

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
Rule 32a-4

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 32(a)(2) of the Investment Company Act of 1940 (15 U.S.C. 80a-31(a)(2)) (“Act”) requires that the selection of a registered management investment company’s or registered face-amount certificate company’s (collectively, “funds”) independent public accountant be submitted to shareholders for ratification or rejection. As discussed in more detail below, rule 32a-4 under the Investment Company Act (17 CFR 270.32a-4) exempts a fund from this requirement if the fund has an audit committee consisting entirely of independent directors. The rule permits continuing oversight of a fund’s accounting and auditing processes by an independent audit committee in place of a shareholder vote.

Under the rule, a fund is exempt from having to seek shareholder approval of its independent public accountant, if (i) the fund’s board of directors establishes an audit committee composed solely of independent directors with responsibility for overseeing the fund’s accounting and auditing processes,¹ (ii) the fund’s board of directors adopts an audit committee charter setting forth the committee’s structure, duties, powers and methods of operation, or sets forth such provisions in the fund’s charter or bylaws,² and (iii) the fund

¹ Rule 32a-4(a).

² Rule 32a-4(b).

maintains and preserves permanently in an easily accessible place a copy of the audit committee charter and any modifications to the charter.³

2. **Purpose and Use of the Information Collection**

In order to rely on rule 32a-4, a fund's board of directors must adopt an audit committee charter and must preserve that charter, and any modifications to the charter, permanently in an easily accessible place. The purpose of these conditions is to ensure that Commission staff will be able to monitor the duties and responsibilities of an audit committee of a fund relying on the rule.

3. **Consideration Given to Information Technology**

Rule 32a-4 does not require funds to file any documents with the Commission, but does require funds to maintain and preserve an audit committee charter if they rely on the rule. Rule 31a-2(f) under the Act permits funds to maintain many types of records on micrographic and electronic storage media.

4. **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. Rule 32a-4 does not require duplicative reporting or recordkeeping.

5. **Effect on Small Entities**

The recordkeeping requirements of rule 32a-4 do not distinguish between large and small entities. The Commission does not believe that compliance with rule 32a-4 is unduly burdensome for small funds.

³ Rule 32a-4(c).

6. **Consequences of Not Conducting Collection**

Rule 32a-4 conditions the exemption provided by the rule on the requirement that the fund's board of directors adopt an audit committee charter, and maintain and preserve that charter and any modifications to the charter, permanently in an easily accessible place. If funds relying on the exemption were not required to adopt, maintain and preserve an audit committee charter, Commission staff would not be able to monitor the duties and responsibilities of an audit committee formed as a condition of the exemption, nor would it be able to determine fund compliance with the conditions of the rule for reliance on the exemption.

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

Rule 32a-4 requires, as a condition to the exemption provided by the rule, that the fund permanently maintain and preserve the audit committee charter and any modifications to the charter. The Commission believes that long-term retention of the charter is necessary because funds may rely on the exemption provided by the rule for indefinite periods of time. Commission staff thus may need to review the information available in the audit committee charter many years after its adoption or modification.

8. **Consultation Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 32a-4 before it submitted this request for extension and approval to OMB. The Commission received no comments in response to this request. The Commission and staff of the Division of Investment Management also 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**

Not applicable.

10. **Confidentiality**

Not applicable.

11. **Sensitive Questions**

No PII collected/not applicable.

12. **Burden of Information Collection**

Each fund that chooses to rely on rule 32a-4 incurs two collection of information burdens. The first, related to the board of directors' adoption of the audit committee charter, occurs once, when the committee is established. The second, related to the fund's maintenance and preservation of a copy of the charter in an easily accessible place, is an ongoing annual burden. Commission staff estimates that on average the board of directors takes 15 minutes to adopt the audit committee charter. Commission staff has estimated that with an average of 8 directors on the board,⁴ total director time to adopt the charter is 2 hours. Combined with an estimated ½ hour of paralegal time to prepare the charter for board review, the staff estimates a total one-time collection of information burden of 2 ½ hours for each fund. Once a board adopts an audit committee charter, the charter is

