

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission**  
**“Rule 38a-1”**

**A. JUSTIFICATION**

**1. Information Collection Necessity**

Rule 38a-1 under the Investment Company Act of 1940 (“Investment Company Act”)<sup>1</sup> is intended to protect investors by fostering better fund compliance with securities laws.<sup>2</sup> The rule requires every registered investment company and business development company (“fund”) to:

(i) adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws by the fund, including procedures for oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent of the fund; (ii) obtain the fund board of directors’ approval of those policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund; (iii) annually review the adequacy of those policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund, and the effectiveness of their implementation; (iv) designate a chief compliance officer to administer the fund’s policies and procedures and prepare an annual report to the board that addresses certain specified items relating to the policies and procedures; and (v) maintain for five years the compliance policies and procedures and the chief compliance officer’s annual report to the board.

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<sup>1</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>2</sup> 17 CFR 270.38a-1.

## **2. Information Collection Purpose**

The purpose of the information collection requirements in rule 38a-1 is to ensure that funds maintain comprehensive, written internal compliance programs that promote compliance with the federal securities laws. The information collections also assist the Commission's examination staff in assessing the adequacy of funds' compliance programs.

## **3. Consideration Given to Information Technology**

Rule 38a-1 does not require the reporting of any information or the filing of any documents with the Commission. Rule 38a-1 does require funds to maintain written policies and procedures. Each fund also is required to maintain for at least five years a copy of the annual compliance report provided to the fund's board of directors. The Electronic Signatures in Global and National Commerce Act<sup>3</sup> and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

## **4. Duplication**

Rule 38a-1 imposes a broad requirement that funds have in place written compliance policies and procedures. Funds also are subject to certain requirements elsewhere in the federal securities laws that require them to maintain written policies and procedures. The staff believes, however, that any duplication of recordkeeping requirements is limited. Moreover, rule 38a-1 does not require funds to maintain duplicate copies of records covered by these more targeted requirements, and a firm's compliance policies and procedures are not required to be maintained in a single location. The staff believes, therefore, that any duplication of regulatory requirements does not impose significant additional costs on funds. The Commission periodically evaluates

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<sup>3</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

rule-based recordkeeping requirements for duplication and reevaluates them whenever it proposes a rule or a change in a rule.

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

Funds, regardless of their size, are subject to the requirements of rule 38a-1. Effective internal compliance programs are essential for firms of all sizes. Rule 38a-1 affords funds the flexibility to tailor their compliance program to the nature of their business. Small firms, which generally have less complex and more limited operations, would likely need less extensive compliance programs than their larger counterparts. Thus, rule 38a-1 does not inappropriately burden small entities. The Commission believes that it could not adjust the rule to lessen the burden on small entities of complying with the rule without jeopardizing the interests of investors in small funds. The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small businesses.

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

Less frequent information collection would be incompatible with the objectives of rule 38a-1. The annual reviews required under rule 38a-1 are integral to detecting and correcting any gaps in the program before irrevocable or widespread harm is inflicted upon investors, and extending the time between reviews increases the likelihood that such harm could go unchecked.

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

Rule 38a-1 would require funds and advisers to maintain their internal compliance policies and procedures and documents related to the annual review of those policies and

procedures for at least five years. Although this period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), the staff believes that this is warranted because the rule contributes to the effectiveness of the Commission's examination and inspection program. Because the period between examinations may be as long as five years, it is important that the Commission have access to records that cover the entire period between examinations.

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

The Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and informal exchanges. These forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry. The Commission requested public comment on the collection of information requirements in rule 38a-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**

No payment or gift to respondents was provided.

#### **10. Confidentiality**

If information collected pursuant to rule 38a-1 is reviewed by the Commission's examination staff, it will be accorded the same level of confidentiality accorded to other responses provided to the Commission in the context of its examination and oversight program.

#### **11. Sensitive Questions**

No questions of a sensitive nature are involved.

#### **12. Time Burden Estimate**

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act of 1995 and are not derived from a comprehensive or even representative survey or study of the costs of Commission rules. Compliance with rule 38a-1 is mandatory for funds.

