

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**Rule 0-1**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

The Investment Company Act of 1940 (the “Act”)<sup>1</sup> establishes a comprehensive framework for regulating the organization and operation of investment companies (“funds”). A principal objective of the Act is to protect fund investors by addressing the conflicts of interest that exist between funds and their investment advisers and other affiliated persons. The Act places significant responsibility on the fund board of directors in overseeing the operations of the fund and policing the relevant conflicts of interest.<sup>2</sup>

In one of its first releases, the Commission exercised its rulemaking authority pursuant to sections 38(a) and 40(b) of the Act by adopting rule 0-1 (17 CFR 270.0-1).<sup>3</sup> Rule 0-1, as subsequently amended on numerous occasions, provides definitions for the terms used by the Commission in the rules and regulations it has adopted pursuant to the Act. The rule also contains a number of rules of construction for terms that are defined either in the Act itself or elsewhere in the Commission’s rules and regulations. Finally, rule 0-1 defines terms that serve as conditions to the availability of certain of the Commission’s exemptive rules. More specifically, the term “independent legal counsel,” as defined in paragraph (a)(6) of rule 0-1, sets

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<sup>1</sup> 15 U.S.C. 80a.

<sup>2</sup> For example, fund directors must approve investment advisory and distribution contracts. See 15 U.S.C. 80a-15(a), (b), and (c).

<sup>3</sup> Investment Company Act Release No. 4 (Oct. 29, 1940) (5 FR 4316 (Oct. 31, 1940)). Note that rule 0-1 was originally adopted as rule N-1.

out conditions that funds must meet in order to rely on any of ten exemptive rules (“exemptive rules”) under the Act.<sup>4</sup>

The Commission amended rule 0-1 to include the definition of the term “independent legal counsel” in 2001.<sup>5</sup> This amendment was designed to enhance the effectiveness of fund boards of directors and to better enable investors to assess the independence of those directors. This requirement was added because independent directors can better perform the responsibilities assigned to them under the Act and the rules if they have the assistance of truly independent legal counsel.

If the board’s counsel has represented the fund’s investment adviser, principal underwriter, administrator (collectively, “management organizations”) or their “control persons”<sup>6</sup> during the past two years, rule 0-1 requires that the board's independent directors make a determination about the adequacy of the counsel’s independence. A majority of the board’s independent directors are required to reasonably determine, in the exercise of their judgment, that the counsel’s prior or current representation of the management organizations or their control persons was sufficiently limited to conclude that it is unlikely to adversely affect the

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<sup>4</sup> See 17 CFR 270.0-1(a)(7). The relevant exemptive rules are: rule 10f-3 (17 CFR 270.10f-3), rule 12b-1 (17 CFR 270.12b-1), rule 15a-4(b)(2) (17 CFR 270.15a-4(b)(2)), rule 17a-7 (17 CFR 270.17a-7), rule 17a-8 (17 CFR 270.17a-8), rule 17d-1(d)(7) (17 CFR 270.17d-1(d)(7)), rule 17e-1(c) (17 CFR 270.17e-1(c)), rule 17g-1 (17 CFR 270.17g-1), rule 18f-3 (17 CFR 270.18f-3), and rule 23c-3 (17 CFR 270.23c-3).

<sup>5</sup> See Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) (66 FR 3735 (Jan. 16, 2001)).

<sup>6</sup> A “control person” is any person – other than a fund – directly or indirectly controlling, controlled by, or under common control, with any of the fund’s management organizations. See 17 CFR 270.01(a)(6)(iv)(B).

counsel's professional judgment and legal representation.<sup>7</sup> Rule 0-1 also requires that a record for the basis of this determination is made in the minutes of the directors' meeting. In addition, the independent directors must have obtained an undertaking from the counsel to provide them with the information necessary to make their determination and to update promptly that information when the person begins to represent a management organization or control person, or when he or she materially increases his or her representation.<sup>8</sup> Generally, the independent directors must re-evaluate their determination no less frequently than annually.

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

Under rule 0-1, if a majority of a fund's independent directors makes a determination that the counsel's representation of fund management organizations (or any of their control persons) is or was so limited that it will not adversely affect the counsel's ability to provide impartial advice to the independent directors, the basis for that determination must be recorded in the board's meeting minutes. The records maintained under the rule are not submitted to the Commission, but may be reviewed by the Commission staff upon request to ensure compliance with the rule. If maintenance of these records were not required, the Commission could not readily determine and review the factors considered by the independent directors in assessing the independence of their counsel. The rule's requirement to maintain such records avoids the need for potentially more burdensome requirements such as mandatory filings of similar information with the Commission.

