SECURITIES AND EXCHANGE COMMISSION

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Transactions of Investment Companies With Portfolio and Subadviser Affiliates

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is adopting amendments to rules under the Investment Company Act of 1940 to expand the current exemptions for investment companies (''funds'') to engage in transactions with ''portfolio affiliates''—companies that are affiliated with the fund solely as a result of the fund (or an affiliated fund) controlling them or owning more than five percent of their voting securities. The Commission is also adopting one new rule and several rule amendments to permit funds to engage in transactions with subadvisers of affiliated funds. The rules are designed to permit transactions between funds and certain affiliated persons under circumstances where it is unlikely that the affiliate would be in a position to take advantage of the fund.

EFFECTIVE DATE: *Effective Date:* February 24, 2003. *Compliance Date:* April 23, 2003. Section II of this document contains more information on transition prior to the compliance date.

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today is adopting new rule 17a–10 (17 CFR 270.17a–10) and amendments to rules 10f–3 (17 CFR 270.10f–3), 12d3–1 (17 CFR 270.12d3–1), 17a–6 (17 CFR 270.17a–6), 17d–1 (17 CFR 270.17d–1), and 17e–1 (17 CFR 270.17e–1) under the Investment Company Act of 1940 (15 U.S.C. 80a) (''Investment Company Act'' or ''Act'').[1]

[1] Unless otherwise noted, when we refer to rules 10f–3, 12d3–1, 17a–6, 17a–10, 17d–1, or 17e–1, or any paragraph of those rules, we are referring to the following sections of the Code of Federal Regulations in which each of these rules is published, as amended by this release: 17 CFR 270.10f–3, 17 CFR 270.12d3–1, 17 CFR 270.17a–6, 17 CFR 270.17a–10, 17 CFR 270.17d–1, or 17 CFR 270.17e–1 respectively.

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Executive Summary

The Commission is adopting one new rule and amending five current rules to permit investment companies (''funds'') and certain of their affiliated persons to enter into a variety of transactions and joint arrangements without first obtaining an individual exemptive order from the Commission. Amendments to rules 17a–17d–1(d)(5) expand the circumstances in which a fund may enter into principal transactions and joint arrangements with its portfolio affiliates, and the portfolio affiliates of affiliated funds. New rule 17a–10 and the amendments to rules 10f–3, 12d3–1, and 17e–1 expand the circumstances in which a fund may engage in transactions and arrangements with persons who are affiliated persons of the fund because they provide investment advice with respect to (i) an affiliated fund, or (ii) a portion of the fund's assets that will be unaffected by the transaction.

I. Discussion

The Investment Company Act prohibits certain transactions between investment companies and their affiliated persons (''first-tier affiliates'') and affiliated persons of their affiliated persons (''second-tier affiliates'').[2] The Act's restrictions are designed to prevent these persons from managing the fund for their own benefit, rather than for the benefit of the fund's shareholders.[3] Affiliated persons of a fund include (i) its investment adviser and any subadvisers,[4] (ii) companies the fund controls or five percent (or more) of whose securities are held by the fund, (iii) persons who control the fund, and (iv) persons who are under common control with the fund.[5]

In April 2002, we proposed to exempt certain persons from the Act's restrictions on affiliated transactions.[6] Under the proposal, funds would be permitted to enter into transactions with two types of affiliated persons—

- Portfolio affiliates, which are companies that are affiliated persons of a fund because the fund controls the company, or holds five percent or more of the company's voting securities, and

[2] *See* section 17(a) [15 U.S.C. 80a–17(a)] (prohibiting first- and second-tier affiliates of a fund from borrowing money or other property from, or selling or buying securities or other property to or from the fund, or any company that the fund controls); section 17(d) [15 U.S.C. 80a–17(d)] (making it unlawful for first- and second-tier affiliates of a fund, the fund's principal underwriters, and affiliated persons of the fund's principal underwriters, acting as principal, to effect any transaction in which the fund or a company controlled by the fund is a joint or a joint and several participant in contravention of Commission rules); rule 17d–1(a) (prohibiting first- and second-tier affiliates of a fund, the fund's principal underwriter, and affiliated persons of the fund's principal underwriter, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such fund or company controlled by a fund is a participant unless an application regarding such enterprise, arrangement or plan has been filed with the Commission and has been granted); section 10(f) [15 U.S.C. 80a–10(f)] (prohibiting a fund from purchasing securities in a primary offering if certain affiliated persons of the fund are members of the underwriting or selling syndicate); section 17(e) [15 U.S.C. 80a–17(e)] (limiting the remuneration that first- and second-tier affiliates of a fund may receive in transactions involving the fund, and companies that the fund controls); and section 12(d)(3) [15 U.S.C. 80a–12(d)(3)] and rule 12d3–1 (together prohibiting a fund from acquiring securities issued by, among others, its own investment adviser).

[3] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. On Banking and Currency,* 76th Cong., 3d Sess. 37 (1940) (Statement of Commissioner Healy).

[4] Many funds use ''subadvisers'' to help manage fund assets. A subadviser is an investment adviser for purposes of the 1940 Act. The 1940 Act describes an ''investment adviser'' as a person who regularly furnishes advice to the fund with respect to the desirability of investing in, purchasing, or selling securities or other property, or is empowered to determine what securities or other property are to be purchased or sold by the fund. 15 U.S.C. 80a–2(a)(20). The investment adviser may act pursuant to a contract with a fund [15 U.S.C. 80a–2(a)(20)(A)] or pursuant to a contract with an investment adviser that has contracted with the fund. 15 U.S.C. 80a–2(a)(20)(B).

[5] *See* 15 U.S.C. 80a-2(a)(3) (defining ''affiliated person''). Unless otherwise noted, in this release we will use the term ''affiliated person'' to include both first- and second-tier affiliates of a fund.

[6] *See* Transactions of Investment Companies With Portfolio and Subadvisory Affiliates, Investment Company Act Release No. 25557 (Apr. 30, 2002) [67 FR 31081 (May 8, 2002)] (''Proposing Release'').

• Subadviser affiliates, which are persons that are affiliated persons of a fund because they are the fund's subadvisers (first-tier affiliates), affiliated persons of the fund's subadvisers (second-tier affiliates), or subadvisers of other affiliated funds (second-tier affiliates).

We published the proposals in response to the growth of funds and changes in their organization, which have resulted in a growing number of persons with whom a fund may *not* enter into transactions.[7] The amendments were designed to permit transactions between funds and these affiliated persons in circumstances in which it is unlikely that the affiliate would be in a position to take advantage of the fund. We received nine comments on the proposal.[8] The commenters supported the proposed rule and amendments, but suggested changes. Today we are adopting rule 17a–10 and amendments to rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 substantially as proposed, with changes that respond to issues raised by commenters.

A. Portfolio Affiliates

1. Second-Tier Affiliates

Rules 17a–6 and 17d–1(d)(5) permit a fund and its portfolio affiliates to engage in principal transactions and enter into joint arrangements that would otherwise be prohibited by section 17(a), or by section 17(d) and rule 17d–1(a). We proposed to amend rules 17a–6 and 17d–1(d)(5) to permit a fund to enter into principal transactions and joint arrangements not only with its own portfolio affiliates, but also with portfolio affiliates of funds that are under common control with the fund. Commenters supported the amendments, and we are adopting them substantially as proposed.[9] The amendments permit funds to enter into transactions with portfolio affiliates of other funds in the same fund complex, subject to the same conditions under which a fund may enter into transactions and arrangements with its own portfolio affiliates.[10]

2. Financial Interests

A fund may not rely on the exemptions in rules 17a–6 and 17d–1(d)(5) to enter into principal transactions or joint arrangements with portfolio affiliates if certain persons (such as the fund's adviser, officers, and principal underwriter, which we will refer to as ''Prohibited Participants''), have a financial interest in a party to the transaction or arrangement (other than the fund itself).[11] We proposed to amend the rules to permit a portfolio affiliate to enter into a transaction or arrangement with the fund if a Prohibited Participant has a financial interest that the fund's board determines is not ''material.''[12] Commenters supported the amendment, and we are adopting it substantially as proposed.[13] In determining whether a financial interest is ''material,'' the board should consider whether the nature and extent of the interest in the transaction is sufficiently small that a reasonable person would not believe that the interest affected the determination of whether to enter into the transaction or arrangement or the terms of the transaction or arrangement.

3. Time Periods

Currently, rule 17a–6 prohibits transactions with portfolio affiliates when a Prohibited Participant ''has, or within six months prior to the transaction had, or pursuant to an arrangement will acquire'' a financial interest in a party to the transaction.[14] Rule 17d–1(d)(5) prohibits joint transactions with portfolio affiliates if the Prohibited Participant ''is, was, or proposes to be a participant'' in the joint arrangement.[15] The Commission proposed to reconcile these time periods, using the more limited approach of rule 17a–6.[16] Under the proposed amendments, the rule would be available unless a Prohibited Participant had a financial interest in a party to the transaction within the previous six months (as opposed to a financial interest at *any* time in the past).[17] We are adopting the amendment as proposed.[18]

B. Subadviser Affiliates

Most funds are today organized by an investment adviser that advises and provides administrative services to a number of other funds in the same fund complex. As a result, advisers and subadvisers to a fund are not only first-tier affiliates of any funds they advise; they may also be second-tier affiliates of the other funds in the complex.[19]

[7] *Id.* at nn. 12–16 and accompanying text.

[8] The comment letters and a summary of comments prepared by our staff are available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW, Washington, DC (File No. S7–21–01). The comment summary is also available on the Commission's Internet Web site.

