

## **SUPPORTING STATEMENT**

### **FOR THE PAPERWORK REDUCTION ACT SUBMISSION FOR AN EXTENSION OF A CURRENT INFORMATION COLLECTION**

#### **“Rule 17f-5”**

##### **A. JUSTIFICATION**

###### **1. Necessity for the Information Collection**

Rule 17f-5 (17 CFR 270.17f-5) under the Investment Company Act of 1940 [15 U.S.C. 80a] (the “Act”) governs the custody of the assets of registered management investment companies (“funds”) with custodians outside the United States. Under rule 17f-5, a fund or its foreign custody manager (as delegated by the fund’s board) may maintain the fund’s foreign assets in the care of an eligible fund custodian under certain conditions. If the fund’s board delegates to a foreign custody manager authority to place foreign assets, the fund’s board must find that it is reasonable to rely on each delegate the board selects to act as the fund’s foreign custody manager. The delegate must agree to provide written reports that notify the board when the fund’s assets are placed with a foreign custodian and when any material change occurs in the fund’s custody arrangements. The delegate must agree to exercise reasonable care, prudence, and diligence, or to adhere to a higher standard of care. When the foreign custody manager selects an eligible foreign custodian, it must determine that the fund’s assets will be subject to reasonable care if maintained with that custodian, and that the written contract that governs each custody arrangement will provide reasonable care for fund assets. The contract must contain certain specified provisions or others that provide at least equivalent care. The foreign custody manager must establish a system to monitor the performance of the contract and the appropriateness of continuing to maintain assets with the eligible foreign custodian.

## 2. Purpose of the Information Collection

The collection of information requirements in rule 17f-5 are intended to provide protection for fund assets maintained with a foreign bank custodian whose use is not authorized by statutory provisions that govern fund custody arrangements,<sup>1</sup> and that is not subject to regulation and examination by U.S. regulators. The requirement that the fund board determine that it is reasonable to rely on each delegate is intended to ensure that the board carefully considers each delegate's qualifications to perform its responsibilities. The requirement that the delegate provide written reports to the board is intended to ensure that the delegate notifies the board of important developments concerning custody arrangements so that the board may exercise effective oversight. The requirement that the delegate agree to exercise reasonable care is intended to provide assurances to the fund that the delegate will properly perform its duties.

The requirements that the foreign custody manager determine that fund assets will be subject to reasonable care with the eligible foreign custodian and under the custody contract, and that each contract contain specified provisions or equivalent provisions, are intended to ensure that the delegate has evaluated the level of care provided by the custodian, that it weighs the adequacy of contractual provisions, and that fund assets are protected by minimal contractual safeguards. The requirement that the foreign custody manager establish a monitoring system is intended to ensure that the manager periodically reviews each custody arrangement and takes appropriate action if developing custody risks may threaten fund assets.<sup>2</sup>

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<sup>1</sup> See section 17(f) of the Act. 15 U.S.C. 80a-17(f).

<sup>2</sup> The staff believes that subcustodian monitoring does not involve "collection of information" within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 - 3502) ("Paperwork Reduction Act").

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

Rule 31a-2(f) under the Act permits investment companies to maintain many types of records on micrographic and electronic storage media.

### **4. 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. Rule 17f-5 does not require duplicative reporting or recordkeeping. Other law generally does not require the board findings concerning delegation, foreign custody manager findings and monitoring systems, delegate reports, and risk analysis, monitoring, and notification systems required by these rules. A few requirements may effectively duplicate requirements of customary custody contracts because these contracts have traditionally incorporated requirements of rule 17f-5.

### **5. Effect on Small Entities**

The Commission does not believe that compliance with rule 17f-5 is unduly burdensome for small entities. Rule 17f-5 affects, among other persons, the relatively small number of global custodians that act as foreign custody managers for funds under rule 17f-5. None of these global custodians would likely qualify as a small entity, because each custodian is a major bank with a global branch network or global ties to other banks. Rule 17f-5 also affects the funds that invest in foreign markets, and the investment advisers to those funds. Few if any of the affected funds and advisers are small entities.<sup>3</sup>

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<sup>3</sup> A fund is considered a small entity for purposes of the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less. 17 CFR 270.0-10. An adviser is considered a small entity if it has assets under management of less than \$25 million, has total assets of less than \$5 million, and is not in a control relationship with other advisers or persons that are not small entities. 17 CFR 275.0-7. Most funds that invest in foreign securities are part of a fund

**6. Consequences of Less Frequent Collection**

The reporting requirements of rule 17f-5 do not recur periodically, but apply only upon the occurrence of certain events, such as when the fund board selects a delegate or the foreign custody manager selects a foreign custodian. These event-triggered requirements include the rule's provisions for board findings and custody contracts. Some custody arrangements, such as arrangements with less established foreign banks, or with reliable subcustodians in countries subject to economic or political turmoil, may require more frequent reporting than other arrangements.

**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-5 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comment in its response to its request.

The Commission and the staff also participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and informal exchanges. These forums provide the Commission and the staff useful means to identify and address paperwork burdens that may confront the industry.

**9. Payment or Gift to Respondents**

Not applicable.

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complex that has net assets of more than \$50 million, and are advised by advisers with assets under management of \$25 million or more.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

Commission staff estimates that each year, approximately 135 registrants<sup>4</sup> could be required to make an average of one response per registrant under rule 17f-5, requiring approximately 2.5 hours of board of director time per response, to make the necessary findings concerning foreign custody managers. The total annual burden associated with these requirements of the rule is up to approximately 337.5 hours (135 registrants x 2.5 hours per registrant). The staff further estimates that during each year, approximately 15 global custodians<sup>5</sup> are required to make an average of 4 responses per custodian concerning the use of foreign custodians other than depositories. The staff estimates that each response will take approximately 270 hours, requiring approximately 1080 total hours annually per custodian. The total annual burden associated with these requirements of the rule is approximately 16,200 hours (15 global custodians x 1080 hours per custodian). Therefore, the total annual burden of all collection of information requirements of rule 17f-5 is estimated to be up to 16,537.5 hours (337.5 + 16,200). The total annual cost of burden hours is estimated to be \$4,914,000 (337.5 hours x \$4000/hour for board of director's time, plus 16,200 hours x \$220/hour for a trust

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<sup>4</sup> This figure is an estimate of the number of new funds each year, based on data reported by funds in 2010 on Form N-1A and Form N-2. In practice, not all funds will use foreign custody managers, and the actual figure may be smaller.

<sup>5</sup> This estimate is based on staff research.

administrator's time).<sup>6</sup> Compliance with the collection of information requirements of the rule is necessary to obtain the benefit of relying on the rule's permission for funds to maintain their assets in foreign custodians.

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

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

Rule 17f-5 does not impose any paperwork related cost burden not discussed in item 12 above.

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

The rule imposes no costs associated with filing reports or any other costs to the Federal government.

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

The increase in the estimated burden of rule 17f-5 by 499.5 hours primarily results from updated information from industry participants regarding annual hourly burdens per board and custodian and changes in the estimated number of respondents. As of year-end 2007 the number of new registrants required to respond under rule 17f-5 was 159. This number decreased to 135 as of year-end 2010. The staff anticipates that the number of existing funds that change their global custodians is negligible and, therefore, primarily new funds are required to make a response.

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<sup>6</sup> The board hourly rate is based on fund industry representations. The \$220/hour figure for a trust administrator is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

**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.