

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission
“Rule 12d1-1”

A. JUSTIFICATION

1. Necessity for the Information Collection

An investment company (“fund”) is generally limited in the amount of securities the fund (“acquiring fund”) can acquire from another fund (“acquired fund”). Section 12(d) of the Investment Company Act of 1940 (the “Investment Company Act” or “Act”)¹ provides that 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.²

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.³

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.⁴ An acquiring fund relying on the exemption may not pay a sales load, distribution fee, or service fee on acquired fund shares, or if

¹ See 15 U.S.C. 80a.

² 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.

³ See 15 U.S.C. 80a-12(d)(1)(B).

⁴ See 17 CFR 270.12d1-1.

it does, the acquiring fund's investment adviser must waive a sufficient amount of its advisory fee to offset the cost of the loads or distribution fees.⁵ 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) of the Act and rule 17d-1 thereunder, which restrict a fund's ability to enter into transactions and joint arrangements with affiliated persons.⁶ These provisions would otherwise prohibit an acquiring fund from investing in a money market fund in the same fund complex,⁷ and 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.⁸

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-7.⁹ In addition, the acquiring fund must reasonably believe that the

⁵ See rule 12d1-1(b)(1).

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

⁷ 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) (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) (definition of "control"). 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.

⁸ See 15 U.S.C. 80a-2(a)(3)(A), (B).

⁹ See 17 CFR 270.2a-7.

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 Act¹⁰ as if it were a registered open-end fund, (iii) has adopted procedures designed to ensure that it complies with these statutory provisions, (iv) maintains the records required by rules 31a-1(b)(1), 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9);¹¹ 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 31a-1 with which the acquiring fund reasonably believes the unregistered money market fund complies are collections of information for the unregistered money market fund. The adoption of procedures by unregistered money market funds to ensure that they comply with sections 17(a), (d), (e), 18, and 22(e) of the Act also constitute collections of information. 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

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

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

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 funds to maintain many types of records on micrographic and electronic storage media.

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.

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 are 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, registered funds may invest in unregistered funds that meet certain conditions, including having an adviser that is registered with the Commission. 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 also inspects 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

No payment or gift to respondents is provided.

10. Assurance of Confidentiality

No assurance of confidentiality is provided.

11. Sensitive Questions

No questions of a sensitive nature are asked.

12. Estimate 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 applications that the Commission received in the past that sought relief for 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 2009 and 2010 PRA submissions regarding rule 2a-7 ("rule 2a-7 submissions").¹² The estimated average burden hours in this collection of information are

¹² 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 October 13, 2009); Securities and Exchange Commission, Request for

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 the rule 2a-7 submissions, Commission staff made the following estimates with respect to aggregate annual hour and cost burdens for collections of information for each existing registered money market fund:

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

81 responses
410 hours of professional time
Cost: \$79,130.

Public website posting of monthly portfolio information:

12 responses
4.4 burden hours of professional time
Cost: \$12,584

The staff estimates that registered funds currently invest in 30 unregistered money market funds in excess of the statutory limits under rule 12d1-1.¹³ Each of these unregistered money market funds engages in the collections of information described above. Accordingly, the staff

OMB Approval of Revision for Approved Collection for Rule 2a-7 under the Investment Company Act of 1940 (OMB Control No. 3235-0268) (approved April 18, 2010).

¹³ This estimate is based on the number of applications seeking exemptions to invest in unregistered money market funds filed with the Commission in 2005 (40), adjusted by the percentage change in registered money market funds from 2005 to November 2011 (870 to 641, according to the Investment Company Institute). This estimate may be understated because applicants generally did not identify the name or number of unregistered money market funds in which registered funds intended to invest, and each application also applies to unregistered money market funds to be organized in the future. Because the Commission adopted rule 12d1-1 in June 2006, 2005 is the last full year in which the Commission received applications seeking an exemption to invest in unregistered money market funds.

estimates that unregistered money market funds complying with the collections of information described above engage in a total of 2790 annual responses under rule 12d1-1,¹⁴ the aggregate annual burden hours associated with these responses is 12,432,¹⁵ and the aggregate annual cost to funds is \$2.75 million.¹⁶