[9] One technical change we have made is discussed in note 13 *infra*.

[10] *See* note 19, *infra,* discussing when funds in a fund complex are affiliated persons because they are under common control.

[11] *See* rules 17a–6(a) and 17d–1(d)(5)(i) (prohibiting the following persons from participating in, or having a financial interest in a participant in the transaction or arrangement: (1) an officer, director, employee, investment adviser, member of an advisory board, depositor, promoter of, or principal underwriter for the fund; (2) a person directly or indirectly controlling the fund; (3) a person directly or indirectly owning, controlling, or holding with power to vote five percent or more of the outstanding voting securities of the fund; (4) a person directly or indirectly under common control with the fund; and (5) affiliated persons of the foregoing).

[12] *See* Proposing Release, *supra* note 6, at n. 28 and accompanying text. We also proposed to eliminate a condition in rule 17d–1(d)(5) that limited a fund to committing no more than five percent of its assets to a joint enterprise with a portfolio affiliate. *Id.* at nn.32–34 and accompanying text. We received no comment on this proposal and are adopting the amendment as proposed.

[13] One commenter pointed out that a fund might be unable to rely on the proposed rules if an affiliated fund has a financial interest in, but is not affiliated with, the portfolio affiliate. For example, assume that Fund A and Fund B, which have the same principal adviser, own six percent and three percent, respectively, of the outstanding voting securities of Company X. Fund A wants to enter into a transaction to purchase commercial paper issued by Company X. Under the proposed amendments to rule 17a–6, Fund A might have been unable to do so. This is because Fund B, a Prohibited Participant, might be deemed to have a disqualifying ''financial interest'' in a party to the transaction (Company X). A second commenter made a similar observation. We have revised the rules to make clear that this type of transaction is permissible. *See* rule 17a–6(a)(4)(ii) (providing that a fund under common control with the participating fund is not a Prohibited Participant if the fund's ''sole interest in the transaction or a party to the transaction is an interest in [the portfolio affiliate]'').

[14] *See* prior rule 17a–6(a)(5)(ii).

[15] *See* prior rule 17d–1(d)(5)(i).

[16] *See* Proposing Release, *supra* note 6, at nn. 29–30 and accompanying text.

[17] As discussed above, the fund's board of directors could also determine that a financial interest held within the 6 months preceding the transaction is not material.

[18] *See* rules 17a–6(b)(1)(ii) and 17d–1(d)(5)(ii)(B). One commenter argued that the rules' exemptions should be available without regard to the past financial interests of the fund's affiliated persons. The commenter asserted that the past financial interest of an affiliated person would probably not raise the investor protection concerns that the rules are intended to address. We disagree. The rules protect funds in circumstances where the actions of an affiliated person may continue to be influenced by the person's prior financial interests. The rules are, in this respect, analogous to regulations that in other contexts prohibit an employee from working on matters that involve former employers or clients. *See, e.g.,* 17 CFR 210.2–01(c)(2)(iii) and (iv) (describing circumstances in which an accountant is not independent as a result of employment by the accountant of a former employee of the audit client, or employment by the audit client of a former employee of the accountant).

[19] Funds in a fund complex are under the common control of an investment adviser or other person when the adviser or other person exercises a controlling influence over the management or policies of the funds. 15 U.S.C. 80a–2(a)(9). Not all advisers control the funds they advise. The determination of whether a fund is under the

Continued

provisions of the Act may restrict the ability of subadviser affiliates to enter into transactions or arrangements with a fund even if the subadviser affiliate lacks the ability to influence the fund.[20] We proposed one rule and a number of rule amendments to exempt transactions and arrangements between funds and their subadviser affiliates where there is little risk that the affiliated person is in a position to take advantage of the fund.

1. Principal Transactions With Subadvisers: Section 17(a)

Section 17(a) of the Act prohibits a subadviser that is an affiliated person of a fund from borrowing money or other property from, or selling or buying securities or other property to or from, the fund or any company that the fund controls.[21] We proposed new rule 17a–10 to permit (i) a subadviser of a fund to enter into transactions with funds the subadviser does not advise but which are affiliated persons of a fund that it does advise (*e.g.,* other funds in the fund complex), and (ii) a subadviser (and its affiliated persons) to enter into transactions and arrangements with funds the subadviser does advise, but only with respect to discrete portions of the subadvised fund for which the subadviser does not provide investment advice.[22]

Our proposed exemption was subject to two conditions. First, the subadvisory relationship must be the sole reason why section 17(a) prohibits the transaction; and second, the participating subadviser (*i.e.*, the one who, or whose affiliated person, enters into the transaction or arrangement) and any subadviser of the participating fund or portion of a fund's portfolio (*i.e.*, the one advising the fund to enter into the transaction) must be prohibited by their advisory contracts from consulting with each other concerning securities transactions of the participating fund or portion.[23]

While all commenters supported the new exemption, two asserted that we should not condition the exemption in rule 17a–10 on fund subadvisers being contractually prohibited from consulting with one another concerning securities transactions of the fund.[24] These commenters suggested that the condition was unnecessary because subadvisers rarely, if ever, consult with one another concerning fund transactions. The rule's exemption, however, is premised on the unlikelihood that a subadviser participating in the transaction will be able to influence investment decisions made on behalf of a fund (or portion of a fund) that it does not advise. To the extent that such discussions among subadvisers do occur, they increase the likelihood of reciprocal arrangements. We are, therefore, adopting the provision as proposed, with one revision that clarifies that the prohibitions extend to transaction of the fund in any type of assets, not just securities.[25]

2. Transactions With Subadvisers as Brokers: Section 17(e)

Section 17(e)(2) of the Act generally limits the remuneration that an affiliated person of a fund, acting as broker, may receive for effecting purchases and sales of securities on a securities exchange on behalf of the fund, or a company the fund controls, to the ''usual and customary broker's commission.'' [26] Section 17(e)(2)'s limits apply to purchases and sales made on behalf of a fund by affiliated persons, which include the fund's subadviser (a first-tier affiliate), affiliated persons of the subadviser (second-tier affiliates), and may include subadvisers of funds under common control with the fund (second-tier affiliates).

Rule 17e–1 describes the circumstances in which remuneration received by an affiliated person of a fund qualifies as the ''usual and customary broker's commission.'' The rule, among other things, requires that the fund's board of directors review transactions to determine that they comply with procedures adopted by the board to ensure that the remuneration received by the affiliated person does not exceed the usual and customary broker's commission (''review requirement'').[27] In addition, the fund must maintain a record of the transactions (''recordkeeping requirement'').[28] The review and recordkeeping requirements of rule 17e–1 were designed to permit fund directors and our examination staff to monitor the reasonableness and fairness of remuneration received by affiliated persons of the fund.[29]

We proposed to amend rule 17e–1 to permit a fund's subadviser (or other affiliated person) to receive remuneration for service as a broker without complying with the recordkeeping and review requirements, in circumstances in which the affiliated person has very limited ability to influence decisions regarding execution of fund securities transactions, *i.e.*, when the affiliated person would be eligible to enter into principal transactions with the fund under rule 17a–10.[30] Commenters supported the

control of its adviser, officers or directors depends on all of the relevant facts and circumstances. *See* Proposing Release, *supra* note 6, at n.14. Throughout this release, we presume that the funds in a fund complex are under common control, as funds that are not affiliated persons will not require and thus will not rely on the proposed exemptions.

[20] For example, if Funds A and B are under the common control of a principal adviser, and Subadviser A provides investment advice only with respect to Fund A, then Subadviser A is a second-tier affiliate of Fund B, and subject to all of the Act's prohibitions against transactions involving second-tier affiliates, even though Subadviser A may not have the ability to influence Fund B.

[21] Section 17(a) also prohibits affiliated persons of the subadviser from entering into such transactions if the subadviser is a first-tier affiliate of the fund.

[22] *See* Proposing Release, *supra* note 6, at nn. 42–46 and accompanying text. This second category of relief would thus be available only when a fund has one or more subadvisers, which are responsible for managing discrete portions of the fund's assets. The rule permits the adviser of one portion of the fund to direct that portion to engage in a principal transaction with the subadviser of another portion of the fund's assets.

[23] *See* Proposing Release, *supra* note 6, at nn. 44–45 and accompanying text. We note that while the rule does not contain a condition prohibiting subadvisers and principal advisers from consulting with each other, the principal adviser (like the subadvisers) remains a fiduciary of the fund and may not collaborate with fund subadvisers for purposes of overreaching the fund. *See* Proposing Release, *supra* note 6, at n. 45.

[24] Two commenters requested that we affirmatively state that two funds, with different principal advisers but a common subadviser, are not under common control, and therefore not affiliated persons. One commenter argued that otherwise the rule would be unnecessary, as two funds that share a principal investment adviser, but different subadvisers could not then be under common control. As we stated in the Proposing Release, not all advisers control the funds they advise, and the determination of whether a fund is under the control of its adviser (or subadviser), officers, or directors depends on the relevant facts and circumstances. *See* Proposing Release, *supra* note 6, at n. 14.

[25] Rule 17a–10(a)(2)(i). As we stated in the Proposing Release, we would not view changes to subadvisory contracts that are made to comply with the conditions of this rule to be material for purposes of section 15 of the Investment Company Act [15 U.S.C. 80a–15], and funds would not have to obtain shareholder approval of such changes. *See* Proposing Release, *supra* note 6, at section III.B.2.

[26] Section 17(e)(2) limits the remuneration that an affiliated person of a fund, acting as broker, may receive in connection with a securities transaction to (A) the usual and customary broker's commission for transactions effected on an exchange, (B) two percent of the sales price for secondary distribution, and (C) one percent of the purchase or sale price for other purchases or sales.

