

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
Rule 2a-5

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 2(a)(41) of the Investment Company Act of 1940 (“Investment Company Act”)¹ requires funds to value their portfolio investments using the market value of their portfolio securities when market quotations for those securities are “readily available,” and, when a market quotation for a portfolio security is not readily available, by using the fair value of that security, as determined in good faith by the fund’s board.² The aggregate value of a fund’s investments is the primary determinant of the fund’s net asset value (“NAV”), which for many funds determines the price at which their shares are offered and redeemed (or repurchased).³ Accordingly, proper valuation, among other things, promotes the purchase and sale of fund shares at fair prices, and helps to avoid dilution of shareholder interests.⁴

On April 21, 2020, the Commission issued a release proposing new rule 2a-5, which would provide requirements for determining in good faith the fair value of the investments of a registered investment company or companies that have elected to be treated as business development companies under the Investment Company Act (“BDCs” and, collectively, “funds”)

¹ 15 U.S.C. 80a 1 et seq.

² 15 U.S.C. 80a-2(a)(41). *See also* 17 CFR 270.2a-4.

³ *See* 15 U.S.C. 80a-22(c) and 23(c). *See also* 17 CFR 270.22c-1(a).

⁴ *See* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) (“Liquidity Risk Management Release”) (adopting rule 22e-4 under the Investment Company Act and noting “the risk of shareholder dilution associated with improper fund pricing”). *See generally* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 136-38 (1940) (discussing the effect of dilution on fund shareholders).

for purposes of section 2(a)(41) of the Investment Company Act.⁵ Under proposed rule 2a-5, the determination of fair value in good faith would require the performance of certain functions, which are: (1) assessing and managing material risks associated with fair value determinations; (2) selecting, applying, and testing fair value methodologies; (3) overseeing and evaluating any pricing services used; and (4) adopting and implementing policies and procedures (collectively, the “Fair Value Functions”); as well as maintaining certain records. Proposed rule 2a-5 also would permit a fund’s board of directors to assign the fair value determination for some or all of the fund’s investments to an investment adviser to the fund. Upon such assignment by the board of directors, the fund’s investment adviser would carry out the Fair Value Functions, subject to board oversight and certain additional reporting, recordkeeping, and other requirements. These requirements are designed to facilitate the board’s ability to oversee effectively the adviser’s fair value determinations and satisfy the board’s obligation under the Act. The proposed rule also would tailor its requirements to unit investment trusts, which do not have boards of directors. Finally, the rule would define when market quotations are “readily available” under the Act, and thus when securities must be fair valued.

Compliance with rule 2a-5 would be mandatory for any fund that would need to determine fair value under the Act. To the extent that records would be required to be created and maintained 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.

⁵ See Good Faith Determinations of Fair Value, Investment Company Act Release No. 33845 (Apr. 21, 2020) (“Proposing Release”).

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”),⁶ 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 specify how a board or adviser must make good faith determinations of fair value as well as when the board can assign this function to an adviser to the fund, while still ensuring that fund investments are valued in a way consistent with the Investment Company Act.

The information collection requirements of proposed rule 2a-5 are designed to protect investors from improper valuations, reflect our view of current market best practices, and help ensure compliance with other requirements. The information collection requirements are also designed to ensure that the board effectively oversees an assigned adviser, including receiving sufficient information to do so.

3. Consideration Given to Information Technology

Proposed rule 2a-5 would require the maintenance of certain records, specifically (1) appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered when making fair value determinations and (2) copies of the policies and procedures as required elsewhere under the proposed rule. Further, if the board assigns fair value determinations to an adviser, the fund must maintain copies of (3) the reports and other information provided to the board as required elsewhere under the proposed rule and (4) a specified list of the investments or investment types

⁶ 44 U.S.C. 3501 *et seq.*

whose fair value determination has been assigned to the adviser. The Electronic Signatures in Global and National Commerce Act⁷ and the conforming amendments to rules under the Investment Company Act permit funds 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. Proposed rule 2a-5 would provide requirements for determining fair value in good faith for purposes of section 2(a)(41) and rule 2a-4 thereunder. This determination would involve assessing and managing material risks associated with fair value determinations; selecting, applying, and testing fair value methodologies; evaluating any pricing services used; adopting and implementing policies and procedures; and maintaining certain records. The proposed rule would permit a fund's board of directors to assign the fair value determination relating to any or all fund investments to an investment adviser of the fund, which would carry out all of these requirements, subject to board oversight and certain reporting, recordkeeping, and other requirements designed to facilitate the board's ability effectively to oversee the adviser's fair value determinations. As relevant here, the rule would require, on a per fund basis, the adoption and implementation of certain policies and procedures designed to address the process for determining fair value in good faith, keeping of certain records regarding the fair value process, and, if the board assigns the adviser to determine fair value, adviser reporting to the board in both periodic and as needed reports with some extra recordkeeping. The information required by proposed rule 2a-5 is not generally duplicated elsewhere.

