

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

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).

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-6⁷¹ 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

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 \times 1 principal transaction per year = 1,400 transactions under rule 17a-6.

⁷² 1,400 affiliate relationships \times 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 \times .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.