

## **SUPPORTING STATEMENT**

### **For the Paperwork Reduction Act Information Collection Submission for Rule 22c-2**

#### **A. JUSTIFICATION**

##### **1. Necessity for the Information Collection**

Rule 22c-2 (17 CFR 270.22c-2) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the “Investment Company Act” or “Act”) requires the board of directors (including a majority of independent directors) of most registered open-end management investment companies (“funds”) to either approve a redemption fee of up to two percent or determine that imposition of a redemption fee is not necessary or appropriate for the fund. Rule 22c-2 also requires a fund to enter into written agreements with their financial intermediaries (such as broker-dealers and retirement plan administrators) under which the fund, upon request, can obtain certain shareholder identity and trading information from the intermediaries. The written agreement must also allow the fund to direct the intermediary to prohibit further purchases or exchanges by specific shareholders that the fund has identified as being engaged in transactions that violate the fund’s market timing policies. These requirements enable funds to obtain the information that they need to monitor the frequency of short-term trading in omnibus accounts and enforce their market timing policies.

The rule includes three “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>1</sup> First, the rule requires boards to either approve a redemption fee of up to two percent or determine that imposition of a redemption fee is not necessary or appropriate for the fund. Second, funds must enter into information sharing agreements with all

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<sup>1</sup> 44 U.S.C. 3501-3520.

of their “financial intermediaries”<sup>2</sup> and maintain a copy of the written information sharing agreement with each intermediary in an easily accessible place for six years. Third, pursuant to the information sharing agreements, funds must have systems that enable them to request frequent trading information upon demand from their intermediaries, and to enforce any restrictions on trading required by funds under the rule.

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

The collections of information created by rule 22c-2 are necessary for funds to effectively assess redemption fees, enforce their policies in frequent trading, and monitor short-term trading, including market timing, in omnibus accounts. These collections of information are mandatory for funds that redeem shares within seven days of purchase. The collections of information also are necessary to allow Commission staff to fulfill its examination and oversight responsibilities.

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

Rule 22c-2 does not require the reporting of any information or the filing of any documents with the Commission. The Electronic Signatures in Global and National Commerce Act<sup>3</sup> and the conforming amendments to rules under the Investment Company Act of 1940 and the Securities Exchange Act of 1934 permit funds and their financial intermediaries to maintain records electronically.

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<sup>2</sup> The rule defines a financial intermediary as: (i) Any broker, dealer, bank, or other person that holds securities issued by the fund in nominee name; (ii) a unit investment trust or fund that invests in the fund in reliance on section 12(d)(i)(E) of the Act; and (iii) in the case of a participant directed employee benefit plan that owns the securities issued by the fund, a retirement plan’s administrator under section 316(A) of the Employee Retirement Security Act of 1974 (29 U.S.C. 1002(16)(A) or any person that maintains the plans’ participant records. Financial Intermediary does not include any person that the fund treats as an individual investor with respect to the fund’s policies established for the purpose of eliminating or reducing any dilution of the value of the outstanding securities issued by the fund. Rule 22c-2(c)(1).

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

#### **4. Duplication**

The Commission is not aware of any duplicate reporting or recordkeeping requirements concerning rule 22c-2.

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

As discussed above, rule 22c-2 provides funds and their boards with the ability to impose a redemption fee designed to reimburse the fund for the direct and indirect costs incurred as a result of short-term trading strategies, such as market timing. The rule was designed to reduce the cost burdens of small entities. Rule 22c-2 requires some funds to develop or upgrade software or other technological systems to enforce certain market timing policies, or make trading information available in omnibus accounts.

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

The rule's requirement that funds enter into agreements with their financial intermediaries is a single event that will provide the fund with the option to receive certain identity and transaction information with which the fund can monitor implementation of its redemption fee program and direct the intermediary to enforce the fund's market timing policies in certain circumstances. The rule's requirement that the board of directors determine whether a redemption fee is necessary or appropriate for the fund is also a single event designed to ensure that consideration is given to the interests of long-term investors. Further information collection (*i.e.*, requests for shareholder identification and trading information) is solely at the discretion of the fund, and therefore is targeted to the individual needs of funds to protect shareholders.

