

## 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.

---

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

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

On December 2, 2020, the Commission issued a release adopting rules 2a-5 and 31a-4 under the Investment Company Act.<sup>3</sup> Rule 2a-5 addresses valuation practices and the role of the board of directors with respect to the fair value of the investments of a fund, and provides requirements for determining fair value in good faith for purposes of the Act. Rule 31a-4 provides the recordkeeping requirements that will be associated with fair value determinations. Upon adoption of rules 2a-5 and 31a-4, rule 38a-1 by its terms will require the adoption and implementation of written policies and procedures reasonably designed to prevent violations of the requirements of rules 2a-5 and 31a-4 (“fair value policies and procedures”).

## **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>4</sup> and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

## **4. Duplication**

---

<sup>3</sup> See Investment Company Act Release No.34128 (Dec. 3, 2020) [FR] (“Adopting Release”).

<sup>4</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

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 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**

As discussed above, upon the adoption of rules 2a-5 and 31a-4, rule 38a-1 by its terms will require the adoption and implementation of written fair value policies and procedures reasonably designed to prevent violations of the requirements of rules 2a-5 and 31a-4. Before adopting rules 2a-5 and 31a-4, the Commission solicited and evaluated public comment on the collection of information requirement. Specifically, the public was given the opportunity to comment on the Commission's estimates for the burdens of rules 31a-4 and 2a-5 as proposed. While comments were received from filers, investors and other market participants, and were considered by the Commission as discussed in the Adopting Release, most of these did not relate to the proposed burden estimates for rules 2a-5 and 31a-4. However we have corrected certain estimates, specifically to update the wage rates for relevant personnel. We have also updated the

estimated number of respondents based upon updated data.<sup>5</sup> Lastly, we added an estimated amount of external cost burdens to account for the likely costs that will be incurred relating to both legal and accounting services necessary to adopt and implement fair value policies and procedures in compliance with rule 38a-1. In addition, 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.

**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

---

<sup>5</sup> See Adopting Release, *supra* footnote 3, at text following n.656.

representative survey or study of the costs of Commission rules. In our most recent Paperwork Reduction Act submission for rule 38a-1, we estimated for rule 38a-1a total hour burden of 235,720 hours, at a time cost of \$86,784,720, and no external burden costs.<sup>6</sup> Compliance with rule 38a-1 is mandatory for funds.

As discussed above, upon the Commission’s adoption of rules 2a-5 and 31a-4, rule 38a-1 will require the adoption and implementation of written policies and procedures reasonably designed to prevent violations of the requirements of the rules. To comply with rule 38a-1, these policies and procedures must be tailored to rules 2a-5 and 31a-4’s requirements to ensure that a board or valuation designee, as applicable, determines the fair value of fund investments in compliance with the rules. Because rules 2a-5 and 31a-4 are new rules under the Act with new fair value determination requirements, and given the intrinsic relationship of the rules to the board’s own statutory functions relating to valuation, the fair value policies and procedures must be approved by the board pursuant to rule 38a-1 and may not be considered material amendments to existing fair value policies and procedures. Further, we believe that funds will likely incur external legal and accounting services in developing the fair value policies and procedures. Therefore, our revised PRA estimates includes external costs.

Table 1 below summarizes our current PRA estimates, revised from the previously approved PRA estimates to account for the initial and ongoing burden estimates associated with the new fair value policies and procedures.

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

Internal initial burden hours	Internal annual burden hours	Wage rate <sup>1</sup>	Internal time costs	Initial external cost burden	Annual external cost burden
<b>FINAL ESTIMATES</b>					

<sup>6</sup> This estimate is based on the last time the rule’s information collection was submitted in 2020.

Establishing and implementing new 38a-1 fair value policies and procedures	6 hours	4 hours <sup>2</sup>	x	\$329 (senior manager)	\$1,316.00	\$3,000.00	\$1,000.00
	6 hours	4 hours <sup>2</sup>	x	\$466 (ass't general counsel)	\$1,864.00		
	3 hours	2 hours <sup>3</sup>	x	\$530 (chief compliance officer)	\$1,060.00		
	3 hours	2 hours <sup>3</sup>	x	\$365 (compliance attorney)	\$730.00		
	3 hours	2 hours <sup>3</sup>		\$4,770 (Board of Directors as a whole) <sup>4</sup>	\$9,540		
Reviewing and updating 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		
	1 hour		X	\$4,770 (Board of Directors as a whole) <sup>4</sup>	\$4,770.00		
Total annual burden per fund		22 hours			\$22,195.00		\$2,000.00
Number of affected funds		x 9,804			x 9,804	x 9,804	x 9,804
<b>Total annual burden</b>		<b>215,688 hours</b>			<b>\$217,599,780</b>	<b>\$29,412,000</b>	<b>\$19,608,000</b>
<b>TOTAL ESTIMATED BURDENS FOR RULE 38a-1</b>							
Current burden estimates		<b>235,720 hours</b>			<b>\$86,784,720</b>	<b>\$0</b>	<b>\$0</b>
Revised burden estimates		<b>451,408 hours</b>			<b>\$304,384,500</b>	<b>\$29,412,000</b>	<b>\$19,608,000</b>

**Notes:**

1. Wage rates 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 ("SIFMA Report"), modified by Commission staff to account for an 1800-hour work year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.
2. Includes initial burden estimates annualized over a three-year period, plus 2 hours of ongoing annual burden hours.
3. Includes initial burden estimates annualized over a three-year period, plus 1 hour of ongoing annual burden hours.
4. 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.

### 13. Cost to Respondents

Cost burden is the cost of goods and services purchased to comply with rule 38a-1, such as legal and accounting services. The cost burden does not include the hour burden discussed in Item 12 above. Estimates are based on the Commission's examination and oversight experience. As summarized in Table 1 above, in our most recent Paperwork Reduction Act submission for

rule 38a-1, Commission staff estimated about that there were no external cost burdens associated with rule 38a-1. However, we believe that funds will likely incur external legal and accounting services associated with developing the fair value policies and procedures. Therefore, our revised PRA estimates includes \$2,000 annual external costs.

**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 increased 215,688 hours, from 235,720 hours to 451,408 hours and an increase in external costs from \$0 to \$2,000. This increase in burden hours and external costs is attributable to additional burdens associated with the Commission's adoption of rules 2a-5 and 31a-4.

**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.