In the rule 2a-7 submissions, Commission staff further estimated the aggregate annual hour and cost burdens for collections of information for fund complexes with registered money market funds as follows:

Review and revise procedures concerning stress testing:

1 response
7 burden hours of professional and director time
Cost: \$5650

Draft, compile, and provide stress testing reports to board of directors:

10 responses
27 burden hours of director, professional, and support staff time
Cost: \$69,990

Maintain records of stress testing reports to board of directors:

10 responses
0.2 burden hours of support staff time
Cost: \$103

Maintain records of creditworthiness evaluations of repurchase counterparties:

¹⁴ The estimate is based on the following calculations: (30 funds x 81 responses for documentation of credit analyses and other determinations) = 2340 responses. (30 funds x 12 responses for public website posting) = 360 responses. 2340 responses + 360 responses = 2790 responses.

¹⁵ This estimate is based on the following calculations: (30 funds x 410 hours for documentation of credit analyses and other determinations) = 12,300 hours. (30 funds x 4.4 hours for public website posting) = 132 hours. 12,300 hours + 132 hours = 12,432 hours.

¹⁶ This estimate is based on the following calculations: (30 funds x \$79,130) = \$2,373,900. (30 funds x \$12,584) = \$377,520. \$2,373,900 + \$377,520 = \$2,751,420.

1 response
2 burden hours of support staff time
Cost: \$124

Reporting of rule 17a-9 transactions:¹⁷

1 response
1 burden hour of legal time
Cost: \$305

In the rule 2a-7 submissions, Commission staff estimated that there are 163 fund complexes with 719 registered money market funds subject to rule 2a-7. The staff estimates that there are 30 fund complexes with unregistered money market funds invested in by mutual funds in excess of the statutory limits under rule 12d1-1.¹⁸ Each of these fund complexes engages in the collections of information described above. Accordingly, the staff estimates that these fund complexes complying with the collections of information described above engage in a total of 690 annual responses under rule 12d1-1,¹⁹ the aggregate annual burden hours associated with these responses is 1116,²⁰ and the aggregate annual cost to funds is \$2,285,160.²¹

¹⁷ See 17 CFR 270.17a-9.

¹⁸ Given the fact that exemptive applications are generally filed on behalf of fund complexes rather than individual funds, the staff estimates that each of the exemptive applications upon which its estimates of the number of unregistered money market funds is based represents a separate fund complex. See *supra* note 13.

¹⁹ The estimate is based on the following calculations: (30 fund complexes x 1 response for revision of procedures concerning stress testing) = 30 responses. (30 fund complexes x 10 responses to provide stress testing reports) = 300 responses. (30 fund complexes x 10 responses to maintain stress testing reports) = 300 responses. (30 fund complexes x 1 response to maintain records of creditworthiness) = 30 responses. (30 fund complexes x 1 response for reporting of rule 17a-9 transactions) = 30 responses. 30 responses + 300 responses + 300 responses + 30 responses + 30 responses = 690 responses.

²⁰ This estimate is based on the following calculations: (30 fund complexes x 7 hours for revision of procedures concerning stress testing) = 210 hours. (30 fund complexes x 27 hours to provide stress testing reports) = 810 hours. (30 fund complexes x 0.2 hours to maintain stress testing reports) = 6 hours. (30 fund complexes x 2 hours to maintain records of creditworthiness) = 60

In the rule 2a-7 submissions, the staff further estimated the aggregate annual burdens for registered money market funds that amend their board procedures as follows:

Amendment of procedures designed to stabilize the fund's net asset value:

1 response
2.4 burden hours of director time
Cost: \$2340

Consistent with the estimate in the rule 2a-7 submissions, Commission staff estimates that approximately 1/4, or 8, unregistered money market funds review and amend their board procedures each year. Accordingly, the staff estimates that unregistered money market funds complying with this collection of information requirement engage in a total of 8 annual responses under rule 12d1-1,²² the aggregate annual burden hours associated with these responses is 19,²³ and the aggregate annual cost to funds to comply with this collection of information is \$18,720.²⁴

In the rule 2a-7 submissions, Commission staff further estimated the aggregate annual burdens for registered money market funds that experience an event of default or insolvency as follows:

hours. (30 fund complexes x 1 hour for reporting of rule 17a-9 transactions) = 30 hours. 210 hours + 810 hours + 6 hours + 60 hours + 30 hours = 1116 hours.

