

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**Rule 18f-4**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 18 of the Investment Company Act of 1940 (“Investment Company Act”)<sup>1</sup> imposes various limitations on the capital structure of funds, including, in part, by restricting the ability of funds to issue “senior securities,” as defined in that section.<sup>2</sup> The protection of investors against the potentially adverse effects of a fund’s issuance of senior securities is a core purpose of the Investment Company Act.<sup>3</sup> Section 18(g) of the Investment Company Act defines “senior security,” in part, as “any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness.”<sup>4</sup>

On November 25, 2019, the Commission issued a release proposing new rule 18f-4, which would permit a fund to enter into derivatives transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under section 18 of the Investment Company Act.<sup>5</sup> Rule 18f-4 would generally require a fund that relies on the rule to enter into derivatives transactions to: (1) adopt a derivatives risk management program; (2) have its board of directors approve the fund’s designation of a derivatives risk manager and receive

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<sup>1</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>2</sup> *See* 15 U.S.C. 80a-18.

<sup>3</sup> *See, e.g.,* 15 U.S.C. 80a-1(b)(7), 1(b)(8), 18(a), and 18(f).

<sup>4</sup> The definition of senior security in section 15 U.S.C. 80a-18 also includes “any stock of a class having priority over any other class as to the distribution of assets or payment of dividends” and excludes certain limited temporary borrowings.

<sup>5</sup> *See* Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers’ Transactions in Certain Leveraged/Inverse Investment Vehicles, Investment Company Act Release No. 33704 (Nov. 25, 2019) (“Proposing Release”).

direct reports from the derivatives risk manager about the derivatives risk management program; and (3) require a fund to comply with an outer limit on fund leverage risk based on value-at-risk, or “VaR,” designed to limit a fund’s leverage risk consistent with the investor protection purposes underlying section 18. This outer limit would be based on a relative VaR test that compares the fund’s VaR to the VaR of a “designated reference index.” If the fund’s derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test. Proposed rule 18f-4 includes an exception from the risk management program requirement and limit on fund leverage risk if a fund is a “limited derivatives user” that either limits its derivatives exposure to 10% of its net assets or it uses derivatives transactions solely to hedge certain currency risks. A fund relying on the proposed exception would be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks. Proposed rule 18f-4 also includes alternative requirements for certain registered investment companies that seek, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time (“leveraged/inverse funds”). Under the proposed rule, a leveraged/inverse fund would not be subject to the proposed VaR-based leverage risk limit if such a fund: (1) meets the definition of a “leveraged/inverse investment vehicle” in proposed rule 15l-2 under the Securities Exchange Act of 1934 and proposed rule 211(h)-1 under the Investment Advisers Act of 1940 (collectively, the “proposed sales practices rules”); (2) limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index; and (3) discloses in its prospectus that it is not subject to proposed rule 18f-4’s limit on fund leverage risk. Proposed rule 18f-4 also would require a fund to adhere to certain

recordkeeping requirements that are designed to provide the Commission's staff, and the fund's board of directors and compliance personnel, the ability to evaluate the fund's compliance with the proposed rule's requirements.

Compliance with proposed rule 18f-4 would be mandatory for all funds that seek to engage in derivatives transactions in reliance on the rule, which would otherwise be subject to the restrictions of section 18. To the extent that records required to be created and maintained by funds under the rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

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

Certain of the provisions of the proposed rule contain "collection of information" requirements within the meaning on the Paperwork Reduction Act of 1995 ("Paperwork Reduction Act"),<sup>6</sup> and the Commission is submitting the collection of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The proposed rule is designed to address the investor protection purposes and concerns underlying section 18 and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives transactions and certain other transactions.

The information collection requirements of proposed rule 18f-4 are designed to ensure that funds appropriately limit the amount of leverage risk that may be obtained through derivatives transactions and manage the risks associated with derivatives transactions and certain other transactions. The information collections also assist the Commission's examination staff in

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<sup>6</sup> 44 U.S.C. 3501 *et seq.*

assessing funds' compliance with the proposed rule and identifying weaknesses in a fund's management of derivatives transactions and certain other transactions.

