

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**Rule 6c-11**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Rule 6c-11<sup>1</sup> under the Investment Company Act of 1940 (the “Act”) permits exchange-traded funds (“ETFs”) that satisfy certain conditions to operate without first obtaining an exemptive order from the Commission. The rule was designed to create a consistent, transparent, and efficient regulatory framework for ETFs and facilitate greater competition and innovation among ETFs. Rule 6c-11 requires an ETF to disclose certain information on its website, to maintain certain records, and to adopt and implement written policies and procedures governing its constructions of baskets, as well as written policies and procedures that set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. These requirements are “collection of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>2</sup> The information collection is integral to the framework of rule 6c-11 and therefore necessary to help further the rule’s aforementioned goals. The information collection also will assist the Commission’s examination staff in assessing ETFs’ compliance with the conditions of rule 6c-11. Rule 6c-11 includes a provision excluding “leveraged/inverse ETFs” from the scope of ETFs that may rely on the rule. The rule defines “leveraged/inverse ETF” to mean an ETF that seeks, directly or indirectly, to provide investment returns over a predetermined period of time that: (i) correspond to the performance of a market index by a specified multiple; or (ii) have an inverse relationship to the performance of a market index (including by an inverse multiple).

On November 25, 2019, the Commission proposed rule 18f-4 under the Act.<sup>3</sup> The proposed rule would apply to mutual funds (other than money market funds), ETFs, registered closed-end funds, and companies that have elected to be treated as business development companies under the Act (collectively, “funds”). It would

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<sup>1</sup> 17 CFR 270.6c-11.

<sup>2</sup> See 44 U.S.C. 3501 through 3521.

<sup>3</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) (“Derivatives Proposing Release”).

permit these funds to enter into derivatives transactions and certain other transactions, notwithstanding the restrictions under sections 18 and 61 of the Act, provided that the funds comply with the conditions of the rule.

Funds that are not “limited derivatives users” under the proposed rule would be required to comply with an outer limit on fund leverage risk. Most leveraged/inverse ETFs would not be able to satisfy the limit on fund leverage risk due to their investment strategies. Proposed rule 18f-4 would not require a leveraged/inverse ETF (or certain other leveraged/inverse funds) to comply with the limit on fund leverage risk, provided that the fund satisfies an alternative set of conditions under the proposed rule. Specifically, such a fund would have to: (i) meet the definition of a “leveraged/inverse investment vehicle” in proposed rules 15l-2 under the Securities Exchange Act of 1934 or 211(h)-1 under the Investment Advisers Act of 1940, as applicable (together, the “sales practices rules”), which the Commission also proposed on November 25, 2019; (ii) limit the investment results in seeks to 300% of the return (or inverse of the return) of the underlying index; and (iii) disclose in its prospectus that it is not subject to the proposed rule 18f-4 limit on fund leverage risk.

In view of proposed rule 18f-4 and the proposed sales practice rules, which are designed to create an updated and more comprehensive regulatory framework for the use of derivatives by funds, including provisions specifically applicable to leveraged/inverse ETFs, the Commission also proposed to amend rule 6c-11 to remove the provision excluding leveraged/inverse ETFs from the scope of that rule one year following the publication of the final amendments in the Federal Register.<sup>4</sup> Accordingly, leveraged/inverse ETFs would be permitted to rely on rule 6c-11 and, in turn, be subject to the rule’s requirements, including the collections of information under the rule.

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

The collection of information under rule 6c-11 is integral to the framework of rule 6c-11 and therefore necessary to help further the rule’s goals of creating a consistent, transparent, and efficient regulatory framework for ETFs, including leveraged/inverse ETFs, and facilitating greater competition and innovation among ETFs. The information collection also will assist the Commission’s examination staff in assessing ETFs’ compliance with the conditions of rule 6c-11. The respondents to rule 6c-11 are ETFs registered as open-end management investment companies other than share-class ETFs, leveraged/inverse ETFs, or non-transparent ETFs.

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<sup>4</sup> *See id.*

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

Rule 6c-11 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>5</sup> and conforming amendments to rules under the Investment Advisers Act of 1940 permit ETF advisers to maintain records electronically.

### **4. Duplication**

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication and reevaluates them whenever it adopts a new rule or a change to a rule. The information collection that is required by the proposed amendment to rule 6c-11 is not duplicated elsewhere.

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

The information collection requirements of rule 6c-11 do not distinguish between small entities and other entities. We do not believe that exempting any subset of ETFs, including small entities, from rule 6c-11 would permit the Commission to achieve its stated objectives. Similarly, the Commission does not believe that it can establish simplified or consolidated compliance requirements for small entities under the rule without compromising its objectives. The conditions necessary to rely on rule 6c-11 are designed to provide investor protection benefits. These benefits should apply to investors in smaller funds as well as investors in larger funds.

Finally, the Commission believes that rule 6c-11 appropriately uses a combination of performance and design standards. Rule 6c-11 provides ETFs that satisfy the requirements of the rule with exemptions from certain provisions of the Act necessary for ETFs to operate. Because the provisions of the Act from which ETFs would be exempt provide important investor and market protections, the conditions of the rule must be specifically designed to ensure that these investor and market protections are maintained. However, where the Commission believes that flexibility is beneficial, it adopted performance-based standards that provide a regulatory framework, rather than prescriptive requirements, to give funds the opportunity to adopt policies and procedures tailored to their specific needs without raising investor or market protection concerns.

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

The collection of information under rule 6c-11 is integral to the framework of rule 6c-11 and therefore necessary to help further the rule's goals of creating a consistent,

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<sup>5</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

transparent, and efficient regulatory framework for such ETFs and facilitating greater competition and innovation among ETFs. Thus, not requiring this collection of information would be incompatible with the goals of rule 6c-11.