[27] Rule 17e–1(a) and (b). The rule also requires that a majority of the directors of the fund not be ''interested persons'' of the fund, that those directors select and nominate any other disinterested directors, and any person who acts as legal counsel for the disinterested directors be an independent legal counsel. Rule 17e–1(c). Section 2(a)(19) identifies persons who are ''interested persons'' of a fund. 15 U.S.C. 80a–2(a)(19).

[28] Rule 17e–1(d).

[29] Agency Transactions by Affiliated Persons on a Securities Exchange, Investment Company Act Release No. 10605 (Feb. 27, 1979) [44 FR 12202 (Mar. 6, 1979)] at n.10 and accompanying text.

[30] *See* Proposing Release, *supra* note 6, at n. 51 and accompanying text.

amendment, which we are adopting as proposed.[31]

3. Purchases During Primary Offering Underwritten by Subadvisers: Section 10(f)

Section 10(f) of the Act prohibits a fund from purchasing any security during an underwriting or selling syndicate if the fund has certain affiliated relationships with a principal underwriter of the security.[32] The section protects fund shareholders by preventing an affiliated underwriter from placing or ''dumping'' unmarketable securities with the fund.[33] Rule 10f–3 provides an exemption from the prohibition in section 10(f) if certain conditions are satisfied.[34] One of rule 10f–3's key conditions is that a fund relying on the rule, together with any other fund advised by the fund's adviser, purchase no more than 25 percent of the offering (''percentage limit'').[35] The purpose of the percentage limit is to provide an indication that a market for the issue exists independent of the adviser and that the securities are not being ''dumped.'' [36]

As we discussed in the Proposing Release, when a fund has multiple advisers or subadvisers, section 10(f) can limit significantly the fund's ability to purchase securities in an offering.[37] Under section 10(f), a fund is subject to the prohibition if *any* of its advisers (in the case of a series fund) or subadvisers (in the case of a multi-managed fund) participated in the underwriting or selling syndicate (or are affiliated persons of participants), regardless of whether the adviser or subadviser that *recommended* the purchase was a participant in the syndicate.[38] We proposed to amend rule 10f–3 to deem each series of a series company (''series'') and the ''managed portions'' [39] of a fund's portfolio (''portion'') to be separate registered investment companies for purposes of section 10(f) and rule 10f–3.[40] As a result, a fund would be subject to the limitation only when an adviser recommending the transaction (or its affiliated person) is a participant in the transaction and thus in a position to take advantage of the fund. Commenters supported this amendment, and we are adopting it substantially as proposed.[41]

We also proposed parallel amendments to rule 10f–3 to revise the way that funds must aggregate purchases to determine compliance with the percentage limits of rule 10f–3 so that only purchases by funds that are advised, and accounts that are controlled, by an investment adviser that is a participant in the underwriting or selling syndicate need be aggregated.[42] If multiple investment advisers provide investment advice to a fund (*e.g.*, a principal adviser and one or more subadvisers) but only one of those advisers (or its affiliated persons) is a participant in the underwriting or selling syndicate, rule 10f–3's percentage limit would apply only to purchases by the funds and accounts of the participating investment adviser.[43]

Although commenters strongly supported limiting the aggregation requirement to purchases by funds and portions of a fund for which an investment adviser that participates in the underwriting syndicate provides investment advice, five commenters opposed requiring aggregation of purchases of other accounts controlled by the investment adviser. While these

[31] Rule 17e–1(b)(3) and (d)(2). Under rule 17e–1, as amended, a fund is exempted from the recordkeeping and review requirements to the same extent that the fund would be permitted to enter into principal transactions with a subadviser. Thus, a fund could use a subadviser that is a first-tier affiliate (because it advises a discrete portion of the fund for which it is not executing a transaction), an affiliated person of such subadviser (a second-tier affiliate of the fund), or a subadviser that is a second-tier affiliate of the fund (because it advises another fund in the fund complex) to execute brokerage transactions without complying with rule 17e–1's recordkeeping and review requirements. Other of our rules requiring funds to retain certain records of brokerage orders by or on behalf of the fund are unaffected by today's amendments. *See* rule 31a–1(b)(5) [17 CFR 270.31a–1(b)(5)].

[32] Section 10(f), in relevant part, prohibits a registered investment company from knowingly purchasing or otherwise acquiring, during the existence of any underwriting or selling syndicate, any security (except a security of which the company is the issuer) a principal underwriter of which is an officer, director, member of an advisory board, investment adviser, or employee of the company, or any person of which any of the foregoing are affiliated persons.

[33] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. On Banking and Currency,* 76th Cong., 3d Sess. 35 (1940) (statement of Commissioner Healy).

[34] Rule 10f–3 permits a fund to purchase securities in a transaction that otherwise would violate section 10(f) if, among other things: (i) The securities either are registered under the Securities Act of 1933 [15 U.S.C. 77a–aa], are part of an issue of government securities, are municipal securities with certain credit ratings, or are offered in certain foreign or private institutional offerings; (ii) the offering involves a ''firm commitment'' underwriting; (iii) the fund (together with other funds advised by the same investment adviser) purchases no more than 25 percent of the offering; (iv) the fund purchases the securities from a member of the syndicate other than its affiliated underwriter; (v) the fund's directors have approved procedures for purchases under the rule and regularly review the purchases to determine whether they have complied with the procedures. *See* prior rule 10f–3(b) (new rule 10f–3(c)).

[35] *See* rule 10f–3(c)(7).

[36] *See* Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 24775 (Nov. 29, 2000) [65 FR 76189 (Dec. 6, 2000)] at n. 22 and accompanying text.

[37] *See* Proposing Release, *supra* note at n. 59 and accompanying text. A fund may have multiple subadvisers because more than one subadviser has been retained to provide investment advice with respect to various portions of the fund (a ''multi-managed'' fund). A fund may also have multiple advisers because the fund is one of several series of a series company, and different advisers provide investment advice with respect to the assets of the different series.

[38] Unless otherwise noted, we will refer to a subadviser that is a principal underwriter, or an affiliated person of a principal underwriter of a security, as a ''participant'' in the underwriting or selling syndicate.

[39] A portion of a fund's portfolio would be a ''managed portion'' if it is a discrete portion of the portfolio for which a subadviser is responsible for providing investment advice, and the subadviser (i) does not provide investment advice with respect to any other portion of the fund's portfolio, (ii) is prohibited by its advisory contract from consulting with any other investment adviser of the investment company that is a principal underwriter or affiliated person of a principal underwriter concerning securities transactions of the fund, and (iii) is not an affiliated person of any other investment adviser, or any promoter, underwriter, officer, director, member of an advisory board, or employee of the investment company. *See* Proposing Release, *supra* note 6, at n. 62 and accompanying text.

[40] *See* Proposing Release, supra note , at n. 63 and accompanying text.

[41] *See* rule 10f–3(a)(6) (defining ''managed portion'') and 10f–3(b) (deeming the series of a series company and Managed Portions of an investment company to be separate investment companies for purposes of section 10(f) and rule 10f–3). The effect of the amendments is to exempt a purchase of securities by an investment company from the prohibition in section 10(f), if the purchase would not be prohibited if each series or portion were a separately registered investment company.

[42] *See* Proposing Release, *supra* note 6, at nn. 67–68 and accompanying text. We proposed to apply the percentage limit to purchases by the *accounts* controlled by a fund's investment adviser, as well as the *funds* advised by the adviser because we were concerned that rule 10f–3's percentage limit may not provide reliable evidence of a market for the security if most or all of the offering is purchased by fund and non-fund clients of an adviser participating in the underwriting or selling syndicate. The amendment would not require an adviser to aggregate its purchases on behalf of funds and other discretionary accounts with those made by affiliated persons of the adviser. Section 48(a) would prohibit those purchases, however, if they were coordinated purchases made for purposes of circumventing the rule's percentage limits. Section 48(a) of the Act [15 U.S.C. 80a–47(a)].

[43] *See* Proposing Release, *supra* note 6, at nn.67–68 and accompanying text. For example, assume that Principal Adviser A advises three funds (Funds 1, 2, and 3), and Subadviser B subadvises Fund 1, and is the principal adviser to unaffiliated Fund 4. If Principal Adviser A participates in the underwriting syndicate, then the aggregate purchases of Funds 1, 2, and 3 must meet the percentage limit, and if Subadviser B participates in the syndicate then the aggregate purchases of Funds 1 and 4 must meet the percentage limit. If more than one investment adviser of a fund is a participant in the underwriting or selling syndicate then the percentage limit would apply independently with respect to each such investment adviser. *See* Proposing Release, *supra* note , at n. 68. The percentage limit would not apply at all if a fund is prohibited from purchasing a security because a person other than the fund's investment adviser or an affiliated person of the investment adviser (*e.g.*, an officer, director, or employee of the fund) is a participant in the underwriting or selling syndicate.

commenters complained that the amendment could limit the ability of funds to purchase securities in principal offerings, none suggested a way to reconcile the policy underlying rule 10f–3's percentage limit with continuing to permit non-fund accounts advised by the fund's adviser to purchase unlimited amounts of the offering.[44] One fund commenter supporting the proposed requirement cited recent allegations of abusive practices in the market for initial public offerings as illustrative of the conflicts of interest that are inherent when underwriting participants have other business relationships with persons who purchase securities during an offering. This commenter concluded that without a limit on aggregate purchases by non-fund accounts, ''there can be no assurance that the fund was participating in a bona fide offering to the public. * * *'' We agree, and are adopting the amendments substantially as proposed.[45]

At the suggestion of three commenters, we have narrowed the new aggregation requirement. Instead of requiring funds to aggregate purchases by accounts over which the fund adviser ''has discretionary authority or otherwise exercises control,'' amended rule 10f–3 requires aggregation of purchases by other accounts with respect to which the adviser exercises ''investment discretion.''[46] The revised approach is more consistent with the current aggregation provision of rule 10f–3, which assumes that advisers to multiple funds have investment discretion with respect to fund assets.

