

MEMO# 24680

November 3, 2010

SEC Staff Issues Letter on Director Responsibilities Under Affiliated Transaction Rules

[24680]

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TO: INVESTMENT COMPANY DIRECTORS No. 26-10
SEC RULES MEMBERS No. 112-10
SMALL FUNDS MEMBERS No. 67-10
COMPLIANCE MEMBERS No. 29-10
INTERNAL AUDIT ADVISORY COMMITTEE No. 8-10 RE: SEC STAFF ISSUES LETTER ON
DIRECTOR RESPONSIBILITIES UNDER AFFILIATED TRANSACTION RULES

The SEC's Division of Investment Management has issued a letter to the Independent Directors Council and the Mutual Fund Directors Forum in connection with the staff's ongoing review of fund directors' duties under the Investment Company Act of 1940 (referred to as the "Director Outreach Initiative"). [\[1\]](#) The letter addresses what the SEC staff describes as some confusion regarding fund directors' responsibilities to make determinations under Rules 10f-3, 17a-7 and 17e-1 under the Act and provides guidance.

The letter notes that the rules give fund boards the authority to permit various types of otherwise prohibited transactions and that each rule requires boards to make a determination, no less frequently than quarterly, that each transaction made during the preceding quarter was effected in compliance with procedures reasonably designed to provide that the transactions comply with the requirements of the relevant rule. The staff observes that some fund boards believe that, especially in light of the subsequent adoption in 2003 of the compliance program rule, [\[2\]](#) a fund board could delegate its responsibility to make the determinations required under these rules. The staff states that it disagrees.

The letter notes that the rules do not specifically require directors to review each transaction in order to make the required determinations. The staff expresses its belief that fund boards may, where consistent with the prudent discharge of their fiduciary duties, make these determinations in reliance on summary quarterly reports of the transactions,

which may be prepared by the fund's chief compliance officer or other designated persons. In addition, the staff states, under appropriate circumstances, fund boards also would have the flexibility to tap other relevant expertise to assist in the quarterly review process (e.g., some combination of fund counsel, counsel to independent directors, investment adviser personnel, and/or independent third parties).

The staff emphasizes that boards still retain ultimate responsibility for making the quarterly determinations required by the three rules and cannot delegate the responsibility.

Annette Capretta
Deputy Managing Director

endnotes

[1] Letter from Michael S. Didiuk, Attorney-Adviser, Division of Investment Management, U.S. Securities and Exchange Commission to Dorothy A. Berry, Chair-Governing Council, Independent Directors Council, and Jameson A. Baxter, Chair, Mutual Fund Directors Forum (November 2, 2010) (available at <http://www.sec.gov/divisions/investment/noaction/2010/idc-mfdf110210.pdf>).

[2] Rule 38a-1 under the Act.

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