IDC
INDEPENDENT DIRECTORS COUNCIL
Committed to Strong Fund Governance

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October 12, 2018

Mr. Paul Cellupica
Deputy Director and Chief Counsel
Division of Investment Management
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Request for no-action position regarding board determinations under Rules 10f-3, 17a-7, and 17e-1

Dear Mr. Cellupica:

The Independent Directors Council ("IDC")[1] seeks assurance that the staff of the Division of Investment Management ("Staff") of the Securities and Exchange Commission ("SEC" or "Commission") will not recommend to the Commission that it take enforcement action for violations of Sections 10(f), 17(a) and 17(e) of the Investment Company Act of 1940, as amended ("1940 Act") if, in lieu of making determinations under Rules 10f-3(c)(10)(iii), 17a-7(e)(3) and 17e-1(b)(3) (each of Rules 10f-3, 17a-7 and 17e-1 under the Act, an "Exemptive Rule"), a fund[2] board receives from the fund's chief compliance officer ("CCO"), no less frequently than quarterly, a written representation that transactions entered into in reliance on an Exemptive Rule were effected in compliance with the procedures adopted by the board pursuant to such rule.

IDC believes that the current regulatory regime governing the role and responsibilities of fund directors can be modernized and improved to better allow directors to dedicate their time and attention

[1] IDC serves the US-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute ("ICI") member funds. ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI's members manage total assets of US$22.7 trillion in the United States, serving more than 100 million US shareholders, and US$7.3 trillion in assets in other jurisdictions. There are approximately 1,800 independent directors of ICI-member funds.

[2] As used herein, the term "fund" may refer to a registered management investment company or a separate series thereof, as the context requires.

to "areas where director oversight is most valuable."[3] We previously provided our preliminary recommendations regarding ways to recalibrate directors' responsibilities and governance requirements in light of industry, technological and regulatory developments.[4] The purpose of this letter is to request from the Staff a no-action position with respect to certain requirements under the Exemptive Rules in order to better align director responsibilities with the oversight role that the Commission has assigned to fund boards with respect to compliance.

I. Background

Rule 10f-3, adopted by the Commission in 1958,[5] exempts from the prohibitions of Section 10(f) of the 1940 Act certain securities purchases during the existence of an underwriting syndicate of which an affiliated person is a member. Section 10(f) generally prohibits any fund from knowingly purchasing or otherwise acquiring, during the existence of an underwriting or selling syndicate, any security (other than a security of which the fund is the issuer) a principal underwriter of which is one of certain affiliated persons (as that term is defined in Section 2(a)(3) of the 1940 Act) of the fund, or affiliated persons of such affiliated persons of the fund.

Rule 17a-7, adopted by the Commission in 1966,[6] provides relief for funds seeking to engage in "cross trades," which are otherwise prohibited by Section 17(a) of the 1940 Act. Cross trades are principal transactions between funds that are affiliated persons, or affiliated persons of affiliated persons, of each other, between separate series of a registered investment company, or between a registered investment company (or separate series thereof) and a person that is an affiliated person of such registered investment company (or affiliated person of such person), solely by reason of having a common investment adviser or investment advisers that are affiliated persons of each other, common directors, and/or common officers.

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[3] *See* Dalia Blass, Director, Division of Investment Management, SEC, Keynote Address: ICI Securities Law Developments Conference (Dec. 7, 2017).

[4] *See* Letter from Amy B.R. Lancellotta, Managing Director, IDC, to Dalia Blass, Director, Division of Investment Management, SEC (Oct. 16, 2017).

[5] Adopted in SEC Release No. IC-2797, 23 F.R. 9548 (Dec. 10, 1958). The Board Determinations (as defined below) and other board requirements under Rule 10f-3(c)(10) were proposed in SEC Release No. IC-10592, 44 F.R. 10580 (Feb. 21, 1979) and adopted in SEC Release No. IC-10736, 44 F.R. 36152 (June 20, 1979). It is noted that, as adopted in 1958, Rule 10f-3 (then Rule N-10F-3) conditioned the exemption from Section 10(f) upon, among other things, certain fund board authorization or approval.

