

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for**  
**Rule 17f-4**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 17(f) of the Investment Company Act of 1940 (the “Act”)<sup>1</sup> permits registered management investment companies and their custodians to deposit the securities they own in a system for the central handling of securities (“securities depositories”), subject to rules adopted by the Securities and Exchange Commission (“Commission”). Rule 17f-4 under the Act specifies the conditions for the use of securities depositories by funds<sup>2</sup> and their custodians.<sup>3</sup> Rule 17f-4 contains two general conditions. First, a fund’s custodian must be obligated, at a minimum, to exercise due care in accordance with reasonable commercial standards in discharging its duty as a securities intermediary to obtain and thereafter maintain financial assets.<sup>4</sup> If the fund deals directly with a depository, the depository’s contract or written rules for

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<sup>1</sup> 15 U.S.C. 80a.

<sup>2</sup> As amended in 2003, rule 17f-4 permits any registered investment company, including a unit investment trust or a face-amount certificate company, to use a security depository. *See Custody of Investment Company Assets With a Securities Depository, Investment Company Act Release No. 25934 (Feb. 13, 2003) (68 FR 8438 (Feb. 20, 2003))*. The term “fund” or “fund series” is used in this Supporting Statement to mean a series of a registered investment company.

<sup>3</sup> 17 CFR 270.17f-4.

<sup>4</sup> Rule 17f-4(a)(1). This provision incorporates into the rule the standard of care provided by section 504(c) of Article 8 of the Uniform Commercial Code when the parties have not agreed to a standard. Rule 17f-4 does not impose any substantive obligations beyond those contained in Article 8. Uniform Commercial Code, Revised Article 8 -- Investment Securities (1994 Official Text with Comments) (“Revised Article 8”). This obligation does not contain a collection of information because it does not impose identical reporting, recordkeeping or disclosure requirements. Funds and custodians may determine the specific measures the custodian will take to comply with this obligation. Moreover, the rule does not impose any requirement regarding evidence of the obligation.

its participants must provide that the depository will meet similar obligations,<sup>5</sup> which is a collection of information for purposes of the Paperwork Reduction Act of 1995 (“PRA”).<sup>6</sup> Second, the custodian must provide, promptly upon request by the fund, such reports as are available about the internal accounting controls and financial strength of the custodian.<sup>7</sup> If a fund deals directly with a depository, the depository’s contract with or written rules for its participants must provide that the depository will provide similar financial reports, which is a collection of information under the PRA.<sup>8</sup>

If a fund deals directly with a securities depository, rule 17f-4 also requires that the fund implement internal control systems reasonably designed to prevent an unauthorized officer’s instructions (by providing at least for the form, content, and means of giving, recording, and reviewing all officers’ instructions).<sup>9</sup>

## **2. Purpose and Use of the Information Collection**

The general purpose of rule 17f-4 is to enable funds to participate, with minimum risks, in the potential benefits incident to the deposit of assets in securities depositories. The conditions a fund must satisfy in order to rely on rule 17f-4, including the collections of information are designed to assure that the fund’s own custodian or securities depository would comply with the specified duties of a securities intermediary or issuer under Revised Article 8 of

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<sup>5</sup> Rule 17f-4(b)(1)(i).

<sup>6</sup> 44 U.S.C. 3501-3520.

<sup>7</sup> Rule 17f-4(a)(2).

<sup>8</sup> Rule 17f-4(b)(1)(ii).

<sup>9</sup> Rule 17f-4(b)(2).

the Uniform Commercial Code.<sup>10</sup> This assurance is important because Revised Article 8 sharply limits the ability of a fund to seek recourse from any party other than its own custodian for assets mishandled by the custodian.<sup>11</sup>

### **3. Consideration Given to Information Technology**

Rule 17f-4 permits funds to take advantage of information technology that enables the securities industry to handle a large volume of securities transactions without physical delivery of securities. Custodians also may use electronic data transmissions to funds to meet the reporting requirement. This rule does not require information systems; hence, start-up and maintenance costs required for this rule are zero.

### **4. 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-4 does not require duplicative reporting or recordkeeping.

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

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<sup>10</sup> The securities intermediary's duties under commercial law include: (i) maintaining sufficient unencumbered financial assets to cover all security entitlements of all entitlement holders, *see* Revised Article 8, 10, § 8-504; (ii) obtaining for the entitlement holder payments made by the issuer of a financial asset, *see id.*, § 8-505; (iii) exercising rights with respect to a financial asset (such as the right to vote proxy materials) as directed by the holder, *see id.*, § 8-506; (iv) complying with orders given by the holder concerning financial assets (such as to dispose of entitlements), *see id.*, § 8-507; and (v) changing the holder's entitlement into another available form of holding upon request (such as converting it into a security certificate in a direct holding arrangement), *see id.*, § 8-508. A transfer agent may be subject to the duties of an issuer under commercial law. *See, e.g.*, Revised Article 8, § 8-207 (duties of issuer concerning registered owner); § 8-401 (duty of issuer to register transfer).