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

Proposed rule 18f-4 would require a fund to maintain certain records documenting its derivatives risk management program's written policies and procedures, along with its stress test results, VaR backtesting results, internal reporting or escalation of material risks under the program, and reviews of the program. The proposed rule would also require a fund to maintain records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager and any written reports relating to the derivatives risk management program. A fund that is required to comply with the proposed VaR test would also have to maintain records documenting the determination of: its portfolio VaR; the VaR of its designated reference indexes, as applicable; its VaR ratio (the value of the VaR of the fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any of its VaR calculation model and the basis for any material changes to its VaR model. A fund that is a limited derivatives user under the proposed rule would have to maintain a written record of its policies and procedures that are reasonably designed to manage derivatives risks. A fund engaging in unfunded commitment agreements would be required to maintain records documenting the sufficiency of its funds to meet its obligations with respect to all unfunded commitment agreements. The Electronic Signatures in Global and National Commerce Act<sup>7</sup> and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

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<sup>7</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

#### **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. Proposed rule 18f-4 would impose information collection requirements for funds relying on the proposed rule relating to: the derivatives risk management program, board oversight and reporting, the VaR-based limit on fund leverage risk, disclosure requirements for leveraged/inverse funds and money market funds, limited derivatives users' policies and procedures, and associated recordkeeping requirements. The information required by proposed rule 18f-4 is not generally duplicated elsewhere.

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

The information collection requirements of proposed rule 18f-4 do not distinguish between small entities and other funds. The burden of the conditions on smaller funds may be proportionally greater than for larger funds. The Commission believes, however, that imposing different requirements on smaller investment companies would not be consistent with investor protection and the purposes of the rule's conditions and could potentially jeopardize the interests of investors in small funds. While proposed rule 18f-4 does not distinguish between small entities and other funds, the rule includes a limited derivatives user exception, which requires fewer information collection burdens. To the extent smaller funds generally use derivatives transactions on a more limited basis, and therefore could qualify as limited derivatives users under the rule, these funds would incur fewer burdens associated with their compliance as compared to other funds that would not qualify as limited derivatives users. The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small businesses.

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

Proposed rule 18f-4 would impose information collection requirements for funds relying on the proposed rule relating to: the derivatives risk management program, board oversight and reporting, the VaR-based limit on fund leverage risk, disclosure requirements for leveraged/inverse funds and money market funds, limited derivatives users' policies and procedures, and associated recordkeeping requirements.

Not collecting information or collecting such information less frequently would be incompatible with the objectives of rule 18f-4. The reporting of information and the establishment of written policies and procedures and maintaining written reports are integral parts to ensuring compliance with the proposed rule and detecting and correcting any violations or potential violations.

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

Proposed rule 18f-4 would require a fund to maintain for a period of five years:

(1) certain records documenting the fund's derivatives risk management program; (2) records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager; (3) for a fund that is required to comply with the proposed VaR-based limit on fund leverage risk, records documenting the fund's determination of: the VaR of its portfolio; the VaR of the fund's designated reference index, as applicable; the fund's VaR ratio (the value of the VaR of the fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any VaR calculation models used by the fund, as well as the basis for any material changes made to those models; (4) for a fund that is a limited derivatives user, a written record of its policies and procedures that are reasonably designed to manage its derivatives risk; and (5) for a fund that enters into unfunded

commitment agreements, a record documenting the basis for the fund's belief regarding the sufficiency of its cash and cash equivalents to meet its obligations with respect to its unfunded commitment agreements.<sup>8</sup> Although this five-year period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2), the Commission believes that this is warranted because the rule contributes to the effectiveness of the Commission's examination and inspection program. Because the period between examinations may be as long as five years, it is important that the Commission have access to records that cover the entire period between examinations.