[6] Adopted in SEC Release No. IC-4697, 31 F.R. 12092 (Sept. 16, 1966). The Board Determinations and other board requirements under Rule 17a-7(e) were proposed in SEC Release No. IC-11136, 45 F.R. 29067 (May 1, 1980) ("17a-7 Board Proposal") and adopted in SEC Release No. IC-11676, 46 F.R. 17011 (Mar. 17, 1981).

Rule 17e-1, adopted by the Commission in 1979,[7] provides that, for purposes of Section 17(e)(2)(A) of the 1940 Act, a commission, fee, or other remuneration shall be deemed as not exceeding the usual and customary broker's commission provided certain requirements are met. Section 17(e)(2)(A) generally prohibits an affiliated person of a fund, or an affiliated person of such affiliated person, acting as broker, in connection with the sale of securities to or by such fund or any controlled company thereof, from receiving from any source a commission, fee, or other remuneration for effecting such transaction, which exceeds the usual and customary broker's commission if the sale is effected on a securities exchange.

Each of the Exemptive Rules is subject to several conditions that, among other things, impose certain responsibilities on the board. Under each Exemptive Rule, the board, including a majority of the directors who are not "interested persons" of the fund as that term is defined in Section 2(a)(19) of the 1940 Act ("independent directors"), must (i) adopt procedures that are reasonably designed to provide that the transactions comply with the conditions of the Exemptive Rule, (ii) make and approve such changes to those procedures as the board deems necessary, and (iii) determine no less frequently than quarterly that all transactions made pursuant to the Exemptive Rule for the preceding quarter were effected in compliance with such procedures (such determinations, the "Board Determinations"[8]).

More than two decades after the adoption of the Exemptive Rules, the Commission adopted Rule 38a-1 in 2003.[9] The rule requires, among other things, that a fund adopt and implement written compliance policies and procedures reasonably designed to prevent violation of the Federal Securities Laws, including the Exemptive Rules.[10] Under Rule 38a-1, the board, including a majority of the independent directors, must approve such policies and procedures initially, approve the designation of a

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[7] Proposed in SEC Release No. IC-10605, 44 F.R. 12202 (Mar. 6, 1979) ("17e-1 Proposing Release") and adopted in SEC Release No. IC-10741, 44 F.R. 37202 (June 26, 1979).

[8] *See* Rules 10f-3(c)(10)(iii), 17a-7(e)(3) and 17e-1(b)(3). The Commission has stated that the quarterly review of transactions entered into pursuant to the Exemptive Rules provides boards an opportunity to "monitor the procedures and identify any problems that might require adjustment." *See* SEC Release No. IC-19719, 58 F.R. 49919 (Sept. 17, 1993). *See also* SEC Release No. IC-10592, 44 F.R. 10580 (Feb. 13, 1979).

[9] Proposed in SEC Release No. IC-25925, 68 F.R. 7038 (Feb. 11, 2003) ("38a-1 Proposing Release") and adopted in SEC Release No. IC-26299, 68 F.R. 74714 (Dec. 24, 2003) ("38a-1 Adopting Release").

[10] The term "Federal Securities Laws" is defined in Rule 38a-1 to include the 1940 Act and the rules thereunder. *See* Rule 38a-1(e)(1). Thus, the term Federal Securities Laws as used in Rule 38a-1 includes the Exemptive Rules. *Cf.* 38a-1 Proposing Release at text accompanying n.33 ("Fund procedures would ordinarily cover a number of additional areas, including: . . . Identification of affiliated persons with whom the fund cannot enter into certain transactions, and compliance with exemptive rules and orders that permit such transactions") and n.33 (discussing Rules 10f-3 and 17a-7 under the 1940 Act).

CCO to be responsible for administering the policies and procedures, and approve the CCO's compensation.[11]

II. Discussion

The no-action position we are requesting would align the Board Determinations with the role that the Commission has assigned to fund boards with respect to compliance under Rule 38a-1.