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

5. Effect on Small Entities

The information collection requirements of proposed rule 2a-5 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. Further, the board reporting and additional recordkeeping provisions of proposed rule 2a-5 only affect fund boards that assign fair value determinations to a fund adviser and, therefore, the rule would require funds to comply with these specific requirements only if they assigned responsibilities to their adviser. However, we expect that most funds holding securities that must be fair valued will do so. Therefore if a board to a small entity does not do this and instead performs its statutory function directly, then the small entity would not be subject to these provisions of proposed rule 2a-5. 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 2a-5 would impose information collection requirements for funds that need to fair value under the Investment Company Act relating to adopting and implementing policies and procedures, board reporting, and recordkeeping.

Not collecting information or collecting such information less frequently would be incompatible with the objectives of rule 2a-5. These requirements 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 2a-5 would require a fund to maintain (1) appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered when making fair value determinations, as well as any necessary or appropriate adjustments in methodologies, for at least five years from the time the determination was made, the first two years in an easily accessible place; and (2) a copy of policies and procedures as required under the proposed rule that are in effect, or were in effect at any time within the past five years, in an easily accessible place.⁸ The proposed rule would also require, should the board assign the functions that would be required under the rule to an adviser to the fund, that the fund maintain, for at least five years after the end of the fiscal year in which the documents were created, (1) copies of the reports and other information provided to the board under the proposed rule and (2) a specified list of the investments or investment types whose fair value determination has been assigned to the adviser pursuant to the proposed rule. 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 2a-5 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

⁸ See proposed rule 2a-5(a)(6).

five-year retention period would lessen the compliance burden of proposed rule 2a-5 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 2a-5, 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.

9. Payment or Gift

No payment or gift to respondents was provided.

10. Confidentiality

No information would be submitted directly to the Commission under proposed rule 2a-5. 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 2a-5 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.⁹

The respondents to proposed rule 2a-5 would be registered investment companies and companies that have elected to be treated as business development companies under the Investment Company Act.¹⁰ We estimate that 9,986 funds would be affected by rule 2a-5, of which 9,501 are not unit investment trusts as defined in the Investment Company Act (“UITs”).¹¹ Compliance with rule 2a-5 would be mandatory for any fund that would need to determine fair value under the Act. To the extent that records would be required to be created and maintained

⁹ 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”).

¹⁰ *See* proposed rule 2a-5(e)(1) (defining “fund”).

¹¹ 13,733 registered investment companies that filed Form N-CEN – 3,845 registered investment companies that filed Form N-CEN and are estimated to hold securities that would not need to be fair valued under the Investment Company Act + 98 BDCs estimated to exist. $3,845 = 28\% * 13,733$ registered investment companies that filed Form N-CEN.

$28\% = (3,209$ open-end funds without securities that would need to be fair valued according to disclosures on Form N-PORT + 29 closed-end funds without securities that would need to be fair valued according to disclosures on Form N-PORT + 5 ETFs registered as UITs without securities that would need to be fair valued according to disclosures on Form N-PORT + 3 variable annuity separate accounts registered as management companies without securities that would need to be fair valued according to disclosures on Form N-PORT) / 11,436 funds that filed Form N-PORT.

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. Policies and Procedures

Proposed rule 2a-5 would require the adoption and implementation of fair value policies and procedures, which would address the process for the determination of the fair value of the fund's investments under the proposed rule.¹² The fair value policies and procedures are designed to help ensure that the determination of fair value is carried out effectively and to facilitate board oversight. The policies and procedures, as proposed, must be reasonably designed to achieve compliance with the certain requirements of the proposed rule, which are: (1) periodically assessing any material risks associated with the determination of the fair value, including material conflicts of interest, and managing those identified valuation risks; (2) selecting and applying in a consistent manner methodologies for determining and calculating the fair value; (3) testing the appropriateness and accuracy of the fair value methodologies that have been selected; and (4) selecting and overseeing pricing service providers, if used.

