

35,139 burden hours¹⁰⁴ and \$3,513,900 in outside legal costs¹⁰⁵ to comply with the new rules and rule and form amendments.

Form 12b-25

Form 12b-25 provides notice to the Commission and the marketplace that registrants will be unable to file a required report in a timely manner. If certain conditions are met, the registrant will be granted an automatic filing extension. The proposed amendments would permit investment companies to use Form 12b-25 for the purpose of obtaining extensions with respect to filing Form N-CSR. We estimate that an average of 168 investment companies per year use Form 12b-25 to obtain extensions of time for filing Form N-SAR spending, on average, approximately 2.5 hours completing the form. We estimate that the same number of investment companies, though not necessarily the same specific investment companies, will also use Form 12b-25 to obtain extensions of filing Form N-CSR annually, resulting in an incremental increase of 420 burden hours¹⁰⁶ to comply with the new rules and form and rule amendments.

V. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. Our rules and rule and form amendments more fully implement Section 302 of the Sarbanes-Oxley Act by requiring a registered management investment company, other than a small business investment company ("SBIC"), to file certified shareholder reports with the Commission on Form N-CSR containing (i) a copy of any required report to shareholders, (ii) additional information regarding disclosure controls and procedures, and (iii) the certification required by Section 302 of the Sarbanes-Oxley Act. These amendments also will designate certified shareholder reports on Form N-CSR, filed by management investment companies, as periodic reports filed with the Commission under the Exchange Act. Therefore, these amendments will require the certification of each management investment company's principal

executive and financial officer to be included in its certified shareholder reports on Form N-CSR. We also are amending the instructions to Form N-SAR, the semi-annual reporting form for registered investment companies, to remove the certification requirement from the form and designate it as an Investment Company Act only filing for registered management investment companies other than SBICs. Further, we are amending Form 12b-25 to permit investment companies to use Form 12b-25 for the purpose of obtaining extensions with respect to filing Form N-CSR. In addition, the rules will require all registered management investment companies, other than SBICs, to maintain, and regularly evaluate the effectiveness of, disclosure controls and procedures designed to ensure that the information required in their filings on Form N-CSR is recorded, processed, summarized, and reported on a timely basis.

Finally, we are requiring registered management investment companies to include new disclosures on Form N-CSR or Form N-SAR, as appropriate, in order to implement the requirements of Sections 406 and 407 of the Sarbanes-Oxley Act of 2002. First, the rules require a management investment company to disclose whether it has at least one "audit committee financial expert" serving on its audit committee, and if so, the name of the expert and whether the expert is independent of management. A management investment company that does not have an audit committee financial expert must disclose this fact and explain why it has no such expert. Second, the rules require a management investment company to disclose whether it has adopted a code of ethics that applies to the company's principal executive officer and senior financial officers, or persons performing similar functions, regardless of whether they are employed by the management investment company or any third party. A management investment company disclosing that it has not adopted such a code must disclose this fact and explain why it has not done so. A management investment company also will be required to disclose amendments to, and waivers from, the code of ethics relating to any of those officers.

We received one comment letter specifically addressing this Section. The commenter urged the Commission to review its cost-benefit analysis with a view not only to the new rules but to the increased costs, such as legal and accounting fees, imposed on smaller investment companies associated with other recently adopted rules, such as

anti-money laundering procedures. The purpose of this cost-benefit analysis is to focus on the costs associated only with the adoption of the rules requiring the filing of Form N-CSR. The costs associated with other recently adopted rules imposed on smaller investment companies should be discussed in the cost-benefit sections of those specific rulemakings.

A. Benefits

Certification of Form N-CSR

In adopting these new rules and rule and form amendments, we intend to more fully implement the intent of Section 302 of the Sarbanes-Oxley Act, by improving the quality of the disclosure that an investment company provides about its financial condition in its periodic reports to investors. Section 302 of the Sarbanes-Oxley Act requires the principal executive and financial officers of an issuer to certify the information contained in the issuer's quarterly or annual reports filed under Section 13(a) or 15(d) of the Exchange Act. Currently, Form N-SAR is the reporting form for registered investment companies that satisfies the filing requirement under Section 13(a) or 15(d) of the Exchange Act. Form N-SAR does not contain financial statements and is a regulatory compliance form that is not delivered to investors. Thus, the amendments will remove the certification requirement from Form N-SAR, a form that does not contain financial statements, and will impose the certification requirement on Form N-CSR, a form that contains financial statements. Requiring a registered investment company's principal executive and financial officers to file certified shareholder reports on Form N-CSR will require these officers to certify, in part, that the financial statements and other financial information contained in the report fairly present in all material respects the financial condition, results of operations, changes in net assets, and cash flows (if the financial statements are required to include a statement of cash flows) of the registered investment company.

The rules should help to ensure that registered investment companies maintain sufficient disclosure controls and procedures to provide reasonable assurance to investors that registered investment companies can record, process, summarize, and report on a timely basis information that is required on Form N-CSR, including information

¹⁰⁴ 43,150 hours for certification + 1,851 hours for audit committee financial expert disclosure + 1,851 hours for code of ethics disclosure = 46,852 hours × .75 = 35,139 hours.

¹⁰⁵ 43,150 hours for certification + 1,851 hours for audit committee financial expert disclosure + 1,851 hours for code of ethics disclosure = 46,852 hours × .25 for outside counsel × \$300 per hour = \$3,513,900.

¹⁰⁶ 168 registered investment companies × 2.5 hours = 420 burden hours.