

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for Proposed
Rule 211(h)-1

A. JUSTIFICATION

1. Necessity for the Information Collection

Proposed new rule 211(h)-1 under the Investment Advisers Act of 1940 (17 CFR 275.211(h)-1) (the “Advisers Act”) would impose burdens on investment advisers registered with the Commission (“investment advisers”) relating to investments in “leveraged/inverse investment vehicles” by their retail clients.¹ Under the proposed rule, the term “leveraged/inverse investment vehicle” means a registered investment company, or exchange-listed commodity- or currency-based trust or fund, that seeks, 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. The proposed rule is designed to address investor protection concerns related to leveraged/inverse investment vehicles by helping to ensure that retail investors in those products are capable of evaluating their characteristics and the unique risks they present.

Under the proposed rule, before placing an order for the account of a client that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, the investment adviser must approve the client’s account to engage in those transactions in accordance with the proposed rule. To make

¹ 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).

this approval determination, the proposed rule would require an investment adviser (or any supervised person of the investment adviser) to exercise due diligence to ascertain certain essential facts about the client. Specifically, the investment adviser would have to seek to obtain certain information about the retail investor as described in the proposed rule. An investment adviser could approve the retail investor’s account to buy or sell shares of leveraged/inverse investment vehicles only if, based on the information obtained, the investment adviser had a reasonable basis to believe that the investor is capable of evaluating the risks associated with leveraged/inverse investment vehicles. Proposed rule 211(h)-1 also would require investment advisers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule’s provisions. Finally, proposed rule 211(h)-1 includes related recordkeeping provisions.

The proposed rule contains “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).² The information collections are integral to the framework of proposed rule 211(h)-1 and therefore necessary to help further the proposed rule’s aforementioned goals. The information collections also would assist the Commission’s examination staff in assessing investment advisers’ compliance with the requirements of proposed rule 211(h)-1.

2. Purpose and Use of the Information Collection

The collection of information under proposed rule 211(h)-1 is integral to the framework of the proposed rule and therefore necessary to further the proposed rule’s goal of helping to ensure that retail investors who invest in leveraged/inverse investment

² 44 U.S.C. 3501 through 3521.

vehicles are capable of evaluating the unique risks of those products. The information collection also would assist the Commission's examination staff in assessing investment advisers' compliance with the requirements of the proposed rule. The respondents to proposed rule 211(h)-1 would be investment advisers registered with the Commission that place orders for retail clients to invest in leveraged/inverse investment vehicles.

3. Consideration Given to Information Technology

Proposed rule 211(h)-1 would not require the reporting of any information or the filing of any documents with the Commission. The Electronic Signatures in Global and National Commerce Act³ and conforming amendments to rules under the Investment Advisers Act of 1940 permit investment advisers to maintain records electronically.

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. Investment advisers are subject to other disclosure and recordkeeping requirements under the federal securities laws and agency rules, which may require investment advisers to seek to obtain similar information about retail investors and to retain related records. Proposed rule 211(h)-1, however, has the distinct purpose of helping to ensure that retail investors that invest in leveraged/inverse investment vehicles are capable of understanding the risks of those products.

5. Effect on Small Entities

We recognize that the collections of information required by proposed rule 211(h)-1 may require different amounts of time or external assistance for different

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

investment advisers. The Commission believes, however, that imposing different requirements on smaller investment advisers would not be consistent with the investor protection purposes of proposed rule 211(h)-1. 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

The collection of information under proposed rule 211(h)-1 is integral to the framework of proposed rule 211(h)-1 and therefore necessary to help further the proposed rule's goal of helping to ensure that retail investors in leveraged/inverse investment vehicles are capable of evaluating the characteristics and unique risks those products present. Thus, not requiring this collection of information would be incompatible with the goals of proposed rule 211(h)-1.

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

Proposed rule 211(h)-1 would require an investment adviser to maintain a written record of the information that it obtained under the rule 211(h)-1 due diligence requirement and its written approval of the client's account for buying or selling shares of leveraged/inverse investment vehicles, as well as the investment adviser's policies and procedures under the proposed rule, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the client's account. Although this six-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 six years, it is

important that the Commission have access to records that cover the entire period between examinations.

8. Consultation Outside the Agency

Before adopting proposed rule 211(h)-1, 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 and investment adviser industries 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.

9. Payment or Gift

No payment or gift to respondents was provided.

10. Confidentiality

Responses 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 211(h)-1 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, or personally identifiable information (PII) would be required under this collection of information. 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.⁴

The respondents to the proposed rule would be investment advisers registered under the Advisers Act that place orders for retail clients to invest in leveraged/inverse investment vehicles. Compliance with proposed rule 211(h)-1 would be mandatory for all such investment advisers. To the extent that records required to be created and maintained by investment advisers under the proposed 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.