The five-year retention period in proposed rule 18f-4 is consistent with that in rules 38a-1(d) and 22e-4 under the Investment Company Act. We believe that consistency in these retention periods is appropriate because funds currently have program-related recordkeeping procedures in place incorporating a five-year retention period. Furthermore, we believe that a five-year retention period would lessen the compliance burden of proposed rule 18f-4 slightly, compared to choosing a different, longer retention period (such as the six-year recordkeeping retention period under rule 31a-2 of the Investment Company Act).

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

Before adopting proposed rule 18f-4, the Commission will receive and evaluate public comments on the proposal and its collection of information requirements. Moreover, the Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and information exchanges. These various forums provide the Commission and staff with a means of ascertaining and acting upon the paperwork burdens confronting the industry.

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<sup>8</sup> See proposed rule 18f-4(c)(6).

**9. Payment or Gift**

No payment or gift to respondents was provided.

**10. Assurance of Confidentiality**

No information would be submitted directly to the Commission under proposed rule 18f-4. Other information provided to the Commission in connection with staff examinations or investigations would be kept confidential subject to the provisions of applicable law. If information collected pursuant to proposed rule 18f-4 is reviewed by the Commission's examination staff, it 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.

**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. Estimate of Hour Burden**

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.<sup>9</sup>

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<sup>9</sup> The Commission's estimates of the relevant wage rates in the tables below are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2013. The estimated wage figures are modified by Commission staff to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, overhead, and adjusted to account for the

The respondents to proposed rule 18f-4 would be registered open- and closed-end management investment companies, and companies that have elected to be treated as business development companies under the Investment Company Act (collectively, “funds”).<sup>10</sup> We estimate that 5,091 funds would likely rely on rule 18f-4.<sup>11</sup> Compliance with proposed rule 18f-4 would be mandatory for all funds that seek to engage in derivatives transactions in reliance on the rule, which would otherwise be subject to the restrictions of section 18. To the extent that records required to be created and maintained by funds under the rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

#### **A. Derivatives Risk Management Program**

Proposed rule 18f-4 would require certain funds relying on the rule to adopt and implement a written derivatives risk management program, which would include policies and procedures reasonably designed to manage the fund’s derivatives risks. The proposal would require a fund’s program to include the following elements: (1) risk identification and assessment; (2) risk guidelines; (3) stress testing; (4) backtesting; (5) internal reporting and escalation; and (6) periodic review of the program.<sup>12</sup> Under the proposed rule, the derivatives risk manager is responsible for administering the derivatives risk management program and its policies and procedures. Certain funds relying on the proposed rule would not be subject to the

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effects of inflation. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 (“SIFMA Report”).

<sup>10</sup> *See* proposed rule 18f-4(a) (defining “fund”).

<sup>11</sup> 2,693 funds that would be subject to the proposed derivatives risk management program and limit on fund leverage risk requirements + 2,398 funds relying on the limited derivatives user exception and complying with the related limited derivatives user requirements.

<sup>12</sup> *See* proposed rule 18f-4(c)(1)(i)-(vi).

program requirement.<sup>13</sup> We estimate that 2,693 funds would likely be subject to the program requirement.<sup>14</sup> Below we estimate the initial and annual ongoing burdens associated with initial documentation of the program, and any revision (and related documentation) of the derivatives risk management program arising from the periodic review of the program. In addition to the initial burden to document the program, including policies and procedures reasonably designed to manage the fund's derivatives risks, we estimate that a fund relying on the proposed rule would have an ongoing burden associated with the proposed periodic review requirements to evaluate the program's effectiveness and to reflect changes in the fund's derivatives risks over time. Below we estimate the initial and annual ongoing burdens associated with documentation and any review and revision of funds' programs including their policies and procedures.

Table 1 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the derivatives risk management program requirement under proposed rule 18f-4. We do not estimate that there will be any initial or ongoing external costs associated with the derivatives risk management program requirement.