While rule 38a-1 requires each fund to maintain written policies and procedures, most funds are located within a fund complex. The experience of the Commission's examination and oversight staff suggests that each fund in a complex is able to draw extensively from the fund complex's "master" compliance program to assemble appropriate compliance policies and procedures. Many fund complexes already have written policies and procedures documenting their compliance programs. Further, a fund needing to develop or revise policies and procedures on one or more topics in order to achieve a comprehensive compliance program can draw on a number of outlines and model programs available from a variety of industry representatives, commentators, and organizations.

There are currently approximately 4,157 registered investment companies and 80 business development companies.<sup>4</sup> Thus, approximately 4,237 funds are currently subject to rule 38a-1. Among these funds, approximately 146 funds were newly registered in the past year. These 146 funds, therefore, were required to adopt and document the policies and procedures that make up their compliance programs. Commission staff estimates that the average hour burden for a newly-registered fund to adopt and document these policies and procedures is 105 hours: the fund board of directors, at an hourly rate of \$4,500 for the board as a whole, performs an estimated 4 burden hours; a chief compliance officer, at an hourly rate of \$433, performs an estimated 79 burden hours; and compliance clerks, at an hourly rate of \$60, perform the

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<sup>4</sup> These numbers are based on Commission filings and are current as of June 2012.

remaining 22 burden hours.<sup>5</sup> Thus, assuming that 146 funds register with the Commission each year, the staff estimates that the aggregate annual hour burden associated with the adoption and documentation requirement for newly-registered funds is 15,330 hours,<sup>6</sup> and the aggregate annual cost of the burden hours associated with the adoption and documentation requirement is \$7,814,942.<sup>7</sup>

In 2010, Commission staff began to estimate the hour burden associated with money market funds' adoption of certain policies and procedures aimed at ensuring that these funds meet reasonably foreseeable shareholder redemptions (the "general liquidity requirement").<sup>8</sup> The staff currently estimates that each newly-registered money market fund will incur a one-time additional average burden of 8 hours to document policies and procedures that will assist in complying with the general liquidity requirement. In addition, the staff estimates that the board of directors of each money market fund will take 1 hour to review and adopt these policies and procedures. Approximately 10 money market funds were newly registered in the past year. Assuming that 10 money market funds register with the Commission each year, the staff

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<sup>5</sup> The estimate for the cost of board time as a whole is derived from estimates made by the staff regarding typical board size and compensation, which are based on information received from fund representatives and publicly-available sources. The rates for all the other occupations in this statement are derived from the SIFMA Report on Management & Professional Earnings in the Securities Industry 2011, and are modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead; or, the SIFMA Report on Office Salaries in the Securities Industry 2011, and are modified to account for a 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 calculation: 146 funds x 105 hours = 15,330 hours.

<sup>7</sup> This estimate is based on the following calculations: (146 funds x 4 hours by board of directors for adoption of policies and procedures x \$4,500 per hour = \$2,628,000) + (146 funds x 79 hours by chief compliance officer for adoption and documentation of policies and procedures x \$433 per hour = \$4,994,222) + (146 funds x 22 hours by clerical staff for adoption and documentation of policies and procedures x \$60 per hour = \$192,720) = \$7,814,942.

<sup>8</sup> See Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) (adopting the general liquidity requirement).

estimates that the aggregate additional annual hour burden associated with the requirement for newly-registered money market funds to adopt and document procedures to comply with the general liquidity requirement is 90 hours, and the aggregate annual cost of the burden hours associated with this requirement is \$70,760.<sup>9</sup>

All funds are required to conduct an annual review of the adequacy of their existing policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund, and the effectiveness of their implementation. In addition, each fund chief compliance officer is required to prepare an annual report that addresses the operation of the policies and procedures of the fund and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund, any material changes made to those policies and procedures since the date of the last report, any material changes to the policies and procedures recommended as a result of the annual review, and certain compliance matters that occurred since the date of the last report. The staff estimates that each fund spends 49 hours per year, on average, conducting the annual review and preparing the annual report to the board of directors. The staff estimates that the chief compliance officer performs 32 of these burden hours, at an hourly rate of \$433. Compliance clerks perform the remaining 17 hours of work, at an estimated hourly rate of \$60. Thus, the staff estimates that the aggregate annual hour burden associated with the annual review and annual report requirements is 207,613 hours,<sup>10</sup> and the aggregate annual cost of the burden