We estimate that, as of December 31, 2018, approximately 8,235 investment advisers registered with the Commission have some portion of their business dedicated to retail investors, including either individual high net worth clients or individual non-high net worth clients. Based on our experience with registered investment advisers, we further estimate that 2,000 of these investment advisers with retail client accounts (approximately 25%) have retail client accounts that invest in leveraged/inverse

⁴ 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 effects of inflation. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 ("SIFMA Report").

investment vehicles. As such, the investment advisers for those client accounts would be subject to the requirements of proposed rule 211(h)-1.

(a) Due Diligence and Account Approval

Under proposed rule 211(h)-1, before placing an order for the account of a client that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, the investment adviser must approve the client's account to engage in those transactions in accordance with the proposed rule. To make this determination, the adviser must exercise due diligence to ascertain certain facts about the client, his or her financial situation, and investment objectives. To comply with this due diligence requirement, the investment adviser must seek to obtain certain information described in the proposed rule. Proposed rule 211(h)-1, as well as companion rule 15l-2 under the Securities Exchange Act of 1934, is modeled in large part after the FINRA rule requiring due diligence and account approval for retail investors to trade in options.⁵ Based on our understanding of how broker-dealers comply with the FINRA options account requirements (which we assume, for purposes of this PRA estimate, that investment advisers could model their compliance programs after), we believe that investment advisers likely would comply with this due diligence obligation by utilizing in-house legal and compliance counsel, as well as in-house computer and website specialists, to create an online form for clients to complete with the required information for approval of their accounts to trade in leveraged/inverse investment vehicles. We also believe that a portion of the due diligence would be performed by individuals associated with an investment adviser by telephone or in-person meetings with investors.

⁵ See, e.g., FINRA rule 2360(b)(16), (17) (requiring firm approval, diligence, and recordkeeping for options accounts).

Currently, there are 105 leveraged/inverse mutual funds, 164 leveraged/inverse ETFs, and 17 exchange-listed commodity- or currency-based trusts or funds that meet the definition of “leveraged/inverse investment vehicle” under the proposed rule. Accordingly, there are 286 leveraged/inverse investment vehicles in total for which an investment adviser would be required to approve a retail client’s account before the client could transact in the shares those vehicles. Based on our experience with registered investment advisers and leveraged/inverse investment vehicles, we estimate that each of these leveraged/inverse investment vehicles is held by approximately 2,500 separate retail investor accounts held by investment advisers, for a total of 715,000 existing accounts requiring approval to trade in leveraged/inverse investment vehicles. Based on our experience, we further estimate that approximately 10,000 new retail accounts will be opened each year requiring approval to trade in leveraged/inverse investment vehicles.

Table 1 below summarizes our initial and ongoing PRA burden estimates associated with the due diligence requirement in proposed rule 211(h)-1. Based on our understanding of current investment adviser practices, we do not estimate that there will be any initial or ongoing external costs associated with the proposed due diligence and approval requirements.

Table 1: Proposed Rule 211(h)-1 Due Diligence and Account Approval PRA Estimates

	Internal initial burden hours	Internal annual burden hours ¹		Wage rate ²	Internal time costs	Initial external cost burden	Annual external cost burden
PROPOSED ESTIMATES							
Development and implementation of client due diligence	6 hours	2 hours	×	\$365 (compliance attorney)	\$730		
	9 hours	3 hours	×	\$284 (senior systems analyst)	\$852	\$0	\$0
	12 hours	4 hours	×	\$331 (senior programmer)	\$1324		
Annual burden per investment adviser		9 hours			\$2906		
Estimated number of affected investment advisers		2000			2000		
Total burden (I)		18,000 hours			\$5,812,000		
Client due diligence	3 hours	1 hour	×	\$365 (compliance attorney)	\$365		
	3 hours	1 hour	×	\$70 (compliance clerk)	\$70		
Evaluation of client information for account approval/disapproval	1 hour	.33 hours		\$309 (compliance manager)	\$101.97		
Total annual burden per client account	7 hours	2.33 hours			\$536.97		
Estimated number of affected client accounts		× 248,333.33 ³			× 248,333.33		
Total burden (II)		578,616.66 hours			\$133,347,548		
Total annual burden (I+II)		596,616.66 hours			\$139,159,548	\$0	\$0

Notes:

1. Includes initial burden estimates annualized over a three-year period.

2. See *supra* footnote 3.

3. We estimate that 715,000 existing client accounts with registered investment advisers would require the proposed rule 211(h)-1 account approval for trading in leveraged/inverse investment vehicles, and that 10,000 new client accounts opened each year would require such approval. Accordingly, we believe that over a three-year period, a total of 745,000 client accounts would require approval, which when annualized over a three-year period, is 248,333.33 accounts per year.