We believe that the fund's board or adviser likely would establish the fair value policies and procedures by adjusting the current systems for implementing and enforcing the compliance policies and procedures of the fund (if the requirements are not assigned) or the adviser's (if the requirements are assigned). While funds and advisers have policies and procedures in place to address compliance with the federal securities laws (among other obligations), including fair value determinations, they would need to update their existing policies and procedures to account for the specific requirements of proposed rule 2a-5. To comply with this obligation, we believe

¹² See proposed rule 2a-5(a)(5).

that fund boards or advisers (by assignment by the board) would use in-house legal and compliance counsel to update existing policies and procedures to account for the requirements of proposed rule 2a-5. For purposes of these PRA estimates, we assume that either the fund or the adviser would review the fair value policies and procedures annually (for example, to assess whether the fair value methodology requires adjustments). We therefore have estimated initial and ongoing burdens associated with the proposed policies and procedures requirement. As discussed above, we estimate that approximately 9,986 funds may rely on the proposed rule and therefore would require these funds or their advisers to adopt and implement fair value policies and procedures.¹³

Table 1 below summarizes the proposed PRA initial and ongoing burden estimates associated with the policies and procedures requirements under proposed rule 2a-5.

¹³ See Proposing Release, *supra* footnote 5, at n.215 and accompanying text.

Table 1: Fair Value Policies and Procedures Estimates

	Internal initial burden hours	Internal annual burden hours ¹		Wage rate ²	Internal time costs	Initial external cost burden	Annual external cost burden
Establishing and implementing rule 2a-5 policies and procedures	6 hours	2 hours	x	\$329 (senior manager)	\$658.00	\$3,000.00	\$1,000.00
	6 hours	2 hours	x	\$466 (ass't general counsel)	\$932.00		
	3 hours	1 hour	x	\$530 (chief compliance officer)	\$530.00		
	3 hours	1 hour	x	\$365 (compliance attorney)	\$365.00		
Reviewing and updating rule 2a-5 policies and procedures		3 hours	x	\$329 (senior manager)	\$987.00		\$1,000.00
		3 hour	x	\$466 (ass't general counsel)	\$1,398.00		
		1 hour	x	\$530 (chief compliance officer)	\$530.00		
Total annual burden per fund		13 hours			\$5,400.00		\$2,000.00
Number of affected funds		9,986			9,986		9,986
Total annual burden		129,818 hours			\$53,924,400		\$19,972,000

Notes:

1. Includes initial burden estimates annualized over a three-year period.
2. See SIFMA Report, *supra* footnote 9.

B. Board Reporting

The proposed rule would require, if the board assigns the fair value determinations to an adviser of the fund, that the adviser report to the fund's board in writing (1) a quarterly report containing an assessment of the adequacy and effectiveness of the adviser's process for determining the fair value of the assigned portfolio of investments and (2) promptly (but in no event later than three business days after the adviser becomes aware of the matter) on matters associated with the adviser's process that materially affect or could have materially affected the fair value of the assigned portfolio of investments. These reports would be required to include such information as may be reasonably necessary for the board to evaluate the matters covered in the report. The periodic reports that would be required by the proposed rule would have a minimum of five items required as part of the report, and the prompt reports must include material weaknesses in the design or implementation of the adviser's fair value determination process or material changes in the fund's risks as would be required elsewhere under the proposal.¹⁴ UITs could not assign fair value determinations to an adviser under the proposed rule because they are unmanaged and therefore would not be subject to this collection of information.¹⁵ We estimate that 9,501 funds would utilize the proposed rule and therefore be subject to these requirements.¹⁶

Table 2 below summarizes the proposed PRA initial and ongoing burden estimates associated with the board reporting requirements under proposed rule 2a-5.

¹⁴ See proposed rule 2a-5(b)(1).

¹⁵ See proposed rule 2a-5(d).

¹⁶ See Proposing Release, *supra* footnote 5, at n.215 and accompanying text.