4. Ownership of Securities Issued by Subadvisers: Section 12(d)(3)

Section 12(d)(3) of the Act generally prohibits funds, and companies controlled by funds, from purchasing securities issued by a registered investment adviser, broker, dealer, or underwriter (''securities-related businesses'').[47] Rule 12d3–1 permits a fund to invest up to five percent of its assets in securities of an issuer deriving more than fifteen percent of its gross revenues from securities-related businesses,[48] but a fund could not rely on rule 12d3–1 to acquire securities of its own investment adviser or any affiliated person of its own investment adviser.[49] As a result, a fund could not rely on rule 12d3–1 to acquire securities issued by any of its subadvisers.

Consistent with our other proposals, we proposed to amend rule 12d3–1 to permit a fund to purchase securities issued by its subadvisers (or affiliated persons of its subadvisers) in circumstances in which the subadviser would have little ability to take advantage of the fund, because it is not in a position to direct the fund's securities purchases.[50] The exemption in rule 12d3–1 would be available in circumstances identical to those in which the subadviser (or affiliated person) would be permitted by rule 17a–10 to enter into a principal transaction with the fund.[51] Commenters supported the amendments, which we are adopting as proposed.[52]

II. Effective Date

The Administrative Procedure Act generally provides that a substantive rule may become effective no less than 30 days after publication in the **Federal Register**.[53] Accordingly, new rule 17a–10 and amendments to rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 will become effective February 24, 2003.

We are, however, delaying the compliance date with respect to the amendments to rule 10f–3 until April 23, 2003. After April 23, 2003, a fund must comply with all of the conditions in rule 10f–3 as amended in order to rely on the exemption in that rule. A registered investment company that purchases securities between February 24, 2003 and April 23, 2003 may rely on either rule 10f–3 as amended, or rule 10f–3 as it existed prior to today's amendments.

III. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits that result from its rules. As described above, the rule and amendments expand the circumstances under which portfolio companies and subadvisers that are affiliated persons of funds may engage in otherwise prohibited transactions with those funds without first obtaining an exemptive order from the Commission. We have identified certain costs and benefits that may result from today's rulemaking. Because the new rule and rule amendments are exemptive, rather than prescriptive, funds and their affiliated persons are not required to rely on them. Therefore, we assume that funds will rely on the rule and amendments only if the anticipated benefits from such actions would exceed the anticipated costs. In the Proposing Release, we requested comment and specific data regarding the costs and benefits of the proposed amendments. The comments we received are discussed below; we did not receive any data.

A. Benefits

1. In General

We anticipate that funds, their shareholders, advisers and other affiliated persons will benefit from the new rule and amendments. Absent the rule and amendments, we anticipate that affiliated persons, prohibited by the Act from entering into transactions with funds, would continue to seek Commission exemptive orders. The process for obtaining such an exemption

[44] Commenters also argued that other protections in rule 10f–3 make it unlikely that securities could be ''dumped'' in the fund. These commenters, in effect, argued that there should be no quantitative limitation on the amount of purchase under the rule, an approach the Commission rejected when we amended the rule in 1997. *See* Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 22775 (July 31, 1997) [62 FR 42401 (Aug. 7, 1997)].

[45] *See* rule 10f–3(c)(7).

[46] Rule 10f–3(c)(7)(i). Under the rule the purchase must be aggregated if (i) the adviser has investment discretion over the account, and (ii) the adviser has exercised such discretion in connection with the purchase.

[47] With minor exceptions, section 12(d)(3) prohibits a fund from purchasing or otherwise acquiring ''any security issued by or any other interest in the business of any person who is a broker, a dealer, is engaged in the business of underwriting, or is [an] investment adviser.''

[48] Paragraph (a) of rule 12d3–1 permits a fund to acquire any security issued by any person that, in its most recent fiscal year, derived 15 percent or less of its gross revenues from securities-related activities unless the fund would control such person after the acquisition. Paragraph (b)(3) of rule 12d3–1 permits a fund to invest up to five percent of the value of its total assets in the securities of an issuer that derives more than 15 percent of its gross revenues from securities-related activities. Rule 12d3–1(d)(1) defines ''securities related activities'' as a person's activities as a broker, a dealer, an underwriter, an investment adviser registered under the Investment Advisers Act of 1940 [15 U.S.C. 80b], or an investment adviser to a registered investment company.

[49] Rule 12d3–1(d)(8) provides that any class or series of an investment company that issues two or more classes or series of preferred or special stock, each of which is preferred over all other classes or series with respect to assets specifically allocated to that class or series, shall be treated as if it is a registered investment company. Accordingly, a fund that is a series of a series company may rely on rule 12d3–1 to purchase securities issued by subadvisers (and persons affiliated with those subadvisers) of the other series of the investment company.

[50] *See* Proposing Release, *supra* note 6, at n. 77 and accompanying text.

[51] *Id.* The exemption in rule 12d3–1 is available if (i) the subadviser is not, and is not an affiliated person of, an investment adviser that provides advice with respect to the portion of the fund that is acquiring the securities, and (ii) the advisory contracts of the subadviser, and any subadviser that is advising the purchasing portion of the fund, prohibit them from consulting with each other concerning securities transactions of the fund, and limit their responsibility in providing advice to providing advice with respect to discrete portions of the fund's portfolio. *See* rule 12d3–1(c)(3)(i) and (ii).

[52] Rule 12d3–1(c)(3).

[53] 5 U.S.C. 553(d).

imposes direct costs on applicants.[54] The new rule and amendments will benefit funds, their shareholders, and their affiliated persons by eliminating these costs.

The application process also produces indirect costs, because funds and their affiliated persons forego beneficial transactions rather than undertake to obtain an exemptive order. Funds and their affiliated persons may forego transactions either because the anticipated benefit of the transaction does not exceed the cost of obtaining an exemptive order, or because the transaction is time-sensitive, and it is not feasible to obtain an exemptive order quickly enough to permit the transaction to occur.[55] Encouraging beneficial transactions by eliminating these potentially significant costs and delays will likely be a benefit resulting from these changes. As discussed in the Proposing Release, eliminating direct and indirect costs of filing applications may also reduce factors that discriminate against smaller funds and smaller transactions.[56]

2. Portfolio Affiliates

The amendments to rules 17a–6 and 17d–1(d)(5) regarding transactions and joint arrangements with portfolio affiliates may expand the range of possible partners with which funds may enter into transactions and joint arrangements. Funds, their second-tier portfolio affiliates, and their shareholders each may benefit from the transactions and arrangements made possible by the amendments.[57] Similarly, amending rules 17a–6 and 17d–1(d)(5), to provide that the term ''financial interest'' does not include interests that the fund's board of directors finds to be not material, may expand the range of possible partners for transactions and joint arrangements with funds by making the rules' exemptions more widely available.[58] A similar benefit may result from the removal of rule 17d–1(d)(5)'s condition limiting a fund to committing no more than five percent of its assets in any particular joint enterprise.

3. Subadviser Affiliates

Principal Transactions

Rule 17a–10 may benefit subadvisers and funds by allowing subadviser affiliates to enter into principal transactions with (i) affiliated funds of the subadvised fund and (ii) those portions of the subadvised fund for which the subadviser does not provide investment advice. By broadening the markets available to both buyers and sellers, rule 17a–10 may permit sellers to obtain more favorable pricing, and may make a wider range of investment options available to buyers.

Brokerage Transactions

Rule 17e–1 will, under certain circumstances, permit subadvisers and their affiliated persons to receive remuneration when acting as broker for an affiliated fund, without complying with all of the rule's recordkeeping and transaction review requirements. Our staff estimates that boards of directors of funds that employ affiliated brokers currently spend approximately 12.5 hours per year per fund conducting the required review. Our staff further estimates that a fund that uses in-house counsel to assist fund directors in reviewing these transactions incurs a cost of $775 per year for counsel, based on an hourly cost for in-house counsel of $62 per hour.[59] Funds incur the additional incremental cost of maintaining records of the transaction. The amendments to rule 17e–1 may benefit funds and their shareholders by allowing funds to avoid these burdens.

Purchases During Primary Offerings Underwritten by Affiliated Subadvisers

The amendments to rule 10f–3 may benefit funds by broadening their investment options. The Act prohibits a series of a series company from purchasing securities during an underwriting or selling syndicate of which an adviser to any of the series (or affiliated person of such adviser) is a member. By providing that, for purposes of section 10(f) and rule 10f–3, a series of a series company is a separate investment company, the proposed amendments to rule 10f–3 could broaden (i) the investment opportunities available to such funds and (ii) the range of possible purchasers when a subadviser participates in an underwriting syndicate. Funds, fund shareholders, and subadvisers all may benefit from this change.

The Act also does not distinguish between a fund with multiple subadvisers that manage discrete portions of its portfolio, and a fund whose subadvisers manage the portfolio in its entirety. The amendments to rule 10f–3 that deem separately managed portions of a fund's portfolio to be separate investment companies for purposes of section 10(f) and rule 10f–3 may increase the investment opportunities of that type of fund. Quantifying the potential magnitude of these benefits may not be possible.

