

SUPPORTING STATEMENT
Rule 10f-3

A. JUSTIFICATION

1. Necessity for the Information Collection

Section 10(f) of the Investment Company Act of 1940 (the “Act”) prohibits a registered investment company (“fund”) from purchasing any security during an underwriting or selling syndicate if the fund has certain relationships with a principal underwriter for the security.¹ Congress enacted this provision in 1940 to protect funds and their shareholders by preventing underwriters from “dumping” unmarketable securities on affiliated funds.

Rule 10f-3 permits a fund to engage in a securities transaction that otherwise would violate section 10(f) if, among other things: (i) each transaction effected under the rule is reported on Form N-SAR; (ii) the fund’s directors have approved procedures for purchases made in reliance on the rule, regularly review fund purchases to determine whether they comply with these procedures, and approve necessary changes to the procedures; and (iii) a written record of each transaction effected under the rule is maintained for six years, the first two of which in an easily accessible place.² The written record must state: (i) from whom the securities were acquired; (ii) the identity of the underwriting syndicate’s members; (iii) the terms of the transactions; and (iv) the information or materials on which the fund’s board of directors has determined that the purchases were made in compliance with procedures established by the board.

The rule also conditionally allows managed portions of fund portfolios to purchase securities offered in otherwise off-limits primary offerings. To qualify for this exemption, rule

¹ 15 U.S.C. 80a-10(f).

² 17 CFR 270.10f-3.

10f-3 requires that the subadviser that is advising the purchaser be contractually prohibited from providing investment advice to any other portion of the fund's portfolio and consulting with any other of the fund's advisers that is a principal underwriter or affiliated person of a principal underwriter concerning the fund's securities transactions.

These requirements provide a mechanism for fund boards to oversee compliance with the rule. The required recordkeeping facilitates the Commission staff's review of rule 10f-3 transactions during routine fund inspections and, when necessary, in connection with enforcement actions.

2. Purpose of the Information Collection

The collection of information requirements of rule 10f-3 are designed to limit transactions under the rule to purchases that are consistent with the rule's conditions for relief and the board's procedures governing such purchases. The records required to be maintained are reviewed by the Commission in the course of its compliance and examination program and are used by fund directors to evaluate transactions executed pursuant to the rule. Additionally, the purpose of requiring specific subadvisory contract provisions is to ensure that the exemptive relief in the rule is limited to circumstances when the subadviser that engages in the transaction does not influence the investment decision of the fund to engage in the transaction.

3. Role of Improved Information Technology

To the extent the rule includes recordkeeping requirements, the Electronic Signatures in Global and National Commerce Act³ and the conforming amendments to recordkeeping rules under the Investment Company Act permit funds to maintain records electronically.

³ P.L. 106-229, 114 Stat. 464 (June 30, 2000).

4. Efforts to Identify Duplication

Rule 31a-1 under the Act requires the retention of ledger accounts for each portfolio security and each person through which a portfolio transaction is effected. Although some of the identifying information contained in the rule 10f-3 transaction records may overlap with information in the ledgers, the rule 10f-3 records contain additional information specifically related to the concerns underlying section 10(f). The requirements regarding limitations in the subadvisers' contracts are similar to conditions in exemptive rules 12d3-1,⁴ 17a-10,⁵ and 17e-1.⁶ To the extent that a fund relies on any one of these rules, its subadviser may use the same contract language to satisfy the comparable condition in the other rules.

5. Effect on Small Entities

The Commission does not believe that compliance with rule 10f-3 is unduly burdensome for large or small entities. The information collection requirements of the rule apply to all funds that rely on rule 10f-3 to purchase securities regardless of whether they are small entities. The requirements help to protect small and large funds alike from potential overreaching by affiliated underwriters by aiding fund boards in overseeing rule 10f-3 transactions and enabling the Commission to fulfill its statutory mandate. 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 the small entities.

6. Consequences of Less Frequent Collection

Records of transactions subject to rule 10f-3 are created only when transactions take place in reliance on the rule. A record of each transaction must be appended to the Form N-SAR

⁴ 17 CFR 270.12d3-1.

⁵ 17 CFR 270.17a-10.

