

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
Rule 12d3-1

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 12(d)(3) of the Act generally prohibits a registered investment company (“fund”) and companies controlled by the fund from purchasing securities issued by a registered investment adviser, broker, dealer, or underwriter (“securities-related businesses”).¹ Rule 12d3-1 permits a fund to invest up to five percent of its assets in securities of an issuer deriving more than fifteen percent of its gross revenues from securities-related businesses, but a fund may not rely on rule 12d3-1 to acquire securities of its own investment adviser or any affiliated person of its own investment adviser.²

A fund may, however, rely on an exemption in rule 12d3-1 to acquire securities issued by its subadvisers in circumstances in which the subadviser would have little ability to take advantage of the fund, because it is not in a position to direct the fund’s securities purchases. This exemption in rule 12d3-1 is available if: (i) the subadviser is not, and is not an affiliated person of, an investment adviser that provides advice with respect to the portion of the fund that is acquiring the securities; and (ii) the advisory contracts of the subadviser, and any subadviser that is advising the purchasing portion of the fund, prohibit them from consulting with each other concerning securities transactions of the fund, and limit their responsibility in providing advice to providing advice with respect to discrete portions of the fund’s portfolio.³

¹ 15. U.S.C. 80a-17(d)(3).

² See 17 CFR 270.12d3-1(b); 17 CFR 270.12d3-1(c)(3).

³ See 17 CFR 270.270.12d3-1(c)(3).

2. Purpose and Use of the Information Collection

The rule requires funds to amend their subadvisory contracts before they can rely on rule 12d3-1's exemption to ensure that the subadviser that engages in the transaction does not influence the fund's investment decision to engage in the transaction.

3. Consideration Given to Information Technology

To the extent the rule includes recordkeeping requirements, the Electronic Signatures in Global and National Commerce Act⁴ and the conforming amendments to recordkeeping rules under the Investment Company Act permit funds to maintain records electronically.

4. Duplication

The requirement regarding limitations in the subadviser's contracts is similar to conditions in exemptive rules 10f-3⁵ (permitting, under certain conditions, a fund to purchase securities from underwriting syndicates whose members include affiliated persons of the purchasing fund), 17a-10⁶ (permitting a fund's subadviser to enter into certain transactions with their affiliated subadvisers), and 17e-1⁷ (governing the receipt of compensation by a broker affiliated with a fund in connection with securities transactions by the fund). To the extent that a fund relies on more than one of these rules, its subadviser may use the same contract language to satisfy the comparable condition in the other rules.

⁴ P.L. 106-229, 114 Stat. 464 (June 30, 2000).

⁵ 17 CFR 270.10f-3.

⁶ 17 CFR 270.17a-10.

⁷ 17 CFR 270.17e-1.

5. Effect on Small Entities

Rule 12d3-1's exemptive relief is conditioned upon funds including certain provisions in their advisory contracts to ensure that fund interests are the primary consideration for otherwise prohibited transactions; these conditions apply equally to all funds, including small entities.

6. Consequences of Not Conducting Collection

Rule 12d3-1 requires that a fund's subadvisory contract be either initially drafted or amended to qualify for the rule's exemption. This is not a recurring requirement; less frequent collection is not possible.

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

Not applicable. The collection is not inconsistent with 5 CFR 1320.5(d)(2).

8. Consultation Outside the Agency

The Commission requested public comment on the collection of information requirements in rule 12d3-1 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 at 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 various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry.

9. Payment or Gift

Not applicable.

10. Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Burden of Information Collection

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

The staff believes that all existing funds with subadvisory contracts amended those contracts to comply with the rule following amendments to rule 12d3-1 in 2002 that conditioned certain exemptions upon these contractual alterations, and that after that one-time change, there is no continuing burden for those funds. However, the staff assumes that all newly formed subadvised funds, and funds that enter into new contracts with subadvisers, will incur the one-time burden by amending their contracts to add the terms required by the rule.

Based on an analysis of third-party information, the staff estimates that approximately 319 fund portfolios enter into such new subadvisory agreements each year.⁸ Based on discussions with industry representatives, the staff estimates that it will require approximately 3 attorney hours to draft and execute additional clauses in new subadvisory contracts in order for funds and subadvisers to be able to rely on the exemptions in rule 12d3-1. Because these additional clauses are identical to the clauses that a fund would need to insert in their subadvisory contracts to rely on rules 10f-3, 17a-10, and 17e-1 and because we believe that

⁸ Based on information available from Morningstar and the ICI Fact Book, we estimate that 37 percent of funds are advised by subadvisers.

funds that use one such rule generally use all of these rules, we apportion this 3 hour time burden equally to all four rules. Therefore, we estimate that the burden allocated to rule 12d3-1 for this contract change would be 0.75 hours.⁹ Assuming that all 319 funds that enter into new subadvisory contracts each year make the modification to their contract required by the rule, we estimate that the rule's contract modification requirement will result in 239.25 burden hours annually, with an associated time cost of approximately \$92,351.¹⁰

13. Cost to Respondents

We estimated that there is no cost burden of rule 12d3-1, other than the respondent recordkeeping burden identified in Item 12 of this Supporting Statement. Compliance with the rule is part of customary and usual investment company business practice to ensure compliance with applicable laws and regulations.

14. Cost to the Federal Government

There are no costs to the Federal Government associated with rule 12d3-1.

15. Change in Burden

Rule 12d3-1 has a current annual burden of 581 hours and no costs. The hour burden associated with rule 12d3-1 has decreased to 239.25 hours since our last burden analysis due to a change in our estimate of the number of funds using subadvisers. The cost burden has not changed. We now estimate that funds that rely on rule 12d3-1 will incur an annual burden of

⁹ This estimate is based on the following calculation (3 hours ÷ 4 rules = .75 hours).

¹⁰ These estimates are based on the following calculations: (0.75 hours × 319 portfolios = 239.25 burden hours); (\$386 per hour × 239.25 hours = \$92,350.50 total cost). The Commission's hourly wage estimate for an in-house attorney is based on data from the SIFMA's Office Salaries in the Securities Industry Report 2013, modified by Commission staff for an 1,800-hour work-year and inflation (as of January 2016), and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

239.25 hours instead of the previously estimated 581 burden hours, for a total decrease of 341.75 burden hours.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to Omit OMB Expiration Date

Not applicable.

18. Exceptions to Certification Statement for Paperwork Reduction Act

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.