

procedures. Many of these advisers also have well-staffed compliance departments. Many conduct periodic reviews of their compliance programs and some hire independent compliance experts to review the adequacy of their compliance programs and the effectiveness of their implementation. We would expect that funds and advisers with substantial commitments to compliance would incur only minimal costs in connection with the adoption of the Proposed Rules as they reviewed their internal compliance programs for adequacy.

It is our experience that small funds and advisers are less likely than their larger counterparts to have comprehensive, written internal compliance programs in place. The Proposed Rules would impose larger relative costs on these firms. Based on our examination experience, we estimate that as many as one half of SEC-registered investment advisers do not have comprehensive, written internal compliance programs in place. These firms would incur costs in order to develop a compliance program or to convert their current compliance activities into a systematic program. However, we expect a number of factors will enable these firms to control and minimize these costs. Because these small firms typically engage in a limited number and range of transactions and have one or two employees, their internal compliance programs would be markedly less complex than those of their large firm counterparts. In addition, we anticipate that these firms will turn to a variety of industry representatives, commentators, and organizations that have developed outlines and model programs that these firms can tailor to fit their own situations. If these firms need individualized outside assistance, we expect that the number of independent compliance experts will grow to fill this demand at competitive prices, as has been the case in comparable situations.

The requirement that each firm designate a chief compliance officer likely would impose only a minimal cost. Many firms already have large compliance staffs headed by an individual who effectively serves as a chief compliance officer. For other firms, costs associated with designating a chief compliance officer also would be minimized by the fact that the Proposed Rules would not require firms to hire an individual exclusively charged with serving in this capacity.

We anticipate that costs associated with the annual review requirement also would be limited. Many large firms with comprehensive compliance programs

periodically review portions of their compliance programs. These firms would incur a cost associated with transforming their periodic reviews into a more systematic annual review, but this cost is difficult to quantify. Most of the firms without any review mechanism in place are small. For these firms, the annual review requirement likely would be less extensive and, therefore, less costly than for their larger counterparts.

C. Request for Comment

We request comment on the potential costs and benefits identified in the proposal and any other costs or benefits that may result from the Proposed Rules. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,⁸¹ the Commission also requests information regarding the impact of the proposed rule on the economy on an annual basis. Commenters are requested to provide data to support their views.

V. Consideration of Promotion of Efficiency, Competition and Capital Formation

Section 2(c) of the Investment Company Act [15 U.S.C. 80a-2(c)] and section 202(c) of the Advisers Act [15 U.S.C. 80b-2(c)] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.⁸²

As discussed above, the Proposed Rules would require funds and investment advisers to adopt and implement written policies and procedures designed to prevent violations of the federal securities laws, and review those policies and procedures at least annually. Although we recognize that a compliance program may divert resources from funds' and advisers' primary businesses, we expect that the Proposed Rules may indirectly increase efficiency in a number of ways. These compliance programs would increase efficiency by deterring securities law violations, or by facilitating the fund's or adviser's early intervention to decrease the severity of any violations that do occur. In addition, funds and advisers would be required to carry out their internal

compliance functions in an organized and systematic manner, which may be more efficient than their current approach to these functions. The existence of an industry-wide compliance program requirement may enhance efficiency further by encouraging third parties to create new informational resources and guidance to which industry participants can refer in establishing and improving their compliance programs.

Since the Proposed Rules would apply equally to all funds and advisers, we do not anticipate that any competitive disadvantages would be created. To the contrary, the Proposed Rules may encourage competition on a more level basis than exists in the current environment, in which compliance-oriented industry participants incur greater costs to maintain compliance programs than other firms.

We anticipate the Proposed Rules would indirectly foster capital formation. It has been our experience that funds and advisers with effective compliance programs are less likely to violate the securities laws and harm to investors is less likely to result. To the extent such an environment enhances investor confidence in funds and client confidence in investment advisers, investors and clients are more likely to make assets available through these intermediaries for investment in the capital markets.

We request comment on whether the Proposed Rules, if adopted, would impose a burden on competition. We also request comment on whether the Proposed Rules, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

VI. Paperwork Reduction Act

The Proposed Rules would impose "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.⁸³ If adopted, these collections of information would be mandatory. Two of the collections of information are new. The Commission has submitted these new collections to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles of these new collections are "Rule 38a-1" and "Rule 206(4)-7." The OMB has not yet assigned these collections control numbers. The other collection of information takes the form of

⁸¹ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

⁸² Although proposed rule 206(4)-7 is not based on a statutorily-mandated public interest determination, in the interest of comprehensiveness, we include it in this analysis.

⁸³ 44 U.S.C. 3501 to 3520.