accounts for only a small, indiscrete portion of the comprehensive fee charged by the trustee for its services to the UIT. The staff believes that as a matter of good business practices, and for tax preparation reasons, UITs would collect and distribute the capital gains information required to be sent to unitholders under rule 19b-1(c) even in the absence of the rule. The staff estimates that the cost of preparing a notice for a capital gains distribution under rule

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<sup>10</sup> This estimate is based on the following calculation: 10 hours multiplied by \$400 per hour equals \$4,000.

<sup>11</sup> This estimate is based on the following calculation: \$4,000 multiplied by 6 (funds) equals \$24,000.

<sup>12</sup> The Investment Company Institute, Unit Investment Trust Data, (January 2011).

<sup>13</sup> The number of times UITs rely on the rule to make capital gains distributions depends on a wide range of factors and, thus, can vary greatly across years. A number of UITs are organized as grantor trusts, and therefore do not generally make capital gains distributions under rule 19b-1(c), or may not rely on rule 19b-1(c) as they do not meet the rule's requirements. Other UITs may distribute capital gains biannually, annually, quarterly, or at other intervals.

19b-1(c)(2) is approximately \$50. There is no separate cost to mail the notices because they are mailed with the capital gains distribution. Thus, the staff estimates that the capital gains distribution notice requirement imposes an annual cost on UITs of approximately \$187,950.<sup>14</sup> The staff therefore estimates that the total cost imposed by rule 19b-1 is \$211,950 (\$187,950 plus \$24,000 equals \$211,950). This cost estimate is made solely for purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of the costs of Commission rules.

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

This rule does not impose any additional costs on the Federal Government.

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

The estimated burden hours associated with rule 19b-1 have increased from the current allocation of 20 hours to 30 hours, an increase of 10 hours. This increase in the time burden is due to an increase in the number of funds filing applications for exemptive orders (from 5 to 6 per year), and a slight increase in the staff's estimate of hours required to prepare an exemptive application (from 4 to 5).

The estimated cost burden of \$326,500 has decreased to \$211,950, a reduction of \$114,550. The decrease in the cost burden is largely due to a decrease in the estimated total number of respondents to the rule from 6,035 (6,030 UITs plus 5 funds filing an application under rule 19b-1(e)) to 3,765 (3,759 UITs plus 6 funds filing an application under rule 19b-1(e)). The cost burden has also been adjusted to reflect the staff's updated estimates of hourly salary rates and cost of preparation of applications.

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<sup>14</sup> This estimate is based on the following calculation: 3759 UITs multiplied by \$50 equals \$187,950.

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

Not applicable.

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

We request authorization to omit the expiration date on the electronic version of the information collection for design and project scheduling reasons. The OMB control number will be displayed.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.