The amendment to the percentage limit of rule 10f–3 also may broaden the investment options available to funds. The Act does not distinguish between purchases by funds or portions of funds that are recommended by a subadviser that is (or is an affiliated person of) a participant in the underwriting or selling syndicate, and purchases by funds or portions of funds for which *other* subadvisers provide investment advice. By providing that the percentage limit of rule 10f–3 applies only to purchases by funds, portions of funds, and accounts for which participants provide investment advice, the amendments to rule 10f–3 may increase the investment opportunities of a fund with multiple subadvisers that manage discrete portions of its portfolio.

The amendments to the percentage limit may reduce the cost of complying with rule 10f–3 because purchases made by funds that are *not* advised by participants in the underwriting or selling syndicate will no longer need to be aggregated with purchases made by funds that *are* advised by advisers that are participants in the underwriting. Because multiple advisers will no longer be required to coordinate their actions, the amendment may make it easier to ensure compliance with the rule, and less expensive to collect and compile the relevant information.

Ownership of Securities Issued by Subadvisers

Similarly, the amendments to rule 12d3–1 may also benefit funds by broadening their investment options. Amending rule 12d3–1 to permit a fund to acquire securities issued by one of its subadvisers, or an affiliated person of one of its subadvisers, when the subadviser is not in a position to influence the decision by the fund to purchase the securities, may increase the investment opportunities of these funds.

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[54] *See* Proposing Release, *supra* note 6, at section III.A.1. (estimating the cost of applying for an order exempting affiliated persons from the prohibitions of sections 17(a), 17(d), 17(e), 10(f), and 12(d)(3) to be between $20,000 and $80,000, depending on the complexity of the application).

[55] *See* Proposing Release, *supra* note 6, at nn. 79–80 (estimating the length of time between filing of applications and granting of exemptive orders to be between 4 to 17 months, depending on the complexity of the application).

[56] *See* Proposing Release, *supra* note 6, at section III.A.1.

[57] It has not been possible to quantify this benefit, which varies on a case-by-case basis depending on the characteristics of individual transactions and joint arrangements and on the extent to which funds involved in such transactions have second-tier portfolio affiliates.

[58] Expansion of the exemption in this manner may also impose costs by eliminating what has been a ''bright line'' prohibition and expanding the opportunities for harmful transactions.

[59] *See* notes 85–87 *infra*, and accompanying text.

B. Costs

The Commission anticipates that funds, their shareholders, and their advisers and other affiliated persons may incur certain costs, including certain direct costs from complying with the new rule and amendments. The exemptions resulting from today's rulemaking also may encourage shifts in market behavior that could create direct and indirect costs for certain entities. Furthermore, the exemptions may allow funds to proceed with disadvantageous transactions that existing restrictions would have prevented.

1. Portfolio Affiliates

We do not anticipate that there will be any costs associated with the amendments to rules 17a–6 and 17d–1(d)(5), other than a cost associated with the provision that a fund's board of directors may find that an interest is not material and hence not a ''financial interest.'' Because a fund may avail itself of the amendment only if the fund's directors make certain findings and record the basis for those findings in the minutes of their meeting, the benefit of the change is minimally offset by the cost to the fund of the board fulfilling its obligations. Based on discussions with industry representatives, our staff estimates that reviewing the materiality of a Prohibited Participant's interest in a party to the transaction and recording the basis for those findings would require approximately 11.2 hours and $1,140 per meeting, in addition to the discussions that occur during the board meeting.[60] This cost may partially offset the benefits of the exemption, including the direct benefit of allowing a fund to forego the cost of applying for exemptive relief from the restrictions of section 17(a) and rule 17d–1. We assume that if the cost of holding such a meeting exceeds the benefit to the fund, the fund will either forego the opportunity to engage in the transaction or require the Prohibited Participant to divest itself of its interest.

2. Subadvisory Affiliates

A fund and its advisers and subadvisers may incur costs in complying with the requirements of rule 17a–10 and amended rules 10f–3, 12d3–1, and 17e–1 that partially offset the benefits of these rules. In order for a fund to rely on the exemptions in the rule and amendments, the fund's advisory contracts must include certain provisions that they may not currently include. Because such contracts generally are subject to renewal at regular intervals, adding such provisions may not entail additional administrative costs. As discussed above, we do not view the required changes to subadvisory contracts to be material for purposes of section 15 of the Investment Company Act and, as a result, funds will not have to obtain shareholder approval of the change.[61] Based on discussions with industry representatives, the staff estimates that drafting and executing revised subadvisory contracts would require approximately 6 hours. Assuming that all funds that are advised by subadvisers modify their advisory contracts in order that they and their affiliated funds may rely on the exemptions, the rule and rule amendments would create an estimated initial one-time cost of approximately $836,000.[62]

Rule 17e–1 may result in increased costs to funds as a result of higher brokerage commissions. By exempting the commissions paid to certain affiliated subadvisers from the requirement for scrutiny by the board of directors, rule 17e–1 may allow a rise in brokerage commissions that the fund pays. Whether this increased cost occurs will depend on the extent to which the scrutiny currently required of boards of directors has resulted in findings that commissions to be paid by funds are excessive. Although we requested comment on the frequency of boards of directors making such findings, we received no comments on this issue.

The amendments to rule 10f–3 may encourage division of funds into discrete parts managed by multiple subadvisers. A fund that is advised by subadvisers that participate, or are affiliated with persons that participate, in underwriting syndicates may have an incentive to reorganize in order to take advantage of the opportunity to have a part of the fund purchase securities during the syndicate. Likewise, a fund that is advised by a subadviser that participates in underwriting syndicates may have an incentive to reorganize in order to comply with the percentage limit of rule 10f–3 and take advantage of the opportunity to purchase securities in reliance on that rule's exemption. Such a development would benefit subadvisers, but the use of additional subadvisers could also result in increased costs to funds and their shareholders.[63]

Investment advisers may incur costs in connection with the new requirement of rule 10f–3 that fund purchases be aggregated with purchases of certain non-funds for purposes of compliance with the rule's percentage limits. Commenters suggested that fund complexes that automate such calculations could incur significant one-time costs in connection with reconfiguring existing information collection systems to accommodate the amendments.[64] We assume that if the cost of compiling the required information would outweigh the benefits of relying on the exemption in rule 10f–3, then these advisers will forego the exemption in rule 10f–3, and comply with the prohibition in section 10(f).

IV. Consideration of Promotion of Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.[65]

Portfolio Affiliates

The amendments to rules 17a–6 and 17d–1(d)(5) will expand the circumstances under which funds, and companies they control, may enter into principal transactions and joint arrangements with portfolio affiliates without first obtaining an exemptive order from the Commission. The amendments will permit funds and companies they control to engage in otherwise prohibited transactions with: (i) A broader array of first-tier portfolio affiliates than the rules currently permit; and (ii) certain second-tier portfolio affiliates.[66] We anticipate that the amendments will promote efficiency and competition. The Act's restrictions on transactions involving funds and their affiliated persons respond to market failures that can occur when an affiliated person, in a position to influence the management of a fund, causes the fund to behave in a manner

[60] *See* notes 68–74 *infra*, and accompanying text.

[61] *See* note 25 *supra.*

[62] *See* notes 75–78 *infra*, and accompanying text.

[63] It has been estimated that expenses of subadvised funds are on average 15–20% higher than those of non-subadvised funds. *See* James Paton, *Outside Fund Managers Don't Bring Outsize Benefits*, Reuters, Sept. 11, 2002, *available in* Westlaw, Reuters Eng. News Serv. File and Bridget O'Brian, Fund Track, *Some Fund Managers Hand Reins to 'Subadvisers,'* WALL ST. J., Aug. 31, 2001, at C1.

[64] One commenter stated that for a large fund complex with many non-fund accounts the cost of such a system reconfiguration would be $300,000 at a minimum.

[65] 15 U.S.C. 80a–2(c).

[66] An additional change to rule 17d–1(d)(5) would remove existing limitations regarding the percentage of a fund's assets that the fund could commit to a joint enterprise.

that benefits the affiliated person, rather than the shareholders of the fund. The amendments to rules 17a–6 and 17d–1(d)(5) will permit market forces to operate to allocate resources in circumstances where market failure is unlikely because the affiliated person is not in a position to influence fund management. The amendments to rules 17a–6 and 17d–1(d)(5) are unrelated to, and we believe will have no effect on, capital formation.

Subadvisory Affiliates

New rule 17a–10 and the amendments to rules 17e–1, 10f–3, and 12d3–1 permit funds, and companies controlled by funds, to engage in transactions with subadvisers that are affiliated persons of the fund, but which are not in a position to influence the fund's decision to participate in the transaction. The amendments to rule 17e–1 permit, in limited circumstances, an affiliated subadviser acting as broker to receive remuneration without complying with certain conditions of the rule. As in the case of the amendments to rules 17a–6 and 17d–1(d)(5), we anticipate that these amendments will promote efficiency and competition by permitting market forces to operate in circumstances where there is limited chance of market failure. We also believe that the amendments to rule 10f–3 may enhance capital formation by enabling funds to purchase securities during primary offerings, when they would otherwise be prohibited from doing so without a Commission exemptive order.

The rule and amendments may, however, adversely affect competition by promoting increased concentration of the market for subadvisory services. Rule 17a–10 may reduce or eliminate any incentive to select subadvisers specifically because they are not affiliated with a large number of funds, which may encourage funds to shift subadvisory business toward certain particularly successful subadvisers. The amendments to rule 10f–3 may remove an incentive to select subadvisers that are not either major participants or affiliated with major participants in the underwriting business. By removing disincentives against market concentration, these rules may have the effect of encouraging concentration in the market for subadvisory services.