⁶ 17 CFR 270.17e-1.

filed by the fund for the period during which the transaction took place. Management investment companies must file Form N-SAR twice each year and unit investment trusts must file the form annually. Less frequent collection would detract from the relevance of the records. The rule also requires the board of directors to adopt procedures for making purchases in reliance upon the rule, to review and change such procedures as necessary, and to review rule 10f-3 transactions quarterly for compliance with the rule. Less frequent review could hinder a fund's ability to take timely action to correct violations of the rule 10f-3 procedures adopted by the fund's board.

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

Rule 10f-3 requires funds to preserve certain records for six years and other records permanently. We believe that the long-term retention of records is necessary to carry out our examination and enforcement responsibilities, and our mandate to ensure that the Act's provisions are legally enforceable. We periodically inspect the operations of funds to ensure compliance with the rules and regulations under the Act; however, each fund may be inspected only at intervals of several years due to limits on our resources. Furthermore, Congress has placed no time limit on the prosecution of persons engaged in certain types of conduct that violate the securities laws. For these reasons, we often need information relating to events or transactions that occurred years ago. In section 31(a) of the Act,⁷ Congress specifically authorized the Commission to require funds to “maintain and preserve” books and records “for such period or periods as the Commission may prescribe by rules.” Computerized record storage has made long-term retention of records less burdensome.

8. Consultation Outside the Agency

The Commission and staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the industry through public conferences, meetings, and

⁷ 15 U.S.C. 80a-30(a).

informal exchanges. The Commission requested public comment on the collection of information requirements in rule 10f-3 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to its request.

9. Payment or Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

Not applicable.

11. Sensitive Questions

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

12. Estimate of Hour Burden

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.

The staff estimates that approximately 350 funds engage in a total of approximately 4,400 rule 10f-3 transactions each year.⁸ Rule 10f-3 requires that the purchasing fund create a written record of each transaction that includes, among other things, from whom the securities were purchased and the terms of the transaction. The staff estimates⁹ that it takes an average fund approximately 30 minutes per transaction at a cost of \$88 per transaction to document each

⁸ These estimates are based on staff extrapolations from filings with the Commission.

⁹ Unless stated otherwise, the information collection burden estimates contained in this Supporting Statement are based on conversations between the staff and representatives of funds.

transaction.¹⁰ Thus, annually funds spend approximately 2,200 hours¹¹ at a cost of \$387,200 documenting these transactions.¹²

The funds also must maintain and preserve these transactional records in accordance with the rule's recordkeeping requirement, and the staff estimates that it takes a fund approximately 20 minutes per transaction at a cost of \$18.67 per transaction to comply with this part of the rule.¹³ The staff estimates that annually, in the aggregate, funds spend approximately 1,467 hours¹⁴ at a cost of \$82,152 to comply with rule 10f-3's recordkeeping requirements.¹⁵

In addition, fund boards must, no less than quarterly, examine each of these transactions to ensure that they comply with the fund's policies and procedures. The information or materials upon which the board relied in making its determination also must be maintained and the staff estimates that it takes a fund 1 hour per quarter at a cost of \$159 per quarter to comply with this

¹⁰ Typically, personnel from several departments, including portfolio management and compliance, share this task. The staff estimates that the blended average hourly rate for these personnel is \$176. Unless stated otherwise, all hourly rates in this Supporting Statement are derived from the average annual salaries reported in Securities Industry Association, Management and Professional Earnings in the Securities Industry (2006) and Securities Industry Association, Office Salaries in the Securities Industry (2006).

¹¹ This estimate is based on the following calculation: (30 minutes x 4,400 = 2,200 hours).

¹² This estimate is based on the following calculation: (4,400 transactions x \$88 = \$387,200).

¹³ The wage figure of \$18.67 is one third of an average compliance clerk's salary of \$56 per hour.

¹⁴ This estimate is based on the following calculations: (20 minutes x 4,400 transactions = 88,000 minutes; 88,000 minutes / 60 = 1,467 hours).

¹⁵ This estimate is based on the following calculation: (1,467 hours x \$56 = \$82,152).

rule requirement.¹⁶ Thus annually, in the aggregate, funds spend approximately 1,400 hours¹⁷ at a cost of \$222,600 to comply with this recordkeeping requirement.¹⁸

The staff further estimates that reviewing and revising as needed written procedures for rule 10f-3 transactions takes, on average for each fund, two hours of a compliance attorney's time at a cost of approximately \$522¹⁹ per year.²⁰ Thus, annually, in the aggregate, the staff estimates that funds spend a total of approximately 700 hours²¹ at a cost of approximately \$182,700²² on monitoring and revising rule 10f-3 procedures.

