

THE ASSOCIATION OF GLOBAL CUSTODIANS

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June 28, 2002

BY MESSENGER

Michael E. Bartell
Associate Executive Director
Office of Information Technology
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0506

Re: **Request for Comments Regarding Information Collection Requirements Under Rule 17f-5 and 17f-7**

Dear Mr. Bartell:

The Association of Global Custodians¹ submits this letter in response to the Commission's recent release regarding collection of information pursuant to Investment Company Act Rules 17f-5 and 17f-7.² The Release sets forth the Commission's understanding of the costs and burdens that information collection under Rules 17f-5

^{1/} The Association of Global Custodians ("Association") is an informal association of nine banks that are major providers of custody services to registered investment companies. The members of the Association are listed above.

^{2/} Securities and Exchange Commission - Existing Collection; Comment Request, SEC File Nos. 270-259; 270-470; 270-231; 270-187; 270-312 (May 3, 2002); 67 FR 34737 (May 15, 2002) ("Release"). The Release also invites comments on Investment Company Act Rule 17d-1 and Rules 18f-1 and 19b-1(e). These rules are not addressed in this letter.

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and 17f-7 imposes on investment companies and their custodians and invites public comment on these cost and burden estimates.³

1. Rule 17f-5

Investment Company Act Rule 17f-5 governs the custody of assets of registered investment companies outside the U.S. As indicated in the Release, Rule 17f-5 requires a fund's Foreign Custody Manager to make certain determinations regarding foreign custodians that hold fund assets and to establish a system to monitor the continuing appropriateness of maintaining assets with each foreign custodian utilized by the fund. Rule 17f-5 permits fund boards to perform the Foreign Custody Manager functions directly or to delegate these responsibilities; in order to make a delegation, fund directors must make certain findings.

The staff estimates that each global custodian must spend approximately 800 hours per year to comply with the information-gathering obligations of Rule 17f-5. This estimate is based on the assumption that each global custodian will make an average of four "responses"⁴ per year regarding the use of foreign custodians (excluding depositories) and that each such response will require 200 hours. Based on these assumptions, the staff calculates the total custodian cost of complying with Rule 17f-5 as \$40,000 per year (800 hours x \$50 per hour of professional time). The staff further assumes that 15 global custodians are subject to this burden. This results in a total cost

^{3/} The Release indicates that the Commission proposes to submit these information collection requirements to the Office of Management and Budget for extension and approval pursuant to the Paperwork Reduction Act of 1995, 44 U.S.C. §§ 3501-3520.

^{4/} The release adopting Rule 17f-7 indicates that a global custodian "response" for Rule 17f-5 purposes may involve negotiating new custodial contracts with funds, establishing bank custody arrangements for fund complexes, preparing reports for funds, and establishing a system to monitor custody arrangements. Investment Company Act Release No. IC-24424 (April 27, 2000), 65 FR 25630, 25635 n.55 (May 3, 2000).

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to all global custodians in the aggregate of \$600,000 (15 custodians x \$40,000 per custodian).⁵

In the Association's view, this estimate is significantly below the actual costs incurred by global custodians in complying with the information-gathering requirements of Rule 17f-5. In our view, the staff's estimate should be revised in two respects.

First, the Association believes that, on average, global custodians make at least six "responses" each year pursuant to Rule 17f-5, rather than four, as estimated by the staff. Based on the staff's assumption that each response requires 200 hours, the custodian time devoted annually to Rule 17f-5 compliance with respect to negotiating new custodial contracts with funds, establishing new foreign custody arrangements for fund complexes, preparing reports for funds, and establishing a system to monitor custody arrangements⁶ would be 1,200 hours per custodian (6 responses x 200 hours).

^{5/} The staff estimates that the annual total cost of Rule 17f-5 compliance for both funds and global custodians is \$6,760,000, although this calculation appears to be the result of an arithmetic error by the staff. The Release states that approximately 160 funds are required to make an average of one determination per fund per year under Rule 17f-5. In the staff's view, approximately two hours of fund director time per determination is required to make the appropriate findings regarding foreign custody managers. As a result, the estimated burden on fund directors is approximately 320 hours (160 funds x 2 hours each). Director time is estimated at \$500 per hour. Thus, the total industry-wide cost to funds would, under the staff's assumptions, be \$160,000 (320 hours x \$500 per hour). The sum of the \$160,000 in fund costs and of the \$600,000 in global custodian costs is \$760,000.