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<sup>13</sup> A fund that is a limited derivatives user would not be required to comply with the proposed program requirement. Funds that are limited derivatives users would be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks. *See* proposed rule 18f-4(c)(3).

<sup>14</sup> *See supra* note 11.

**Table 1: Derivatives Risk Management Program PRA Estimates**

|   | Internal initial burden hours | Internal annual burden hours <sup>1</sup> |       | Wage rate <sup>2</sup>            | Internal time costs |       |
|---|-------------------------------|---|-------|-----------------------------------|---------------------|-------|
| <b>PROPOSED ESTIMATES</b>                               |                               |   |       |                                   |                     |       |
| Written derivatives risk management program development | 12 hours                      | 4 hours                                   | ×     | \$357 (derivatives risk manager)  | \$1,428             |       |
|   | 12 hours                      | 4 hours                                   | ×     | \$466 (assistant general counsel) | \$1,864             |       |
|   | 12 hours                      | 4 hours                                   | ×     | \$365 (compliance attorney)       | \$1,460             |       |
| Periodic review and revisions of the program            | 0 hours                       | 2 hours                                   | ×     | \$357 (derivatives risk manager)  | \$714               |       |
|   | 0 hours                       | 2 hours                                   | ×     | \$466 (assistant general counsel) | \$932               |       |
|   | 0 hours                       | 2 hours                                   | ×     | \$365 (compliance attorney)       | \$730               |       |
| Total annual burden per fund                            |                               | 18 hours                                  |       |                                   | \$7,128             |       |
| Number of funds   |                               | ×   | 2,693 |                                   | ×                   | 2,693 |
| Total annual burden                                     |                               | 48,474 hours                              |       |                                   | \$19,195,704        |       |

Notes:

1. For “Written derivatives risk management program development,” these estimates include initial burden estimates annualized over a three-year period.

2. See *supra* note 9.

## **B. Board Oversight and Reporting**

The proposed rule would require: (1) a fund's board of directors to approve the designation of the fund's derivatives risk manager,<sup>15</sup> (2) the derivatives risk manager to provide written reports to the board regarding the program's implementation and effectiveness,<sup>16</sup> and (3) the derivatives risk manager to provide written reports describing any exceedances of the fund's guidelines and the results of the fund's stress testing and backtesting.<sup>17</sup> We estimate that 2,693 funds would be subject to these requirements.<sup>18</sup>

Table 2 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the board oversight and reporting requirements under proposed rule 18f-4. We do not estimate that there will be any initial or ongoing external costs associated with the board oversight and reporting requirements.

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<sup>15</sup> See proposed rule 18f-4(c)(5)(i).

<sup>16</sup> See proposed rule 18f-4(c)(5)(ii).

<sup>17</sup> See proposed rule 18f-4(c)(5)(iii).

<sup>18</sup> See *supra* note 11.

**Table 2: Board Oversight and Reporting PRA Estimates**

|  | Internal<br>initial<br>burden<br>hours | Internal annual<br>burden hours <sup>1</sup> |       | Wage rate <sup>2</sup>                                   | Internal time costs |
|--|--|--|-------|--|---------------------|
| PROPOSED ESTIMATES   |  |  |       |  |                     |
| Approving the designation of<br>the derivatives risk manager | 3 hours                                | 1 hour                                       | ×     | \$17,860 (combined rate<br>for 4 directors) <sup>2</sup> | \$17,860            |
| Derivatives risk manager<br>written reports                  |  | 8 hours                                      | ×     | \$357 (derivatives risk<br>manager)                      | \$2,856             |
|  |  | 1 hour                                       | ×     | \$17,860 (combined rate<br>for 4 directors)              | \$17,860            |
| Total annual burden per fund                                 |  | 10 hours                                     |       |  | \$11,786            |
| Number of funds  |  | ×  | 2,693 |  | ×                   |
| Total annual burden  |  | 26,930 hours                                 |       |  | \$31,739,698        |

Notes:

1. For “Approving the designation of the derivatives risk manager,” this estimate includes initial burden estimates annualized over a three-year period.

