

**SUPPORTING STATEMENT**  
**Rule 17f-2**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Rule 17f-2 (17 CFR 270.17f-2), entitled “Custody of Investments by Registered Management Investment Company,” was adopted in 1940 under section 17(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-17(f)) (the “Act”), and was last amended materially in 1947. Rule 17f-2 establishes safeguards for arrangements in which a registered management investment company (“fund”) is deemed to maintain custody of its own assets, such as when the fund maintains its assets in a facility that provides safekeeping but not custodial services.<sup>1</sup> The rule includes several recordkeeping or reporting requirements. The fund's directors must prepare a resolution designating not more than five fund officers or responsible employees who may have access to the fund's assets. The designated access persons (two or more of whom must act jointly when handling fund assets) must prepare a written notation providing certain information about each deposit or withdrawal of fund assets, and must transmit the notation to another officer or director designated by the directors. Independent public accountants must verify the fund's assets three times each year, and two of those examinations must be unscheduled.<sup>2</sup>

**2. Purpose of the Information Collection**

Rule 17f-2's requirement that directors designate access persons is intended to ensure that directors evaluate the trustworthiness of insiders who handle fund assets. The requirements that access persons act jointly in handling fund assets, prepare a written notation of each transaction, and transmit the notation to another designated person are intended to reduce the

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<sup>1</sup> The rule generally requires all assets to be deposited in the safekeeping of a “bank or other company whose functions and physical facilities are supervised by Federal or State authority.” The fund's securities must be physically segregated at all times from the securities of any other person.

<sup>2</sup> The accountant must transmit to the Commission promptly after each examination a certificate describing the examination on Form N-17f-2. The third (scheduled) examination may coincide with the annual verification required for every fund by section 30(g) of the Act (15 U.S.C. 80a-29(g)).

risk of misappropriation of fund assets by access persons, and to ensure that adequate records are prepared, reviewed by a responsible third person, and available for examination by the Commission. The requirement that auditors verify fund assets without notice twice each year is intended to provide an additional deterrent to the misappropriation of fund assets and to detect any irregularities. Less frequent examinations by a fund's accountants could impair the ability of the Commission's examination staff to ascertain the fund's compliance with the rule.

### **3. Role of Improved Information Technology**

The Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") provides for the automated filing, processing, and dissemination of full disclosure filings. The automation provides for speed, accuracy and public availability of information, generating benefits to investors and financial markets. The Electronic Signatures in Global and National Commerce Act<sup>3</sup> and the conforming amendments to recordkeeping rules under the Investment Company Act permit funds to maintain records electronically. The notations required under rule 17f-2 normally would be prepared and maintained on paper because they are required to appear on consecutively numbered forms.

### **4. Efforts to Identify Duplication**

The Commission evaluates reporting requirements for duplication periodically, and whenever a rule or a change in a rule is proposed. Rule 17f-2 does not require recordkeeping or reporting of information available elsewhere. The scheduled verification of the fund's assets required each year by rule 17f-2 may be combined with the annual verification of every fund's assets required by section 30(g) of the Act (15 U.S.C. 80a-29(g)).

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<sup>3</sup>

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

**5. Effect on Small Entities**

Rule 17f-2 potentially benefits smaller funds by permitting them to use self-custody procedures that may be simpler or less expensive than the bank custody arrangements used by most funds. The Commission believes that the rule's safeguards are necessary to protect fund assets from potential misappropriation by fund insiders.

**6. Consequences of Less Frequent Collection**

The frequency with which the fund prepares notations of transactions under rule 17f-2 depends on circumstances within the control of the fund. Elimination of one or both of the twice-annual unscheduled verifications of fund assets under the rule might lessen the deterrent and detection value of these verifications and increase the risk of misappropriation of fund assets. In addition, less frequent collection under rule 17f-2 could inhibit the dissemination of timely information to the public and could impair the ability of the Commission's examination staff to ascertain compliance with the rule.

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

None.

**8. Consultation Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 17f-2 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 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 forums provide the Commission and the staff means of ascertaining and acting upon paperwork burdens confronting the industry.

**9. Payment or Gift to Respondents**

Not applicable.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

The estimate of average burden hours is made solely for the purposes of the Paperwork Reduction Act, and is not derived from a comprehensive or even a representative survey or study of the costs of Commission rules and forms.

