

**SUPPORTING STATEMENT**  
**Rule 17a-8**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 17(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-17(a)) (the “Investment Company Act” or “Act”) generally prohibits a person that has specified affiliate relationships with a registered investment company (“fund”),<sup>1</sup> when acting as principal, from knowingly selling securities or property to or purchasing securities or property from the fund.<sup>2</sup> Congress enacted section 17(a) to protect funds and their shareholders from overreaching by fund affiliates. Mergers of funds with their affiliates (“affiliated fund mergers”) are among the affiliated transactions that section 17(a) prohibits. Section 17(b) of the Act authorizes the Commission to permit affiliated transactions if: (i) the terms of the transaction are reasonable and fair and do not involve overreaching on the part of any person concerned; (ii) the proposed transaction is consistent with the policy of each fund; and (iii) the proposed transaction is consistent with the general purposes of the Act.<sup>3</sup>

In 1980, the Commission adopted rule 17a-8, exempting affiliated fund mergers from the prohibitions in section 17(a) if the affiliation arose as the result of a common investment adviser, common directors, or common officers. The amendments to rule

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<sup>1</sup> Unless otherwise indicated, the term “fund” will be used in this supporting statement to refer to both registered investment companies and series or portfolios of registered investment companies.

<sup>2</sup> 15 U.S.C. 80a-17(a). Section 17(a) governs transactions involving affiliated persons of funds, promoters of or principal underwriters for a fund, or affiliated persons of any affiliated person, promoter, or underwriter. See also section 2(a)(3) of the Investment Company Act (defining the term “affiliated person”). 15 U.S.C. 80a-2(a)(3).

<sup>3</sup> 15 U.S.C. 80a-17(b).

17a-8, adopted in 2002,<sup>4</sup> expanded the types of mergers exempted by the rule to include mergers between funds affiliated for any reason and mergers between funds and certain unregistered entities.<sup>5</sup>

To ensure that mergers permitted under the amended rule will not raise the types of investor protection issues that require Commission review, funds must satisfy certain conditions in order to rely on the rule. These conditions include information collection requirements.<sup>6</sup> These collections of information requirements are voluntary, because rule 17a-8 is an exemptive rule and, therefore, funds may choose whether or not to rely on it.

The rule requires that the board of any fund participating in the merger (“Merging Company”) determine that participation in the merger is in the best interests of the Merging Company, and that the interests of the Merging Company’s existing shareholders will not be diluted as a result of the merger.<sup>7</sup> The directors must request and evaluate such information as may reasonably be necessary to their determinations, and consider and give appropriate weight to all pertinent factors.<sup>8</sup>

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<sup>4</sup> Investment Company Mergers, Investment Company Act Release No. IC-25666 (July 18, 2002) [67 FR 48512 (July 24, 2002)] (“Adopting Release”).

<sup>5</sup> Eligible unregistered entities include collective trust funds, as described in section 3(c)(11) of the Act, and common trust funds and similar funds, as described in section 3(c)(3) of the Act. Rule 17a-8(b)(2).

<sup>6</sup> Fund boards must determine that participation in the merger is in the best interests of the fund and that it will not dilute the interests of existing shareholders. Rule 17a-8(a)(2)(i).

<sup>7</sup> Rule 17a-8(a)(2)(i).

<sup>8</sup> Rule 17a-8(a)(2)(ii). The rule includes a note that refers to the adopting release, which provides factors that the board should consider, if relevant, in connection with the determination that participation in the merger is in the best interests of the fund. The factors relate to the following issues: the federal income tax consequences to the shareholders, the fees or expenses that the Merging Company will pay in connection with the merger, any change in fees or expenses to be paid or borne by shareholders (directly or indirectly) after the merger, any change in services to be provided to shareholders, and any change in investment objectives, restrictions, and policies after the merger. See Note to Rule 17a-8(a)(2)(i); Adopting Release, supra note Error: Reference source not found at 48513.

In order to enable boards of directors to assess whether the interests of existing shareholders would be diluted as a result of improper valuations in connection with a merger transaction, the directors of any fund merging with an unregistered entity must approve procedures for the valuation of assets received from that entity. The procedures must provide for the preparation of a report by an independent evaluator that sets forth the fair value of each such asset for which market quotations are not readily available.<sup>9</sup>

A Merging Company must record the determinations of its board, and the bases for those determinations, in its minute books.<sup>10</sup> The rule also requires a fund being acquired to obtain approval of the merger transaction by a majority of its outstanding voting securities, except in certain situations.<sup>11</sup> Finally, the rule requires any surviving fund to preserve written records describing the merger and its terms for six years after the merger (the first two in an easily accessible place).<sup>12</sup>

## **2. Purposes of the Information Collection**

The purpose of the information collection requirements in rule 17a-8 is to ensure that the interests of each merging fund and its shareholders are sufficiently considered and protected throughout the merger negotiation and approval process. The information collection requirements in the rule also ensure that adequate records are available for Commission review in the course of its compliance and examination program.

