

**SUPPORTING STATEMENT**  
**Rule 17d-1**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 17(d) of the Investment Company Act of 1940 (the “Act”) (15 U.S.C. 80a-17(d)) makes it unlawful for an affiliated person of or a principal underwriter for a registered investment company (“fund”), or any affiliated person of such a person or principal underwriter, acting as principal, to effect any transaction in which the fund is a joint or a joint and several participant, in contravention of Commission rules.<sup>1</sup> Pursuant to this provision, the Commission adopted rule 17d-1 (17 CFR 270.17d-1) in 1946 and has subsequently amended the rule on numerous occasions.<sup>2</sup>

Commission approval of joint enterprises or arrangements. Rule 17d-1 prohibits an affiliated person of or principal underwriter for any fund (a “first-tier affiliate”), or any affiliated person of such person or underwriter (a “second-tier affiliate”), acting as principal, from participating in or effecting any transaction in connection with a joint enterprise or other joint arrangement in which the fund is a participant, unless prior to entering into the enterprise or arrangement “an application regarding [the transaction] has been filed with the Commission and has been granted by an order.”<sup>3</sup> In reviewing the proposed affiliated transaction, the rule provides that the Commission will consider whether the proposal is (i) consistent with the provisions, policies, and purposes of the Act, and (ii) on a basis different from or less

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<sup>1</sup> Affiliated persons of a fund include (i) its investment adviser and any subadvisers, (ii) companies the fund controls or five percent (or more) of whose securities are held by the fund, (iii) persons who control the fund, and (iv) persons who are under common control with the fund. 15 U.S.C. 80a-2(a)(3).

<sup>2</sup> The rule was revised to substantially its present form, prohibiting a broad range of joint transactions with affiliates, in 1957. See Applications Regarding Joint Enterprises and Certain Profit-Sharing Plans, Investment Company Act Release No. 2472 (Jan. 10, 1957).

<sup>3</sup> 17 CFR 270.17d-1(a).

advantageous than that of other participants in determining whether to grant an exemptive application for a proposed joint enterprise, joint arrangement, or profit-sharing plan.<sup>4</sup>

Exceptions to the Commission approval process. Rule 17d-1 also contains a number of exceptions to the requirement that a fund must obtain Commission approval prior to entering into joint transactions or arrangements with affiliates.<sup>5</sup> For example, funds do not have to obtain Commission approval for certain employee compensation plans, certain tax-deferred employee benefit plans, certain transactions involving small business investment companies, the receipt of securities or cash by certain affiliates pursuant to a plan of reorganization, and arrangements regarding liability insurance policies. The Commission amended rule 17d-1 most recently in 2003 to expand the current exemptions from the Commission approval process to permit funds to engage in transactions with "portfolio affiliates" – companies that are affiliated with the fund solely as a result of the fund (or an affiliated fund) controlling them or owning more than five percent of their voting securities.<sup>6</sup> This amendment was designed to permit funds' transactions with portfolio affiliates without seeking Commission approval, as long as certain other affiliated persons of the fund (e.g., the fund's adviser, persons controlling the fund, and persons under common control with the fund) ("prohibited participants") are not parties to the transaction and do not have a "financial interest" in a party to the transaction. The rule excludes from the definition of "financial interest" any interest that the fund's board of directors (including a majority of the directors who are not interested persons of the fund) finds to be not material, as long as the board records the basis for its finding in its meeting minutes.<sup>7</sup>

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<sup>4</sup> 17 CFR 270.17d-1(b).

<sup>5</sup> 17 CFR 270.17d-1(d).

<sup>6</sup> 17 CFR 270.17d-1(d)(5). See Transactions of Investment Companies with Portfolio and Subadviser Affiliates, Investment Company Act Release No. 25888 (Jan. 14, 2003) [68 FR 3153 (Jan. 22, 2003)].

<sup>7</sup> 17 CFR 270.17d-1(d)(5)(ii)(8).

