

**SUPPORTING STATEMENT
RULE 31a-2**

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 31(a)(1) of the Investment Company Act of 1940 (the “Act”) requires registered investment companies (“funds”) and certain principal underwriters, broker-dealers, investment advisers and depositors of funds to maintain and preserve records as prescribed by Commission rules.¹ Rule 31a-1 specifies the books and records that each of these entities must maintain.² Rule 31a-2, which was adopted on April 17, 1944, specifies the time periods that entities must retain books and records required to be maintained under rule 31a-1.³

Rule 31a-2 requires the following:

1. Every fund must preserve permanently, and in an easily accessible place for the first two years, all books and records required under rule 31a-1(b)(1)-(4).⁴
2. Every fund must preserve for at least six years, and in an easily accessible place for the first two years:
 - a. all books and records required under rule 31a-1(b)(5)-(12);⁵
 - b. all vouchers, memoranda, correspondence, checkbooks, bank statements,

¹ 15 U.S.C. 80a-30(a)(1).

² 17 CFR 270.31a-1.

³ 17 CFR 270.31a-2.

⁴ 17 CFR 270.31a-1(b)(1)-(4). These include, among other records, journals detailing daily purchases and sales of securities or contracts to purchase and sell securities, general and auxiliary ledgers reflecting all asset, liability, reserve, capital, income and expense accounts, separate ledgers reflecting, separately for each portfolio security as of the trade date all “long” and “short” positions carried by the fund for its own account, and corporate charters, certificates of incorporation and by-laws.

⁵ 17 CFR 270.31a-1(b)(5)-(12). These include, among other records, records of each brokerage order given in connection with purchases and sales of securities by the fund, all other portfolio purchases, records of all puts, calls, spreads, straddles or other options in which the fund has an interest, has granted, or has guaranteed, records of proof of money balances in all ledger accounts, files of all advisory material received from the investment adviser, and memoranda identifying persons, committees or groups authorizing the purchase or sale of securities for the fund.

- canceled checks, cash reconciliations, canceled stock certificates and all schedules that support each computation of net asset value of fund shares;
- c. any advertisement, pamphlet, circular, form letter or other sales literature addressed or intended for distribution to prospective investors;
 - d. any record of the initial determination that a director is not an interested person of the fund, and each subsequent determination that the director is not an interested person of the fund, including any questionnaire and any other document used to determine that a director is not an interested person of the company;
 - e. any materials used by the disinterested directors of a fund to determine that a person who is acting as legal counsel to those directors is an independent legal counsel; and
 - f. any documents or other written information considered by the directors of the fund pursuant to [section 15\(c\) of the Act](#) in approving the terms or renewal of a contract or agreement between the company and an investment advisor.
3. Every underwriter, broker or dealer that is a majority-owned subsidiary of a fund must preserve records required to be preserved by brokers and dealers under rules adopted under section 17 of the Securities Exchange Act of 1934⁶ (“section 17”) for the periods established in those rules.
4. Every depositor of any fund, and every principal underwriter of any fund other

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15 U.S.C. 78q.

than a closed-end fund, must preserve for at least six years records required to be preserved by brokers and dealers under rules adopted under section 17 to the extent the records are necessary or appropriate to record the entity's transactions with the fund.

5. Every investment adviser that is a majority-owned subsidiary of a fund must preserve the records required to be maintained by investment advisers under rules adopted under section 204 of the Investment Advisers Act of 1940⁷ ("section 204") for the periods specified in those rules.
6. Every investment adviser that is not a majority-owned subsidiary of a fund must preserve for at least six years records required to be maintained by registered investment advisers under rules adopted under section 204 to the extent the records are necessary or appropriate to reflect the adviser's transactions with the fund.

The records required to be maintained and preserved under this part may be maintained and preserved for the required time by, or on behalf of, a fund on (i) micrographic media, including microfilm, microfiche, or any similar medium, or (ii) electronic storage media, including any digital storage medium or system that meets the terms of this section. The fund, or

person that maintains and preserves records on its behalf, must arrange and index the records in a way that permits easy location, access, and retrieval of any particular record.⁸

⁷ 15 U.S.C. 80b-4.

⁸ In addition, the fund, or whoever maintains the documents for the fund must provide

We periodically inspect the operations of all funds to ensure their compliance with the provisions of the Act and the rules under the Act. Our staff spends a significant portion of its time in these inspections reviewing the information contained in the books and records required to be kept by rule 31a-1 and to be preserved by rule 31a-2.