Based on an analysis of fund filings, the staff estimates that approximately 600 fund portfolios enter into subadvisory agreements each year.²³ Based on discussions with industry representatives, the staff estimates that it will require approximately 3 attorney hours²⁴ to draft and execute additional clauses in new subadvisory contracts in order for funds and subadvisers to be able to rely on the exemptions in rule 10f-3. Because these additional clauses are identical to

¹⁶ The staff estimates that a compliance clerk spends half an hour, at \$56 per hour, preparing the report and a compliance attorney spends half an hour, at \$261 per hour, reviewing the report for an average wage figure of \$159 per hour.

¹⁷ This estimate is based on the following calculation: (1 hour per quarter x 4 quarters x 350 funds = 1400 hours).

¹⁸ This estimate is based on the following calculation: (1400 hours x \$159 = \$222,600).

¹⁹ This estimate is based on the following calculation: (2 hours x \$261 = \$522).

²⁰ These averages take into account the fact that in most years, fund attorneys and boards spend little or no time modifying procedures and in other years, they spend significant time doing so.

²¹ This estimate is based on the following calculation: (350 funds x 2 hours = 700 hours).

²² This estimate is based on the following calculation: (350 funds x \$522 = \$182,700).

²³ The use of subadvisers has grown rapidly over the last several years, with approximately 600 portfolios that use subadvisers registering between December 2005 and December 2006. Based on information in Commission filings, we estimate that 31 percent of funds are advised by subadvisers.

²⁴ The Commission staff's estimates concerning the wage rates for attorney time are based on salary information for the securities industry compiled by the Securities Industry Association. The \$292 per hour figure for an attorney is from the SIA Report on Management & Professional Earnings in the Securities Industry 2006.

the clauses that a fund would need to insert in their subadvisory contracts to rely on rules 12d3-1, 17a-10, and 17e-1, and because we believe that funds that use one such rule generally use all of these rules, we apportion this 3 hour time burden equally to all four rules. Therefore, we estimate that the burden allocated to rule 10f-3 for this contract change would be 0.75 hours.²⁵ Assuming that all 600 funds that enter into new subadvisory contracts each year make the modification to their contract required by the rule, we estimate that the rule's contract modification requirement will result in 450 burden hours annually, with an associated cost of approximately \$131,400.²⁶

The staff estimates, therefore, that rule 10f-3 imposes an information collection burden of 6217 hours²⁷ at a cost of \$1,006,052.²⁸ This estimate does not include the time spent filing transaction reports on Form N-SAR, which is encompassed in the information collection burden estimate for that form.

13. Estimate of Total Annual Cost Burden

There is no annual cost burden associated with complying with the information collection requirements in the rule, aside from the cost of the burden hours discussed above. The staff has not estimated a capital/startup cost in connection with the proposed recordkeeping requirements because funds and their advisers are likely to use existing recordkeeping systems to maintain records related to mergers.

14. Estimate of Cost to the Federal Government

²⁵ This estimate is based on the following calculation (3 hours ÷ 4 rules = .75 hours).

²⁶ These estimates are based on the following calculations: (0.75 hours × 600 portfolios = 450 burden hours); (\$292 per hour × 450 hours = \$131,400 total cost).

²⁷ This estimate is based on the following calculation: (2,200 hours + 1,467 hours + 1,400 hours + 700 hours + 450 hours = 6,217 total burden hours).

²⁸ This estimate is based on the following calculation: (\$387,200 + \$82,152 + \$222,600 + \$182,700 + \$131,400 = \$1,006,052).

The rule does not require anything to be filed with the Commission. Commission staff may, in the course of routine fund inspections, monitor compliance with the rule.

15. Explanation of Changes in Burden

The estimated annual burden hours increased by 1967 hours from 4,250 hours to 6217. hours. The increase in hours reflects an increase in the number of funds that rely on the rule, changes in the market, and resulting shifts in fund investment behavior.

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. Exception to Certification Statement

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

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

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