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

The requirements of rule 17d-1 are designed to prevent fund insiders from managing funds for their own benefit, rather than for the benefit of the funds' shareholders. As discussed above, the rule contains two filing and recordkeeping requirements that constitute collections of information. First, rule 17d-1 requires funds that wish to engage in a joint transaction or arrangement with affiliates to meet the procedural requirements for obtaining exemptive relief from the rule's prohibition on joint transactions or arrangements involving first- or second-tier affiliates. This filing requirement assures that Commission staff can review the proposed joint transaction or arrangement for compliance with the Act's restrictions on affiliated transactions. These restrictions were enacted in 1940 in response to a wide array of abuses that occurred in the 1920s and 1930s. The breadth of some of the Act's provisions, including the restrictions in section 17(d) and rule 17d-1 on joint transactions or arrangements, however, prohibits some transactions that do not involve the concerns the provisions are intended to address, and the process of applying for exemptive relief enables the Commission to narrow the prohibitions on affiliated transactions in certain areas where the Act's prohibitions can be relaxed without reducing the protection of funds and their shareholders. Without the Commission's application process under rule 17d-1 it would be difficult for the Commission to provide this flexibility.

Second, rule 17d-1 permits a portfolio affiliate to enter into a joint transaction or arrangement with the fund if a prohibited participant has a financial interest that the fund's board determines is not material and records the basis for this finding in its meeting minutes. This recordkeeping requirement provides fund boards of directors with the flexibility to authorize joint transactions with remote affiliates, rather than requiring that such transactions be reviewed by the Commission. The collection of information is necessary to ensure that Commission staff

can review, in the course of its compliance and examination functions, the basis for a finding by a fund's board of directors that the financial interest of a prohibited participant in a party to a transaction with a portfolio affiliate is not material.

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

The Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") provides for the automated filing, processing, and dissemination of full disclosure filings. The automation provides for speed, accuracy, and public availability of information, generating benefits to investors and financial markets. In order to keep EDGAR current and make it useful for investors, funds, and the Commission staff, in November 2007, the Commission proposed to require funds to submit applications under rule 17d-1 electronically using the EDGAR system.<sup>8</sup>

To the extent the rule includes recordkeeping requirements, the Electronic Signatures in Global and National Commerce Act<sup>9</sup> and the conforming amendments to recordkeeping rules under the Investment Company Act permit funds to maintain records electronically.

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

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or form, or a change in either. The records described in rule 17d-1 may include some of the same records required by rules 31a-1 and 31a-2 under the Investment Company Act, however funds would not be required to retain duplicate records.

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<sup>8</sup> Rulemaking for EDGAR System; Mandatory Electronic Submission of Applications for Orders under the Investment Company Act and Filings Made Pursuant to Regulation E, Investment Company Act Release No. 28042 (Nov. 1, 2007) [72 FR 63513 (Nov. 9, 2007)].

<sup>9</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

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

Rule 17d-1 applies to any transaction involving small entities, if the fund participating in the transactions complies with the conditions set forth in the rules. These requirements protect the interests of the funds and their shareholders from overreaching by fund affiliates. The rule 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 investors in the small entities.

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

The information collection requirements in rule 17d-1 arise when a fund applies for an exemptive order or a prohibited participant may have a financial interest in a party to a joint transaction involving a fund and a portfolio affiliate of the fund. The rule's filing requirements are designed to provide the Commission with the information needed to determine whether an exemptive order under section 17(d) and rule 17d-1 is warranted. Less frequent information collection may impede the applications process as well as the Commission's inspection staff's ability to monitor the board's oversight of otherwise prohibited joint transactions and would not be consistent with protecting fund shareholders from overreaching by fund affiliates.

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

The rule's required filings with the Commission and recordkeeping requirements may require certain information to be provided to the Commission or recorded more often than quarterly, depending on the circumstances of a particular fund's proposed joint transactions or

arrangements with affiliates within a given quarter. The Commission believes, however, that such circumstances are highly unlikely.

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

The Commission requested public comment on the collection of information requirements in rule 17d-1 before it submitted this request for approval to the Office of Management and Budget. The Commission received no comments in response to this request.

The Commission and the staff of the Division of Investment Management also participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry.

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

Not applicable.

#### **10. Assurance of Confidentiality**

Not applicable.

#### **11. Sensitive Questions**

Not applicable. No issues of a sensitive nature are involved.

#### **12. Estimate of Hour Burden**

Commission approval of joint transactions. Applicants seeking exemptive relief under section 17(d) and rule 17d-1 must file an application with the Commission setting forth a basis for the relief requested (including a detailed justification for removal of any statutory protections), and identifying any benefits expected for investors and any conditions imposed to protect investors. Applications are reviewed in the order received, unless the applicant makes a compelling demonstration that the application could not have been filed in time to allow it to be

addressed and acted upon in due course. During the review process, the staff may send comment letters to the applicant requesting clarifications or modifications to the application to assure that the requested relief is consistent with statutory standards. Once review of an application is completed, a notice outlining the requested relief is published in the Federal Register to give interested persons an opportunity to request that the matter be set down for a hearing. After a notice of approximately 25 days, and unless a hearing is requested by an interested party or is ordered by the Commission on its own motion, an order is issued granting the requested relief.