<sup>11</sup> *See* Revised Article 8, §§ 8-116, 8-502, 8-503 and cmts. 2-3, 8-510 (providing that adverse claims may not be asserted against a purchaser who acquires a security entitlement for value and without notice of the adverse claims; an entitlement holder may assert a claim against a purchaser other than its securities intermediary only if its own intermediary is insolvent and lacks sufficient assets to satisfy its claims, and the purchaser knowingly colluded with the intermediary to violate duties to the holder).

Rule 17f-4 specifies the conditions for the use of securities depositories by all funds regardless of the size of the fund, or the size of its custodian or securities depository. The risks accompanying a fund's use of a securities depository do not vary based on the size of the entity involved.

**6. Consequences of Not Conducting Collection**

Rule 17f-4 requires periodic reporting by the custodian or securities depository to the fund of internal accounting controls and financial strength. This information assures that the fund assets are safe and secure, and assists the Commission in implementing its examination program.

**7. Inconsistencies With Guidelines in 5 CFR 1230.5(d)(2)**

Not applicable.

**8. Consultation Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 17f-4 before it submitted this request for extension and approval to OMB. The Commission received no comments in response to this request.

In addition, the Commission and its staff participate in an ongoing dialogue with representatives of the investment company 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.

**9. Payment or Gift**

Not applicable.

**10. Confidentiality**

Not applicable.

**11. Sensitive Questions**

No information of a sensitive nature, including social security numbers, will be required under this collection of information. The information collection does not collect personally identifiable information (PII). The agency has determined that a system of records notice (SORN) and privacy impact assessment (PIA) are not required in connection with the collection of information.

## **12. Burden of Information Collection**

The Commission staff estimates that 794 respondents (including an estimated 768 active funds that may deal directly with a securities depository, an estimated 13 custodians, including 7 sub-custodians, and 13 possible securities depositories)<sup>12</sup> are subject to the requirements in rule 17f-4. To the extent that Rule 17f-4(c)(4) provides that a sub-custodian can be qualified as a custodian for purposes of Rule 17f-4, this Supporting Statement will include such sub-custodians as “custodians” in the estimates of burden hours and costs. While the rule is elective, most, if not all, funds use depository custody arrangements.<sup>13</sup>

Rule 17f-4 contains two general conditions. First, a fund’s custodian must be obligated, at a minimum, to exercise due care in accordance with reasonable commercial standards in discharging its duty as a securities intermediary to obtain and thereafter maintain financial assets. If the fund deals directly with a depository, the depository’s contract or written rules for its participants must provide that the depository will meet similar obligations. All funds that deal directly with securities depositories in reliance on rule 17f-4 should have either modified their

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<sup>12</sup> The Commission estimates that, as permitted by the rule, an estimated 4% of all funds may deal directly with a securities depository.. In addition, the Commission staff estimates the number of possible securities depositories by adding the 12 Federal Reserve Banks and one active registered clearing agency. The Commission staff recognizes that not all of these entities may currently be acting as a securities depository for fund securities.

contracts with the relevant securities depository, or negotiated a modification in the securities depository's written rules when the rule was amended. Therefore, we estimate there is no ongoing burden associated with this collection of information.<sup>14</sup>

Second, the custodian must provide, promptly upon request by the fund, such reports as are available about the internal accounting controls and financial strength of the custodian. If a fund deals directly with a depository, the depository's contract with or written rules for its participants must provide that the depository will provide similar financial reports. Custodians and depositories usually transmit financial reports to funds twice each year.<sup>15</sup> The Commission staff estimates that 13 custodians spend approximately 2,330 hours (by support staff) annually in transmitting such reports to funds.<sup>16</sup> In addition, approximately 768 funds (*i.e.*, four percent of all funds) deal directly with a securities depository and may request periodic reports from their depository. Commission staff estimates that depositories spend approximately 179 hours (by

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<sup>13</sup> Based on responses to Items C.12 on the Form N-CEN (17 CFR 274.101), approximately 96 percent of funds' custodians maintain some or all fund securities in a securities depository pursuant to rule 17f-4.

<sup>14</sup> The Commission staff assumes that new funds relying on rule 17f-4 would choose to use a custodian instead of directly dealing with a securities depository because of the high costs associated with maintaining an account with a securities depository. Thus, new funds would not be subject to this condition.

<sup>15</sup> The estimated 13 custodians would handle requests for reports from 9,984 fund clients (approximately 768 fund clients per custodian) and the depositories from the remaining 768 funds that choose to deal directly with a depository. It is our understanding based on staff conversations with industry representatives that custodians and depositories transmit these reports to clients in the normal course of their activities as a good business practice regardless of whether they are requested. Therefore, for purposes of this PRA estimate, the Commission staff assumes that custodians transmit the reports to all fund clients.