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

Rule 22c-2 requires funds to retain certain written records for more than three years. The

fund must maintain and preserve a written copy of any information sharing agreements then in effect, or that has been in effect at any time in the previous six years, in an easily accessible place. The long-term retention of these records is necessary for the Commission's inspections program to determine compliance with rule 22c-2.

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

In its releases proposing and adopting rule 22c-2 and its amendments, the Commission requested public comment on the rule's collection of information requirements and whether the estimates contained in the proposal were reasonable. The Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the industry through public conferences, meetings, and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining the magnitude of paperwork burdens confronting the industry.

We received extensive comments on the projected costs of the rule both at the proposing stage and after adoption. In many cases, funds and intermediaries, including a number of small intermediaries, generally argued that the system functionality or start-up costs necessary to assess and collect redemption fees on shares held through omnibus accounts, coupled with the operational and maintenance costs, would be significant and in some cases greater than what we originally estimated. The Commission adopted amendments to the rule intended to address these concerns, and to alleviate any unnecessary burdens on funds and intermediaries.

The Commission requested public comment on the collection of information requirements of rule 22c-2 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to this

request.

**9. Payment or Gift**

Not applicable.

**10. Confidentiality**

Responses provided to the Commission 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. Responses provided in the context of the Commission's examination and oversight program are generally kept confidential.

**11. Sensitive Questions**

No information of a sensitive nature, including social security numbers, will be required under this collection of information. The information collection does not collect 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**

**A. Board Determination**

Rule 22c-2(a)(1) requires the board of directors of all registered open-end management investment companies and series thereof (except for money market funds, ETFs, or funds that affirmatively permit short-term trading of its securities) to approve a redemption fee for the fund, or instead make a determination that a redemption fee is either not necessary or appropriate for

the fund. Commission staff understands that the boards of all funds currently in operation have undertaken this process for the funds they currently oversee, and the rule does not require boards to review this determination periodically once it has been made. Accordingly, we expect that only boards of newly registered funds or newly created series thereof would undertake this determination. Commission staff estimates that 42 funds (excluding money market funds and ETFs) are newly formed each year and would need to make this determination.<sup>4</sup>

Based on conversations with fund representatives,<sup>5</sup> Commission staff estimates that it takes 2 hours of the board's time as a whole (at a rate of \$4465 per hour)<sup>6</sup> to approve a redemption fee or make the required determination on behalf of all series of the fund. In addition, Commission staff estimates that it takes compliance personnel of the fund 8 hours (at a rate of \$66 per hour)<sup>7</sup> to prepare trading, compliance, and other information regarding the fund's operations to enable the board to make its determination, and takes internal compliance counsel of the fund 3 hours (at a rate of \$345 per hour)<sup>8</sup> to review this information and present its recommendations to the board. Therefore, for each fund board that undertakes this

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<sup>4</sup> This estimate is based on the number of registrants filing initial Form N-1A or N-3. This estimate does not carve out money market funds, ETFs, or funds that affirmatively permit short-term trading of their securities, so this estimate corresponds to the outer limit of the number of registrants that would have to make this determination.

<sup>5</sup> Unless otherwise stated, estimates throughout this analysis are derived from a survey of funds and conversations with fund representatives.

<sup>6</sup> The estimate of \$4465 per hour for the board's time as a whole is based on conversations with representatives of funds and their legal counsel.

<sup>7</sup> The \$66 per hour figure for a compliance clerk is from SIFMA's *Office Salaries in the Securities Industry 2013*, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

<sup>8</sup> The \$345 per hour figure for internal compliance counsel 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.

determination process, Commission staff estimates it expends 13 hours<sup>9</sup> at a cost of \$10,493.<sup>10</sup>

As a result, Commission staff estimates that the total time spent for all funds on this process is 546 hours at a cost of \$440,706.<sup>11</sup>

## **B. Information Sharing Agreements**

Rule 22c-2(a)(2) requires a fund to enter into information-sharing agreements with each of its financial intermediaries. Commission staff understands that all currently registered funds have already entered into such agreements with their intermediaries. Funds enter into new relationships with intermediaries from time to time, however, which requires them to enter into new information sharing agreements. Commission staff understands that, in general, funds enter into information-sharing agreement when they initially establish a relationship with an intermediary, which is typically executed as an addendum to the distribution agreement. The Commission staff understands that most shareholder information agreements are entered into by the fund group (a group of funds with a common investment adviser), and estimates that there are currently 850 currently active fund groups.<sup>12</sup> Commission staff estimates that, on average, each active fund group enters into relationships with 3 new intermediaries each year.