⁴ This estimate is based on staff experience and on discussions with a representative of an entity that surveys funds and calculates fund board statistics based on responses to its surveys.

preserved as part of the fund's records. Commission staff estimates that there is no annual hourly burden associated with preserving the charter in accordance with this rule.⁵

Because virtually all existing funds have now adopted audit committee charters, the annual one-time collection of information burden associated with adopting audit committee charters is limited to the burden incurred by newly established funds. Commission staff estimates that fund sponsors establish approximately 112 new funds each year,⁶ and that all of these funds will adopt an audit committee charter in order to rely on rule 32a-4. Thus, Commission staff estimates that the annual one-time hour burden associated with adopting an audit committee charter under rule 32a-4 is approximately 280 hours.⁷

As noted above, all funds that rely on rule 32a-4 are subject to the ongoing collection of information requirement to maintain and preserve a copy of the charter in an easily accessible place. This ongoing requirement, which Commission staff estimates has no hourly burden, applies to new funds that adopt an audit committee charter each year and to all of the funds that have previously adopted the charter and continue to maintain and preserve it.

Funds incur internal costs associated with the one-time collection of information burden related to adopting an audit committee charter. As noted above, Commission staff estimates that it takes approximately 2 hours of aggregate directors' time at \$4500 per hour,⁸

⁵ This estimate is based on staff experience and discussions with funds regarding the hour burden related to maintenance of the charter.

⁶ This estimate is based on the average number of notifications of registration on Form N-8A filed from 2013-2015.

⁷ This estimate is based on the following calculation: (2.5 burden hours for establishing charter × 112 new funds = 280 burden hours).

⁸ The estimate for the cost of board time as a whole is based on staff experience and derived from estimates made by the staff regarding typical board size and compensation that is based on information received from fund representatives and publicly available sources.

and ½ hour of paralegal time at \$101 per half hour,⁹ to adopt an audit committee charter. Thus, Commission staff estimates a total internal cost of \$9101 per fund to adopt the charter¹⁰ and a total annual cost of \$1,019,312.¹¹

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 the rule.

13. Cost to Respondents

When funds adopt an audit committee charter in order to rely on rule 32a-4, they also may incur one-time costs related to hiring outside counsel to prepare the charter. Commission staff estimates that those costs average approximately \$1500 per fund.¹²

As noted in the previous section, Commission staff estimates that approximately 112 new funds each year will adopt an audit committee charter in order to rely on rule 32a-4. Thus, Commission staff estimates that the ongoing annual cost burden associated with rule 32a-4 in the future will be approximately \$168,000.¹³

⁹ The \$101/half hour figure for a paralegal is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

¹⁰ This estimate is based on the following calculations: (\$4500 per hour for directors' time × 2 hours = \$9000); (\$9000 + \$101 = \$9101).

¹¹ This estimate is based on the following calculations: (\$9101 cost of hour burden per fund × 112 new funds = \$1,019,312).

¹² Costs may vary based on the individual needs of each fund. However, based on the staff's experience and conversations with outside counsel that prepare these charters, legal fees related to the preparation and adoption of an audit committee charter usually average \$1500 or less. The Commission also understands that model audit committee charters are available, which reduces the costs associated with drafting a charter.

¹³ This estimate is based on the following calculations: (\$1500 cost of adopting charter × 112 newly established funds = \$168,000).

These estimates of average costs 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.

14. Cost to the Federal Government

There are no costs to the Federal Government associated with the collection of information requirements of rule 32a-4.

15. Change in Burden

The decrease in the number of annual burden hours from 417 to 280 is the result of a decrease in the estimated number of new funds each year and from a decrease in the estimated number of hours associated with paralegal preparation of the audit committee charter for board review. The decrease in the ongoing annual cost burden from \$208,500 to \$168,000 is a result of the decrease in the estimated number of new funds each year.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to Omit OMB Expiration Date

Not applicable.

18. Exception to Certification Statement for Paperwork Reduction Act

Submission

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.