Table 2: Board Reporting Estimates

	Internal initial burden hours	Internal annual burden hours		Wage rate ¹	Internal time costs	Initial external cost burden	Annual external cost burden
PROPOSED ESTIMATES							
Adviser written reports ²	0 hours	8 hours	×	\$329 (senior manager)	\$2,632	\$2,000	\$2,000
	0 hours	1 hour	×	\$17,860 (combined rate for 4 directors)	\$17,860		
	0 hours	1 hour	×	\$365 (compliance attorney)	\$365		
Total annual burden per fund		10 hours			\$20,857		\$2,000
Number of funds		× 9,501			× 9,501		× 9,501
Total annual burden		95,010 hours			\$198,162,357		\$19,002,000

Notes:

1. See SIFMA Report, *supra* footnote 9.
2. See *supra* Proposing Release, *supra* footnote 5, at nn. **Error! Bookmark not defined.** and accompanying text.

C. Recordkeeping

Proposed rule 2a-5 would require the maintenance of certain records, specifically (1) appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered when making fair value determinations and (2) copies of the policies and procedures as required elsewhere under the proposed rule.¹⁷ Further, if the board assigns fair value determinations to an adviser, the fund must maintain copies of (3) the reports and other information provided to the board as required elsewhere under the proposed rule and (4) a specified list of the investments or investment types whose fair value determination has been assigned to the adviser.¹⁸ We estimate that 9,986 funds would be subject to the proposed rule and therefore to these requirements.¹⁹

Table 3 below summarizes the proposed PRA initial and ongoing burden estimates associated with the recordkeeping requirements under proposed rule 2a-5.

¹⁷ See proposed rule 2a-5(a)(6).

¹⁸ See proposed rule 2a-5(b)(3).

¹⁹ While only 9,501 of these 9,986 funds would be subject to the last two of these recordkeeping requirements, we believe that this distinction is immaterial for this purpose and would result in only a de minimis lowering of the estimate. See also Proposing Release, *supra* footnote 5, at n.215 and accompanying text.

Table 5: Recordkeeping 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						
Establishing recordkeeping policies and procedures	1.5	.5	\$62 (general clerk)	\$31	\$1,800	\$1,800
	1.5	.5	\$95 (senior computer operator)	\$47.50		
Recordkeeping	0 hours	2 hours	×	\$62 (general clerk)	\$31	\$0
	0 hours	2 hours	×	\$95 (senior computer operator)	\$47.50	
Total annual burden per fund		5 hours		\$157		\$600
Number of funds		×	9,986		×	9,986
Total annual burden		49,930 hours		\$1,567,802		\$5,991,600

Notes:

1. For "Establishing Recordkeeping Policies and Procedures," these estimates include initial burden estimates annualized over a three-year period.
2. . See SIFMA Report, *supra* footnote 9.

D. Proposed Rule 2a-5 Total Estimated Burden

As summarized in Table 4 below, we estimate that the total hour burdens and time costs associated with proposed rule 2a-5, including the burden associated with the adoption and implementation of fair value policies and procedures, board reporting, and recordkeeping requirements, amortized over three years, would result in an average aggregate annual burden of 274,758 hours and an average aggregate annual monetized time cost of \$253,654,559. We also estimate that, amortized over three years, there would be external costs of \$44,965,600 associated with this collection of information. Therefore, each fund required to comply with the rule would incur an average annual burden of approximately 27.51 hours, at an average annual monetized time cost of approximately \$25,401, and an external cost of \$4,503 to comply with proposed rule 2a-5.

Table 4: Proposed Total Burden Estimates

	Internal hour burden	Internal burden time cost
Policies and Procedures	129,818 hours	\$53,924,400
Board reporting	95,010 hours	\$198,162,357
Recordkeeping requirements	49,930 hours	\$1,567,802
Total annual burden	274,758	\$253,654,559
Number of funds	÷ 9,986	÷ 9,986
Average annual burden per fund	27.51 hours	\$25,401

13. Cost to Respondents

As summarized in Table 5 below, we estimate that, amortized over three years, there would be external costs of \$44,965,600 associated with this collection of information. Therefore, each fund subject to proposed rule 2a-5 would incur an annualized external cost of \$4,503 to comply with the proposed rule. The cost burden is

the cost associated with a fund meeting the policies and procedures, board reporting, and recordkeeping requirements under rule 2a-5. The cost burden does not include the hour burden discussed in Item 12 above.

Table 5: Proposed Total Cost Estimates

	External cost burden
Policies and Procedures	\$19,972,000
Board reporting	\$19,002,000
Recordkeeping requirements	\$5,991,600
Total annual burden	\$44,965,600
Number of funds	÷ 9,986
Average annual burden per fund	\$4,503

14. Costs to Federal Government

Proposed rule 2a-5 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.