The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

**MEMO# 13098**

January 26, 2001

# INSTITUTE DRAFT LETTER ON SEC PROPOSED AMENDMENTS TO RULE 10F-3 UNDER THE INVESTMENT COMPANY ACT

[13098] January 26, 2001 TO: SEC RULES COMMITTEE No. 11-01 RE: INSTITUTE DRAFT LETTER ON SEC PROPOSED AMENDMENTS TO RULE 10F-3 UNDER THE INVESTMENT COMPANY ACT The Investment Company Institute has prepared the attached draft letter on the SEC's proposed amendments to Rule 10f-3 under the Investment Company Act of 1940, the rule that permits a fund that has certain affiliations with an underwriting participant to purchase securities during an offering. As we previously informed you,1 the proposed amendments would (1) expand the exemption provided by the rule to permit a fund to purchase government securities in a syndicated offering, and (2) modify the rule's quantitative limit on purchases to cover purchases by a fund and any other account advised by the fund's investment adviser. The comment period ends February 15, 2001. Please provide any comments on the draft letter to Barry Simmons by phone at (202) 326-5923, by facsimile at (202) 326-5827, or by email at bsimmons@ici.org by Tuesday, February 6, 2001. Government Securities. The Institute's draft letter supports the Commission's proposal to include government securities as a permitted investment under Rule 10f-3. In response to the Commission's request for comment, the letter notes that it is not necessary for the proposal to include any limitations on the purchase of government securities that do not apply to other securities purchased under the rule. The letter explains that the nature, quality, and marketability of government securities, when combined with the other restrictions of the rule, provide adequate safeguards to protect against the potential abuses that Rule 10f-3 is intended to address. Percentage Limit. The draft letter expresses the Institute's view that the current 25 percent limit imposed by Rule 10f-3 is more restrictive than necessary for the protection of investors and does not provide sufficient flexibility to funds given the growth of the fund industry and the increasing number of funds with affiliated underwriter relationships. Consistent with the Institute's previous recommendations in this regard, the letter recommends increasing the threshold to 50 percent. The letter states that a 50 percent limit, when combined with the other conditions of the rule, would provide sufficient protection against potential "dumping" of securities, without placing undue restrictions on funds. 1 Memorandum to SEC Rules Committee No. 132-00, dated December 12, 2000. 2Next, the draft letter opposes the Commission's proposal to modify the rule's 25 percent limit to include purchases by any non-fund account over which the adviser has discretionary authority or exercises control. The letter asserts that the need for this condition has not been demonstrated, adding that the proposing

release fails to point to any example where the conduct that this proposal seeks to address has occurred, much less where fund shareholders have been harmed as a result. The letter also expresses concern that requiring an adviser to aggregate purchases by non-fund accounts could potentially harm fund shareholders by unduly restricting their investment opportunities, and could have a similar adverse effect on non-fund accounts. Moreover, requiring aggregation of fund and non-fund accounts could cause the adviser to forego potential investment opportunities altogether, because the amount that each fund or account could purchase might be too small to have any significant effect on any individual fund or account. The letter notes that if the Commission decides to adopt the aggregation requirement despite the Institute's objections, the need for an increase in the percentage limit becomes even more acute. Group Sales. The draft letter urges the Commission to amend its proposal to permit funds to purchase municipal securities in group sales so as to provide funds wider access to municipal bond offerings. The letter notes that when Rule 10f-3 was last amended in 1997, the Commission had proposed, but never adopted, revisions that would have permitted such purchases in certain circumstances. The letter notes that increasing demand for municipal securities has shown that the need for rulemaking relief still exists. Do members agree? If so, is there more specific information available that could bolster the argument? Transactions Involving Subadvisers. The draft letter discusses how unnecessarily restrictive Rule 10f-3 can be when applied to certain purchases of securities solely on the basis of a technical affiliation. It notes that a fund with one or more subadvisers may be subject to the prohibitions of Section 10(f), and the conditions of Rule 10f-3, if the fund wishes to purchase securities during the existence of an underwriting or selling syndicate and an affiliated fund has a different subadviser that directly, or through an affiliate, is a principal underwriter in such a syndicate. The letter asserts that the abuses Section 10(f) was designed to prevent are not present in the context of these subadvisory relationships. It adds that no individual subadviser to a fund is in a position to furnish advice, make investment decisions, or otherwise influence those portions of the fund that it is not contractually assigned. Accordingly, the application of Rule 10f-3's restrictions in such circumstances serves no investor protection purpose and may act as an impediment to otherwise desirable transactions. The letter therefore reiterates a previous Institute recommendation that the Commission adopt a new rule under Section 10(f) to clarify that these transactions are not subject to Rule 10f-3's restrictions. Barry E. Simmons Associate Counsel Attachment 3Attachment (in .pdf format)

---