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

Rule 6c-11 requires ETFs to preserve and maintain copies of all written authorized participant agreements ETFs. Additionally, rule 6c-11 requires ETFs to maintain records setting forth the following information for each basket exchanged with an authorized participant: (i) the names and quantities of the positions composing the basket; (ii) identification of the basket as a “custom basket” and a record stating that the custom basket complies with the ETF’s custom basket policies and procedures (if applicable); (iii) cash balancing amounts (if any); and (iv) the identity of the authorized participant conducting the transaction. ETFs have to maintain these records for at least five years, the first two years in an easily accessible place. 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.

## **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 investment company industry through public conferences, meetings, and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry. Before adopting the proposed amendment to rule 6c-11, the Commission will receive and evaluate public comments on the proposal and its collection of information requirements.

## **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 rule 6c-11 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>6</sup>

Rule 6c-11 requires an ETF to disclose certain information on its website, to maintain certain records, and to adopt and implement written policies and procedures governing its constructions of baskets, as well as written policies and procedures that set forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders. These requirements are collections of information under the PRA.

The current respondents to rule 6c-11 are ETFs registered as open-end management investment companies other than share-class ETFs, leveraged/inverse ETFs, or non-transparent ETFs. This collection is not mandatory, but is necessary for those ETFs seeking to operate without individual exemptive orders.

Under current PRA estimates, 1,735 ETFs would be subject to these requirements. The current PRA estimates for rule 6c-11 include 74,466.2 total internal burden hours, \$24,771,740.10 in internal time costs, and \$1,735,000 in external time costs.

The Commission believes that the current annual burden and cost estimates for rule 6c-11 are appropriate, but estimates that the proposed amendment to rule 6c-11

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<sup>6</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 effects of inflation. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013.

would result in an increase in the number of respondents. Specifically, the Commission estimates that an additional 164 ETFs (all leveraged/inverse ETFs) would rely on rule 6c-11, resulting in an increase in the number of respondents to 1,899 ETFs.<sup>7</sup> Table 1 below summarizes these revisions to the estimated annual responses, burden hours, and burden-hour costs based on the proposed amendment to rule 6c-11.

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<sup>7</sup> See Derivatives Proposing Release, *supra* note 3, at n.467 and accompanying text.

**Table 1: Rule 6c-11 PRA Estimates**

	Previously estimated annual internal hour burden <sup>1</sup>	Updated estimated annual internal hour burden <sup>2</sup>	Previously estimated annual internal burden time cost	Updated estimated annual internal time burden cost	Previously estimated annual external cost burden	Updated estimated annual external cost burden
Website disclosure	33,398.75 hours	36,555.75 hours	\$10,717,945.15	\$11,731,053.51	\$1,735,000	\$1,899,000
Recordkeeping	8,675 hours	9,495 hours	\$680,987.50	\$745,357.50	\$0	\$0
Policies and procedures	32,392.45 hours	35,454.33 hours	\$13,372,807.45	\$14,636,865.33	\$0	\$0
<b>Total annual burden</b>	<b>74,466.2 hours</b>	<b>81,505.08 hours</b>	<b>\$24,771,740.10</b>	<b>\$27,113,276.34</b>	<b>\$1,735,000</b>	<b>\$1,899,000</b>
Number of affected ETFs	÷ 1,735	÷ 1,899	÷ 1,735	÷ 1,899	÷ 1,735	÷ 1,899
<b>Average annual burden per ETF</b>	<b>42.92 hours</b>	<b>42.92 hours</b>	<b>\$14,277.66</b>	<b>\$14,277.66</b>	<b>\$1,000</b>	<b>\$1,000</b>

**Notes:**

1. The previously estimated burdens and costs in this table are based on an estimate of 1,735 ETFs relying on rule 6c-11.
2. The updated estimated burdens and costs in this table are based on an estimate of 164 leveraged/inverse ETFs that would rely on rule 6c-11 pursuant to the proposed amendment to that rule, for a total estimate of 1,899 ETFs that would rely on rule 6c-11.

### **13. Cost to Respondents**

As shown in Table 1 above, the estimated external cost burden is the estimated cost associated with ETFs consulting outside professionals to assist with website development relating to new website disclosures. The current estimate of the initial external cost is \$3,000 for an external website developer to develop the webpage. Commission staff does not believe there will be any ongoing external costs related to the website disclosure requirements. Amortized over a 3-year period, the external cost is approximately \$1,000. The Commission estimates that an additional 164 ETFs would rely on rule 6c-11, resulting in an increase in the number of respondents to 1,899 ETFs from 1,735 ETFs. Accordingly, the Commission estimates that the total external cost related to the website disclosures would be \$1,899,000. We estimate that the costs related to rule 6c-11's recordkeeping and policies and procedures requirements are fully captured as internal hour burdens in Item 12.

### **14. Costs to Federal Government**

The annual cost of reviewing and processing disclosure documents, including new registration statements, post-effective amendments, proxy statements, shareholder reports, and other filings of investment companies amounted to approximately \$22.2 million in fiscal year 2018, based on the Commission's computation of the value of staff time devoted to this activity and related overhead.

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

The total annual hour burden of 81,505.08 hours represents an increase of 7,038.99 hours over the previous burden hour estimate of 74,466.2 hours. In addition, the annual external cost burden of \$1,899,000 represents an increase of \$164,000 over the previous annual external cost burden estimate of \$1,735,000. The changes in burden hours and external cost burdens are due to the staff's estimates of the time costs and external costs that would result from the proposed amendment to rule 6c-11.

### **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.