²¹ This estimate is based on the following calculations: (30 fund complexes x \$5650 for revision of procedures concerning stress testing) = \$169,500. (30 fund complexes x \$69,990 to provide stress testing reports) = \$2,099,700. (30 fund complexes x \$103 to maintain stress testing reports) = \$3090. (30 fund complexes x \$124 to maintain records of creditworthiness) = \$3720. (30 fund complexes x \$305 for reporting of rule 17a-9 transactions) = \$9150. \$169,500 + \$2,099,700 + \$3090 + \$3720 + \$9150 = \$2,285,160.

²² The estimate is based on the following calculation: (8 funds x 1 response for board review and amendment of procedures) = 8 responses.

²³ This estimate is based on the following calculation: (8 funds x 2.4 hours for review and amendment of procedures) = 19.2 hours.

²⁴ This estimate is based on the following calculation: (8 funds x \$2340) = \$18,720.

Written record of board determinations and actions related to failure of a security to meet certain eligibility standards or an event of default or default or insolvency:

2 responses
1 burden hour of legal time
Cost: \$270

Notice to Commission of an event of default or insolvency:

1 response
1.5 burden hours of legal time
Cost: \$405

Consistent with the estimate in the rule 2a-7 submissions, Commission staff estimates that approximately 2 percent, or 1, unregistered money market fund experiences an event of default or insolvency each year. Accordingly, the staff estimates that one unregistered money market fund will comply with these collection of information requirements and engage in 3 annual responses under rule 12d1-1,²⁵ the aggregate annual burden hours associated with these responses is 2.5,²⁶ and the aggregate annual cost to funds is \$675.²⁷

In the rule 2a-7 submissions, Commission staff further estimated the aggregate annual burdens for newly registered money market funds as follows:

Establishment of written procedures designed to stabilize the fund's net asset value and guidelines for delegating board authority for determinations under the rule:

1 response
15.5 hours of director, legal, and support staff time
Cost: \$5610.

Adopt procedures concerning stress testing:

²⁵ The estimate is based on the following calculations: (1 fund x 2 responses) + (1 fund x 1 response) = 3 responses.

²⁶ This estimate is based on the following calculations: (1 fund x 1 hour) + (1 fund x 1.5 hours) = 2.5 hours.

²⁷ This estimate is based on the following calculations: (1 fund x \$270) + (1 fund x \$405) = \$675.

1 response per fund complex
8.33 burden hours of professional and director time per fund complex
Cost: \$6017 per fund complex

Commission staff estimates that the proportion of unregistered money market funds that intend to newly undertake the collection of information burdens of rule 2a-7 will be similar to the proportion of money market funds that are newly registered. Because of the recent decrease in registered money market funds and the lack of newly registered money market funds, the staff believes that there will be no unregistered money market funds that will undertake the collections of information required for newly registered money market funds.²⁸ As a result, the staff estimates that there will be no burdens associated with these collection of information requirements.

Accordingly, the estimated total number of annual responses under rule 12d1-1 for the collections of information described in the rule 2a-7 submissions is 3491, the aggregate annual burden hours associated with these responses is 13,570, and the aggregate cost to funds is \$5.1 million.²⁹

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

²⁸ See *supra* note 13.

²⁹ These estimates are based upon the following calculations: $2790 + 690 + 8 + 3 = 3491$ annual responses; $12,432 + 1116 + 19 + 2.5 = 13,569.5$ burden hours; and $\$2,751,420 + \$2,285,160 + \$18,720 + 675 = \$5,055,975$.

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.

