

**SUPPORTING STATEMENT**  
**Rule 17a-7**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Section 17(a) of the Investment Company Act of 1940 (the “Act”) generally prohibits an affiliated person<sup>1</sup> (“first-tier affiliate”) of a registered investment company (“fund”) or an affiliated person of that person (“second-tier affiliate”) from engaging in a purchase, sale, or loan transaction with the fund (or any company controlled by the fund). Section 17(b) of the Act authorizes the Commission to exempt proposed transactions from the prohibitions of section 17(a) when it finds that the terms of the transaction are fair and reasonable and do not involve overreaching on the part of any person involved, the transaction is consistent with the policy of each fund, and the transaction is consistent with the purposes of the Act.

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<sup>1</sup> Under section 2(a)(3) of the Act, “affiliated person” of another person means:

- (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

In 1966, the Commission exercised its exemptive rulemaking authority by adopting rule 17a-7 [17 C.F.R. § 270.17a-7].<sup>2</sup> Rule 17a-7, as subsequently amended on several occasions, provides an exemption from section 17(a) of the Act for purchases and sales of securities between funds that are first- or second-tier affiliates, or between a fund and a first- or second-tier affiliate other than another fund, when the affiliation arises solely because of a common investment adviser, director, or officer. The exemption is subject to conditions intended to eliminate the likelihood of overreaching. The rule permits funds and other companies under common management to trade securities with each other and thus to avoid brokerage commissions. The rule also limits the prices at which purchase and sale transactions may occur, to prevent inequitable pricing practices that could harm a participating fund.

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<sup>2</sup>

Investment Company Act Release No. 4697 (Sept. 8, 1966).

Rule 17a-7(e) requires the board of directors of a fund to establish procedures reasonably designed to ensure that the conditions of the rule have been satisfied for purchases and sales effected in reliance on the rule, and to make changes to these policies as necessary. In addition, the rule requires that the fund maintain and preserve a written copy of the procedures adopted by the board. Under the rule, the board is required to determine, at least on a quarterly basis, that all affiliated transactions effected during the preceding quarter in reliance on the rule were made in compliance with these established procedures. If a fund enters into a purchase or sale transaction with an affiliated person, the rule requires the fund to maintain written records of the transaction for a period of not less than six years.<sup>3</sup> In order to rely on the rule, the fund also must comply with certain fund governance standards – including requirements that independent directors must select and nominate other independent directors, independent directors must be affirmatively authorized to hire their own staff, and any person who acts as legal counsel for the independent directors must be an independent legal counsel.<sup>4</sup>

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

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<sup>3</sup> Rule 17a-7(g) requires the written record of the affiliated transaction to include the following information: a description of the security purchased or sold, the identity of the person on the other side of the transaction, the terms of the purchase or sale transaction, and the information or materials upon which the board determined that the purchase or sale complied with the procedures set by the board.

<sup>4</sup> See Rule 0-1(a)(7) [17 C.F.R. § 270.0-1(a)(7)].

The records maintained under the rule are not submitted to the Commission, but may be reviewed by Commission staff on request to ensure compliance with the rule. Fund directors use the records to evaluate procedures and transactions executed pursuant to the rule.

If maintenance of these records were not required, the Commission and fund directors could not readily monitor or evaluate potentially unfair or unreasonable transactions between funds and their affiliates. The rule's requirement to maintain such records avoids the need for potentially more burdensome requirements such as mandatory filings of similar information with the Commission.

### **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. Although rule 17a-7 does not require the filing of any documents with the Commission, the Commission in the future may use its EDGAR facility to improve the examination of records the rule requires funds to keep. Under rule 31a-2(f) [17 CFR 270.31a-2(f)], the Commission permits funds to maintain (and produce as necessary) on magnetic tape, disk or other electronic storage media, many types of records, including records like those maintained under rule 17a-7.