The Commission staff estimates that each fund makes 941 responses and spends an average of 271 hours annually in complying with the rule's requirements.<sup>4</sup> Commission staff estimates that on an annual basis it takes: (i) 0.5 hours of fund accounting personnel at a total cost of \$75.50 to draft director resolutions;<sup>5</sup> (ii) 0.5 hours of the fund's board of directors at a total cost of \$1000 to adopt the resolution; (iii) 263 hours for the fund's accounting personnel at a total cost of \$60,864 to prepare written notations of transactions;<sup>6</sup> and (iv) 7 hours for the fund's accounting personnel at a total cost of \$1057 to assist the independent public accountants when they perform verifications of fund assets.<sup>7</sup> Approximately 300 funds rely upon rule 17f-2 annually.<sup>8</sup> Thus, the total annual hour burden for rule 17f-2 is estimated to be 81,300 hours.<sup>9</sup>

<sup>4</sup> The 941 responses are: 1 (one) response to draft and adopt the resolution and 940 notations. Estimates of the number of hours are based on conversations with individuals in the mutual fund industry. The actual number of hours may vary significantly depending on individual fund assets.

<sup>5</sup> This estimate is based on the following calculation: 0.5 (burden hours per fund) x \$151 (fund senior accountant's hourly rate) = \$75.50.

<sup>6</sup> Respondents estimated that each fund makes 941 responses on an annual basis and spent a total of 0.28 hours per response. The fund personnel involved are Fund Payable Manager (\$156 hourly rate), Fund Operations Manager (\$252 hourly rate) and Fund Accounting Manager (\$285 hourly rate). The weighted hourly rate of these personnel is \$231. The estimated cost of preparing notations is based on the following calculation: 941 x 0.28 x \$231 = \$60,863.88.

<sup>7</sup> This estimate is based on the following calculation: 7 x \$151 (fund senior accountant hourly rate) = \$1057.

<sup>8</sup> Based on a review of Form N-17f-2 filings in 2007, the Commission staff estimates that 300 funds relied on rule 17f-2 in 2007.

<sup>9</sup> This estimate is based on the following calculation: 300 (funds) x 271 (total annual hourly burden per fund) = 81,300 hours for rule. The annual burden for rule 17f-2 does not include time spent

Based on the total costs per fund listed above, the total cost of the Rule 17f-2's collection of information requirements is estimated to be \$18.9 million.<sup>10</sup>

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

Funds relying on rule 17f-2 generally use outside counsel to assist in drafting directors' resolutions. Commission staff estimates the annual cost of these services per fund is \$48.23.<sup>11</sup> In addition, rule 17f-2 requires an independent public accountant to verify the fund's assets three times each year and to prepare and file with the Commission a certificate of examination each time it performs the verification. Commission staff estimates this cost per fund is \$31,750.<sup>12</sup> Thus the total estimated annual cost to the industry is \$9.5 million.<sup>13</sup>

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

The federal government does not incur any direct costs in connection with the requirements of rule 17f-2.

### **15. Explanation of Changes in Burden**

The estimated total annual hour burden for rule 17f-2 has increased from 13,300 hours to 81,300 hours. The estimated total annual cost has increased from \$8 million to \$9.5 million.

The increase in hours is attributable to: (i) an increase in the number of funds relying on rule

preparing Form N-17f-2. The burden for Form N-17f-2 is included in a separate collection of information.

<sup>10</sup> This estimate is based on the following calculation: \$62,996.50 (total annual cost per fund) x 300 funds = \$18,898,950.

<sup>11</sup> This estimate is based on the following calculation: 0.13 (hours) x \$371 (associate hourly billing rate) = \$48.23. The hourly wage figure for an associate attorney is from the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2007, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

<sup>12</sup> This estimate is based on the following calculation: 115 (hours to verify fund assets) x \$250 (accountant hourly billing rate) = \$28,750; 12 (hours to prepare certificates of examination) x \$250 (accountant hourly billing rate) = \$3000; \$28,750 + \$3000 = \$31,750. The hourly wage figure for an independent public accountant is from the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2007, modified by Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

<sup>13</sup> This estimate is based on the following calculation: 300 funds x \$(31,750 + \$48.23) = \$9,539,469.

17f-2; and (ii) a significant increase in the number of notations. The increase in the total annual cost burden is attributable to an increase in the number of funds relying on rule 17f-2.

**16. Information Collection Planned for Statistical Purposes**

Not applicable.

**17. Approval to not Display Expiration Date**

Not applicable.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.