

**MEMO# 33813**

October 11, 2021

## **ICI Submits Follow-Up Response to SEC Staff's Statement on Cross Trading**

[33813]

October 12, 2021

TO: ICI Members

Investment Company Directors SUBJECTS: Audit and Attest

Audit Committees

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Fund Accounting & Financial Reporting

Fund Governance

Intermediary Oversight

Investment Advisers

Operations

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Risk Oversight

Valuation RE: ICI Submits Follow-Up Response to SEC Staff's Statement on Cross Trading

Yesterday, ICI provided additional information in response to the SEC staff's request for feedback on funds' cross trading practices under Rule 17a-7 of the Investment Company Act (the "cross trading rule").[\[1\]](#) The attached report further informs the SEC's rulemaking efforts[\[2\]](#) by providing survey data on funds' equity cross trading activity, complementing our earlier report on funds' fixed-income cross trading.[\[3\]](#)

### **Funds' Equity Cross Trading Activity**

ICI conducted a member survey to better understand and quantify funds' equity cross trading activity. Forty-four ICI member firms responded, representing more than \$24.5 trillion, or approximately 75 percent of US-registered fund assets, as of July 31, 2021. The results are summarized below.

- Respondents engaged in 667,949 cross trades of equity securities, totaling \$185 billion, in 2020.
- This cross trading activity (in dollars) was largely concentrated in US equities (\$166 billion, or 90 percent), with a smaller portion in international equities (\$19 billion, or 10 percent).
- Fifty-seven percent of respondents indicated that at least one of their funds cross traded an equity security in 2020. In total, at least 926 of respondents' funds engaged

in at least one equity cross trade.

- A large majority of cross trades (estimated at 84 percent) involved two registered funds, as opposed to just one registered fund cross trading with other adviser client types (e.g., a nonregistered pooled vehicle or a separately managed account).
- A little more than half of respondents' equity cross trading activity was approximately the same (56 percent) in March and April 2020 as compared to the remainder of 2020.
- We estimate that funds' equity cross trading activity in their mutual funds and ETFs represents about 1.8 percent of their total trading activity in equity securities.
- Sixty-eight percent of respondents that engaged in equity cross trading in 2020 described it as "very beneficial," with another 32 percent calling it "moderately beneficial."

### **Continued Advocacy for Rule 17a-7 Reform**

Our latest submission emphasizes the importance of the SEC addressing the negative impact that its guidance in the fair value rules' adopting release would have on funds' cross trading activity (specifically, fixed-income cross trading).<sup>[4]</sup> This guidance puts at risk cross trading's substantial benefits to funds and their shareholders. Far from providing any decisive and final guidance on cross trading, the Fair Value Adopting Release acknowledged—but did not quantify or fully reflect—its effect on cross trading and asked for input on the SEC's anticipated modernization of Rule 17a-7.

To support the SEC's work, ICI's two reports provide extensive information and detailed survey data on funds' cross trading activity, with the April report estimating the quantitative benefits that fixed-income cross trading provides for investors and offering policy recommendations. Our April report estimated that fixed-income cross trading saved funds and their shareholders nearly \$329 million in 2020 and advisers' clients generally (i.e., funds, other pooled investment vehicles, and separately managed accounts) over \$390 million.

We urge the staff and SEC to move forward expeditiously to complete this rulemaking for the benefit of fund investors.

Matthew Thornton  
Associate General Counsel

#### **endnotes**

<sup>[1]</sup> Staff Statement on Investment Company Cross Trading, SEC Division of Investment Management Staff (March 11, 2021), *available at* [www.sec.gov/news/public-statement/investment-management-statement-investment-comp-any-cross-trading-031121](https://www.sec.gov/news/public-statement/investment-management-statement-investment-company-cross-trading-031121).

<sup>[2]</sup> The SEC's regulatory agenda can be accessed through the SEC's website at [www.sec.gov/news/press-release/2021-99](https://www.sec.gov/news/press-release/2021-99). The item related to the cross trading rule states, "The Division [of Investment Management] is considering recommending that the Commission propose amendments to Rule 17a-7 under the Investment Company Act of 1940 concerning the exemption of certain purchase or sale transactions between an investment company and certain affiliated persons."

[3] Rule 17a-7 at the Crossroads: The Right Path Forward, Investment Company Institute (April 2021)(the "April report"), *available at* [www.sec.gov/file/investment-company-institute.pdf](http://www.sec.gov/file/investment-company-institute.pdf).

[4] Good Faith Determinations of Fair Value, SEC Release No. IC-34128 (Dec. 3, 2020)(the "Fair Value Adopting Release"), *available at* [www.sec.gov/rules/final/2020/ic-34128.pdf](http://www.sec.gov/rules/final/2020/ic-34128.pdf). To be eligible for cross trading under Rule 17a-7, a transaction must be a "purchase or sale...of a security for which market quotations are readily available." But virtually no fixed-income securities have "readily available market quotations" under the SEC's new definition (which applies for purposes of the fair value and cross trading rules), which means that funds' ability to cross trade fixed-income securities will be severely restricted. As we quantify in the April report, even if the SEC staff retains existing no-action letters that permit cross trading of municipal securities—far from certain—this would permit only a minority of funds' existing cross trading of fixed-income securities.

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