

## SUPPORTING STATEMENT

### For the Paperwork Reduction Act Information Collection Submission for Rule 38a-1

#### A. JUSTIFICATION

##### 1. Necessity for the Information Collection

Rule 38a-1 under the Investment Company Act of 1940 (“Investment Company Act”)<sup>1</sup> is intended to protect investors by fostering better fund compliance with securities laws.<sup>2</sup> The rule requires every registered investment company and business development company (“fund”) to: (i) adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws by the fund, including procedures for oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent of the fund; (ii) obtain the fund board of directors’ approval of those policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund; (iii) annually review the adequacy of those policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund, and the effectiveness of their implementation; (iv) designate a chief compliance officer to administer the fund’s policies and procedures and prepare an annual report to the board that addresses certain specified items relating to the policies and procedures; and (v) maintain for five years the compliance policies and procedures and the chief compliance officer’s annual report to the board.

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

<sup>2</sup> 17 CFR 270.38a-1.

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

The purpose of the information collection requirements in rule 38a-1 is to ensure that funds maintain comprehensive, written internal compliance programs that promote compliance with the federal securities laws. The information collections also assist the Commission's examination staff in assessing the adequacy of funds' compliance programs.

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

Rule 38a-1 does not require the reporting of any information or the filing of any documents with the Commission. Rule 38a-1 does require funds to maintain written policies and procedures. Each fund also is required to maintain for at least five years a copy of the annual compliance report provided to the fund's board of directors. The Electronic Signatures in Global and National Commerce Act<sup>3</sup> and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

## **4. Duplication**

Rule 38a-1 imposes a broad requirement that funds have in place written compliance policies and procedures. Funds also are subject to certain requirements elsewhere in the federal securities laws that require them to maintain written policies and procedures. The staff believes, however, that any duplication of recordkeeping requirements is limited. Moreover, rule 38a-1 does not require funds to maintain duplicate copies of records covered by these more targeted requirements, and a firm's compliance policies and procedures are not required to be maintained in a single location. The staff believes, therefore, that any duplication of regulatory requirements does not impose significant additional costs on funds. The Commission periodically evaluates

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

rule-based recordkeeping requirements for duplication and reevaluates them whenever it proposes a rule or a change in a rule.

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

Funds, regardless of their size, are subject to the requirements of rule 38a-1. Effective internal compliance programs are essential for firms of all sizes. Rule 38a-1 affords funds the flexibility to tailor their compliance program to the nature of their business. Small firms, which generally have less complex and more limited operations, likely need less extensive compliance programs than their larger counterparts. Thus, rule 38a-1 does not inappropriately burden small entities. The Commission believes that it could not adjust the rule to lessen the burden on small entities of complying with the rule without jeopardizing the interests of investors in small funds. 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**

Less frequent information collection would be incompatible with the objectives of rule 38a-1. The annual reviews required under rule 38a-1 are integral to detecting and correcting any gaps in the program before irrevocable or widespread harm is inflicted upon investors, and extending the time between reviews increases the likelihood that such harm could go unchecked.

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

Rule 38a-1 requires funds and advisers to maintain their internal compliance policies and procedures and documents related to the annual review of those policies and procedures for at least five years. Although this period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), the staff 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 forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry. The Commission requested public comment on the collection of information requirements in rule 38a-1 before it submitted this request for revision and approval to the Office of Management and Budget. The Commission received no comments in response to its request. Further, no person has submitted a petition for rulemaking regarding rule 38a-1 to the Commission.

#### **9. Payment or Gift**

No payment or gift to respondents was provided.

#### **10. Confidentiality**

If information collected pursuant to rule 38a-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 is 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. Burden of Information Collection**

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act of 1995 and are not derived from a comprehensive or even representative survey or study of the costs of Commission rules. Compliance with rule 38a-1 is mandatory for funds.

While rule 38a-1 requires each fund to maintain written policies and procedures, most funds are located within a fund complex. The experience of the Commission's examination and oversight staff suggests that each fund in a complex is able to draw extensively from the fund complex's "master" compliance program to assemble appropriate compliance policies and procedures. Many fund complexes already have written policies and procedures documenting their compliance programs. Further, a fund needing to develop or revise policies and procedures on one or more topics in order to achieve a comprehensive compliance program can draw on a number of outlines and model programs available from a variety of industry representatives, commentators, and organizations.

Table 1 below summarizes our current PRA estimates.