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

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates those requirements whenever it proposes a rule or form or a change in either. Section 31(a) of the Act [15 U.S.C. 80a-31(a) and rules 31a-1 and 31a-2 thereunder [17 CFR 270.31a-1, 17 CFR 270.31a-2] require funds to maintain and preserve records similar to those required to be kept pursuant to rule 17a-7. Rule 17a-7 does not require that duplicate records be kept, but reiterates the requirement to maintain and preserve such records.

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

The recordkeeping requirements of rule 17a-7 are the same for all funds subject to the rule, including small entities. The Commission believes that compliance with rule 17a-7 is not unduly burdensome for large or small entities, and that the minimal costs of complying with the rule are justified by the benefits it affords.

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

Rule 17a-7 requires fund directors to establish and maintain written procedures for review of pertinent transactions, and requires funds to maintain records concerning each transaction undertaken pursuant to the rule. Less frequent collection of this information would make it difficult for fund directors to evaluate transactions executed pursuant to the rule, and could hamper the ability of the Commission's examination staff to ensure compliance with the rule.

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

Rule 17a-7 requires funds to retain certain records for more than three years. The fund must maintain and preserve permanently a written copy of the procedures (and any modifications thereto) established by the board of directors to ensure that all conditions of the rule have been satisfied. Additionally, the fund must maintain and preserve for a period of six years from the end of the fiscal year in which any transactions occurred a written record of each such transaction setting forth a description of the security purchased or sold, the identity of the person on the other side of the transaction, the terms of the purchase or sale transaction, and the information or materials upon which the board of directors' determination that the transaction was in compliance with the procedures was made.

The long-term retention of records required under rule 17a-7 is necessary to carry out the Commission's examination and enforcement responsibilities, and its mandate to ensure that the Act's provisions are legally enforceable. The Commission periodically inspects the operations of funds to ensure compliance with the rules and regulations under the Act. Each fund, however, may only be inspected at intervals of several years due to the Commission's limited resources. For this reason, the Commission often needs information relating to events or transactions which occurred years ago. Moreover, in section 31(a) of the Act, Congress specifically empowered the Commission to require funds to "maintain and preserve" books and records "for such period or periods as the Commission may

prescribe by rules.” Electronic record storage has made long-term retention of records less burdensome.

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

Rule 17a-7 was adopted in 1966 and amended several times since then. Prior to its adoption, and before adoption of each amendment, the Commission sought, received, and considered public comment. The Commission requested public comment on the collection of information requirements in Rule 17a-7 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.

The Commission and staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and informal exchanges. These forums provide the Commission and the staff useful means to identify and address paperwork burdens that may affect the industry.

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

Not applicable.

## **10. Assurance of Confidentiality**

Not applicable.

## **11. Sensitive Questions**

Not applicable.

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

While most funds do not commonly engage in transactions covered by rule 17a-7, the Commission staff estimates that nearly all funds have adopted procedures for complying with the rule.<sup>5</sup> Of the approximately 3891 currently active funds, the staff estimates that virtually all have already adopted procedures for compliance with rule 17a-7. This is a one-time burden, and the staff therefore does not estimate an ongoing burden related to the policies and procedures requirement of the rule for funds.<sup>6</sup> The staff estimates that there are approximately 150 new funds that register each year, and that each of these funds adopts the relevant policies and procedures. The staff estimates that it takes approximately 4 hours to develop and adopt these policies and procedures, as follows; 3 hours spent by a compliance attorney at a rate of \$270 per hour, and 1 hour collectively spent by the board of directors at a rate of \$2000 per hour, for a total cost of \$2810.<sup>7</sup> Therefore, the total annual burden related to developing and

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<sup>5</sup> Unless stated otherwise, these estimates are based on conversations with the examination and inspections staff of the Commission and fund representatives.

<sup>6</sup> Based on our reviews and conversations with fund representatives, we understand that funds rarely, if ever, need to make changes to these policies and procedures once adopted, and therefore we do not estimate a paperwork burden for such updates.

