

SUPPORTING STATEMENT
RULE 31a-4

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 2(a)(41) of the Investment Company Act of 1940 (“Investment Company Act” or “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 December 3, 2020, the Commission issued a release adopting two new rules, rule 2a-5 and rule 31a-4.⁵ Rule 2a-5 will provide the requirements for determining in good faith the fair value of the investments of a registered investment company or companies that have elected to

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).

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. Under rule 2a-5, fair value as determined in good faith will require 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. Rule 2a-5 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.⁶ 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 rule 2a-5, this rule requires the board to oversee the valuation designee’s performance of fair value determinations. To facilitate such oversight, rule 2a-5 also includes certain reporting and other requirements.⁷

Rule 31a-4 contains the recordkeeping requirements associated with rule 2a-5. Specifically, registered investment companies and BDCs, or their advisers, will be required to maintain appropriate documentation to support fair value determinations made pursuant to rule 2a-5.⁸ Further, if the board of the fund designates performance of fair value determinations to a valuation designee under rule 2a-5, the fund or adviser will need to maintain certain additional records relating to that designation.⁹

⁵ See Good Faith Determinations of Fair Value, Investment Company Act Release No. 34128 (Dec. 7, 2020) (“Adopting Release”).

⁶ Rule 2a-5(e)(4).

⁷ Rule 2a-5(b).

⁸ Rule 31a-4(a).

⁹ Rule 31a-4(b).

Compliance with rule 31a-4 will be mandatory for any fund that will need to determine fair value under the Act. To the extent that records that will be required to be created and maintained under this rule are provided to the Commission in connection with examinations or investigations, such information will 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 31a-4 is to help ensure compliance with rule 2a-5's requirements and aid in oversight.

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 Act¹⁰ 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 recordkeeping requirements concerning rule 31a-4.

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. These requirements will impose burdens on all funds,

¹⁰ P.L. 106-229, 114 Stat. 464 (June 30, 2000).

including those that are small entities. There are different factors that would affect whether a smaller fund incurs costs relating to this requirement that are on the higher or lower end of the estimated range. For example, we would expect that smaller funds – and more specifically, smaller funds that are not part of a fund complex – may not have recordkeeping systems that meet all the elements that are required under this rule. Also, while larger funds or funds that are part of a large fund complex may incur higher costs related to these requirements 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 requirements because it will not be able to benefit from a larger fund complex’s economies of scale.¹¹

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, certain elements of the rule only affects fund boards that designate a valuation designee to perform fair value determinations, and, therefore, the rule will require 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.

6. Consequences of Not Conducting Collection

¹¹ See Adopting Release, *supra* footnote 5, at section III.E.

Less frequent information collection would be incompatible with the objectives of rule 31a-4. The requirements of the rule are necessary to help ensure compliance with rule 2a-5's requirements and aid in oversight.

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

Not applicable.

8. Consultations Outside the Agency

Before adopting rule 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 rule 2a-5, which at proposal included certain recordkeeping requirements. At adoption, in part in response to comments received, the Commission moved the proposed recordkeeping requirements of proposed rule 2a-5 (modified as discussed below) to a new rule, rule 31a-4.

Some commenters argued that the burden estimates as proposed for rule 2a-5's recordkeeping requirements were too low. Specifically, these commenters stated that the proposed requirement to maintain documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered when making fair value determinations, would result in the valuation designee needing to obtain significant amounts of data that it would not otherwise obtain and retain it when it utilizes a pricing service, and would require funds or valuation designees to hire additional personnel to be able to comply. While we have clarified that certain recordkeeping that commenters thought was suggested in the proposed rule will not be required in rule 31a-4 as

adopted and made other changes to address these concerns,¹² we are nonetheless significantly increasing our estimates for this rule in consideration of these comments. We have also updated the estimated number of respondents based upon updated data.¹³ We also further revised certain estimates, specifically to include the likely involvement of a compliance attorney in the formulation of policies and procedures relating to this requirement and to update the wage rates for relevant personnel.

In addition, the Commission and 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 staff with a means of ascertaining and acting upon paperwork burdens that may confront the industry.

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

¹² See Adopting Release, *supra* footnote 5, at section II.C.

¹³ See Adopting Release, *supra* footnote 5, at nn. **Error! Bookmark not defined. - Error! Bookmark not defined.** and accompanying text.

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 31a-4.¹⁴

Rule 31a-4 PRA Estimates Table

	Initial internal 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 hours	0.5 hours	×	\$62 (general clerk)	\$62	\$1,800	\$600	
	1.5 hours	0.5 hours	×	\$95 (senior computer operator)	\$95			
Recordkeeping	0 hours	2 hours	×	\$62 (general clerk)	\$124	\$0	\$0	
	0 hours	2 hours	×	\$95 (senior computer operator)	\$190			
Total annual burden per fund		5 hours			\$471	\$1,800	\$600	
Number of funds		×	9,986		×	9,986	×	9,986
Total proposed annual burden		49,930 hours			\$4,703,406³	\$17,974,800⁴	\$5,991,600	
FINAL ESTIMATES								

¹⁴ 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 inflation, and multiplied by 5.35 for professional staff and 2.93 for clerical staff 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").

Establishing recordkeeping policies and procedures⁵	0 hours	0 hours	×	N/A	\$0	\$0	\$0
	6 hours	18 hours	×	\$63 (general clerk)	\$1,134		
Recordkeeping	6 hours	18 hours	×	\$96 (senior computer operator)	\$1,728	\$0	\$0
	6 hours	18 hours	×	\$368 (compliance attorney)	\$6,624		
Total annual burden per fund		54 hours			\$9,486	\$0	\$0
Number of funds		×	9,804		×	9,804	
Total final annual burden		529,416 hours			\$93,000,744	\$0	\$0
TOTAL ESTIMATED BURDENS FOR BOARD REPORTING							
Proposed burden estimates		49,930 hours			\$4,703,406	\$17,974,800	\$5,991,600
Proposed total respondents		9,986					
Revised burden estimates		529,416 hours			\$93,000,744	\$0	\$0
Revised total respondents		9,804					

Notes:

1. These estimates include initial burden estimates annualized over a three-year period.
2. See SIFMA Report, *supra* footnote 14.
3. Due to a math error, these costs were erroneously reported as \$1,567,802 in the Proposing Release.
4. The total initial external cost burden was not calculated in the Proposing Release.
5. We are now accounting for the burdens associated with the policies and procedures aspect of this rule as part of our burden estimates relating to rule 38a-1. See Adopting Release, *supra* footnote 5, at section IV.D.

13. Cost to Respondents

Cost burden is the cost of goods and services purchased to collect the information required under rule 31a-4. 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 31a-4 to be \$93,000,744.

14. Cost to the Federal Government

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

15. Changes in Burden

Not applicable. This is the first request for approval of a collection of information for this proposed rule.

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.