<sup>16</sup> (9,984 fund clients x 2 reports) = 19,968 transmissions. The staff estimates that each transmission would take approximately 7 minutes for a total of approximately 2,330 hours (7 minutes x 19,968 transmissions).

support staff) annually transmitting reports to the 768 funds.<sup>17</sup> The total annual burden estimate for compliance with rule 17f-4's reporting requirement is therefore 2,509 hours.<sup>18</sup>

If a fund deals directly with a securities depository, rule 17f-4 requires that the fund implement internal control systems reasonably designed to prevent an unauthorized officer's instructions (by providing at least for the form, content, and means of giving, recording, and reviewing all officers' instructions). All funds that seek to rely on rule 17f-4 should have already implemented these internal control systems when the rule was amended. Therefore, there is no ongoing burden associated with this collection of information requirement.<sup>19</sup>

Based on the foregoing, the Commission staff estimates that the total annual hour burden of the rule's collection of information requirements is 2,509 hours. As displayed in Table 1 below, the total estimated annual cost of the burden hours is \$240,864. This figure is based on 2,509 hours of support staff time at \$96.00 per hour.<sup>20</sup>

The estimate of average burden hours is made solely for the purposes of the PRA. The estimate is not derived from a comprehensive or even representative survey or study of Commission rules.

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<sup>17</sup> (768 fund clients who may deal directly with a securities depository x 2 reports) = 1,536 transmissions. The staff estimates that each transmission would take approximately 7 minutes for a total of approximately 179 hours (7 minutes x 1,536 transmissions).

<sup>18</sup> 2,230 hours for custodians and 179 hours for securities depositories.

<sup>19</sup> The Commission staff assumes that new funds relying on rule 17f-4 would choose to use a custodian instead of directly dealing with a securities depository because of the high costs associated with maintaining an account with a securities depository. Thus new funds would not be subject to this condition.

<sup>20</sup> 2,509 hours x \$96.00 (salary for an executive assistant) = \$240,864. The Commission staff's estimates concerning the wage rates for support staff time are from the Securities Industry Association's Report on Office Salaries in the Securities Industry 2013, modified to account for an 1800-hour work-year and inflation, and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

**Table 1: Summary of Revised Annual Responses, Burden Hours, and Burden Hour Costs Estimates for Each Rule 17f-4 Information Collection (“IC”)**

| IC Title   | Annual No. of Responses    |                  |               | Annual Time Burden (Hrs.)  |                  |               | Cost Burden (\$)           |                  |               |
|--|----------------------------|------------------|---------------|----------------------------|------------------|---------------|----------------------------|------------------|---------------|
|  | <i>Previously approved</i> | <i>Requested</i> | <i>Change</i> | <i>Previously approved</i> | <i>Requested</i> | <i>Change</i> | <i>Previously approved</i> | <i>Requested</i> | <i>Change</i> |
| IC1: Recordkeeping                                       | NA                         | NA               | NA            | NA                         | NA               | NA            | NA                         | NA               | NA            |
| IC 2: Custodians Transmit Reports to Funds               | 7,915                      | 19,968           | +16,051       | 914                        | 2,330            | +1,416        | \$83,174                   | \$223,680        | +\$140,506    |
| IC 3: Securities Depositories Transmits Reports to Funds | 80                         | 1,536            | +1,456        | 19                         | 179              | +160          | \$1,729                    | \$17,184         | +\$15,455     |
| IC 4: Annual reporting                                   | 7,995                      | 21,504           | +13,509       | 933                        | 2,509            | +1,576        | \$84,903                   | \$240,864        | +\$155,961    |
| <b>TOTAL</b>   | 7,995                      | 21,504           | +13,509       | 933                        | 2,509            | +1,576        | \$84,903                   | \$240,864        | +\$155,961    |

### **13. Cost to Respondents**

Commission staff believes that compliance with rule 17f-4 does not require special start-up costs or other capital expenditures, because electronic systems and other resources needed to comply with the rule are essential to doing business as a custodian, agent, fund or securities depository. Rule 17f-4 does not impose any paperwork related cost burden not discussed in Item 12 above.

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

There is no cost to the federal government of administering the information collection requirements in rule 17f-4.

### **15. Changes in Burden**

The estimated total annual burden for rule 17f-4 has increased from 933 hours to 2,509 hours. The increase in hours reflects a change in methodology in estimating burdens due to the



estimated number of funds that rely on rule 17f-4. We continue to estimate no external cost associated with this information collection.

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

Not applicable.

**17. Approval to Omit OMB Expiration Date**

Not applicable.

**18. Exceptions to Certification Statement for Paperwork Reduction Act**

**Submission**

Not applicable.

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

Not applicable.