The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

MEMO# 10202

August 13, 1998

PROPOSED ADDITIONAL DRAFT RECOMMENDATIONS FOR NEW AND AMENDED RULES CONCERNING AFFILIATED TRANSACTIONS

* See Memorandum to SEC Rules Committee No. 53-98, dated June 4, 1998. 1 [10202] August 13, 1998 TO: SEC RULES COMMITTEE No. 81-98 RE: PROPOSED ADDITIONAL DRAFT RECOMMENDATIONS FOR NEW AND AMENDED RULES CONCERNING AFFILIATED TRANSACTIONS ____ Before the last meeting of the SEC Rules Committee, we distributed to the Committee a draft submission to the SEC recommending various new rules, rule amendments and/or interpretive relief regarding the regulation of affiliated transactions primarily by Section 17 and also by various other related provisions of the Investment Company Act.* The topics covered in the draft submission were: (1) mergers of certain affiliated investment companies that cannot rely on Rule 17a-8; (2) transactions involving subadvisory affiliates; (3) in-kind redemptions by affiliated persons; (4) sales of shares of money market funds to affiliated investment companies; (5) joint trading accounts; (6) transactions involving upstream affiliates; and (7) riskless principal transactions. At the June 17th Committee meeting, we discussed the draft document and agreed to circulate two additional sections for the Committee's consideration. Those sections, which are attached, propose rulemaking to address: (1) lending agreements among affiliated investment companies; and (2) "coincidental transactions" by a fund and an affiliate of, or separate unit or division of, the fund's investment adviser, at or around the same time, involving securities of the same issuer. We also are attaching for your review a third possible additional section of the document that would recommend changes to Rules 17a-6 and 17d-1(d)(5) to clarify that a mutual fund could engage in certain transactions with a "portfolio affiliate" of another mutual fund that has the same or an affiliated investment adviser, common directors or common officers. (A "portfolio affiliate" is an issuer 5% or more of the shares of which are owned by the second mutual fund.) The proposal concerning lending agreements among affiliated investment companies is designed to make it easier for investment companies to gain access to an alternative source of short-term liquidity in a way that would benefit both the lending and the borrowing funds. It would codify, subject to certain modifications, a small number of exemptive orders that the Commission has granted in this area to date. The proposal concerning coincidental transactions essentially seeks to eliminate some of the uncertainty generated by the Commission's and the staff's broad reading of Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder through a new rule under

Section 17(d). The proposal concerning transactions with an affiliated portfolio company is intended to expressly allow transactions that may be prohibited under current rules, to the extent that the Commission or the staff takes the position that funds sharing the same investment adviser are under common control. 2The proposals regarding coincidental transactions and portfolio affiliated transactions differ in certain key respects from the other proposals in the draft submission. For example, the other proposals generally would codify relief that the Commission or its staff already has granted. In contrast, to our knowledge, firms have not sought, and the Commission has not granted, relief along the lines that these two proposals would provide. Thus, the Commission has not developed or had experience with conditions that would form the basis for the relief. As a result, the Commission might be reluctant to adopt a rule (or rule amendments) in these areas on the grounds that such action would be premature. On the other hand, these latter two proposals -- in large part -- are responsive to Barry Barbash's comments at the Mutual Funds and Investment Management Conference earlier this year to the effect that the Commission should clarify the scope and application of Section 17(d) and Rule 17d-1, particularly given the consolidation within the financial services industry. Thus, there may be a "window of opportunity" for progress on these issues at this time. If members support inclusion of the proposals governing coincidental transactions and transactions with an affiliated portfolio company in the Institute's submission, a related question on which we would appreciate your views is whether to suggest that consideration be given to addressing either or both of these issues through interpretive relief (to the extent the authority to do so exists). For example, we could suggest interpretive relief as an alternative to rulemaking. One advantage of a rule is that it might offer greater protection to an investment company and its affiliates in the event of a lawsuit challenging a particular transaction. A possible advantage of interpretive relief is that it might be issued more quickly than a rule and courts typically give great deference to an agency's interpretation of its own rules in private lawsuits. By the same token, however, interpretive relief usually does not involve an opportunity for notice and comment. (We note that the draft submission originally distributed to you specifically recommends interpretive or no-action relief as an alternative to rulemaking in the context of our proposal concerning redemptions-in-kind. In addition, the introduction to the draft submission states that it may be possible to address other of the Institute's recommendations through interpretive or no-action relief.) Please review the attached materials and provide any comments to me or to Barry Simmons by Monday, August 31, 1998. I can be reached by phone at (202) 326-5822, by fax at (202) 326-5827 or by e- mail to frances@ici.org. Barry can be reached by phone at (202) 326-5923, by fax at (202) 326-5839 or by e- mail to simmonbe@ici.org. Frances M. Stadler Deputy Senior Counsel Attachment

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