

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

A. JUSTIFICATION

1. Necessity for the Collection of Information

Section 12(b) of the Investment Company Act of 1940 (the “Act”)¹ prohibits a registered open-end investment company (“fund”), other than a fund complying with Section 10(d) of the Act,² from acting as a distributor of securities that it has issued, except through an underwriter, in contravention of Commission rules.³ Rule 12b-1 under the Act permits a fund to bear expenses associated with the distribution of its shares, provided that the fund complies with certain requirements.⁴

Rule 12b-1 requires, among other things, that the fund adopt a written plan describing all material aspects of the proposed financing of distribution (“rule 12b-1 plan”).⁵ The rule 12b-1 plan must be in writing and approved by the fund’s board of directors, and separately by the “independent” directors (as described in the rule).⁶ If the rule 12b-1 plan is being adopted after public offering of the fund’s voting securities, it must also be approved initially by a vote of at least a majority of the fund’s outstanding voting securities.⁷ Similarly, any material amendments to the rule 12b-1 plan must be approved by the fund’s directors, including the independent directors, and any material increase in the amount to be spent under the rule 12b-1 plan must be approved by the fund’s shareholders.⁸ In considering the implementation or continuance of a rule 12b-1 plan, the fund’s board must request and evaluate information reasonably necessary to make an informed decision.⁹ The board also must conclude, in the exercise of reasonable business judgment and in

¹ 15 U.S.C. 80a-1 *et seq.*

² 15 U.S.C. 80a-10(d).

³ 15 U.S.C. 80a-12(b).

⁴ 17 CFR 270.12b-1.

⁵ 17 CFR 270.12b-1(b).

⁶ 17 CFR 270.12b-1(b)(2).

⁷ 17 CFR 270.12b-1(b)(1).

⁸ 17 CFR 270.12b-1(b)(4).

⁹ 17 CFR 270.12b-1(d).

light of the directors' fiduciary duties, that there is a reasonable likelihood that the rule 12b-1 plan will benefit the fund and its shareholders.¹⁰

The rule 12b-1 plan and, in certain instances, any related agreements must incorporate certain specified provisions, including that: (i) the plan or agreement will continue in effect for more than one year only if the board, including the independent directors, approve the continuance at least annually;¹¹ (ii) the fund's board will review quarterly reports of the amounts spent under the plan;¹² and (iii) the plan may be terminated at any time by a majority vote of the independent directors or outstanding voting securities.¹³ Rule 12b-1 also requires the fund to preserve for six years copies of the rule 12b-1 plan and any related agreements and reports, as well as minutes of board meetings that describe the factors considered and the basis for implementing or continuing the rule 12b-1 plan.¹⁴

Rule 12b-1 also prohibits funds from paying for distribution of fund shares with brokerage commissions on their portfolio transactions.¹⁵ The rule requires funds that use broker-dealers that sell their shares to also execute their portfolio securities transactions, to implement policies and procedures reasonably designed to prevent: (i) the persons responsible for selecting broker-dealers to effect transactions in fund portfolio securities from taking into account broker-dealers' promotional or sales efforts when making those decisions; and (ii) a fund, its adviser, or its principal underwriter, from entering into any agreement under which the fund directs brokerage transactions or revenue generated by those transactions to a broker-dealer to pay for distribution of the fund's (or any other fund's) shares.¹⁶

2. Purpose and Use of the Information Collection

Rule 12b-1 enables funds to use their own assets to pay for distribution of their shares. The board and shareholder approval requirements of the rule are designed to ensure that fund shareholders and directors receive adequate information to evaluate and approve a rule 12b-1 plan and, thus, are necessary for investor protection. The provisions that require the board to be provided with quarterly reports and termination authority are designed to ensure that the rule 12b-1 plan continues to

¹⁰ 17 CFR 270.12b-1(e).

¹¹ 17 CFR 270.12b-1(b)(3)(i).

¹² 17 CFR 270.12b-1(b)(3)(ii).

¹³ 17 CFR 270.12b-1(b)(3)(iii).

¹⁴ 17 CFR 270.12b-1(f).

¹⁵ 17 CFR 270.12b-1(h)(1).

¹⁶ 17 CFR 270.12b-1(h)(2)(ii).

benefit the fund and its shareholders. The recordkeeping requirements of the rule are necessary to enable Commission staff to oversee compliance with the rule. The requirement that funds or their advisers implement, and fund boards approve, policies and procedures in order to prevent persons charged with allocating fund brokerage from taking distribution efforts into account is designed to ensure that funds' selection of brokers to effect portfolio securities transactions is not influenced by considerations about the sale of fund shares.

3. Consideration Given to Information Technology

The Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system provides for the automated filing, processing, and dissemination of full disclosure filings. This automation has increased the speed, accuracy, and availability of information, generating benefits to investors and financial markets. Although rule 12b-1 does not require the filing of any documents with the Commission, the Commission may use its EDGAR facility in the future to improve the examination of records funds must keep under the rule. The Electronic Signatures in Global and National Commerce Act and the conforming amendments to rules under the Act permit funds to preserve records electronically.¹⁷

4. Efforts to Identify 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 12b-1 does not require duplicative reporting or recordkeeping. Although rules 31a-1 and 31a-2 under the Act generally require the maintenance and preservation of records, including board minutes,¹⁸ rule 12b-1 specifies documents to be retained under rule 12b-1 and substantive issues to be addressed in the board minutes. Although rule 38a-1 under the Act requires funds to adopt and implement compliance policies and procedures,¹⁹ the requirement in rule 12b-1 to adopt procedures is intended to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute a fund's shares.

