

Regulatory Flexibility Act,⁴³ a fund is a small entity if the fund, together with other funds in the same group of related funds, has net assets of \$50 million or less as of the end of its most recent fiscal year.⁴⁴ Approximately 4,850 registered investment companies, including approximately 233 registered investment companies that are small entities, will be affected by amended rule 17f-4.⁴⁵ Approximately 130 custodians, most of which are banks or registered broker-dealers, will be affected by rule 17f-4. Few if any of these custodians are small entities.⁴⁶ Approximately 25 entities that could serve as securities depositories will be affected by the rule;⁴⁷ few if any of these entities are small entities. The rule imposes conditions for the use of securities depositories by all funds regardless of the size of the fund, its custodian, or the securities depository. The risks attendant to funds' use of securities depositories do not vary based on the size of the entities involved.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The amendments will significantly ease rule 17f-4's reporting, recordkeeping, and other compliance requirements. The amendments eliminate a number of specific requirements⁴⁸ and substitute two general compliance requirements for custodians and depositories.⁴⁹ First, the custodian must, at a minimum, exercise due care in accordance with reasonable commercial standards in discharging its duty as a securities intermediary to obtain and thereafter maintain financial assets.⁵⁰ If the fund deals directly with a depository, the fund's contract with the securities depository (or the depository's own written rules for its participants) must provide that the depository will meet similar obligations.⁵¹ 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.⁵² If the fund deals directly with a depository, the depository's contract or written rules for its participants must provide that the depository will provide similar financial reports.⁵³

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap, or conflict with the rule amendments.

F. Agency Action to Minimize Effect on Small Entities

In connection with the amendments, the Commission considered the following alternatives: (i) Establishing different compliance or reporting standards that take into account the resources available to small entities; (ii) clarifying, consolidating or simplifying the compliance requirements for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of all or part of the rule.

We do not believe that special compliance, timetable, or reporting requirements or an exemption from coverage of the rule for small entities would be consistent with investor protection. Similarly, any further clarification, consolidation, or simplification of the reporting requirements for small entities could compromise the safeguards embodied in the new rule and amendments. The rule amendments use performance, rather than design standards, in the sense that the amendments require that custodians exercise due care in accordance with reasonable commercial standards in discharging their duty as a securities intermediary to obtain and thereafter maintain financial assets.

VI. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of the amendments to rule 17f-4 contain "collection of information" requirements within the meaning of the Paperwork Reduction Act [44 U.S.C. 3501-3520] ("PRA"). We published notice soliciting comments on the collection of information requirements in the Proposing Release and submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for

the collection of information is "Custody of Investment Company Assets with a Securities Depository." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number. The OMB control number for rule 17f-4 is 3235-0225.

As discussed above, today we are adopting amendments to rule 17f-4 that are substantially similar to the amendments that we proposed in November 2001. The amendments permit additional types of investment companies to rely on the rule, and allow depositories to perform additional functions under the rule. The amendments also eliminate a number of specific custodial compliance requirements of rule 17f-4, and substitute two more general compliance requirements. None of the commenters addressed the PRA burden associated with these amendments.

VII. Statutory Authority

The Commission is amending rule 17f-4 pursuant to the authority set forth in sections 6(c), 17(f), 26, 28, 30, 31, and 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-6(c), 80a-17(f), 80a-26, 80a-28, 80a-29, 80a-30, and 80a-37(a)].

Text of Rule

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is revised to read as follows:

List of Subjects in 17 CFR Part 270

Incorporation by reference, Investment companies, Reporting and recordkeeping requirements, Securities.

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, and 80a-39, unless otherwise noted;

* * * * *

2. Section 270.17f-4 is revised to read as follows:

§ 270.17f-4 Custody of investment company assets with a securities depository.

(a) *Custody arrangement with a securities depository.* A fund's custodian may place and maintain financial assets, corresponding to the fund's security entitlements, with a securities depository or intermediary custodian, if the custodian:

⁴³ 5 U.S.C. 601-612.

⁴⁴ 17 CFR 270.0-10.

⁴⁵ There are approximately 5,000 registered investment companies, including 240 small entities. Approximately 97 percent of registered investment companies (4,850) report that they maintain assets in securities depositories. Assuming that a proportionate number of small entities use securities depositories, then approximately 233 registered investment companies that are small entities will be affected by the rule amendments.

⁴⁶ A bank is considered by the Small Business Administration to be a small entity if it has less than \$150 million in assets. See 13 CFR 121.201 (1999). See also 5 U.S.C. 601(3).

⁴⁷ This includes approximately 12 Federal Reserve Banks and 13 registered clearing agencies.

⁴⁸ See *supra* Section II.C.

⁴⁹ Rule 17f-4(a) and (b)(1).

⁵⁰ Rule 17f-4(a)(1).

⁵¹ Rule 17f-4(b)(1)(i).

⁵² Rule 17f-4(a)(2).

⁵³ Rule 17f-4(b)(1)(ii).