

## **SUPPORTING STATEMENT RULE 31a-1**

### **A. JUSTIFICATION**

#### **Necessity for the Information Collection**

Rule 31a-1 [17 CFR 270.31a-1] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the “Act”) requires registered investment companies (“funds”), and certain of their majority-owned subsidiaries, to maintain and keep current the accounts, books, auditors’ certificates, and other documents that underlie and support the financial statements these entities are required to file with the Commission under section 30 of the Act [15 U.S.C. 80a-30]. Rule 31a-1(a) defines the entities that must comply with the rule. As mentioned, the rule encompasses funds as well as every underwriter, broker, dealer, or investment adviser that is a majority-owned subsidiary of a fund. Rule 31a-1(b) describes the specific records that must be maintained and kept current by the entities identified in rule 31a-1(a). These records consist of the following: (i) journals detailing purchases and sales of securities; (ii) general and auxiliary ledgers reflecting all asset, liability, reserve, capital income, and expense accounts; (iii) a record of all “long” and “short” positions carried by the fund for its own account; (iv) corporate charters, certificates of incorporation, bylaws, shareholder and director meeting minutes; (v) a record of each brokerage order made by the fund for the purchase or sale of securities; (vi) a record of all other portfolio purchases or sales; (vii) a record of all options and contractual commitments

to purchase or sell securities or other property; (viii) a record of the money balances in all ledger accounts in the form of trial balances; (ix) a quarterly record of the specific basis upon which each purchase or sale of portfolio securities was made; (x) a record identifying the person or persons who authorized the purchase or sale of portfolio securities; and (xi) files of advisory material received from the investment adviser or other person from whom the fund accepts investment advice.

Rule 31a-1(c) requires underwriters, brokers, and dealers that are majority-owned subsidiaries of a fund to maintain the accounts, books, and other documents that are required to be maintained by brokers and dealers by rule adopted under section 17 of the Securities Exchange Act of 1934 [15 U.S.C. 78q] (the “1934 Act”). Rule 31a-1(d) requires depositors and principal underwriters for any fund other than a closed-end fund to maintain the accounts, books, and other documents that are required to be maintained by brokers and dealers by rule adopted under section 17 of the 1934 Act, to the extent those records are necessary or appropriate to record such persons' transactions with such funds.

Rule 31a-1(e) requires investment advisers that are majority-owned subsidiaries of funds to maintain the accounts, books, and other documents that are required to be maintained by investment advisers under section 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-4] (the “Advisers Act”). Finally, rule 31a-1(f) requires investment advisers that are not

majority-owned subsidiaries of funds to maintain the accounts, books, and other documents that are required under section 204 of the Advisers Act, to the extent those records are necessary or appropriate to record such persons' transactions with such funds.

### **Purpose of the Information Collection**

The Commission regularly conducts inspections and examinations of funds and other regulated entities to foster compliance with the securities laws, to detect violations of the law, and to keep the Commission informed of developments in the regulated community. The books and records required to be maintained by rule 31a-1 constitute a major focus of the Commission's inspection and examination programs. Without the information contained in the records required by rule 31a-1, the Commission could not readily determine whether funds are in compliance with the Act's provisions. The rule's requirement to maintain such records avoids the need for potentially more burdensome requirements such as mandatory filings of similar information with the Commission.

### **Role of Improved Information Technology**

The records required by rule 31a-1 are required to be preserved pursuant to rule 31a-2 under the Investment Company Act [17 CFR 270.31a-2]. Rule 31a-2(f) permits funds to maintain many types of records (and produce them for the Commission's inspections and examinations as necessary) on photographic film, magnetic tape, disk, or other computer

storage media. The Commission's Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") is designed to automate the filing, processing, and dissemination of full disclosure filings. The system permits publicly held companies to transmit many filings to the Commission electronically. Although EDGAR currently is limited to disclosure filings, EDGAR may be used in the future to obtain other types of information from sources outside the Commission. As previously noted, rule 31a-1 does not require the filing of any documents with the Commission.

### **Efforts to Identify Duplication**

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or a change in a rule. The recordkeeping required by rule 31a-1 is not duplicated elsewhere in the Commission's rules. To the extent the rule requires the maintenance of books and records by underwriters, brokers, dealers, and investment advisers to funds, the requirements are consistent with those that apply to these entities under other federal securities laws and do not require the keeping of duplicate records.

### **Effect on Small Entities**

The Commission does not believe that compliance with rule 31a-1 is unduly burdensome for large or small entities. The information collection requirements of rule 31a-1 are the same for all registered funds, including those that are small entities. Most of the information required to be

maintained is the type that generally would be maintained as a matter of good business practice and to prepare the fund's financial statements. The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act [5 U.S.C. 610], to identify methods to minimize recordkeeping or filing requirements affecting small businesses.