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<sup>9</sup> Rule 17a-8(a)(2)(iii). These procedures are unnecessary for mergers between registered investment companies because they value assets according to methods set forth in the Investment Company Act. See, e.g., 15 U.S.C. 2(a)(41); 17 C.F.R. 2a41-1.

<sup>10</sup> Rule 17a-8(a)(2)(iv).

<sup>11</sup> Rule 17a-8(a)(3).

<sup>12</sup> Rule 17a-8(a)(5).

### **3. Role of Improved Information Technology**

Rule 17a-8 does not require the reporting of any information or the filing of any documents with the Commission. The amended rule requires merging funds to keep board minutes and maintain written records describing the merger transaction and its terms. The Electronic Signatures in Global and National Commerce Act<sup>13</sup> and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

### **4. Efforts to Identify Duplication**

Rule 17a-8 does not impose any requirements that are duplicated elsewhere in federal securities laws, and similar information is not available from other sources. The written records that describe the merger and its terms may be encompassed by the general recordkeeping requirements contained in rules 31a-1 and 31a-2 under the Investment Company Act.<sup>14</sup> For example, the rule requires the preservation of minute books recording board meetings at which the merger was considered and advisory materials received from the investment adviser in connection with the merger, both of which fall within categories of records required to be kept under the general recordkeeping rules.<sup>15</sup> The record preservation requirements under rule 17a-8 are more specific than those in rules 31a-1 and 31a-2 and are designed to ensure preservation of adequate information to assess the compliance of Merging Funds with the rule's conditions. A fund that has

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<sup>13</sup> Pub. L. No. 106-229, 114 Stat. 464 (June 30, 2000).

<sup>14</sup> 17 CFR 270.31a-1 and 270.31a-2.

<sup>15</sup> See rule 31a-1(b)(4) (requiring investment companies to maintain, among other things, minute books of directors' meetings); rule 31a-1(b)(11) (requiring investment companies to maintain, among other things, "files of all advisory material received from the investment adviser"). Funds will not be required to maintain duplicate copies of any overlapping records.

preserved those records for purposes of rule 17a-8 will have also satisfied the requirements for the preservation of such records pursuant to rules 31a-1 and 31a-2.

#### **5. Effect on Small Entities**

Rule 17a-8 is available for any mergers, including mergers involving small entities, as long as the registered funds participating in the merger comply with the conditions set forth in the rule. These requirements protect the interests of the funds and their shareholders from overreaching by fund affiliates. Rule 17a-8 does not disproportionately burden small entities. The Commission believes that it could not adjust the rule to lessen the burden on small entities of complying with the rule without jeopardizing the interests of holders of securities of those entities.

#### **6. Consequences of Less Frequent Collection**

The information collection requirements of rule 17a-8 apply to a fund only if the fund relies on the rule to merge with an affiliated fund or affiliated common or collective trust fund. Less frequent information collection would be incompatible with the event-specific nature of the rule.

#### **7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)**

Rule 17a-8 requires that written records describing the merger transaction and terms be maintained for six years after the merger, the first two in an easily accessible place. Although this provision exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2)(iv), the Commission believes that the unusual and important nature of merger transactions in the life of a fund warrants the six-year recordkeeping requirement. The requirement contributes to the effectiveness of the Commission's examination and inspection program.

## **8. Consultations Outside the Agency**

The Commission requested public comment on the collection of information requirements in rule 17a-8 before it submitted these requests for extension and approval to OMB. The Commission received no comments in response to this request.

The Commission and the staff also participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings, and informal exchanges. These forums provide the Commission and the staff with means to identify and address paperwork burdens that may confront the industry.

## **9. Payment or Gift to Respondents**

Not applicable.

## **10. Assurances of Confidentiality**

Not applicable.

## **11. Sensitive Questions**

Not applicable.

## **12. Estimates of Hour Burden**

During 2006, there were approximately 460 mergers of affiliated series or portfolios of registered investment companies.<sup>16</sup> The staff estimates that none of the affiliated mergers proceeded pursuant to an exemptive order under section 17(b). Accordingly, the staff believes that the remaining affiliated mergers (i.e., all 460)

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<sup>16</sup> This figure is based on data from Lipper Inc. Each portfolio or series merger was counted separately. This way of counting reflects the staff's determination to assess the paperwork burden faced at the series or portfolio level rather than at the level of the registered investment company, in order to be consistent with the amendments discussed above, which require that the impact of the merger be separately assessed for each series or portfolio involved.

proceeded under rule 17a-8.<sup>17</sup> Assuming that there will be approximately 460 mergers annually, we estimate that approximately 920 registered investment companies, or, in many cases, portfolios or series thereof, would be subject to the rule's information collection requirements annually.