2. See *supra* note 9.

### C. Disclosure Requirement Associated with Limit on Fund Leverage Risk

The proposed rule would also generally require funds relying on the rule to comply with an outer limit on fund leverage risk based on VaR. This outer limit would be based on a relative VaR test that compares the fund's VaR to the VaR of a "designated reference index." If the fund's derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test.<sup>19</sup> Under the proposed rule, a fund must disclose its designated reference index in its annual report.<sup>20</sup> We estimate that 2,424 funds would be required to implement VaR tests and therefore would be subject to this disclosure requirement.<sup>21</sup>

Table 3 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the disclosure requirement associated with the proposed limit on fund leverage risk. We do not estimate that there will be any paperwork-related initial or ongoing external costs associated with this proposed disclosure requirement.

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<sup>19</sup> The collections of information burdens for disclosure requirements associated with the proposed limit on fund leverage risk are reflected in the PRA for proposed rule 18f-4 and not in the funds' applicable disclosure forms because the burden arises from the proposed rule. The Paperwork Reduction Act analysis for the funds' applicable disclosure forms will not reflect the collections of information burdens for disclosure requirements associated with the proposed limit on fund leverage risk.

A fund that is a leveraged/inverse investment vehicle, as defined in the proposed sales practices rules, would not be required to comply with the proposed VaR-based limit on fund leverage risk. Broker-dealers and investment advisers would be required to approve retail investors' accounts to purchase or sell shares in these funds. The proposed rule also would provide an exception from the proposed VaR tests for funds that use derivatives to a limited extent or only to hedge currency risks.

VaR test burdens related to recordkeeping and reporting are reflected in the recordkeeping section below, and also in the Forms N-PORT, N-CURRENT, and N-CEN burdens.

<sup>20</sup> See proposed rule 18f-4(c)(2)(iv).

<sup>21</sup> See Proposing Release, *supra* note 5, at n.520 and accompanying text.

**Table 3: Disclosure Requirement Associated with Limit on Fund Leverage Risk PRA Estimates**

|   | Internal<br>initial<br>burden<br>hours | Internal annual<br>burden hours |   | Wage rate <sup>1</sup>         | Internal time costs |
|---|--|---------------------------------|---|--------------------------------|---------------------|
| <b>PROPOSED ESTIMATES</b>                   |  |                                 |   |                                |                     |
| Disclosure of designated<br>reference index | 0 hours                                | .5 hours                        | × | \$309 (compliance<br>manager)  | \$154.50            |
|   | 0 hours                                | .5 hours                        | × | \$365 (compliance<br>attorney) | \$182.50            |
| Total annual burden per fund                |  | 1 hour                          |   |                                | \$337               |
| Number of funds                             |  | × 2,424                         |   |                                | × 2,424             |
| Total annual burden                         |  | 2,424 hours                     |   |                                | \$816,888           |

Notes:

1. *See supra* note 9.

#### **D. Disclosure Requirement for Leveraged/Inverse Funds**

Under the proposed rule, a fund would not have to comply with the proposed VaR-based leverage risk limit if it: (1) meets the definition of a “leveraged/inverse investment vehicle” in the proposed sales practices rules; (2) limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index; and (3) discloses in its prospectus that it is not subject to proposed rule 18f-4’s limit on fund leverage risk.<sup>22</sup> We estimate that 269 funds would be subject to the proposed prospectus disclosure requirement for leveraged/inverse funds.<sup>23</sup>

Table 4 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the disclosure requirement in the proposed rule’s alternative provision for leveraged/inverse funds. We do not estimate that there will be any initial or ongoing external costs associated with this proposed disclosure requirement.

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<sup>22</sup> See proposed rule 18f-4(c)(4).

<sup>23</sup> 164 leveraged/inverse ETFs + 105 leveraged mutual funds.

