

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

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

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

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.