Section 15 of the Act⁹ requires that fund directors, including a majority of independent directors, approve the fund's advisory contract each year.¹⁰ Section 15(c) of the Act requires that the directors first obtain from the adviser the information reasonably necessary to evaluate the

promptly any of the following that the Commission (by its examiners or other representatives) or the directors of the fund may request: (A) a legible, true, and complete copy of the record in the medium and format in which it is stored; (B) a legible, true, and complete printout of the record; and (C) means to access, view, and print the records; and separately store, for the time required for preservation of the original record, a duplicate copy of the record on any medium allowed by this section. In the case of records retained on electronic storage media, the fund, or person that maintains and preserves records on its behalf, must establish and maintain procedures: (i) to maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction; (ii) to limit access to the records to properly authorized personnel, the directors of the fund, and the Commission (including its examiners and other representatives); and (iii) to reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.

⁹ 15 U.S.C. 80a-15.

¹⁰ The directors must approve the advisory contract initially, and annually thereafter if it continues in effect for more than two years. 15 U.S.C. 80a-15(a) and 80a-15(c). The Act also requires that shareholders approve the contract, and prohibits the assignment of the contract to other advisers. 15 U.S.C. 80a-15(a) and (b). The advisory contract must be very specific about the amount of the adviser's fee, and the adviser has a fiduciary duty with respect to that fee. 15 U.S.C. 80a-15(a)(1), 80a-35(b).

contract.¹¹ The information request requirement in section 15(c) provides fund directors, including independent directors, a tool for obtaining the information they need to represent shareholder interests. Careful consideration of the information enables them to better negotiate the amount of the advisory fee. Conversely, the failure of a board to acquire information sufficient to scrutinize the advisory fee and other fund expenses can suggest an inability or lack of interest on the part of the board in negotiating on behalf of the fund. Rule 31a-2 requires funds to maintain copies of materials consulted by its fund board to approve the fund's advisory contracts, though some funds may maintain records of these materials as part of the requirement under rule 31a-1(b)(4) for funds to maintain records of board minutes.

2. Purpose of the Information Collection

The retention of records, as required by the rule, is necessary to ensure that the public has access to material business and financial information about issuers of securities and regulated entities. As noted above, we periodically inspect the operations of funds to ensure they are in compliance with the Act and regulations under the Act. Due to the limits on our resources, however, each fund may only be inspected at intervals of several years. In addition, under the federal securities laws, there is no time limit on the prosecution of persons engaged in certain types of conduct that violate the securities laws. For these reasons, we often need information relating to events or transactions that occurred years ago. Without the requirement to preserve books, records and other documents, our staff would have difficulty determining whether the fund was in compliance with the law in such areas as valuation of its portfolio securities, computation of the prices investors paid and, when purchasing and selling fund shares, types and

¹¹ 15 U.S.C. 80a-15(c). This requirement was added to the Act in 1970, to ensure that directors would have adequate information upon which to base their decision about the advisory contract generally and the advisory fee in particular. See Securities and Exchange Commission, Analysis of S. 1659 (included in Staff of Senate Comm. on Banking and Currency, 90th Cong., 1st Sess., Comparative Print Showing Changes in Existing Law 9 (Comm. Print 1967)). See also Senate Committee on Banking and Currency, Fund Act Amendments of 1968, S. Rep. No. 1351, at 6 (July 1, 1968).

amounts of expenses the fund incurred, kinds of investments the fund purchased, actions of affiliated persons, or whether the fund had engaged in any illegal or fraudulent activities. As part of our examinations of funds, our staff also reviews the materials that directors consider in approving the advisory contract.

3. Role of Improved Information Technology

The Electronic Signatures in Global and National Commerce Act¹² and rule 31a-2(f) permit many records that are required to be maintained and preserved under the rule to be maintained electronically. 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. Although the rule does not require the filing of any documents with the Commission, the Commission may, in the future, use its EDGAR facility to improve the examination of records the rule requires funds and affiliated entities to keep. Records of materials on which directors relied to approve a fund's advisory contract under section 15(c) are also required to be maintained and thus could be maintained electronically.

4. Efforts to Identify Duplication

The requirements of rule 31a-2 are not generally duplicated anywhere else. While funds may currently maintain records of some of these materials under the requirements of rule 31a-1(b)(4), which requires funds to maintain records of the minutes of fund board meetings, funds are not specifically required to do so by the terms of rule 31a-1(b)(4).

5. Effect on Small Entities

The recordkeeping requirements of rule 31a-2 do not distinguish between large and small

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

entities. We believe that compliance with rule 31a-2 is not unduly burdensome for large or small entities.

6. Consequences of Less Frequent Collection

Rule 31a-1 requires funds and certain of their majority-owned subsidiaries to maintain records of their activities and transactions. Rule 31a-1 also requires other entities to maintain records of their transactions with funds. The frequency with which entities collect this information depends, to a large extent, on circumstances of activities and transactions within the fund and its subsidiaries. Rule 31a-2 requires funds, their majority-owned subsidiaries, and others who have transactions with the funds to preserve the records required to be maintained under rule 31a-1. Rule 31a-2 also requires funds to maintain records of materials considered by a fund board every time that it approves a fund's advisory contract, as well as records relating to the independence of legal counsel, directors, and officers. If entities did not have to preserve these records, our staff would have difficulty determining whether a fund is in compliance with the Act.