**TABLE 1: RULE 38A-1 PRA ESTIMATES**

<b>REVISED ESTIMATES FOR NEWLY- REGISTERED FUNDS</b>			
	<b>Internal Hour Burdens</b>	<b>Wage Rate</b>	<b>Internal Annual Time Costs</b>
Adopt and document policies and procedures			
	4 hours	\$4,465 <sup>4</sup> (Board of Directors as a whole)	\$1,803,860 <sup>5</sup>
	79 hours	\$535 (Chief Compliance Officer)	\$4,268,765 <sup>6</sup>
	22 hours	\$71 (Compliance Clerk)	\$157,762 <sup>7</sup>
<b>Total annual burden per response</b>	<b>105</b>		
Number of annual responses	× 101 <sup>8</sup>		
<b>Revised total estimated annual burden</b>	<b>10,605</b>		<b>\$6,230,387</b>
<b>TOTAL ESTIMATED BURDENS FOR NEWLY- REGISTERED FUNDS</b>			
<b>Current total estimated annual burden</b>	<b>10,185</b>		<b>\$5,721,739</b>
<b>Revised total estimated annual burden</b>	<b>10,605</b>		<b>6,230,387</b>
<b>REVISED ESTIMATED BURDENS FOR ANNUAL REVIEW</b>			
Annual Review and documentation of policies and procedures			

<sup>4</sup> The estimate for the cost of board time as a whole is derived from estimates made by the staff regarding typical board size and compensation, based on information received from fund representatives and publicly-available sources. The rates for all the other occupations in this statement are derived from the SIFMA Report on Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, and adjusted for inflation.

<sup>5</sup> This estimate is based on the following calculation: 101 newly-registered funds x 4 hours by board of directors for adoption of policies and procedures x \$4,465 per hour = \$1,803,860.

<sup>6</sup> This estimate is based on the following calculation: 101 newly-registered funds x 79 hours by chief compliance officer for adoption and documentation of policies and procedures x \$535 per hour = \$4,268,765.

<sup>7</sup> This estimate is based on the following calculation: 101 newly-registered funds x 22 hours by clerical staff for adoption and documentation of policies and procedures x \$71 per hour = \$157,762.

<sup>8</sup> These numbers are based on Commission filings and are current as of March 20, 2020.

	32 hours	\$535 (Chief Compliance Officer.)	\$70,072,160 <sup>9</sup>
	17 hours	\$71 (Compliance Clerk)	\$4,940,251 <sup>10</sup>
<b>Total annual burden per response</b>	<b>49</b>		
Number of annual responses	× 4,093 <sup>11</sup>		
<b>Revised total estimated annual burden</b>	<b>200,557</b>		<b>\$75,012,411</b>

**TOTAL ESTIMATED BURDENS FOR ANNUAL REVIEW**

<b>Current total estimated annual burden</b>	<b>202,517 hours</b>	<b>\$70,756,960</b>
<b>Revised total estimated annual burden</b>	<b>200,557 hours</b>	<b>\$75,012,411</b>

**REVISED ESTIMATED BURDENS FOR RECORD MAINTENANCE**

Record maintenance	2 hours	\$535 (chief compliance office)	\$4,379,510 <sup>12</sup>
	4 hours	\$71 (compliance clerk)	\$1,162,412
<b>Total annual burden per response</b>	<b>6 hours</b>		
Number of annual responses	× 4,093		
<b>Revised total estimated annual burden</b>	<b>24,558 hours</b>		<b>\$5,541,922</b>

**TOTAL ESTIMATED BURDENS FOR RECORD MAINTENANCE**

<b>Current total estimated annual burden</b>	<b>24,798 hours</b>	<b>\$5,199,314</b>
<b>Revised total estimated annual burden</b>	<b>24,558 hours</b>	<b>\$5,541,922</b>

**TOTAL ESTIMATED AGGREGATE BURDENS**

<b>Current total estimated aggregate annual burden</b>	<b>237,500 hours</b>	<b>\$81,678,013</b>
<b>Revised total estimated aggregate annual burden</b>	<b>235,720 hours</b>	<b>\$86,784,720</b>

### 13. Cost to Respondents

The staff estimates that rule 38a-1 does not impose any material cost burdens on funds, apart from the cost of the burden hours discussed above. Although rule 38a-1 requires funds to

<sup>9</sup> This estimate is based on the following calculation: 4,093 funds x 32 hours by chief compliance officer for review and documentation of policies and procedures x \$535 per hour = \$70,072,160.

<sup>10</sup> This estimate is based on the following calculation: 4,093 funds x 17 hours by clerical staff for review and documentation of policies and procedures x \$71 per hour = \$4,940,251.

<sup>11</sup> These numbers are based on Commission filings and are current as of March 20, 2020 for the number of registered investment companies and as of June 2019 for the number of business development companies.

<sup>12</sup> This estimate is based on the following calculation: 4,093 funds x 2 hours by chief compliance officer for maintaining records x \$535 per hour = 4,379,510.

maintain certain records for five years, these records may be maintained electronically and, even if maintained in hard copy, are unlikely to be voluminous. The staff has not estimated a capital cost in connection with the recordkeeping requirements because funds and their advisers likely use existing recordkeeping systems to maintain the required compliance records.

**14. Cost to the Federal Government**

Rule 38a-1 does not impose a cost on the federal government. Rule 38a-1 does not require funds to file any documents with the Commission. However, the Commission staff may records produced pursuant to the rule in order to assist the Commission in carrying out its examination and oversight program.

**15. Change in Burden**

The estimated total annual burden hours decreased 1,780 hours, from 237,500 hours to 235,720 hours. This decrease in burden hours is attributable to changes in the number of registrants.

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

Not applicable.

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

Not applicable.

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

Not applicable.

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

Not applicable.