The following estimates of average burden hours are made solely for the purposes of the Paperwork Reduction Act. The estimates are not derived from a comprehensive or even a representative survey or study of the costs of Commission rules. Depending on a fund's circumstances and the novelty or complexity of the proposed affiliated joint transaction or arrangement, the burden hours associated with complying with these requirements may vary widely. Based on an analysis of past filings, Commission staff estimates that on average 4 funds file applications under section 17(d) and rule 17d-1 per year.<sup>10</sup> Based on a limited survey of persons in the mutual fund industry, the Commission staff estimates that each applicant will spend an average of 154 hours to comply with the Commission's applications process.<sup>11</sup> The Commission staff therefore estimates the annual burden hours per year for all funds under rule 17d-1's application process to be 616 hours.<sup>12</sup> The Commission staff further estimates an average cost per institution of \$52,098,<sup>13</sup> for a total annual cost of \$208,392.<sup>14</sup>

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<sup>10</sup> In the past three years, the Commission has received 13 applications for exemptive relief under section 17(d) and rule 17d-1.  $13 \text{ applications} \div 3 \text{ years} = 4.33 \text{ applications per year}$ .

<sup>11</sup> The Commission staff estimate that a senior executive, such as the fund's chief compliance officer, will spend an average of 62 hours and a mid-level compliance attorney will spend an average of 92 hours to comply with this collection of information.  $62 \text{ hours} + 92 \text{ hours} = 154 \text{ hours}$ .

<sup>12</sup>  $4 \text{ funds} \times 154 \text{ burden hours} = 616 \text{ burden hours}$ .

Exceptions to the Commission approval process. Based on analysis of past filings, the Commission's staff estimates that 148 funds are affiliated persons of 668 issuers as a result of the fund's ownership or control of the issuer's voting securities, and that there are approximately 1,000 such affiliate relationships. Staff discussions with mutual fund representatives have suggested that no funds currently rely on the rule 17d-1 exemptions. We do not know definitively the reasons for this transactional behavior, but differing market conditions from year to year may offer some explanation for the current lack of fund interest in the exemptions under rule 17d-1. Accordingly, we estimate that annually there will be no joint transactions under rule 17d-1 that will result in a collection of information.

The Commission staff therefore estimate the total burden hours per year for all funds under rule 17d-1 to be 616 hours.

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

In addition to the hourly burden discussed above, based on a limited survey of persons in the mutual fund industry, the Commission staff estimates that on average funds spend an additional \$93,131 for outside legal services in connection with seeking Commission approval of affiliated joint transactions.

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

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<sup>13</sup> The Commission staff estimate that the chief compliance officer is paid \$407 per hour and the compliance attorney is paid \$292 per hour.  $(\$407 \text{ per hour} \times 62 \text{ hours}) + (\$292 \text{ per hour} \times 92 \text{ hours}) = \$52,098$  per institution. The \$407 and \$292 per hour figures are based on salary information compiled by the Securities Industry Association ("SIA," now named the Financial Industry Regulatory Authority). The Commission staff has modified the SIA's information to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. See Securities Industry Association, Report on Management and Professional Earnings in the Securities Industry (2006).

<sup>14</sup>  $\$52,098 \text{ per fund} \times 4 \text{ funds} = \$208,392$ .



The Commission processes and reviews applications made pursuant to rule 17d-1 in connection with its overall exemptive applications program.<sup>15</sup> The Commission's operational cost of reviewing and processing rule 17d-1 applications is not significant, however, because there are so few of these requests each year.

**15. Explanation of Changes in Burden**

The increase in estimated total annual burden hours associated with the rule from 1 hour to 617 hours is based on the identification of a new collection of information requirement (the Commission's application process) contained in rule 17d-1. We believe this estimate more accurately reflects funds' total annual burden hours in complying with rule 17d-1.

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

Not applicable. The information is not published for statistical use.

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

The Commission is not seeking such approval.

**18. Exceptions to Certification Statements**

The Commission is not seeking an exception to the certification statement.

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

Not applicable because the collection of information will not employ statistical methods.

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<sup>15</sup> In at least 33 separate instances, the Act authorizes the Commission to issue exemptive orders for different types of relief from specific statutory requirements.