**Table 4: Disclosure Requirement Associated with Leveraged/Inverse Funds PRA Estimates**

|   | Internal<br>initial<br>burden<br>hours | Internal annual<br>burden hours |   | Wage rate <sup>1</sup>         | Internal time costs |
|---|--|---------------------------------|---|--------------------------------|---------------------|
| <b>PROPOSED ESTIMATES</b>                       |  |                                 |   |                                |                     |
| Leveraged/inverse fund<br>prospectus disclosure | 0 hours                                | .25 hours                       | × | \$309 (compliance<br>manager)  | \$77                |
|   | 0 hours                                | .25 hours                       | × | \$365 (compliance<br>attorney) | \$91                |
| Total annual burden per fund                    |  | 1 hour                          |   |                                | \$168               |
| Number of funds                                 |  | × 269                           |   |                                | × 269               |
| Total annual burden                             |  | 269 hours                       |   |                                | \$45,192            |

Notes:

1. See *supra* note 9.

## E. Disclosure Changes for Money Market Funds

Money market funds are excluded from the scope of the rule and could not rely on proposed rule 18f-4 to enter into derivatives transactions or other transactions addressed in the proposed rule.<sup>24</sup> To the extent a money market fund currently discloses in its prospectus that it may use any of these transactions—even if it is not currently entering into these transactions—money market funds would be subject to the burdens associated with making disclosure changes to their prospectuses. We estimate that 413 funds could be subject to such disclosure changes on account of money market funds’ exclusion from the proposed rule.<sup>25</sup>

Table 5 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with disclosure changes that money market funds could make because of their exclusion from proposed rule 18f-4.<sup>26</sup> We do not estimate that there will be any initial or ongoing external costs associated with this disclosure change requirement.

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<sup>24</sup> See proposed rule 18f-4(a) (defining the term “Fund” to “...not include a registered open-end company that is regulated as a money market fund”).

<sup>25</sup> This likely overestimates the total number of funds subject to these disclosure changes, because we believe that money market funds currently do not typically engage in derivatives transactions or the other transactions addressed by proposed rule 18f-4.

<sup>26</sup> These per-fund burden estimates likely overestimate the total burden associated with these disclosure changes.

**Table 5: Disclosure Changes for Money Market Funds PRA Estimates**

|   | Internal<br>initial<br>burden<br>hours | Internal annual<br>burden hours |   | Wage rate <sup>1</sup>         | Internal time costs |
|---|--|---------------------------------|---|--------------------------------|---------------------|
| <b>PROPOSED ESTIMATES</b>                     |  |                                 |   |                                |                     |
| Money market prospectus<br>disclosure changes | .75 hours                              | .25 hours                       | × | \$309 (compliance<br>manager)  | \$77                |
|   | .75 hours                              | .25 hours                       | × | \$365 (compliance<br>attorney) | \$91                |
| Total annual burden per fund                  |  | .5 hour                         |   |                                | \$168               |
| Number of funds                               |  | × 413                           |   |                                | × 413               |
| Total annual burden                           |  | 207 hours                       |   |                                | \$69,384            |

Notes:

1. See *supra* note 9.

## F. Policies and Procedures for Limited Derivatives Users

Proposed rule 18f-4 would require funds relying on the limited derivatives user provisions to adopt and implement written policies and procedures reasonably designed to manage the fund's derivatives risks.<sup>27</sup> Only funds that limit their derivatives exposure to 10% of their net assets or that use derivatives transactions solely to hedge certain currency risks would be permitted to rely on these provisions. We estimate that 2,398 funds would be subject to the limited derivatives user requirements.<sup>28</sup> In addition to the initial burden to document the policies and procedures, we estimate that limited derivatives users would have an ongoing burden associated with any review and revisions to its policies and procedures to ensure that they are “reasonably designed” to manage the fund's derivatives risks. Below we estimate the initial and annual ongoing burdens associated with documentation and any review and revision of the limited derivatives users' policies and procedures.

Table 6 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the policies and procedures requirement for limited derivatives users under proposed rule 18f-4. We do not estimate that there will be any initial or ongoing external costs associated with the policies and procedures requirement for limited derivatives users.