5. Effect on Small Entities

The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act,²⁰ to identify methods to minimize recordkeeping or reporting requirements affecting small businesses. The recordkeeping requirements of rule

¹⁷ See 17 CFR 270.31a-2(f).

¹⁸ 17 CFR 270.31a-1; 17 CFR 270.31a-2.

¹⁹ 17 CFR 270.38a-1.

²⁰ 5 U.S.C. 601 *et seq.*

12b-1 are the same for all funds that choose to rely on the rule, including small entities. The burden on smaller funds, however, to prepare a 12b-1 plan and to comply with the other conditions of the rule, may be proportionally greater than for larger funds. The Commission believes, however, that imposing different conditions on smaller funds would not be consistent with investor protection and the purposes of the rule's conditions. Rule 12b-1 is not mandatory, and funds may choose other distribution arrangements. All funds that use their selling brokers to execute fund portfolio securities transactions, however, are required to adopt policies and procedures under rule 12b-1(h).

6. Consequences of Not Conducting Collection

Pursuant to rule 12b-1, fund directors receive information regarding a rule 12b-1 plan and any related agreements (i) when the plan or any related agreements are implemented or when a material amendment is made to the plan; (ii) quarterly in connection with reports concerning amounts spent under the plan; and (iii) annually when the board decides whether to continue the plan and any related agreements. The fund also must provide information to fund shareholders when their vote is required to implement the plan and if any material increases in amounts spent under the plan are proposed. These requirements are necessary to ensure proper approval by fund boards and shareholders in connection with the adoption, continuance, or amendment of a rule 12b-1 plan, and to ensure that fund boards can monitor payments made under a rule 12b-1 plan. These requirements also are necessary for Commission staff to monitor the duties and responsibilities of fund boards and to determine fund compliance with the requirements of the rule. Rule 12b-1 also requires that, before a fund uses a broker-dealer that sells fund shares to also execute portfolio transactions, the fund implement (and its board approve) policies and procedures to prevent distribution efforts from being a factor in the selection of executing broker-dealers. This requirement is necessary to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute the fund's shares.

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

Rule 12b-1 requires funds to retain certain written records for more than three years. Funds relying on rule 12b-1 must preserve copies of the rule 12b-1 plan, related agreements and reports, and board minutes related to the rule for at least six years and maintain such records in an easily accessible place for the first two years. The long-term retention of these records is necessary for the Commission's staff to determine compliance with rule 12b-1.

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 fund industry through

public conferences, meetings, and informal exchanges. These various forums provide the Commission and 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 12b-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. Assurance of Confidentiality

No assurance of confidentiality was provided.

11. Sensitive Questions

No information of a sensitive nature, including social security numbers, will be required under this collection of information. The collection of information does not collect personally identifiable information. The agency has determined that a system of records notice and privacy impact assessment are not required in connection with the collection of information.

12. Burden of Information Collection

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act of 1995²¹ and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms. Reliance on rule 12b-1 is generally voluntary, but compliance with its conditions for funds that do rely on it is mandatory.

Rule 12b-1 requires the board of each fund with a rule 12b-1 plan to (i) initially approve the plan and thereafter consider the plan's continuation on an annual basis and to approve any material amendments to the plan; (ii) review quarterly reports of amounts spent under the plan; and (iii) approve policies and procedures to enable the fund to effect portfolio securities transactions through an executing broker-dealer that also distributes the fund's shares. The number of hours required to comply with rule 12b-1 will vary considerably depending on several factors, including the complexity of the rule 12b-1 plan and the number of classes of fund shares covered by the plan.

Based on information filed with the Commission by funds, Commission staff estimates that there are approximately 7,858 fund portfolios that have at least one share class subject to a rule 12b-1 plan.²² However, many of these portfolios are part

²¹ 44 U.S.C. 3501 *et seq.*

²² This estimate is based on information from the Commission's Form N-SAR database.

of an affiliated group of funds, or fund family, that is overseen by a common board of directors. Although the board must review and approve the rule 12b-1 plan for each fund separately, we have allocated the costs and hourly burden related to rule 12b-1 based on the number of fund families that have at least one fund that charges rule 12b-1 fees, rather than on the total number of fund portfolios that individually have a rule 12b-1 plan.²³ Based on information filed with the Commission, the staff estimates that there are approximately 323 fund families with common boards of directors that have at least one fund with a rule 12b-1 plan.