However, in the Release, the total industry-wide cost of compliance is estimated to be \$6,760,000. The Release indicates that this cost figure was calculated by multiplying the total burden hours of 12,320 (12,000 for global custodians plus 320 for fund) by \$500 per hour for director time (12,320 x 500 = 6,170,000) and by multiplying total custodian hours (12,000) by \$50 (12,000 x 50 = 600,000). The sum of these two calculations is \$6,760,000. It seems clear, however, that, under the logic of the staff's estimates only the total director hours (320) should be multiplied by \$500; there is no apparent reason to apply the \$500 per hour rate to the global custodian hours, which the staff states should be valued at \$50 per hour.

^{6/} See note 4 supra.

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Using the staff's estimated rate of \$50 per hour for custodian time, the total cost of such responses would be \$60,000 per custodian per year (1,200 hours x \$50 per hour of professional time). In turn, the total annual response cost to all global custodians (based on the staff's estimate of 15 industry members) would be \$900,000 (15 custodians x \$60,000 per custodian).⁷

Second, the staff's estimate ignores the substantial information-gathering costs and related out-of-pocket expense associated with performing the required ongoing monitoring of foreign custody arrangements. We believe that the costs associated with a global custodian's monitoring of its foreign custody network pursuant to Rule 17f-5 vary widely between global custodians, depending on the extent to which network members are affiliates of the global custodian, the nature of the markets in which the global custodian offers custody to registered funds, and various other factors. Cost information of this nature is proprietary and confidential, and we have not attempted to gather such information from Association members.

However, as a rough estimate, we believe that the total annual cost of subcustodian monitoring approximates on average \$525,000 per global custodian.⁸ We

^{7/} We recognize that, as in the case of subcustodian monitoring, global custodians are required to engage in some of these activities for business reasons. See note 9, *infra*. We believe, however, that the \$60,000 per custodian estimate is a reasonable approximation of the incremental cost associated with the requirements of Rule 17f-5.

^{8/} We have assumed that the average global custodian provides custody services to registered investment companies in 85 jurisdictions and that 100 hours per year of staff time are devoted to gathering information concerning each of the 85 local market subcustodians pursuant to the monitoring requirement of Rule 17f-5. Using the \$50 per hour rate for global custodian professional time suggested in the Release, these assumptions result in a total annual monitoring staff cost per global custodian of \$425,000 (85 markets x 100 hours per market x \$50 per hour for professional time). In addition, the monitor process and reporting thereon to clients that are registered investment companies entails substantial out-of-pocket costs, especially for travel and printing. We estimate these costs are \$100,000 per custodian per year. Thus, total estimated Rule 17f-5 monitoring costs per global custodian are \$525,000 (\$425,000 in personnel costs plus \$100,000 in out-of-pocket expenses).

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also believe that roughly 50 percent of that cost -- or \$262,500 per bank -- is attributable to information-gathering pursuant to Rule 17f-5.⁹ Therefore, assuming, as does the Release, that 15 global custodians bear this cost, the total annual industry cost of Rule 17f-5 monitoring would be \$3,937,500 (\$525,000 x 15 custodians x 50%). When added to the "response" costs estimated by the Association, the total annual cost of information-gathering under Rule 17f-5 would be \$322,500 (\$60,000 + \$262,500) per bank or \$4,837,500 (\$322,500 x 15 custodians) on an industry-wide basis.

2. Rule 17f-7

Rule 17f-7 governs the custody of a fund's assets with a foreign securities depository. As set forth in the Release, Rule 17f-7 requires, among other things, that a fund's "primary custodian" provide the fund with a risk analysis with respect to each foreign securities depository utilized by the fund.

The staff estimates that each primary custodian must spend approximately 800 hours per year to comply with the information-gathering obligations of Rule 17f-7. This estimate is based on the assumption that each global custodian will make an average of four "responses"¹⁰ per year regarding the use of foreign depositories, and that each such response will require 200 hours. Based on these assumptions, the Release calculates the total primary custodian cost of complying with Rule 17f-7 as \$40,000 per year (800 hours x \$50 per hour of professional time). The staff further assumes that 15

^{9/} The Association recognizes that network management and due diligence reviews of foreign subcustodians and markets are inherent elements of the business of global custody. It is difficult to distinguish costs attributable to Rule 17f-5 from subcustodian monitoring costs that global custodians must bear in order to properly conduct their businesses, regardless of regulatory requirements.