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<sup>27</sup> See proposed rule 18f-4(c)(3).

<sup>28</sup> See *supra* note 11.

**Table 6: Policies and Procedures for Limited Derivatives Users PRA Estimates**

|                                   | Internal<br>initial<br>burden<br>hours | Internal annual<br>burden hours <sup>1</sup> | Wage rate <sup>2</sup>                     | Internal time<br>costs |
|-----------------------------------|--|--|--|------------------------|
| <b>PROPOSED ESTIMATES</b>         |  |  |  |                        |
| Written policies and procedures   | 3 hours                                | 1 hour                                       | × \$329 (senior manager) <sup>4</sup>      | \$329                  |
|                                   | 3 hours                                | 1 hour                                       | × \$365 (compliance attorney) <sup>4</sup> | \$365                  |
| Review of policies and procedures | 0 hours                                | .25 hours                                    | \$329 (senior manager) <sup>4</sup>        | \$82.25                |
|                                   | 0 hours                                | .25 hours                                    | \$365 (compliance attorney) <sup>4</sup>   | \$91.25                |
| Total annual burden per fund      |  | 2.5 hours                                    |  | \$867.50               |
| Number of funds                   |  | × 2,398                                      |  | × 2,398                |
| Total annual burden               |  | 5,995 hours                                  |  | \$2,080,265            |

Notes:

1. For “Written policies and procedures,” these estimates include initial burden estimates annualized over a three-year period.
2. See *supra* note 9.

## G. Recordkeeping Requirements

Proposed rule 18f-4 would require a fund to maintain certain records documenting its derivatives risk management program's written policies and procedures, along with its stress test results, VaR backtesting results, internal reporting or escalation of material risks under the program, and reviews of the program.<sup>29</sup> The proposed rule would also require a fund to maintain records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager and any written reports relating to the derivatives risk management program.<sup>30</sup> A fund that is required to comply with the proposed VaR test would also have to maintain records documenting the determination of: its portfolio VaR; the VaR of its designated reference indexes, as applicable; its VaR ratio (the value of the VaR of the Fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any of its VaR calculation model and the basis for any material changes to its VaR model.<sup>31</sup> A fund that is a limited derivatives users under the proposed rule would have to maintain a written record of its policies and procedures that are reasonably designed to manage derivatives risks.<sup>32</sup> A fund engaging in unfunded commitment agreements would be required to maintain records documenting the sufficiency of its funds to meet its obligations with respect to all unfunded commitment agreements.<sup>33</sup>

We estimate that 5,091 funds would be subject to the recordkeeping requirements.<sup>34</sup>

Below we estimate the average initial and ongoing annual burdens associated with the

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<sup>29</sup> See proposed rule 18f-4(c)(6)(i)(A).

<sup>30</sup> See proposed rule 18f-4(c)(6)(i)(B).

<sup>31</sup> See proposed rule 18f-4(c)(6)(i)(C).

<sup>32</sup> See proposed rule 18f-4(c)(6)(i)(D).

<sup>33</sup> See proposed rule 18f-4(e)(2).

<sup>34</sup> See *supra* note 11.

recordkeeping requirements. This average takes into account that some funds such as limited derivatives users may have less extensive recordkeeping burdens than other funds that use derivatives more substantially.

Table 7 below summarizes the proposed PRA estimates associated with the recordkeeping requirements in rule 18f-4.