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<sup>9</sup> These estimates are based on the following calculations: 10 funds x (8 hours + 1 hour) = 90 hours; (10 funds x 8 hours by a senior portfolio manager for documentation of policies and procedures x \$322 per hour = \$25,760) + (10 funds x 1 hour by board of directors for review and adoption of policies and procedures x \$4,500 per hour = \$45,000) = \$70,760.

<sup>10</sup> This estimate is based on the following calculation: 4,237 funds x 49 hours = 207,613 hours.

hours associated with the annual review and annual report requirements is \$63,029,612.<sup>11</sup>

In addition, the staff estimates that each fund spends 6 hours annually maintaining the records required by rule 38a-1.<sup>12</sup> Thus, the aggregate annual hour burden associated with the recordkeeping requirement is 25,422 hours.<sup>13</sup> The staff estimates that the chief compliance officer performs 2 of these burden hours, at an hourly rate of \$433. Compliance clerks perform the remaining 4 hours of work, at an estimated hourly rate of \$60 per hour. Thus, the aggregate annual cost of the burden hours associated with the recordkeeping requirement is \$4,686,122.<sup>14</sup>

In total, the staff estimates that the information collection under rule 38a-1 entails 248,455 aggregate annual burden hours.<sup>15</sup> The staff further estimates the aggregate annual cost of those burden hours is \$75,601,436.<sup>16</sup>

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

The staff estimates that rule 38a-1 does not impose any material cost burdens on funds, apart from the cost of the burden hours discussed above. Although rule 38a-1 requires funds to

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<sup>11</sup> This estimate is based on the following calculations: (4,237 funds x 32 hours by chief compliance officer for review and documentation of policies and procedures x \$433 per hour = \$58,707,872) + (4,237 funds x 17 hours by clerical staff for review and documentation of policies and procedures x \$60 per hour = \$4,321,740) = \$63,029,612.

<sup>12</sup> These records are copies of the fund's compliance policies and procedures and the annual report provided to the fund board.

<sup>13</sup> This estimate is based on the following calculation: 4,237 funds x 6 hours = 25,422 hours.

<sup>14</sup> This estimate is based on the following calculations: (4,237 funds x 2 hours by chief compliance officer for maintaining records x \$433 per hour = \$3,669,242) + (4,237 funds x 4 hours by clerical staff for maintaining records x \$60 per hour = \$1,016,880) = \$4,686,122.

<sup>15</sup> This estimate is based on the following calculation: 15,330 hours adopting and documenting policies and procedures + 90 hours adopting and documenting policies and procedures regarding general liquidity requirement + 207,613 hours reviewing policies and procedures and preparing annual report + 25,422 hours maintaining records = 248,455 hours.

<sup>16</sup> This estimate is based on the following calculation: \$7,814,942 (cost of adopting policies and procedures) + \$70,760 (cost of adopting and documenting policies regarding general liquidity requirement) + \$63,029,612 (cost of reviewing policies and procedures and preparing annual report) + \$4,686,122 (cost of maintaining records) = \$75,601,436.



maintain certain records for five years, these records may be maintained electronically and, even if maintained in hard copy, are unlikely to be voluminous. The staff has not estimated a capital cost in connection with the recordkeeping requirements because funds and their advisers likely use existing recordkeeping systems to maintain the required compliance records.

**14. Cost to the Federal Government**

Rule 38a-1 does not impose a cost on the federal government. Rule 38a-1 does not require funds to file any documents with the Commission. Commission staff may, however, review records produced pursuant to the rule in order to assist the Commission in carrying out its examination and oversight program.

**15. Changes in Burden**

The estimated total annual burden hours decreased 6,248 hours, from 254,703 hours to 248,455 hours. This decrease in burden hours is attributable to a decrease in the number of funds subject to rule 38a-1.

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

Not applicable.

**17. Approval to Omit OMB Expiration Date**

Not applicable.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.