Commission staff understands that funds generally use a standard information sharing agreement, drafted by the fund or an outside entity, and modifies that agreement according to the

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<sup>9</sup> This calculation is based on the following estimates: (2 hours of board time + 3 hours of internal compliance counsel time + 8 hours of compliance clerk time = 13 hours).

<sup>10</sup> This calculation is based on the following estimates: (\$8930 (\$4465 board time × 2 hours = \$8930) + \$528 (\$66 compliance time × 8 hours = \$528) + \$1035 (\$345 attorney time × 3 hours = \$1035) = \$10,493).

<sup>11</sup> This calculation is based on the following estimates: (13 hours × 42 funds = 546 hours); (\$10,493 × 42 funds = \$440,706).

<sup>12</sup> ICI, 2017 INVESTMENT COMPANY FACT BOOK at Fig 1.8 (2017) (<https://www.ici.org/research/stats/factbook>).

requirements of each intermediary. Commission staff estimates that negotiating the terms and entering into an information sharing agreement takes a total of 4 hours of attorney time (at a rate of \$392 per hour)<sup>13</sup> per intermediary (representing 2.5 hours of fund attorney time and 1.5 hours of intermediary attorney time). Accordingly, Commission staff estimates that it takes 12 hours at a cost of \$4704 each year<sup>14</sup> to enter into new information sharing agreements, and all existing market participants incur a total of 10,200 hours at a cost of \$3,998,400.<sup>15</sup>

In addition, newly created funds advised by new entrants (effectively new fund groups) must enter into information sharing agreements with all of their financial intermediaries. Commission staff estimates that there are 47 new fund groups that form each year that will have to enter into information sharing agreements with each of their intermediaries.<sup>16</sup> Commission staff estimates that fund groups formed by new advisers typically have relationships with significantly fewer intermediaries than existing fund groups, and estimates that new fund groups will typically enter into 100 information sharing agreements with their intermediaries when they begin operations.<sup>17</sup> As discussed previously, Commission staff estimates that it takes 4 hours of

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<sup>13</sup> The \$392 per hour figure for attorneys 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.

<sup>14</sup> This estimate is based on the following calculations: (4 hours × 3 new intermediaries = 12 hours); (12 hours × \$392 = \$4704).

<sup>15</sup> This estimate is based on the following calculations: (12 hours × 850 fund groups = 10,200 hours); (10,200 hours × \$392 = \$3,998,400).

<sup>16</sup> ICI, 2017 INVESTMENT COMPANY FACT BOOK at Fig 1.8 (2017) (<https://www.ici.org/research/stats/factbook>).

<sup>17</sup> Commission staff understands that funds generally use a standard information sharing agreement, drafted by the fund or an outside entity, and then modifies that agreement according to the requirements of each intermediary.



attorney time (at a rate of \$392 per hour)<sup>18</sup> per intermediary to enter into information sharing agreements. Therefore, Commission staff estimates that each newly formed fund group will incur 400 hours of attorney time at a cost of \$156,800<sup>19</sup> and that all newly formed fund groups will incur a total of 18,800 hours at a cost of \$7,369,600 to enter into information sharing agreements with their intermediaries.<sup>20</sup>

Rule 22c-2(a)(3) requires funds to maintain records of all information-sharing agreements for 6 years in an easily accessible place. Commission staff understands that most shareholder information agreements are stored at the fund group level and estimates that there are currently approximately 850 fund groups.<sup>21</sup> Commission staff understands that information-sharing agreements are generally included as addendums to distribution agreements between funds and their intermediaries, and that these agreements would be stored as required by the rule as a matter of ordinary business practice. Therefore, Commission staff estimates that maintaining records of information-sharing agreements requires 10 minutes of time spent by a general clerk (at a rate of \$59 per hour)<sup>22</sup> per fund, each year. Accordingly, Commission staff estimates that all

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<sup>18</sup> The \$392 per hour figure for an attorney 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.