The staff estimates that compliance with the rule's requirements imposes a total annual burden on each merging portfolio or series of an average of 7 hours (3 hours of professional time and 4 hours of clerical time)<sup>18</sup> to prepare and record board resolutions documenting the board's findings and to compile a record documenting the merger transaction and its terms.<sup>19</sup> The staff therefore estimates the total annual burden imposed by the rule on all affected funds to be approximately 6,440 hours, based on an estimate of 460 affiliated mergers under rule 17a-8 per year.<sup>20</sup> The total annual cost of the burden hours for all funds of complying with rule 17a-8 is anticipated to be approximately \$871,240.<sup>21</sup>

The estimate of average burden hours is made solely for the purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a

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<sup>17</sup> Any merger that involved affiliated funds would not be able to proceed without either relying on rule 17a-8 or on an exemptive order obtained under section 17(b).

<sup>18</sup> These estimates are based on a survey of mutual funds and service providers.

<sup>19</sup> The surviving fund would maintain the documents describing the merger transaction and its terms.

<sup>20</sup> This estimate is based on the following calculation: 7 hours x 920 funds = 6,440 hours. This represents an increase of 2,240 hours over the annual hour burden of 4,200 hours estimated in 2005 for rule 17a-8.

<sup>21</sup> In calculating the total annual industry cost of complying with rule 17a-8, the Commission staff estimated that 2,760 hours would be incurred by compliance attorneys with an average hourly wage rate of \$261.00 per hour, and 3,680 hours would be incurred by clerical staff with an average hourly wage rate of \$41.00 per hour. *See Securities Industry Association, Report on Management & Professional Earnings in the Securities Industry 2006* (2006) (reporting median salary paid to compliance attorneys); *Securities Industry Association, Report on Office Salaries in the Securities Industry 2006* (2006) (reporting median salary paid to compliance clerks).

representative survey or study of the costs of Commission rules. The number of burden hours may vary depending on the nature of the merger transaction and the number of records a fund is required to preserve pursuant to the rule.

### **13. Estimate of Total Annual Cost Burden**

The rule imposes an annual cost burden on the industry in addition to the cost arising from the hour burden described in Item 12 of this Supporting Statement. The directors of any fund merging with an unregistered entity must approve procedures for the valuation of assets received from that entity. The procedures must provide for the preparation of a report by an independent evaluator that sets forth the fair value of each such asset for which market quotations are not readily available. The staff estimates, based on discussions with professionals who have prepared similar valuation reports, that obtaining a valuation report from independent evaluators typically would cost each fund that merges with an unregistered entity approximately \$15,000. In 2006, an estimated 15 affiliated fund mergers involved the kinds of unregistered entities covered by the rule.<sup>22</sup> The annual cost to the industry of this requirement is expected to be approximately \$225,000 (\$15,000 x 15 merging funds).

We anticipate that the condition in the rule requiring non-surviving funds to obtain shareholder approval would result in shareholder votes by approximately 22 funds that otherwise would not have conducted shareholder votes.<sup>23</sup> The funds or their advisers

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<sup>22</sup> The staff's estimate that there will be approximately 15 mergers each year involving common or collective trust funds is based on a review of fund filings, and is more than the estimate in the Commission's 2005 change worksheet because of the increase in the estimated number of total mergers.

<sup>23</sup> This estimate is based on the fact that many funds are constrained by state law to conduct a shareholder vote in the event of a merger. Moreover, even funds that are not required by state law to obtain shareholder approval may do so in order to maintain good relations with their shareholders.



incur legal, mailing, printing, solicitation, and tabulation costs in connection with a shareholder vote. We estimate, based on discussions with representatives of funds and service providers, that the total cost to an acquired fund of obtaining shareholder approval for a fund merger is approximately \$75,000. Thus, we anticipate that the aggregate annual cost associated with this provision will be approximately \$1,650,000 (\$75,000 x 22 funds).

The staff estimates that the total annual cost burden associated with rule 17a-8 will be approximately \$1,875,000.<sup>24</sup>

#### **14. Estimate of Cost to the Federal Government**

Rule 17a-8 imposes essentially no costs on the federal government. The rule does not require funds to file any documents with the Commission. Commission staff may review board minutes and records related to the merger as a matter of course during fund inspections.

#### **15. Explanation of Changes in Burden**

The increase in the estimated burden of rule 17a-8 by 2,240 hours results from a change in the estimated number of mergers between affiliated funds or fund portfolios. The rule imposes on the industry an estimated total annual cost burden (excluding the cost of the hour burden) of approximately \$1,875,000, compared to the estimate of \$900,000 in 2005. The increase in the estimated total annual cost burden is attributable primarily to increases in the estimated number of mergers involving unregistered entities, the estimated number of mergers requiring shareholder approval, and the estimated cost of obtaining shareholder approval.

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<sup>24</sup> This figure is the total of the estimated (i) \$225,000 annual cost associated with valuing the securities of common and collective trust funds, and (iii) \$1,650,000 annual cost associated with obtaining shareholder approval.

**16. Information Collection Planned for Statistical Purposes**

Not applicable.

**17. Approval to not Display Expiration Date**

Not applicable.

**18. Exception to Certification Requirement**

Not applicable.

**B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS**

Not applicable.