V. Paperwork Reduction Act

Certain provisions of rule 17a–10 and the amendments to rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501–3520] (''PRA''). The Commission submitted the proposed collections of information 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 titles for the collections of information are: (i) ''Rule 10f–3 under the Investment Company Act of 1940, Exemption for the acquisition of securities during the existence of an underwriting or selling syndicate''; (ii) ''Rule 12d3–1 under the Investment Company Act of 1940, Exemption of acquisitions of securities issued by persons engaged in securities related businesses''; (iii) ''Rule 17a–6 under the Investment Company Act of 1940, Exemption for transactions with portfolio affiliates''; (iv) ''Rule 17a–10 under the Investment Company Act of 1940, Exemption for transactions with certain subadvisory affiliates''; (v) ''Rule 17d–1 under the Investment Company Act of 1940, Applications regarding joint enterprises or arrangements and certain profit-sharing plans''; and (vi) ''Rule 17e–1 under the Investment Company Act of 1940, Brokerage transactions on a securities exchange.'' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.[67] The OMB control number for rule 17a–10 is 3235–0563, and the control numbers for amended rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 are 3235–0226, 3235–0561, 3235–0564, 3235–0562, and 3235–0217, respectively.

A. Portfolio Affiliates

Rules 17a–6 and 17d–1

Under rules 17a–6 and 17d–1, a fund or company controlled by a fund may enter into principal and joint transactions with a portfolio affiliate, or an affiliated person of a portfolio affiliate, as long as certain other Prohibited Participants are not parties to the transaction and do not have a financial interest in a party to the transaction. Rules 17a–6 and 17d–1 include a list of interests that are not ''financial interests'' for purposes of the rule.[68] We have amended that list to provide that ''financial interest'' does not include an interest that the fund's board of directors finds to be not material, provided that the directors record the basis for that finding in the minutes of their meeting.[69] This aspect of the amendments creates a paperwork burden.

Based on public filings with the Commission, the Commission's staff estimates that 200 registered investment companies are affiliated persons of 900 issuers as a result of the investment company's ownership or control of the issuer's voting securities, and that there are approximately 1,400 such affiliate relationships.[70] The staff estimates that annually there will be a total of 1,400 principal transactions under rule 17a–6[71] and 1,400 joint arrangements under rule 17d–1(d)(5),[72] and that for each rule approximately 420 transactions or arrangements will result in a paperwork burden.[73]

The Commission staff estimates that compliance with the amendments will impose a burden of .2 hours (12 minutes) for each transaction for which there is a paperwork burden.[74] Therefore we estimate 84 burden hours to be associated with the amendments to rule 17a–6 annually and 84 burden

[67] Rule 10f–3 was adopted pursuant to authority set forth in sections 10(f), 31(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a–10(f), 80a–30(a), and 80a–37(a)]. Rule 12d3–1 was adopted pursuant to authority set forth in sections 6(c) and 38(a) of the Act. [15 U.S.C. 80a–6(c)]. Rule 17a–6 was adopted pursuant to authority set forth in sections 6(c), 17(b), 31(a), and 38(a) of the Act [15 U.S.C. 80a–17(b)]. Rule 17d–1 was adopted pursuant to authority set forth in sections 6(c), 17(d), and 38(a). Rule 17e–1 was adopted pursuant to authority set forth in sections 6(c), 31(a), and 38(a) of the Act.

[68] Rules 17a–6(b)(1) and 17d–1(d)(5)(iii).

[69] Rules 17a–6(b)(1)(H) and 17d–1(d)(8). Collection of this information is necessary to obtain the benefit of the exemption in the proposed rule amendments.

[70] For purposes of this analysis, the staff estimates that investment companies will enter into one principal transaction and one joint arrangement each year with each of their portfolio affiliates, and that in thirty percent of those transactions and arrangements a Prohibited Participant will have a financial interest in a party to the transaction that the board of directors of the affected investment company will consider for purposes of determining whether that financial interest is material.

[71] 1,400 affiliate relationships × 1 principal transaction per year = 1,400 transactions under rule 17a–6.

[72] 1,400 affiliate relationships × 1 joint arrangement per year = 1,400 joint arrangements under rule 17d–1(d)(5). As discussed above, in addition to expanding fund business opportunities by allowing funds to transact with a wider range of portfolio affiliates, we have also eliminated the limit imposed by rule 17d–1(d)(5) on the percentage of assets a fund can commit to any given joint enterprise. Rule 17d–1(d)(5)(ii). The staff does not anticipate that allowing funds to increase the size of their commitment to a joint transaction will result in an increase in the expected number of such transactions.

[73] 1,400 transactions or arrangements × .30 (percentage of transactions or arrangements in which a Prohibited Participant is assumed to have a financial interest) = 420.

[74] The staff estimates the hourly burden to comply with the board of director's obligation to make a finding as to the materiality of a prohibited person's financial interest in a transaction to be 11 hours. The staff estimates that funds will spend .2 hours complying with the requirement that the basis for the board's findings be recorded in the minutes of its meeting.

hours to be associated with the amendments to rule 17d–1 annually.

B. Subadviser Affiliates

The Commission staff estimates that 1,900 portfolios of approximately 800 investment companies use the services of one or more subadvisers.[75] Based on discussions with industry representatives, the Commission staff estimates that it will require approximately 6 hours to draft and execute revised subadvisory contracts (5 staff attorney hours, 1 supervisory attorney hour), in order for funds and subadvisers to be able to rely on the exemptions in rule 17a–10 and the proposed amendments to rule 10f–3, 17e–1, and 12d3–1.[76] Assuming that all funds that are advised by subadvisers modify their advisory contracts in this manner, the new rule and rule amendments will create an estimated initial one-time burden of approximately 11,400 burden hours. The total estimated first year cost of these burden hours is $836,000.[77]

ESTIMATED ONE TIME BURDEN HOURS AND COST OF SUBADVISORY RULE AND AMENDMENTS

Number of funds modifying contracts	Staff attorney hours	Supervisory attorney hours	Total burden hours	Cost per staff attorney hour	Cost per supervisory attorney hour	Total cost of se 75burden hours
1,900	5	1	11,400	$62	$130	$836,000

Rule 17a–10 and the amendments to rules 10f–3, 12d3–1, and 17e–1 would require virtually identical modifications to fund advisory contracts. The Commission staff assumes that funds will rely equally on the exemptions in all of these rules, and therefore the burden hours associated with the required contract modifications should be apportioned equally among the four rules. Therefore the estimated one-time burden hours associated with rules 17a–10, 10f–3, 12d3–1, and 17e–1 are 2,850 hours for each rule (11,400 total burden hours for all of the rules/four rules), and the estimated one-time cost of these burden hours is $209,000 for each rule ($836,000/four rules).[78]

The staff estimates that a total of 60 funds will enter into subadvisory agreements each year after the first year in which the rule and rule amendments are adopted.[79] Assuming that each of these funds enters into a contract that permits it and its affiliated funds to rely on the exemptions in rule 17a–10, and the amendments to rules 10f–3, 12d3–1, and 17e–1, an estimated 360 burden hours (90 hours per rule) will be associated with these rules annually, with an associated cost of $26,400 ($6,600 per rule).[80]

Proposed Amendments to Rule 10f–3

Rule 10f–3 currently has an estimated burden of 4,407.5 hours at a cost of $793,752. This burden estimate will change as a result of the amendments to rule 10f–3. As we discuss above,[81] we assume that all funds that are advised by subadvisers will modify their subadvisory contracts so as to allow the fund and their affiliated funds to rely on the proposed exemptions. The staff calculates that the estimated one-time burden hours associated with the proposed amendments to rule 10f–3 would be 2,850 hours, with an estimated one-time cost of $209,000,[82] and an ongoing estimated burden of 90 hours for subsequent years, with an estimated cost associated with this hour burden of $6,600 for subsequent years.[83] We estimate that these additional burdens will, for the first year following adoption, increase the burden hours of compliance with rule 10f–3 from the current 4,407.5 hours at a cost of $793,752, to 7,257.5 hours at a cost of $1,002,760. We anticipate that in the years following the adoption of amended rule 10f–3 the ongoing estimated burden hours for rule 10f–3 will be 4,497.5 hours at a cost of $800,360.[84]

Rule 17e–1

Based on an analysis of investment company filings, the staff estimates that approximately 293 investment companies use at least one affiliated broker and that each of these investment companies spends an estimated 12.5 hours per year (at a cost of $775 per year) complying with rule 17e–1's requirements that (i) the fund retain records of transactions entered into pursuant to the rule (''recordkeeping requirement''), and (ii) the fund's directors review those transactions quarterly (''review requirement'').[85] Based on conversations with representatives of investment companies, the staff estimates that the amendments to rule 17e–1 would exempt approximately 40 percent of transactions that occur under rule 17e–1 from the rule's recordkeeping and review requirements.

The Commission staff estimates, therefore, that the amendments to rule 17e–1 will, in this respect, *decrease* the rule's information collection burden to 2,200 hours,[86] at a cost of $136,422 per year.[87]

[75] *See* Proposing Release, *supra* note 6, at n. 13 and accompanying text.

[76] The fund's advisory contracts must include these conditions in order for the fund to obtain the benefit of the exemptions in the new rule and rule amendments.

[77] (5 in-house staff attorney hours × $62 = $310) + (1 deputy general counsel hour x $130 = $130) = $440. $440 × 1,900 funds = $ 836,000.

[78] The amendments to rule 17e–1 will also, as discussed below, decrease the burden hours associated with that rule.