(b) Policies and Procedures

Proposed rule 211(h)-1 would require investment advisers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule's provisions. We believe that investment advisers likely would establish these policies and procedures by adjusting their current systems for implementing and enforcing compliance policies and procedures. While investment advisers already have policies and procedures in place to address compliance with other Commission rules (among other obligations), they would need to update their existing policies and procedures to account for rule 211(h)-1. To comply with this obligation, we believe that investment advisers would use in-house legal and compliance counsel to update their existing policies and procedures to account for the requirements of rule 211(h)-1. For purposes of these PRA estimates, we assume that investment advisers would review the policies and procedures that they would adopt under proposed rule 211(h)-1 annually (for example, to assess whether the policies and procedures continue to be "reasonably designed" to achieve compliance with the proposed rule, and in compliance with Advisers Act rule 206(4)-7(b)). We therefore have estimated initial and ongoing burdens associated with the proposed policies and procedures requirement. We do not estimate that there will be any initial or ongoing external costs associated with the proposed policies and procedures requirement.

Table 2 below summarizes our PRA estimates associated with the policies and procedures requirement in proposed rule 211(h)-1.

Table 2: Proposed Rule 211(h)-1 Policies and Procedures PRA Estimates

	Internal initial burden hours	Internal annual burden hours ¹		Wage rate ²	Internal time costs
PROPOSED ESTIMATES					
Establishing and implementing rule 211(h)-1 policies and procedures	3 hours	1 hour	x	\$309 (compliance manager)	\$309
	1 hours	0.33 hours	x	\$365 (compliance attorney)	\$120.45
	1 hour	0.33 hours	x	\$530 (chief compliance officer)	\$174.90
Reviewing and updating rule 211(h)-1 policies and procedures		1 hour		\$309 (compliance manager)	\$309
		1 hour		\$365 (compliance attorney)	\$365
		1 hour		\$530 (chief compliance officer)	\$530
Total annual burden per investment adviser		4.66 hours			\$1808.35
Number of affected investment advisers		× 2,000			× 2,000
Total annual burden		9,320 hours			\$3,616,700

Notes:

1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 3.

(c) Recordkeeping

Under the proposed rule, a registered investment adviser would have to maintain a written record of the information that it obtained under the rule 211(h)-1 due diligence requirement and its written approval of the client's account for buying or selling shares of leveraged/inverse investment vehicles, as well as the investment adviser's policies and procedures, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the client's account. To comply with this obligation, we believe that investment advisers would use in-house personnel to compile and maintain the relevant records. We do not estimate that there will be any initial or ongoing external costs associated with this requirement.

Table 3 below summarizes our PRA estimates associated with the recordkeeping requirement in proposed rule 211(h)-1.

Table 3: Proposed Rule 211(h)-1 Recordkeeping PRA Estimates

	Internal initial burden hours	Internal annual burden hours ¹		Wage rate ²	Internal time costs
PROPOSED ESTIMATES					
Recordkeeping	0 hours	2.5 hours	×	\$62 (general clerk)	\$155
	0 hours	2.5 hours	×	\$95 (senior computer operator)	\$237.50
Total annual burden per investment adviser	0 hours	5 hours			\$392.50
Number of affected investment advisers	× 2000	× 2000			× 2000
Total annual burden	0 hours	10,000			\$785,000

Notes:

1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 3.

(d) Proposed Rule 211(h)-1 Total Estimated Burdens

As summarized in Table 4 below, we estimate that the total hour burdens and time costs associated with proposed rule 211(h)-1, including the burden associated with the due diligence and account approval requirement, the policies and procedures requirement, and the recordkeeping requirement, would result in an average aggregate annual burden of 615,936.66 hours and an average aggregate time cost of \$143,561,248. Therefore, each investment adviser would incur an annual burden of approximately 307.97 hours, at an average time cost of approximately \$71,780.62 to comply with proposed rule 211(h)-1.

Table 4: Proposed Rule 211(h)-1 Total Estimated PRA Burden

	Internal initial burden hours	Internal burden time cost	External cost burden
Due diligence and account approval	596,616.66	\$139,159,548	\$0
Policies and procedures	9,320	\$3,616,700	\$0
Recordkeeping	10,000	\$785,000	\$0
Total annual burden	615,936.66	\$143,561,248	\$0
Number of affected investment advisers	÷ 2000	÷ 2000	÷ 2000
Average annual burden per investment adviser	307.97	\$71,780.62	\$0

13. Cost to Respondents

As discussed in Item 12, we estimate that proposed rule 211(h)-1's costs related to the client due diligence and account approval, recordkeeping, and policies and procedures requirements are fully captured as internal hour burdens in Item 12.

14. Costs to Federal Government

Proposed rule 211(h)-1 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.