

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

Rule 2a-5 provides 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”) for purposes of section 2(a)(41) of the Investment Company Act and rule 2a-4 thereunder.⁴ Under the rule, fair value as determined in good faith requires assessing and managing material risks associated with fair value determinations; selecting, applying, and testing fair value methodologies; and overseeing and evaluating any pricing services used. The

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).

rule also permits a fund's board to designate a "valuation designee" to perform fair value determinations. The valuation designee can be the adviser of the fund or an officer of an internally managed fund.⁵ When a board designates the performance of determinations of fair value to a valuation designee for some or all of the fund's investments under the rule, the rule requires the board to oversee the valuation designee's performance of fair value determinations.

To facilitate the board's oversight, the rule also includes certain reporting and other requirements in the case of designation to a valuation designee.⁶ As relevant here, the rule requires, if the board designates performance of fair value determinations to a valuation designee, that the valuation designee report to the board in both periodic and as needed reports on a per-fund basis.

Specifically, on a periodic basis, the valuation designee must provide to the board:

- Quarterly Reports. At least quarterly, in writing, (1) any reports or materials requested by the board related to the fair value of designated investments or the valuation designee's process for fair valuing fund investments and (2) a summary or description of material fair value matters that occurred in the prior quarter. This summary or description must include (1) any material changes in the assessment and management of valuation risks, including any material changes in conflicts of interest of the valuation designee (and any other service provider), (2) any material changes to, or material deviations from, the fair value methodologies, and (3) any material

⁴ See Good Faith Determinations of Fair Value, Investment Company Act Release No. 34128 (Dec. 7, 2020) ("Adopting Release").

⁵ Rule 2a-5(e)(4).

changes to the valuation designee's process for selecting and overseeing pricing services, as well as any material events related to the valuation designee's oversight of pricing services.

- **Annual Reports.** At least annually, in writing, an assessment of the adequacy and effectiveness of the valuation designee's process for determining the fair value of the designated portfolio of investments. At a minimum, this annual report must include a summary of the results of the testing of fair value methodologies required under the rule and an assessment of the adequacy of resources allocated to the process for determining the fair value of designated investments, including any material changes to the roles or functions of the persons responsible for determining fair value.

Further, the rule requires the valuation designee to provide a written notification to the board of the occurrence of matters that materially affect the fair value of the designated portfolio of investments (defined as "material matters") within a time period determined by the board, but in no event later than five business days after the valuation designee becomes aware of the material matter. Material matters in this instance include, as examples, a significant deficiency or material weakness in the design or effectiveness of the valuation designee's fair value determination process or of material errors in the calculation of net asset value. The valuation designee must also provide such timely follow-on reports as the board may reasonably determine are appropriate.⁷

⁶ Rule 2a-5(b).

⁷ Rule 2a-5(b).

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

2. Purpose and Use of the Information Collection

The purpose of the information collection requirement in rule 2a-5 is to facilitate the board's ability to oversee effectively the adviser's fair value determinations and satisfy the board's obligation under the Act.

3. Consideration Given to Information Technology

The information collected under the rule would not be submitted to the Commission. The proposed rule does not stipulate any particular method for communicating or preserving the information collected. The Electronic Signatures in Global and National Commerce Act⁸ and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

4. Duplication

The Commission is not aware of any duplicate reporting requirements concerning rule 2a-5.

5. Effects on Small Entities

The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), to identify methods to minimize recordkeeping or reporting requirements affecting small businesses. The requirements of rule 2a-5 do not distinguish

between small entities and larger entities. The burden on smaller entities may be greater than for larger entities. There are different factors that affect whether a smaller fund incurs costs related to this requirement that are on the higher or lower end of the estimated range. For example, smaller funds – and more specifically, smaller funds that are not part of a fund complex – may not have an advisory agreement that has a reporting mechanism that meets all the elements that are required under the rule. Also, while larger funds or funds that are part of a large fund complex may incur higher costs, via increased advisory fees for valuation designees to take on this responsibility on behalf of such funds, related to this requirement in absolute terms relative to a smaller fund or a fund that is part of a smaller fund complex, a smaller fund may find it more costly, per dollar managed, to comply with the requirement because it is not be able to benefit from a larger fund complex’s economies of scale.⁹

We do not believe that exempting small funds from the provisions in the rule would permit us to achieve our stated objectives, principally to protect investors from improper valuations. Further, the board reporting of the rule only affects fund boards that designate a valuation designee to perform fair value determinations, and, therefore, the rule requires funds to comply with this specific requirement only if the boards designated responsibilities to a valuation designee. 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 this provisions of the rule.