^{10/} The release adopting Rule 17f-7 indicates that a primary custodian "response" for Rule 17f-7 purposes may involve the preparation of the risk analysis, the monitoring of depository risks, or the preparation of subsequent notifications of material changes in depository risks. Investment Company Act Release No. IC-24424, supra note 4, 65 FR at 25635.

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global custodians are subject to this burden. This results in a total cost to all global custodians in the aggregate of \$600,000 (15 custodians x \$40,000 per custodian).¹¹

We believe that the costs associated with a primary custodian's compliance with the information-gathering requirements of Rule 17f-7 are substantially higher than this estimate. The Association has recently provided estimated cost information to the staff regarding Rule 17f-7 compliance. In connection with consideration of the publication of proposed amendments to Rule 17f-4, the Association submitted a letter to the staff in October 2001 concerning the costs and burdens of Rule 17f-7 compliance.¹² The Association's letter estimates that the total annual per bank cost for the nine Association members of compliance with Rule 17f-7 is approximately \$2.7 million or \$300,000 per bank.¹³ Assuming, as does the Release, that there are 15 global custodians that bear this cost, the total annual industry cost of Rule 17f-7 information-gathering would be \$4,500,000 (15 custodians x \$300,000 per custodian).

* * *

In summary, the Association believes that the total cost for compliance with the information-gathering requirements of Rule 17f-5 is \$322,500 per bank (\$60,000

^{11/} The staff estimates that the annual total cost of Rule 17f-7 compliance for both investment advisers and primary custodians is \$1,500,000. The Release states that approximately 900 investment advisers are required to make an average of four "responses" per year under Rule 17f-5. In the staff's view, approximately five hours of adviser time per response is required for each adviser response. As a result, the estimated burden on advisers is approximately 18,000 hours (900 advisers x 4 responses x 5 hours per response). Professional time for both advisers and custodians is estimated at \$50 per hour. Thus, the total industry-wide cost to advisers would, under the staff's assumptions, be \$900,000 (18,000 hours x \$50 per hour). The sum of the \$900,000 in fund costs and of the \$600,000 in global custodian costs is \$1,500,000.

^{12/} Letter, dated October 17, 2002, to C. Hunter Jones, Assistant Director, Office of Regulatory Policy, Division of Investment Management, from Daniel L. Goelzer, Counsel to the Association of Global Custodians at pages 2-4. A copy of this letter is enclosed and was transmitted to SEC File No. S7-19-00.

^{13/} The Association's October 17, 2002 letter estimated the first-year costs of Rule 17f-7 compliance to be \$400,000 per bank.

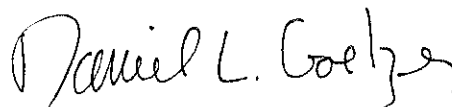
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response costs + \$262,500 network monitoring costs) or \$4,837,500 on an industry-wide for basis for all U.S. global custodians. (This contrasts to the estimate in the Release of \$40,000 per bank or \$600,000 industry-wide). The Association believes that the total cost for compliance with the information-gathering requirements of Rule 17f-7 is \$300,000 per bank or \$4,500,000 on an industry-wide basis for all U.S. global custodians. (This contrasts to the estimate in the Release of \$40,000 per bank or \$600,000 industry-wide). We express no view concerning the accuracy of the staff's estimates of the costs these rules impose on investment companies and their directors and investment advisers, although, as the release acknowledges, these entities also incur substantial information-gathering burdens as a result of these rules. In this connection we also note that, in the experience of the Association's members, funds, fund directors, and investment advisers typically consult with outside counsel with respect to determinations relating to Rules 17f-5 and 17f-7. However, the costs of obtaining such legal advice have not been included in the staff's estimates.

We appreciate the opportunity to comment on the Release. If you have any questions or comments, or if the Association can be of assistance in providing information relevant to consideration of the Release, please contact the undersigned.

Sincerely,



Daniel L. Goelzer
Counsel to the Association of Global Custodians

Enclosure: Letter, dated October 17, 2002, to C. Hunter Jones, Assistant Director, Office of Regulatory Policy, Division of Investment Management, from Daniel L. Goelzer, Counsel to the Association of Global Custodians