<sup>19</sup> This estimate is based on the following calculations: (4 hours × 100 intermediaries = 400 hours); (400 hours × \$392 = \$156,800).

<sup>20</sup> This estimate is based on the following calculations: (47 fund groups × 400 hours = 18,800 hours) (\$392 × 18,800 = 7,369,600).

<sup>21</sup> ICI, 2017 INVESTMENT COMPANY FACT BOOK at Fig 1.8 (2017) (<https://www.ici.org/research/stats/factbook>).

<sup>22</sup> The \$59 per hour figure for a general clerk is derived from SIFMA's Office Salaries in the Securities Industry 2013 modified to account for an 1800-hour work-year and inflation, and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

funds will incur 141.67 hours at a cost of \$8358.53<sup>23</sup> in complying with the recordkeeping requirement of rule 22c-2(a)(3).

Therefore, Commission staff estimates that to comply with the information sharing agreement requirements of rule 22c-2(a)(2) and (3), it requires a total of 29,141.67 hours at a cost of \$11,376,358.53.<sup>24</sup>

The Commission staff estimates that on average, each fund group requests shareholder information once a week, and gives instructions regarding the restriction of shareholder trades every day, for a total of 417 responses related to information sharing systems per fund group each year, and a total 354,450 responses for all fund groups annually.<sup>25</sup> In addition, as described above, the staff estimates that funds make 42 responses related to board determinations, 2550 responses related to new intermediaries of existing fund groups, 4700 responses related to new fund group information sharing agreements, and 850 responses related to recordkeeping, for a total of 8142 responses related to the other requirements of rule 22c-2. Therefore, the Commission staff estimates that the total number of responses is 362,592 (354,450 + 8142 = 362,592).

**Table 1: Summary of Revised Annual Responses, Burden Hours, and Burden Hour Costs Estimates for Each Information Collection**

IC	IC Title	No. of Responses	Burden Hours	Burden Hour Costs
IC1	Board determination	42	546	\$440,706
IC2	Info sharing agreements (existing funds)	2550	10,200	\$3,998,400.00

<sup>23</sup> This estimate is based on the following calculations: (10 minutes × 850 fund groups = 8500 minutes); (8500 minutes / 60 = 141.67 hours); (141.67 hours × \$59 = \$8358.53).

<sup>24</sup> This estimate is based on the following calculations: (10,200 hours + 18,800 hours + 141.67 hours = 29,141.67 hours); (\$3,998,400 + \$7,369,600 + \$8358.53 = \$11,376,358.53).

<sup>25</sup> This estimate is based on the following calculations: (52 + 365 = 417); (417 × 850 fund groups = 354,450).

IC3	Info sharing agreements (new funds)	4700	18,800	\$7,369,600.00
IC4	Recordkeeping (info sharing agreements)	850	141.67	\$8358.53
IC5	Shareholder information requests	354,450	0	0
<b>Totals for all ICs</b>		<b>362,592</b>	<b>29,687.67</b>	<b>\$11,817,064.53</b>

The Commission staff estimates that the total hour burden for rule 22c-2 is 29,687.67 hours at a cost of \$11,817,064.53.<sup>26</sup>

### 13. Cost to Respondents

Rule 22c-2 requires funds to enter into information-sharing agreements with their intermediaries that enable funds to, upon request (i) be provided certain information regarding shareholders and their trades that are held through a financial intermediary or an indirect intermediary, and (ii) require the intermediary to execute instructions from the fund restricting or prohibiting further purchases or exchanges by shareholders that violate the fund's frequent trading policies. As a result of this requirement, some funds and intermediaries have had to develop and maintain information sharing, monitoring, and order execution systems (collectively "information sharing systems"). In general, costs related to these information-sharing systems are borne at the fund group level.