⁸ P.L. 106-229, 114 Stat. 464 (June 30, 2000).

⁹ See Adopting Release, *supra* footnote 4, at section III.C.1.

6. Consequences of Not Conducting Collection

Less frequent information collection would be incompatible with the objectives of rule 2a-5. The requirements of the rule are necessary to facilitate the board's ability to oversee effectively the adviser's fair value determinations and satisfy the board's obligation under the Act.

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

Not applicable.

8. Consultations Outside the Agency

The Commission requested public comment on the collection of information requirements in rule 2a-5 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to its request.

9. Payment or Gift

Not applicable.

10. Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

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 (44 U.S.C. 3501 et seq.) and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.

The table below summarizes the estimated burdens associated with the collection of information from the proposal and the final PRA estimates for internal and external burdens associated with rule 2a-5.¹⁰

¹⁰ The Commission's estimates of the relevant wage rates in the tables above 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 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 ("SIFMA Report").

Rule 2a-5 PRA Estimates Table

| | Internal annual burden hours | | Wage rate ¹ | Internal time costs | Annual external cost burden |
|---|---------------------------------|--------------------|---|----------------------|-----------------------------|
| | 24 hours | × | \$425 (senior operations manager) | \$10,200 | |
| Valuation designee written reports | 2 hours | × | \$4,770 (directors) ² | \$9,540 | \$3,674 ³ |
| | 8 hours | × | \$425 (compliance attorney) | \$3,400 | |
| Total annual burden per fund | 34 hours | | | \$23,140 | \$3,674 |
| Number of funds | × | 9,800 ⁴ | | × | 9,800 |
| Total burden | 333,200 hours | | | \$226,772,000 | \$36,005,200 |

Notes:

1. See SIFMA Report.

2. This wage rate is not from the SIFMA Report but is a staff estimate. It is a combined cost for the entire board (not a per board member cost). This estimate assumes an average of 9 board members per board.

3. This estimated burden is based on the estimated wage rate of \$565/hour, for 4 hours, for outside legal services and of \$353/hour, for 4 hours, for outside accounting services.

4. As of December 2022 (for filings received through June 30, 2023), approximately 27% = (3,378 open-end funds with investments valued using only level 1 inputs that filed Form N-PORT + 29 closed-end funds with investments valued using only level 1 inputs that filed Form N-PORT + 5 ETFs registered as UITs with investments valued using only level 1 inputs that filed Form N-PORT + 5 variable annuity separate accounts registered as management companies with investments valued using only level 1 inputs that filed Form N-PORT) / 12,586 funds that filed Form N-PORT. 9,800 funds = 12,586 funds that filed Form N-PORT – 3,417 funds that hold investments valued using only level 1 inputs and filed Form N-PORT + 125 BDCs + 506 affected UITs. 506 = 701 UITs that filed Form N-CEN * (1 – 27% of funds that only report securities valued using level 1 inputs based on N-PORT data). This calculation assumes that the distribution of investments valued using level 1 inputs for registered investment companies that filed Form N-PORT is similar to the distribution of investments valued using level 1 inputs for UITs that filed Form N-CEN. This calculation also assumes that all 125 BDCs in our sample hold a non-zero amount of investments valued using level 2 and level 3 inputs. This assumption is made because BDCs are required to invest at least 70% of their assets in private or public U.S. firms with market values of less than \$250 million, and these investments usually are securities valued using level 2 or level 3 inputs. See 15 U.S.C. 80a-54(a).

13. Cost to Respondents

Cost burden is the cost of goods and services purchased to collect the information required under rule 2a-5. The cost burden does not include the hour burden discussed in Item 12 above. As outlined in the table above, we estimate the total external cost burden to comply with rule 2a-5 to be \$36,005,200.

14. Cost to the Federal Government

The rule does not entail any costs on the federal government.

15. Changes in Burden

The estimated hourly burden and external cost associated with rule 2a-5 has increased as follows:

Table 2: Comparison of Current and Revised Burden Hours and External Cost:

| | Annual Time Burden (hours) | | | External Cost Burden (dollars) | | |
|------------------|----------------------------|------------------|--------|--------------------------------|------------------|-------------|
| | Currently Approved | Revised Estimate | Change | Currently Approved | Revised Estimate | Change |
| Rule 2a-5 | 317,390 | 333,200 hours | 15,810 | \$29,685,300 | \$36,005,200 | \$6,319,900 |

We have revised the estimates to reflect increases in the number of affected entities and the external cost associated with the information collection requirements. These increases reflect revised estimates.

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.