

prices, as has been the case in comparable situations. Estimates of the cost of developing compliance policies and procedures vary greatly depending on the type of help that an investment adviser seeks.<sup>107</sup>

The requirement that each investment adviser designate a chief compliance officer likely will impose only a minimal cost. Many investment advisers already have large compliance staffs headed by an individual who officially or effectively serves as a chief compliance officer.<sup>108</sup> For other investment advisers, costs associated with designating a chief compliance officer also would be minimized by the fact that the new rules would not require firms to hire an individual exclusively charged with serving in this capacity.<sup>109</sup> One commenter characterized the chief compliance officer requirement as unduly burdensome because it would conflict with the complex and varied organizational structures of investment advisers. As noted above, we believe that it is important for each firm to have one person who coordinates compliance efforts on behalf of the firm, even though that individual may rely heavily on others within and outside the firm for assistance. The cost to funds of appointing a chief compliance officer also should not be significant. Like many investment advisers, many fund complexes already have large compliance staffs headed by an individual who officially or effectively serves as a chief compliance officer. We expect this individual will typically be qualified to serve the fund's board of

directors as the fund's chief compliance officer.<sup>110</sup>

We anticipate that costs associated with the annual review requirement also will be limited. Many large funds and investment advisers with comprehensive compliance programs periodically review portions of their compliance programs. These firms may 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 will be less extensive and, therefore, less costly than for their larger counterparts. We have determined that requiring more frequent reviews would impose unnecessary costs on funds and advisers.

Several commenters stated that there would be a substantial cost associated with the requirement that fund boards approve the compliance policies and procedures and review the annual report prepared by the chief compliance officer. We have clarified in this release that the new rules do not require the board of directors to read every policy and procedure. The board may make its decisions about the adequacy of the compliance policies and procedures based on summary reports. Similarly, the board's review of the chief compliance officer's annual report should focus on ensuring that the compliance programs of the fund and its service providers are reasonably designed and functioning effectively. In light of these clarifications, we do not believe that funds will incur excessive costs in connection with board oversight of compliance under the new rules.

One commenter, a large fund complex, suggested that there would be substantial recordkeeping costs associated with the new rules, and suggested that firms be required to maintain for five years copies of only those policies and procedures that form the backbone of the firm's compliance program. Because records may be maintained electronically, the cost of maintaining copies of all compliance policies and procedures in place during the past five years will be contained.

## 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)) mandate that 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.

As discussed above, the new 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 new rules may indirectly increase efficiency in a number of ways. These compliance programs should increase efficiency by deterring Federal 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 will 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 new rules apply equally to all funds and advisers, we do not anticipate that they will introduce any competitive disadvantages. To the contrary, the new 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. Several commenters cautioned, however, that the new rules could have anti-competitive effects on the advisory industry because they would disproportionately burden small advisers and could even force them to merge with their larger, more established counterparts or go out of business. While small advisers will incur the largest relative costs as a result

<sup>107</sup> One commenter stated that prohibitive costs may be the reason that some firms, particularly small firms, do not have compliance programs. The Financial Planning Association, however, estimated, based on discussions with a number of compliance vendors, a small adviser (with five employees) would spend \$675 to purchase compliance software and customize it in-house. Alternatively, the FPA estimated that such an adviser could purchase a turn-key manual customized for the adviser for \$1,500. Finally, the FPA estimated that the adviser could retain an outside consultant to develop a written compliance manual for \$3,900.

<sup>108</sup> The ICAA noted that most of its members have employees responsible for compliance and many of these have designated a chief compliance officer.

<sup>109</sup> Several commenters expressed concern about the cost to small firms of hiring a chief compliance officer. The rules that we are adopting do not require funds or investment advisers to hire a separate chief compliance officer, and we expect that many small investment advisers will designate a principal or employee of the firm to serve as chief compliance officer. However, a firm that does not currently have a person qualified to serve as chief compliance officer will incur costs associated with training someone in the firm.

<sup>110</sup> The requirement that fund boards approve the designation and compensation of the chief compliance officer, or take action to remove a chief compliance officer, will impose minimal costs, if any, beyond the current costs incurred to prepare briefing materials for directors and convene board meetings. With rare exception, fund boards should be able to take up these issues during their existing schedule of meetings.