The Commission understands that all currently operating funds and intermediaries have either developed information systems themselves or purchased them from third parties. However, these funds and intermediaries also incur certain ongoing costs related to these systems' maintenance and operation. The Commission staff understands that various organizations have developed, enhancements to their systems that allow funds and intermediaries to share the information required by the rule without developing or maintaining systems of their

<sup>26</sup> This estimate is based on the following calculations: (546 hours (board determination) + 29,141.67 hours (information sharing agreements) = 29,687.67 total hours); (\$440,706 (board determination) + \$11,376,358.53 (information sharing agreements) = \$11,817,064.53).

own. Other organizations have developed “22c-2 solution” systems that funds may lease. The Commission staff understands that most funds and intermediaries use these outside systems. In general, the staff estimates that the typical charges involved in operating and maintaining information sharing systems average 25 cents for every 100 account transactions requested. These systems generally also provide analytics, spreadsheets, and other tools designed to enable funds to analyze the data presented, as well as communication tools to process fund instructions regarding the restrictions and prohibitions they may request. Commission staff estimates that the costs of developing, maintaining and operating information systems for funds and intermediaries that do not use outside provider’s systems is comparable to the costs charged by outside providers.<sup>27</sup>

The Commission staff estimates that, on average, each fund group requests information for 100,000 transactions each week, incurring costs of \$250 weekly, or \$13,000 a year.<sup>28</sup> In addition, the Commission staff estimates that funds pay access fees to use these information sharing systems (or comparable internal costs) of \$30,000 each year. The Commission staff therefore estimates that a fund group would typically incur \$43,000 in costs each year related to the operation and maintenance of information sharing systems required by rule 22c-2. The Commission staff has previously estimated that there are 850 fund groups currently active, and

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<sup>27</sup> We include the burden for funds that develop and operate these information sharing systems internally rather than purchasing them from third parties as a cost rather than as an hourly burden because Commission staff understands that, even when developing these systems themselves, funds generally either use independent contractors or hire new personnel, and thereby incur this burden as a cost, not an hourly expenditure.

<sup>28</sup> This estimate is based on the following calculations: (100,000 transaction requests  $\times$  0.0025¢ = \$250); (\$250  $\times$  52 weeks = \$13,000).

therefore estimates that all fund groups incur a total of \$36,550,000 in ongoing costs each year related to maintaining and operating information sharing systems.<sup>29</sup>

In addition, newly formed funds and fund groups advised by advisers who are new entrants would also need to incur certain additional costs related to the initial development or purchase of these information-sharing systems. Commission staff estimates that it requires \$100,000 to purchase or develop and implement such an information sharing system for the first time. Commission staff has previously estimated that 42 funds or fund groups are formed each year managed by new advisers, and therefore estimates that all these funds would incur total costs of \$4,200,000.<sup>30</sup> Therefore the staff estimates that the total annual costs related to rule 22c-2 would be \$40,750,000 ( $\$36,550,000 + \$4,200,000 = \$40,750,000$ ).

#### **14. Cost to the Federal Government**

The rule does not impose any additional costs on the federal government.

#### **15. Changes in Burden**

There has been a decrease in the estimates of burden hours for rule 22c-2. The decrease primarily results from a decrease in the number of new fund groups that form each year. Accordingly, the estimated hour burden has decreased to 29,687.67 hours from a previously estimated 33,829.5, a decrease of 4,141.83 hours. There has been an increase in the cost burden associated with rule 22c-2. The increase primarily results from the staff's estimates of the time costs that would result from the rule. As a result, the estimated cost burden has increased to \$40,750,000 from \$40,243,000, an increase of \$507,000.

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<sup>29</sup> This estimate is based on the following calculation:  $(850 \text{ fund groups} \times \$43,000 = \$36,550,000)$ .

<sup>30</sup> This estimate is based on the following estimate:  $(\$100,000 \times 42 \text{ new fund groups} = \$4,200,000)$ .

**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  
Submission**

Not applicable.

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

Not applicable.