The Board Determinations, as originally proposed, reflected the Commission's view that the board represented the "first line of responsibility for determining compliance" with the Exemptive Rules.[12] In adopting Rule 38a-1 in 2003, however, the Commission "provide[d] fund boards with direct access to a single person with overall compliance responsibility for the fund," a step the Commission believed would "enhance the efficiency of funds' . . . operations by centralizing responsibility for the compliance function."[13] Rule 38a-1 also assigned specific compliance oversight responsibilities to fund boards.[14] These responsibilities reflected the Commission's recognition that the proper role of fund directors is to exercise oversight of the fund's compliance program without "becom[ing] involved in the day-to-day administration of the program."[15] The CCO in turn is responsible under the rule for "keeping the board apprised of significant compliance events at the fund or its service providers,"[16] including through a required annual written report to the board regarding the operation of the fund's compliance policies and procedures.[17]

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[11] Under Rule 38a-1, the CCO may be removed by action of (and only with the approval of) the board, including a majority of the independent directors. The CCO must provide an annual report to the board addressing, among other things, the operation of the policies and procedures, any material changes to those policies and procedures since the last report and any recommended material changes to those policies and procedures. The CCO must also meet separately at least annually with the independent directors.

[12] *See, e.g.*, 17a-7 Board Proposal ("The Commission believes that the first line of responsibility for determining compliance with the proposed amendment should be with each investment company's directors."); 17e-1 Proposing Release ("[T]he first line of responsibility for determining compliance with proposed rule [17e-1] must be with each investment company's directors.").

[13] 38a-1 Adopting Release at sections II.C.2 and IV.A.

[14] *See* 38a-1 Proposing Release at text accompanying n.42; 38a-1 Adopting Release at text accompanying nn.80 – 83.

[15] 38a-1 Proposing Release at text following n.42; *cf.* 38a-1 Adopting Release at text accompanying n.84 (discussing the adoption of a definition for the term "material compliance matter," relating to "those compliance matters about which the fund's board *reasonably needs to know in order to oversee* fund compliance") (emphasis added).

[16] 38a-1 Adopting Release at section II.C.2.

[17] The annual written report from the CCO informs the board, among other matters, of any material changes to the fund's compliance policies and procedures recommended as a result of the CCO's annual review conducted pursuant to Rule 38a-1(a)(3). The report gives directors the information necessary to consider changes to the policies and procedures without having to review transactions and make determinations under the Exemptive Rules. *See supra* note 8 and *infra* note 18.

The no-action position we seek would be consistent with the Commission's policy reflected in Rule 38a-1, and would allow fund boards to avoid duplicating certain functions commonly performed by, or under the supervision of, fund CCOs.[18] We believe that a fund board should be able to satisfy its responsibility to make Board Determinations under each Exemptive Rule by receiving from the fund's CCO a written representation that such transactions were effected in compliance with the procedures adopted by the board pursuant to the Exemptive Rule.[19] We believe such an approach is consistent with the Commission's policy regarding board oversight of the fund's compliance program, including specifically that directors need not become involved in the "day-to-day administration" of the program.[20]

III. Conclusion

In light of the foregoing, we seek your assurance that the Staff will not recommend to the Commission that it take enforcement action for violations of Sections 10(f), 17(a) and 17(e) of the 1940 Act if, in lieu of making the Board Determinations, a fund board receives from the fund's CCO, no less frequently than quarterly, a written representation that such transactions were effected in compliance with the procedures adopted by the board pursuant to the relevant Exemptive Rule.

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If you have any questions about our comments, please contact Annette Capretta, Deputy Managing Director, at (202) 371-5436 or me at (202) 326-5824, or our counsel, Brendan C. Fox at (202) 261-3381 or Aaron D. Withrow at (202) 261-3442, at Dechert LLP.

Sincerely,

Amy B.R. Lancellotta
Managing Director

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[18] *Cf.* 38a-1 Adopting Release at section II.C.2 (criticizing practices that "balkanize responsibility for fund compliance" and noting that, to address such issues, "rule 38a-1 provides fund boards with direct access to a single person with overall compliance responsibility for the fund who answers directly to the board") and n.103 (noting that "the new rules require each firm to adopt a compliance program that conforms with the scope and nature of its operations, thus eliminating the concerns that the new rules will require duplicative . . . compliance programs."). In this regard, we note that it is often the CCO who oversees the gathering of the data, preparation of the reports supporting the determinations required under the Exemptive Rules and identification of any transactions that do not comply with the procedures.

[19] We believe that the written representation could take whatever form the board determines in consultation with the CCO. For example, we understand many CCOs provide the board with a written report on compliance issues and activities during the quarter, and the representation could be included in that report. Other boards could request a standalone document.

[20] *See supra* note 15.