Based on previous conversations with fund representatives, Commission staff estimates that for each of the 323 fund families with a portfolio that has a rule 12b-1 plan, the average annual burden of complying with the rule is 425 hours. This estimate takes into account the time needed to prepare quarterly reports to the board of directors, the board's consideration of those reports, and the board's initial or annual consideration of whether to continue the plan.²⁴ We therefore estimate that the total hourly burden per year for all funds to comply with current information collection requirements under rule 12b-1, is 137,275 hours.²⁵

²³ This allocation is based on previous conversations with fund representatives on how fund boards comply with the requirements of rule 12b-1. Despite this allocation of hourly burdens and costs, the number of annual responses each year will continue to depend on the number of fund portfolios with rule 12b-1 plans rather than the number of fund families with rule 12b-1 plans. The staff estimates that the number of annual responses per fund portfolio will be four per year (quarterly, with the annual reviews taking place at one of the quarterly intervals). Thus, we estimate that funds will make 31,432 responses each year. $7,858 \text{ fund portfolios} \times 4 \text{ responses per year per fund portfolio} = 31,432 \text{ responses per year}$.

²⁴ We do not estimate any costs or time burden related to the recordkeeping requirements in rule 12b-1, as funds are either required to maintain these records pursuant to other rules or would keep these records in any case as a matter of business practice.

²⁵ $323 \text{ fund families} \times 425 \text{ hours per fund family per year} = 137,275 \text{ hours per year}$.

We estimate the annual cost of the hourly burden per fund family under the rule to be \$119,720. This figure reflects an estimate that each fund family with a rule 12b-1 plan would spend the following hours each year complying with rule 12b-1:

ESTIMATED HOURLY BURDEN		ESTIMATED APPLICABLE WAGE RATE ²⁶	ESTIMATED COST OF HOURLY BURDEN
380 hours per year			
by intermediate accountants for preparing quarterly reports	×	\$165	\$62,700
10 hours per year			
by paralegals for assisting with quarterly reports and initial or annual approval materials	×	\$210	\$2,100
20 hours per year			
by compliance attorneys for reviewing quarterly reports and preparing initial or annual approval materials	×	\$352	\$7,040
5 hours per year			
by deputy general counsel for reviewing quarterly reports and initial or annual approval materials	×	\$576	\$2,880
10 hours per year			
by board of directors reviewing quarterly reports and the initial or annual approval materials and making the necessary findings	×	\$4,500	+ \$45,000
TOTAL			\$119,720

Thus, we estimate that the total annual cost to all funds of the rule 12b-1 hour burden is approximately \$39 million.²⁷

As a result, we estimate that there will be an industry total of 137,275 burden hours per year at a cost of \$39 million per year over the three year period for which we are requesting approval of the information collection burden.

13. Cost to Respondents

If a currently operating fund seeks to (i) adopt a new rule 12b-1 plan or (ii) materially increase the amount it spends for distribution under its rule 12b-1 plan, rule 12b-1 requires that the fund obtain shareholder approval. As a consequence, the

²⁶ The Commission's estimate concerning the wage rate is based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for intermediate accountants, paralegals, compliance attorneys, and deputy general counsels, modified to account for an 1,800-hour work year; multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead; and adjusted to account for the effects of inflation, yielding effective hourly rates of \$165, \$210, \$352, and \$576, respectively. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013.

²⁷ 323 fund families with rule 12b-1 plans × \$119,720 per year = \$38,669,560.

fund will incur the cost of a proxy.²⁸ Based on previous conversations with fund representatives, Commission staff estimates that approximately three funds per year prepare a proxy in connection with the adoption or material amendment of a rule 12b-1 plan. Funds typically hire outside legal counsel and proxy solicitation firms to prepare, print, and mail such proxies. The staff further estimates that the cost of each fund's proxy is \$34,849.²⁹ Thus, the total annual cost burden of rule 12b-1 to the fund industry is \$104,547.³⁰

14. Cost to the Federal Government

Rule 12b-1 does not currently impose any costs on the federal government. The rule does not require funds to file any documents with the Commission. Commission staff may 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 annual burden hours for funds with rule 12b-1 plans has decreased from 140,250 to 137,275 hours (a decrease of 2,975 hours). This is due to a decrease in the number of fund families that have at least one fund that has a rule 12b-1 plan. The estimated annual cost burden associated with rule 12b-1 has increased from \$103,116 to \$104,547 (an increase of \$1,431). The increase in cost is due to the effects of inflation.

16. Information Collection Planned for Statistical Purposes

The results of any information collection will not be published.

17. Approval to Omit OMB Expiration Date

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

²⁸ In general, a fund adopts a rule 12b-1 plan before it begins operations. Therefore, the fund is not required to obtain the approval of its public shareholders because the fund's shares have not yet been offered to the public.

²⁹ This estimate is based on staff's 2012 estimate of costs for each fund's proxy (\$32,174), adjusted for inflation to January 2018 values using the Personal Consumption Expenditures Chain-Type Price Index ("PCE Index"). *See* Personal Consumption Expenditures, Chain-type Price Index, *available at* <http://fred.stlouisfed.org/series/PCEPI>.

³⁰ 3 funds requiring a proxy per year × \$34,849 per proxy = \$104,547 per year.

**18. Exceptions to Certification Statement for Paperwork Reduction Act
Submission**

The Commission is not seeking an exception to the certification statement.

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

The collection of information will not employ statistical methods.