[79] Based on an analysis of investment company filings, the staff estimates that approximately 250 funds are created annually. Assuming that the number of these funds that will use the services of subadvisers is proportionate to the number of funds that currently use the services of subadvisers, then approximately 50 new funds will enter into subadvisory agreements each year. The Commission staff estimates, based on an analysis of investment company filings, that an additional 10 funds, currently in existence, will employ the services of subadvisers for the first time each year.

[80] 6 hours × 60 funds = 360 total hours. $440 × 60 funds = $26,400.

[81] *See supra* note 78 and accompanying text.

[82] *Id.*

[83] *Id.*

[84] We are not seeking approval for any collection of information based on burden data for any but the first year following adoption of these proposals. The information regarding burden hours and costs incurred after the first year of adoption is provided to give a fuller understanding of our proposals' long-term impact on the fund industry.

[85] In calculating the total annual cost of complying with amended rule 17e–1, the Commission staff assumes that the entire burden would be attributable to professionals with an average hourly wage rate of $62 per hour.

[86] 293 transactions × 12.5 hours = 3,663 hours if adopted; 60% of the 293 transactions (or 176 transactions) would proceed under rule 17e–1. 176 transactions (60% of the 293 transactions anticipated to be impacted by rule) × 12.5 hours = 2,200 hours.

[87] 3,663 hours × $62 = $227,106; 2,200 hours × $62 = $136,400.

ESTIMATED REDUCTION IN BURDEN HOURS AND COST OF RULE 17E–1

[effect of exemption from review and recordkeeping requirements]

	Number funds relying on rule 17e–1	Number funds subject to record-keeping and review requirements	Burden hours of recordkeeping and review requirements	Total burden hours of rec-ordkeeping and review re-quirements	Cost per hour of record-keeping and review require-ments	Total cost of burden hours
Prior Rule	293	293	12.5	3,663	$62	$227,106
As Amended	293	176	12.5	2,200	62	136,400

This reduction will be offset to some extent by the increase in estimated burden hours described above with respect to the required modifications of the funds' investment advisory contracts. Therefore rule 17e–1, as amended, will impose an estimated burden of 5,050 hours ($345,400) in the first year after the amendments are adopted, and an estimated burden of 2,290 hours ($143,000) in subsequent years.

VI. Summary of Final Regulatory Flexibility Analysis

We have prepared a Final Regulatory Flexibility Analysis (''FRFA'') in accordance with 5 U.S.C. 604 regarding the adoption of new rule 17a–10 and amendments to rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 under the Investment Company Act. A summary of the Initial Regulatory Flexibility Analysis (''IRFA''), which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release. The following summarizes the FRFA.

A. Need for New Rule and Amendments

The FRFA summarizes the background of the amendments. The FRFA also discusses the reasons for the new rule and amendments and the objectives of, and legal basis for, these rulemaking initiatives. Those items are discussed in the release. The FRFA discusses the effect of the new rule and amendments on small entities.

B. Significant Issues Raised by Public Comment

The Commission received no comments on the IRFA.

C. Small Entities Subject to the New Rule and Amendments

The FRFA discusses the effect of the amendments on small entities. For purposes of the Regulatory Flexibility Act,[88] 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.[89] An investment adviser is a small entity if it (i) manages less than $25 million in assets, (ii) has total assets of less than $5 million on the last day of its most recent fiscal year, and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that manages $25 million or more in assets, or any person (other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year.[90] An issuer, other than an investment company, is a small entity if its total assets on the last day of its most recent fiscal year were $5 million or less and it is engaged or proposing to engage in an offering of securities which does not exceed the dollar limitation prescribed by section 3(b) of the Securities Act of 1933. The staff estimates, based upon Commission filings, that there are approximately 3,650 active registered management investment companies, of which approximately 200 are small entities. The staff further estimates that there are approximately 7,560 registered investment advisers, of which approximately 430 are small entities.[91]

Funds and portfolio companies that are small entities will be able to rely on the amendments to rules 17a–6 and 17d–1(d)(5) if they satisfy the rules' conditions. Funds and investment advisers that are small entities will be able to rely on the amendments to rule 10f–3, 12d3–1, 17e–1, and rule 17a–10, if they meet the conditions of those rules.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

Portfolio Affiliates—Rules 17a–6 and 17d–1(d)(5)

The expanded exemptions in rules 17a–6 and 17d–1(d)(5) permitting second-tier portfolio affiliates and funds to enter into principal transactions and joint arrangements would not impose any new reporting, recordkeeping, or other compliance requirements on funds or portfolio affiliates that are small entities.

Subadviser Affiliates—Rules 17a–10, 10f–3, 12d3–1, and 17e–1

The rule and rule amendments permitting subadvisers to enter into otherwise prohibited transactions and arrangements with affiliated funds will impose compliance and recordkeeping requirements on funds and subadvisers that rely on the rules' exemptions, as the funds' advisory contracts will be required to prohibit the fund's subadvisers from consulting with one another concerning the fund's securities transactions.[92] Based on discussions with industry representatives, our staff estimates that modifying advisory contracts in this manner will require 6 hours, at a cost of approximately $440 per fund. While small funds and small advisers are unlikely to be disproportionately impacted by this one-time requirement, a fund complex that includes a large number of funds advised by subadvisers may experience economies of scale, as the amendments to its advisory contracts will be largely duplicative.

E. Agency Action To Minimize Effect on Small Entities

The FRFA explains that we have not identified any federal rules that duplicate or conflict with the rule and rule amendments. The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, the Commission considered the following alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the

[88] 5 U.S.C. 601–612.

[89] 17 CFR 270.0–10.

[90] 17 CFR 275.0–7.

[91] The staff was unable to determine from Commission filings the number of fund portfolio affiliates that are also small entities. We estimate that 875 companies are portfolio affiliates of funds.

[92] *See, e.g.,* rule 12d3–1(c)(3)(ii)(A).

use of performance rather than design standards; and (d) an exemption from coverage of the rule, or any part thereof, for small entities.

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 new rule and rule amendments use performance, rather than design standards, in the sense that they require the fund's board of directors to make certain findings,[93] and the fund's advisory contracts to include certain conditions,[94] rather than specifying the basis for the board's findings, or the specific language to be included in the advisory contracts.

VII. Statutory Authority

The Commission has adopted amendments to rules 10f–3, 12d3–1, 17a–6, 17d–1, and 17e–1 and new rule 17a–10 under the Investment Company Act pursuant to authority set forth in sections 6(c), 10(f), 17(b), 17(d), 31(a), and 38(a) of the Investment Company Act.

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rules

For reasons set forth in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

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, 80a–39, unless otherwise noted;

* * * * *

2. Section 270.10f–3 is amended by:

a. Redesignating paragraph (b) as paragraph (c);

b. Adding paragraphs (a)(6), (a)(7), (a)(8), and new paragraph (b);

c. Revising the paragraph heading in newly redesignated paragraph (c); and

d. Revising newly redesignated paragraph (c)(7).

[93] In the case of the amendments to rules 17a–6 and 17d–1(d)(5).

[94] In the case of rule 17a–10 and the amendments to rules 17e–1, 10f–3, and 12d3–1.

The additions and revisions read as follows:

§ 270.10f–3 Exemption for the acquisition of securities during the existence of an underwriting or selling syndicate.

(a) * * *

(6) *Managed portion* of a portfolio of a registered investment company means a discrete portion of a portfolio of a registered investment company for which a subadviser is responsible for providing investment advice, provided that:

(i) The subadviser is not an affiliated person of any investment adviser, promoter, underwriter, officer, director, member of an advisory board, or employee of the registered investment company; and

(ii) The subadviser's advisory contract:

(A) Prohibits it from consulting with any subadviser of the investment company that is a principal underwriter or an affiliated person of a principal underwriter concerning transactions of the investment company in securities or other assets; and

(B) Limits its responsibility in providing advice to providing advice with respect to such portion.

(7) *Series of a series company* means any class or series of a registered investment company that issues two or more classes or series of preferred or special stock, each of which is preferred over all other classes or series with respect to assets specifically allocated to that class or series.

(8) *Subadviser* means an investment adviser as defined in section 2(a)(20)(B) of the Act (15 U.S.C. 80a–2(a)(20)(B)).

(b) *Exemption for purchases by series companies and investment companies with managed portions.* For purposes of this section and section 10(f) of the Act (15 U.S.C. 80a–10(f)), each Series of a Series Company, and each Managed Portion of a registered investment company, is deemed to be a separate investment company. Therefore, a purchase or acquisition of a security by a registered investment company is exempt from the prohibitions of section 10(f) of the Act if section 10(f) of the Act would not prohibit such purchase if each Series and each Managed Portion of the company were a separately registered investment company.

(c) *Exemption for other purchases.* * * *

(7) *Percentage limit.* (i) *Generally.* The amount of securities of any class of such issue to be purchased by the investment company, aggregated with purchases by any other investment company advised by the investment company's investment adviser, and any purchases by another account with respect to which the investment adviser has investment discretion if the investment adviser exercised such investment discretion with respect to the purchase, does not exceed the following limits:

(A) If purchased in an offering other than an Eligible Rule 144A Offering, 25 percent of the principal amount of the offering of such class; or

(B) If purchased in an Eligible Rule 144A Offering, 25 percent of the total of:

(*1*) The principal amount of the offering of such class sold by underwriters or members of the selling syndicate to qualified institutional buyers, as defined in § 230.144A(a)(1) of this chapter; plus

(*2*) The principal amount of the offering of such class in any concurrent public offering.

