

**MEMO# 14308**

January 8, 2002

# **INSTITUTE LETTER TO SEC REGARDING THE REGULATION OF RISKLESS PRINCIPAL TRANSACTIONS UNDER THE INVESTMENT COMPANY ACT**

[14308] January 8, 2002 TO: BOARD OF GOVERNORS No. 2-02 SEC RULES COMMITTEE No. 2-02 RE: INSTITUTE LETTER TO SEC REGARDING THE REGULATION OF RISKLESS PRINCIPAL TRANSACTIONS UNDER THE INVESTMENT COMPANY ACT The Institute recently sent a letter to the Securities and Exchange Commission (a copy of which is attached) requesting that it reexamine the treatment of riskless principal transactions under Section 17 of the Investment Company Act of 1940 in light of the recent guidance it issued regarding the application of the safe harbor in Section 28(e) of the Securities Exchange Act to these transactions.<sup>1</sup> Section 17(a) of the Investment Company Act prohibits a fund from engaging in principal transactions, including riskless principal transactions, with an affiliate. The letter notes, however, that for all practical purposes, riskless principal transactions more closely resemble agency transactions than traditional principal transactions and, thus, do not present the possibilities for abuse that Section 17(a) was designed to address. The letter discusses that in 1992, the Commission staff considered the regulation of these transactions under the Investment Company Act, at which time it decided against adopting a rule to exempt them from Section 17(a) because of what they perceived as substantive differences between agency and riskless principal transactions. Since 1992, the Institute has made two submissions to the Commission staff recommending that the Commission adopt an exemptive rule under Section 17(a) for riskless principal transactions. The letter continues to urge the Commission to adopt such an exemptive rule for riskless principal transactions generally. In the meantime, however, the letter recommends that the Commission issue interpretive guidance to clarify that those riskless principal transactions that fall within the scope of the Commission's recent Section 28(e) interpretive guidance will be treated like agency transactions and, thus, not subject to the prohibition of Section 17(a).<sup>2</sup> The letter states that the 1 Securities Exchange Act Release No. 45194 (December 27, 2001). See Memorandum to SEC Rules Members No. 1-02, Compliance Advisory Committee No. 1-02, Equity Markets Advisory Committee No. 1-02, Investment Adviser Members No. 1-02 and Closed-End Investment Company Members No. 1-02, dated January 4, 2002. 2 In its recent interpretive guidance, the Commission clarified that certain riskless principal transactions effected by members of the NASD are within the scope of the Section 28(e) safe harbor. In particular, the Commission's position was conditioned on both legs of the transaction being executed at the same price and disclosure of this price on a confirmation that also fully discloses the remuneration paid to the NASD member for effecting the transaction. 2 same policy considerations that underlie the Commission's

Section 28(e) guidance support treating at least some riskless principal transactions in the same manner as agency transactions under Section 17. Ari Burstein Associate Counsel  
Attachment (in .pdf format)

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