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<sup>7</sup> 17 CFR 270.0-1(a)(6)(i)(A).

<sup>8</sup> 17 CFR 270.0-1(a)(6)(i)(B).

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

Minutes of a fund's board meeting are required to be maintained in accordance with rule 31a-2.<sup>9</sup> Under rule 31a-2(f), the board meeting minutes regarding legal counsel independence under rule 0-1 may be maintained and preserved (and produced as necessary) on micrographic media or electronic storage media.<sup>10</sup> As previously noted, rule 0-1 does not require the filing of any documents with the Commission.

### **4. 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 0-1 does not require any duplicative recordkeeping or reporting.

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

Rule 0-1 does not distinguish between large and small entities. We do not believe that the minor recordkeeping provision in rule 0-1 is unduly burdensome for large or small entities.

### **6. Consequences of Not Conducting Collection**

It is necessary to have the basis for each determination made by independent directors regarding independent legal counsel in the board's meeting minutes because the relationships giving rise to counsel's underlying conflict, and the factors considered by independent directors, will be different with each determination. If rule 0-1 did not require a basis for the determination, the Commission staff would not be able to review the factors considered by independent directors in assessing the independence of counsel.

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<sup>9</sup> 17 CFR 270.31a-2.

<sup>10</sup> 17 CFR 270.31a-2(f).

**7. Inconsistencies With Guidelines in 5 CFR 1230.5(d)(2)**

Not applicable.

**8. Consultation Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 0-1 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.

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 means of ascertaining and acting upon paperwork burdens confronting the industry.

**9. Payment or Gift**

Not applicable.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

No information of a sensitive nature will be required under this collection of information. The information collection does not collect any Personally Identifiable Information (PII). The agency has determined that a system of records notice (SORN) and privacy impact assessment (PIA) are not required in connection with the collection of information.

**12. Burden of Information Collection**

Any fund that relies on one of the exemptive rules must comply with the requirements in the definition of “independent legal counsel” under rule 0-1. We assume that approximately

3,108 funds rely on at least one of the exemptive rules annually.<sup>11</sup> We further assume that the independent directors of approximately one-third (1,036) of those funds would need to make the required determination in order for their counsel to meet the definition of independent legal counsel.<sup>12</sup> We estimate that each of these 1,036 funds would be required to spend, on average, 0.75 hours annually to comply with the recordkeeping requirement associated with this determination, for a total annual burden of approximately 777 hours. Based on this estimate, the total annual cost for all funds' compliance with this rule is approximately \$168,350. To calculate this total annual cost, the Commission staff assumed that approximately two-thirds of the total annual hour burden (518 hours) would be incurred by a compliance manager with an average hourly wage rate of \$292 per hour,<sup>13</sup> and approximately one-third of the annual hour burden (259 hours) would be incurred by a compliance clerk with an average hourly wage rate of \$66 per hour.<sup>14</sup>

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<sup>11</sup> Based on statistics compiled by Commission staff, we estimate that there are approximately 3,453 funds that could rely on one or more of the exemptive rules (this figure reflects the three-year average of open-end and closed-end funds (3,349) and business development companies (104)). Of those funds, we assume that approximately 90 percent (3,108) actually rely on at least one exemptive rule annually.

<sup>12</sup> We assume that the independent directors of the remaining two-thirds of those funds will choose not to have counsel, or will rely on counsel who has not recently represented the fund's management organizations or control persons. In both circumstances, it would not be necessary for the fund's independent directors to make a determination about their counsel's independence.

<sup>13</sup> The estimated hourly wages used in this PRA analysis were derived from the Securities Industry and Financial Markets Association's Reports on Management and Professional Earnings in the Securities Industry (2013) (modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead) (adjusted for inflation), and Office Salaries in the Securities Industry (2013) (modified to account for an 1800-hour work year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead) (adjusted for inflation).

<sup>14</sup>  $(518 \times \$292/\text{hour}) + (259 \times \$66/\text{hour}) = \$168,350$ .

The estimate of average burden hours is made solely for the 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**

The recordkeeping requirement of rule 0-1 does not entail any annual cost burden in addition to the cost of the hourly burden discussed above.

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

There are no costs to the Federal Government associated with the recordkeeping requirement of rule 0-1.

**15. Explanation of Changes in Burden**

The estimated burden hours associated with rule 0-1 have decreased from the current allocation of 938 burden hours to 777 burden hours. The decrease in burden hours is due to a decrease in the estimated number of funds that rely on at least one of the exemptive rules under rule 0-1 annually.

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

Not applicable.

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

The Commission is not seeking approval to omit the OMB expiration date.

**18. Exception to Certification Statement**

Not applicable.

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

Not applicable.