Rule 12d1-1 also requires unregistered money market funds in which registered funds invest to adopt procedures designed to ensure that the unregistered money market funds comply with sections 17(a), (d), (e), and 22(e) of the Act. This is a one-time collection of information requirement that applies to unregistered money market funds that intend to comply with the requirements of rule 12d1-1. As discussed above, Commission staff estimates that because of the recent decrease in registered money market funds and the lack of newly registered money market funds there will be no unregistered money market funds that will undertake the collections of information required for newly registered money market funds.³⁰ For similar reasons, the Commission staff estimates that there will be no registered money market funds that will adopt procedures designed to ensure that the unregistered money market funds comply with sections 17(a), (d), (e), and 22(e) of the Act. The staff concludes that there will be no burdens associated with these collection of information requirements.

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

³⁰ See *supra* text accompanying note 28.

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 the rule 2a-7 submissions, Commission staff estimated that the amount an individual money market fund may spend ranges from \$100 per year to \$300,000. We have no reason to believe the range is different for unregistered money market funds. The Commission does not have specific information on the amount of assets managed by unregistered money market funds or the proportion of those assets held in small, medium-sized, or large unregistered money market funds. Accordingly, Commission staff estimates that unregistered money market funds in which registered funds invest in reliance on rule 12d1-1 are similar to registered money market funds in terms of amount and distribution of assets under management.³¹ Based on a cost of \$0.0051295 per dollar of assets under management for small funds, \$0.0005041 per dollar of assets under management for medium-sized funds and \$0.0000009 per dollar of assets under management for large funds, the staff estimates compliance with rule 2-7 for these unregistered money market funds totals \$3.9 million annually.³²

³¹ In the rule 2a-7 submissions, the staff estimated that 757 registered money market funds have \$3.8 trillion in assets under management, or \$5 billion in assets under management per registered money market fund. The staff further estimated that 0.2% of those assets are held in small money market funds (funds with less than \$50 million in assets under management), 3% are held in medium-sized money market funds (funds with \$50 million to \$1 billion in assets under management), and the remaining assets are held in large money market funds (funds with more than \$1 billion in assets under management).

³² This estimate is based on the following calculations: 30 unregistered money market funds x \$5 billion = \$150 billion. (\$150 billion x 0.2% x \$0.0051295) = \$1.5 million for small funds. (\$150 billion x 3% x 0.0005041) = \$2.3 million for medium-sized funds. (\$150 billion x 96.8% x 0.0000009) = \$0.1 million for large funds. \$1.5 million + \$2.3 million + \$0.1 million = \$3.9 million. The estimate of cost per dollar of assets is the same as that used in the rule 2a-7 submissions. *See supra* note 12.

Consistent with estimates made in the rule 2a-7 submissions, Commission staff estimates that unregistered money market funds also incur capital costs to create computer programs for maintaining and preserving compliance records for rule 2a-7 of \$0.0000132 per dollar of assets under management. Based on the assets under management figures described above, staff estimates annual capital costs for all unregistered money market funds of \$1.98 million.³³

Commission staff further estimates that, even absent the requirements of rule 2a-7, money market funds would spend at least half of the amounts described above for record preservation (\$2.0 million) and for capital costs (\$0.99 million). Commission staff concludes that the aggregate annual costs of compliance with the rule are \$2.0 million for record preservation and \$0.99 million for capital costs.

14. Estimate of Cost to the 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 decreased from 81,974 hours to 13,570 hours. The decrease in hours is attributable to decreases in the number of unregistered money market funds in which other funds invest.

The estimated total annual cost is increased from \$11,400 to \$2.99 million annually. The increase in cost is attributable to changes in the estimates and methodology used to calculate compliance with rule 12d1-1. The prior submission assumed that all unregistered money market funds were medium-sized funds that had no capital costs and that had low record preservation costs when measured as a cost per amount of assets under management. In contrast, the current

³³ This estimate is based on the following calculation: \$150 billion x 0.0000132 = \$1.98 million.

submission estimates that unregistered money market funds may be small, medium-sized, or large funds that incur capital costs and that, on average, have greater amounts of assets under management and therefore greater record preservation costs when measured as a cost per amount of assets under management.

16. Information Collection Planned for Statistical Purposes

This collection does not involve statistical methods.

17. Approval to not Display Expiration Date

The Commission is not seeking approval to not display the expiration date for OMB Approval.

18. Exceptions to Certification Statement

This collection complies with the requirements in 5 CFR 1320.9.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

The collection of information will not employ statistical methods.