(ii) *Exemption from percentage limit.* The requirement in paragraph (c)(7)(i) of this section applies only if the investment adviser of the investment company is, or is an affiliated person of, a principal underwriter of the security; and

(iii) *Separate aggregation.* The requirement in paragraph (c)(7)(i) of this section applies independently with respect to each investment adviser of the investment company that is, or is an affiliated person of, a principal underwriter of the security.

* * * * *

3. Section 270.12d3–1 is amended by revising paragraph (c) and adding paragraph (d)(9) before the note:

§ 270.12d3–1 Exemption of acquisitions of securities issued by persons engaged in securities related businesses.

* * * * *

(c) Notwithstanding paragraphs (a) and (b) of this section, this section does not exempt the acquisition of:

(1) A general partnership interest; or

(2) A security issued by the acquiring company's promoter, principal underwriter, or any affiliated person of such promoter, or principal underwriter; or

(3) A security issued by the acquiring company's investment adviser, or an affiliated person of the acquiring company's investment adviser, other than a security issued by a subadviser or an affiliated person of a subadviser of the acquiring company provided that:

(i) *Prohibited relationships.* The subadviser that is (or whose affiliated person is) the issuer is not, and is not an affiliated person of, an investment adviser responsible for providing advice with respect to the portion of the acquiring company that is acquiring the securities, or of any promoter, underwriter, officer, director, member of

an advisory board, or employee of the acquiring company;

(ii) *Advisory contract.* The advisory contracts of the Subadviser that is (or whose affiliated person is) the issuer, and any Subadviser that is advising the portion of the acquiring company that is purchasing the securities:

(A) Prohibit them from consulting with each other concerning transactions of the acquiring company in securities or other assets, other than for purposes of complying with the conditions of paragraphs (a) and (b) of this section; and

(B) Limit their responsibility in providing advice to providing advice with respect to a discrete portion of the acquiring company's portfolio.

(d) * * *

(9) *Subadviser* means an investment adviser as defined in section 2(a)(20)(B) of the Act (15 U.S.C. 80a–2(a)(20)(B)).

* * * * *

4. Section 270.17a–6 is revised to read as follows:

§ 270.17a–6 Exemption for transactions with portfolio affiliates.

(a) *Exemption for transactions with portfolio affiliates.* A transaction to which a fund, or a company controlled by a fund, and a portfolio affiliate of the fund are parties is exempt from the provisions of section 17(a) of the Act (15 U.S.C. 80a–17(a)), provided that none of the following persons is a party to the transaction, or has a direct or indirect financial interest in a party to the transaction other than the fund:

(1) An officer, director, employee, investment adviser, member of an advisory board, depositor, promoter of or principal underwriter for the fund;

(2) A person directly or indirectly controlling the fund;

(3) A person directly or indirectly owning, controlling or holding with power to vote five percent or more of the outstanding voting securities of the fund;

(4) A person directly or indirectly under common control with the fund, other than:

(i) A portfolio affiliate of the fund; or

(ii) A fund whose sole interest in the transaction or a party to the transaction is an interest in the portfolio affiliate; or

(5) An affiliated person of any of the persons mentioned in paragraphs (a)(1)–(4) of this section, other than the fund or a portfolio affiliate of the fund.

(b) *Definitions.* (1) *Financial interest.* (i) The term *financial interest* as used in this section does not include:

(A) Any interest through ownership of securities issued by the fund;

(B) Any interest of a wholly-owned subsidiary of a fund;

(C) Usual and ordinary fees for services as a director;

(D) An interest of a non-executive employee;

(E) An interest of an insurance company arising from a loan or policy made or issued by it in the ordinary course of business to a natural person;

(F) An interest of a bank arising from a loan or account made or maintained by it in the ordinary course of business to or with a natural person, unless it arises from a loan to a person who is an officer, director or executive of a company which is a party to the transaction, or from a loan to a person who directly or indirectly owns, controls, or holds with power to vote, five percent or more of the outstanding voting securities of a company which is a party to the transaction;

(G) An interest acquired in a transaction described in paragraph (d)(3) of § 270.17d–1; or

(H) Any other interest that the board of directors of the fund, including a majority of the directors who are not interested persons of the fund, finds to be not material, provided that the directors record the basis for that finding in the minutes of their meeting.

(ii) A person has a financial interest in any party in which it has a financial interest, in which it had a financial interest within six months prior to the transaction, or in which it will acquire a financial interest pursuant to an arrangement in existence at the time of the transaction.

(2) *Fund* means a registered investment company or separate series of a registered investment company.

(3) *Portfolio affiliate of a fund* means a person that is an affiliated person (or an affiliated person of an affiliated person) of a fund solely because the fund, a fund under common control with the fund, or both:

(i) Controls such person (or an affiliated person of such person); or

(ii) Owns, controls, or holds with power to vote five percent or more of the outstanding voting securities of such person (or an affiliated person of such person).

5. Section 270.17a–10 is added to read as follows:

§ 270.17a–10 Exemption for transactions with certain subadvisory affiliates.

(a) *Exemption.* A person that is prohibited by section 17(a) of the Act (15 U.S.C. 80a–17(a)) from entering into a transaction with a fund solely because such person is, or is an affiliated person of, a subadviser of the fund, or a subadviser of a fund that is under common control with the fund, may nonetheless enter into such transaction, if:

(1) *Prohibited relationship.* The person is not, and is not an affiliated person of, an investment adviser responsible for providing advice with respect to the portion of the fund for which the transaction is entered into, or of any promoter, underwriter, officer, director, member of an advisory board, or employee of the fund.

(2) *Prohibited conduct.* The advisory contracts of the subadviser that is (or whose affiliated person is) entering into the transaction, and any subadviser that is advising the fund (or portion of the fund) entering into the transaction:

(i) Prohibit them from consulting with each other concerning transactions for the fund in securities or other assets; and

(ii) If both such subadvisers are responsible for providing investment advice to the fund, limit the subadvisers' responsibility in providing advice with respect to a discrete portion of the fund's portfolio.

(b) *Definitions.*

(1) *Fund* means a registered investment company and includes a separate series of a registered investment company.

(2) *Subadviser* means an investment adviser as defined in section 2(a)(20)(B) of the Act (15 U.S.C. 80a–2(a)(20)(B)).

6. Section 270.17d–1 is amended by revising paragraphs (d)(5) and (d)(6) to read as follows:

§ 270.17d–1 Applications regarding joint enterprises or arrangements and certain profit-sharing plans.

* * * * *

(d) * * *

(5) Any joint enterprise or other joint arrangement or profit-sharing plan (''joint enterprise'') in which a registered investment company or a company controlled by such a company, is a participant, and in which a portfolio affiliate (as defined in § 270.17a–6(b)(3)) of such registered investment company is also a participant, provided that:

(i) None of the persons identified in § 270.17a–6(a) is a participant in the joint enterprise, or has a direct or indirect financial interest in a participant in the joint enterprise (other than the registered investment company);

(ii) *Financial interest.*

(A) The term *financial interest* as used in this section does not include:

(*1*) Any interest through ownership of securities issued by the registered investment company;

(*2*) Any interest of a wholly owned subsidiary of the registered investment company;

(*3*) Usual and ordinary fees for services as a director;

(*4*) An interest of a non-executive employee;

(*5*) An interest of an insurance company arising from a loan or policy made or issued by it in the ordinary course of business to a natural person;

(*6*) An interest of a bank arising from a loan to a person who is an officer, director, or executive of a company which is a participant in the joint transaction or from a loan to a person who directly or indirectly owns, controls, or holds with power to vote, five percent or more of the outstanding voting securities of a company which is a participant in the joint transaction;

(*7*) An interest acquired in a transaction described in paragraph (d)(3) of this section; or

(*8*) Any other interest that the board of directors of the investment company, including a majority of the directors who are not interested persons of the investment company, finds to be not material, provided that the directors record the basis for that finding in the minutes of their meeting.

(B) A person has a financial interest in any party in which it has a financial interest, in which it had a financial interest within six months prior to the investment company's participation in the enterprise, or in which it will acquire a financial interest pursuant to an arrangement in existence at the time of the investment company's participation in the enterprise.

(6) The receipt of securities and/or cash by an investment company or a controlled company thereof and an affiliated person of such investment company or an affiliated person of such person pursuant to a plan of reorganization: *Provided,* That no person identified in § 270.17a–6(a)(1) or any company in which such a person has a direct or indirect financial interest (as defined in paragraph (d)(5)(iii) of this section):

* * * * *

7. Section 270.17e–1 is amended by revising paragraphs (b)(3) and (d) to read as follows:

§ 270.17e–1 Brokerage transactions on a securities exchange.

* * * * *

(b) * * *

(3) Determines no less frequently than quarterly that all transactions effected pursuant to this section during the preceding quarter (other than transactions in which the person acting as broker is a person permitted to enter into a transaction with the investment company by § 270.17a–10) were effected in compliance with such procedures;

* * * * *

(d) The investment company:

(1) Shall maintain and preserve permanently in an easily accessible place a copy of the procedures (and any modification thereto) described in paragraph (b)(1) of this section; and

(2) Shall maintain and preserve for a period not less than six years from the end of the fiscal year in which any transactions occurred, the first two years in an easily accessible place, a record of each such transaction (other than any transaction in which the person acting as broker is a person permitted to enter into a transaction with the investment company by § 270.17a–10) setting forth the amount and source of the commission, fee or other remuneration received or to be received, the identity of the person acting as broker, the terms of the transaction, and the information or materials upon which the findings described in paragraph (b)(3) of this section were made.

By the Commission.

Dated: January 14, 2003.

Jill M. Peterson,

Assistant Secretary.

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