**Table 7: Recordkeeping PRA Estimates**

|  | Internal<br>initial<br>burden<br>hours | Internal<br>annual<br>burden<br>hours <sup>1</sup> |       | Wage rate <sup>2</sup>             | Internal<br>time costs |
|--|--|--|-------|------------------------------------|------------------------|
| <b>PROPOSED ESTIMATES</b>                                |  |  |       |                                    |                        |
| Establishing<br>recordkeeping policies<br>and procedures | 1.5                                    | .5   |       | \$62 (general clerk)               | \$31                   |
|  | 1.5                                    | .5   |       | \$95 (senior computer<br>operator) | \$47.50                |
| Recordkeeping  | 0 hours                                | 2 hours  | ×     | \$62 (general clerk)               | \$31                   |
|  | 0 hours                                | 2 hours  | ×     | \$95 (senior computer<br>operator) | \$47.50                |
| Total annual burden per<br>fund                          |  | 5 hours  |       |                                    | \$157                  |
| Number of funds  |  | ×  | 5,091 |                                    | ×                      |
| Total annual burden                                      |  | 25,455<br>hours                                    |       |                                    | \$799,287              |

**Notes:**

1. For “Establishing recordkeeping policies and procedures,” these estimates include initial burden estimates annualized over a three-year period.
2. *See supra* note 9.

## H. Proposed Rule 18f-4 Total Estimated Burden

As summarized in Table 8 below, we estimate that the total hour burdens and time costs associated with proposed rule 18f-4, including the burden associated with documenting the derivatives risk management program, board oversight and reporting, disclosure requirements associated with the proposed VaR tests, disclosure requirements associated with the alternative requirements for leveraged/inverse funds, policies and procedures development for limited derivatives users, and recordkeeping, amortized over three years, would result in an average aggregate annual burden of 109,754 hours and an average aggregate annual monetized time cost of \$54,761,797. Therefore, each fund that relies on the rule would incur an average annual burden of approximately 20.56 hours, at an average annual monetized time cost of approximately \$10,757, to comply with proposed rule 18f-4.<sup>35</sup>

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<sup>35</sup> These per-fund burden estimates likely overestimate the total burden of proposed rule 18f-4 because not all funds (*e.g.*, limited derivatives users) would incur the various burdens set forth in the table.

**Table 8: Proposed Rule 18f-4 Total PRA Estimates**

|   | Internal<br>hour burden | Internal<br>burden time<br>cost |
|---|-------------------------|---------------------------------|
| Derivatives risk management program   | 48,474 hours            | \$19,195,704                    |
| Board oversight and reporting   | 26,930 hours            | \$31,739,698                    |
| Disclosure requirement associated with limit on fund leverage risk                          | 2,424 hours             | \$816,888                       |
| Disclosure requirement associated with alternative requirements for leveraged/inverse funds | 269 hours               | \$45,192                        |
| Disclosure changes for money market funds   | 207 hours               | \$69,384                        |
| Policies and procedures for limited derivatives users                                       | 5,995 hours             | \$2,080,265                     |
| Recordkeeping requirements  | 25,455 hours            | \$799,287                       |
| Total annual burden   | 109,754                 | \$54,746,418                    |
| Number of funds   | ÷ 5,091                 | ÷ 5,091                         |
| Average annual burden per fund  | 20.56 hours             | \$10,754                        |

### 13. Cost to Respondents

We estimate that, amortized over three years, there would be external costs of \$3,054,600 associated with this collection of information. Therefore, each fund that relies on proposed rule 18f-4 would incur a one-time annualized external cost of \$600 to comply with the proposed rule. The cost burden is the cost associated with a fund establishing recordkeeping policies and procedures related to the recordkeeping requirements under rule 18f-4. The cost burden does not include the hour burden discussed in Item 12 above.

|  | Initial<br>external<br>cost burden | Annual<br>external cost<br>burden |
|--|------------------------------------|-----------------------------------|
| Establishing recordkeeping policies and procedures | \$1,800                            | \$600                             |
| Total annual burden per fund                       |                                    | \$600                             |

|                     |             |
|---------------------|-------------|
| Number of funds     | 5,091       |
| Total annual burden | \$3,054,600 |

**14. Costs to Federal Government**

Proposed rule 18f-4 does not impose a cost to the federal government.

Commission staff may, however, 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**

This is the first request for approval of the collection of information for this rule.

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

Not applicable.

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

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

**18. Exceptions to Certification for Paperwork Reduction Act Submissions**

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.