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

Rule 31a-2 requires funds to preserve certain records for six years and other records permanently. We believe that the long-term retention of records is necessary to carry out our examination and enforcement responsibilities, and our mandate to ensure that the Act's provisions are legally enforceable. We periodically inspect the operations of funds to ensure compliance with the rules and regulations under the Act; however, each fund may be inspected only at intervals of several years due to limits on our resources. Furthermore, Congress has placed no time limit on the prosecution of persons engaged in certain types of conduct that violate the securities laws. For these reasons, we often need information relating to events or

transactions that occurred years ago. In section 31(a) of the Act,¹³ Congress specifically authorized the Commission to require funds to “maintain and preserve” books and records “for such period or periods as the Commission may prescribe by rules.” Computerized record storage has made long-term retention of records less burdensome.

8. Consultation Outside the Agency

Rule 31a-2 has been previously amended through rulemaking actions. Comments generally are received from registrants, trade associations, the legal and accounting profession, and other interested parties. In addition, we, and our staff from the Division of Investment Management, participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and information exchanges.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Estimate of Hour Burden

There are approximately 4,522 registered investment companies (“funds”) as of September 30, 2009, all of which are required to comply with rule 31a-2. Based on conversations with representatives of the fund industry and past estimates, our staff estimates that each fund currently spends 220 hours per year complying with rule 31a-2. Our staff estimates that the 220 hours spent by a typical fund would be split evenly between administrative and computer operation personnel,¹⁴ with 110 hours spent by a general clerk at a rate of \$49 per

¹³ 15 U.S.C. 80a-30(a).

¹⁴ However, the hour burden may be incurred by a variety of fund staff, and the type of staff

hour and 110 hours spent by a senior computer operator at a rate of \$75 per hour.¹⁵ Based on these estimates, our staff estimates that the total annual burden for a fund to comply with rule 31a-2, is 220 hours, with a total annual burden for all funds of 994,840 hours at an estimated cost of \$61,680,080.¹⁶

The hour burden estimates for retaining records under rule 31a-2 are based on our experience with registrants and our experience with similar requirements under the Act and the rules under the Act. The number of burden hours may vary depending on, among other things, the complexity of the fund, the issues faced by the fund, and the number of series and classes of the fund. The estimated average burden hours are made solely for purposes of the Paperwork Reduction Act and are not derived from quantitative, comprehensive, or even representative survey or study of the burdens associated with our rules and forms.

13. Estimate of Total Annual Cost Burden

The Commission staff estimates the average cost of preserving books and records required by rule 31a-2, to be approximately \$70,000 annually per fund. As discussed previously, there are approximately 4,522 funds currently operating, for a total cost of preserving records as required by rule 31a-2 of \$316,540,000 per year.¹⁷ Our staff understands, however, based on conversations with representatives of the fund industry, that funds would already spend approximately half of this amount (\$158,270,000) to preserve these same books and records, as

position used for compliance with the rule may vary widely from fund to fund.

¹⁵ The estimated salary rates are derived from SIFMA's *Office Salaries in the Securities Industry 2008*, 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.

¹⁶ This estimate is based on the following calculations : 4,522 registered investment companies \times 220 hours = 994,840 total hours; 994,840 hours / 2 = 497,420 hours; 497,420 \times \$49 rate per hour for a clerk = \$24,373,580; 497,420 \times \$75 rate per hour for a computer operator = \$37,306,500; \$24,373,580 + \$37,306,500 = \$61,680,080 total cost.

¹⁷ This estimate is based on the following calculation: 4,522 funds \times \$70,000 = \$316,540,000.

they are also necessary to prepare financial statements, meet various state reporting requirements, and prepare their annual federal and state income tax returns. Therefore, we estimate that the total annual cost burden for funds as a result of compliance with rule 31a-2 is \$158,270,000 per year.

14. Estimate of Cost to the Federal Government

There is no cost to the Federal Government for these recordkeeping activities.

15. Explanation of Changes in Burden

The staff's hour burden estimate for compliance with rule 31a-2 has decreased slightly, from 1,082,400 hours to 994,840 hours today, a net decrease of 87,560 hours. Similarly, the staff's estimate for the cost of compliance has been reduced slightly, from \$175,000,000 to \$158,270,000, a reduction of \$16,730,000. Both of these changes are primarily due to a decrease in the number of active investment companies to which the rule applies, from approximately 4,920 registrants in 2006 to approximately 4,522 registrants in 2009.

16. Information Collection Planned for Statistical Purposes

Not Applicable.

17. Approval to not Display Expiration Date

Not Applicable.

18. Exceptions to Certification Statements

Not Applicable.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.