### **Consequences of Less Frequent Collection**

As noted above, without the information contained in the records required to be maintained and kept current by rule 31a-1, it would be difficult or impossible to determine if a fund was in compliance with the provisions of the Act. Funds' maintenance of these records avoids the need for potentially more burdensome requirements such as mandatory filings with the Commission.

### **1. (2) Inconsistencies with Guidelines in 5 CFR 1320.5(d)**

Not applicable.

### **Consultations Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 31a-1 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.

The Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and informal

exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry.

**Payment or Gift to Respondents**

Not applicable.

**Assurance of Confidentiality**

Not applicable.

**Sensitive Questions**

Not applicable.

**Estimate of Hour Burden**

There are approximately 4300 active investment companies registered with the Commission all of which are required to comply with rule 31a-1.<sup>1</sup> For purposes of estimating the burden imposed on the industry by rule 31a-1, the Commission staff estimates that, on average, each of the above investment companies is divided into approximately four series and that each series is required to comply with the recordkeeping requirements of rule 31a-1. Thus, the Commission staff estimates that a total of approximately 17,200 series must comply with the recordkeeping requirements of rule 31a-1 (4300 registrants x 4 series per registrant = 17,200 series).

Based on conversations with fund representatives, the Commission staff estimates that each series spends approximately 1500 hours per year

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<sup>1</sup> This estimate is based on statistics compiled by Commission staff.

complying with rule 31a-1, for a total of 6000 hours annually per registrant (1500 per year/per series x 4 series per registrant = 6000 hours). The estimated total annual burden for all investment companies subject to the rule therefore is approximately 25,800,000 hours (6000 hours per registrant x 4300 registrants = 25,800,000 hours).

Of the 1500 hours spent annually by each series to comply with rule 31a-1, the Commission staff estimates that:

- Fifteen percent (225 hours) are spent by clerical staff at an estimated hourly wage of \$26, for a total of \$5850 per year (225 hours x \$26 per hour = \$5850 per year);
- Eighty percent (1200 hours) are spent by fund accountants at an estimated hourly wage of \$40, for a total of \$48,000 per year (1200 hours x \$40 per hour = \$48,000 per year); and
- Five percent (75 hours) are spent by attorneys at an estimated hourly wage of \$70, for a total of \$5250 per year (75 hours x \$70 per hour = \$5250 per year).<sup>2</sup>

Thus, the estimated annual cost for each series of the hour burden imposed by rule 31a-1 is \$59,100 (\$5850 + \$48,000 + \$5250 = \$59,100), for a total annual cost per registrant of \$236,400 (\$59,100 per series x 4 series per registrant = \$236,400), and a total annual cost to the industry of \$1.017 billion (\$236,400 per registrant x 4300 registrants = \$1,016,520,000).

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<sup>2</sup>

The estimated hourly burdens are based on discussions with fund representatives and employees. The staff estimates concerning the wage rate for clerical staff, accountants, and attorneys are based on salary information compiled by the Securities Industry Association for positions outside of New York. See Securities Industry Association, Report on Management and Professional Earnings in the Securities Industry (2003), modified by the Commission staff for an 1800 hour work year, 5.1% inflation, and an upward adjustment of 35% to reflect possible overhead costs and employee benefits.

Based on conversations with fund representatives, however, the Commission staff estimates that at least 90% (\$915 million) of this total annual industry cost (\$1.017 billion) would be incurred by funds in any case to keep books and records that are necessary to prepare financial statements for shareholders, to prepare their annual income tax returns and as a normal business custom. Therefore, the Commission staff estimates that compliance with rule 31a-1 by all funds actually costs approximately \$102 million per year (\$1.017 billion - \$915 million = \$102 million).

The estimated average burden hours are made solely for the purposes of the Paperwork Reduction Act and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules.

### **Estimate of Total Annual Cost Burden**

The Commission staff estimates that there is no cost burden of rule 31a-1 other than the costs of the respondent recordkeeping burden identified in section 12 above. Although funds may rely on computer systems to assist with the creation of records required by rule 31a-1, funds likely would need to acquire and maintain these computer systems in any event for the normal functioning of their daily operations and as part of the customary and usual investment company business practice.

### **Estimate of Cost to the Federal Government**

There are no costs to the Federal Government associated with rule 31a-1.

**Explanation of Changes in Burden**

The estimated total annual hour burden has increased from 25,200,000 hours to 25,800,000 hours. This increase is the result of a change in the Commission staff's estimate of the time spent by each registrant in complying with the requirements of rule 31a-1. It should also be noted that the number of funds registered with the Commission decreased from 4500 to 4300. These estimates are based on statistics compiled by Commission staff.

**Information Collections Planned for Statistical Purposes**

Not applicable.

**Approval to not Display Expiration Date**

Not applicable.

**Exceptions to Certification Statement**

Not applicable.

**B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS**

Not applicable.