<sup>7</sup> This estimate is based on the following calculations: (3 hours  $\times$  \$270 = \$810); (\$810 + \$2000 = \$2810). The estimate for compliance attorney pay rates is from SIFMA's Management & Professional Earnings in the Securities Industry 2007, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The staff has estimated the average cost of board of director time as \$2000 per hour for the board as a whole, based on information received from funds, fund intermediaries, and their counsel.

adopting these policies and procedures would be approximately 600 hours at a cost of \$421,500.<sup>8</sup>

Of the 3891 existing funds, the staff assumes that approximately 25%, (or 973) enter into transactions affected by rule 17a-7 each year (either by the fund directly or through one of the fund's series), and that the same percentage (25%, or 38 funds) of the estimated 150 funds that newly register each year will also enter into these transactions, for a total of 1011<sup>9</sup> companies that are affected by the recordkeeping requirements of rule 17a-7. These funds must keep records of each of these transactions, and the board of directors must quarterly determine that all relevant transactions were made in compliance with the company's policies and procedures. The rule generally imposes a minimal burden of collecting and storing records already generated for other purposes.<sup>10</sup> The staff estimates that the burden related to making these records and for the board to review all transactions would be 3 hours annually for each respondent, (2 hours spent by compliance attorneys and 1 hour spent by the board of directors)<sup>11</sup> or 3033

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<sup>8</sup> This estimate is based on the following calculations: (4 hours  $\times$  150 = 600 hours); ( $\$2810 \times 150 = \$421,500$ ).

<sup>9</sup> This estimate is based on the following calculation: (973 + 38 = 1011).

<sup>10</sup> Commission staff believes that rule 17a-7 does not impose any costs associated with record preservation in addition to the costs that funds already incur to comply with the record preservation requirements of rule 31a-2 under the Act. Rule 31a-2 requires companies to preserve certain records for specified periods of time.

<sup>11</sup> The staff estimates that funds that rely on rule 17a-7 annually enter into an average of 8 rule 17a-7 transactions each year. The staff estimates that the compliance attorneys of the companies spend approximately 15 minutes per transaction on this recordkeeping, and the board of directors spends a total of 1 hour annually in determining that all transactions made

total hours each year,<sup>12</sup> at a total cost of \$2540.<sup>13</sup> Thus, the total cost of the rule's recordkeeping requirements is estimated to be approximately \$2,567,940 per year.<sup>14</sup>

Based on these estimates, the staff estimates the combined total annual burden hours associated with rule 17a-7 is 3633 hours at a cost of \$2,989,440.<sup>15</sup> The staff also estimates that there are approximately 1161 respondents and 8238 total responses.<sup>16</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 representative survey or study of the costs of Commission rules.

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

The commission staff estimates that there is no cost burden of rule 17a-7 other than the cost of the burden identified in Item 12 of this Supporting Statement.

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that year were done in compliance with the company's policies and procedures.

<sup>12</sup> This estimate is based on the following calculation: (3 hours  $\times$  1011 companies = 3033 hours).

<sup>13</sup> This estimate is based on the following calculations: (2 hours  $\times$  \$270 = \$540); (\$540 + \$2000 = \$2540).

<sup>14</sup> This estimate is based on the following calculation: (\$2540  $\times$  1011 companies = \$2,567,940).

<sup>15</sup> This estimate is based on the following calculations: (600 hours + 3033 hours = 3633 total hours); (\$421,500 + \$2,567,940 = \$2,989,440).

<sup>16</sup> This estimate is based on the following calculations: (150 newly registered funds + 1011 funds that engage in rule 17a-7 transactions = 1161); (1011 funds that engage in rule 17a-7 transactions  $\times$  8 times per year = 8088); (8088 + 150 = 8238 responses).

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

There are no costs to the Federal Government associated with rule 17a-7.

**15. Explanation of Changes in Burden**

The estimated burden hours associated with rule 17a-7 has increased to 3633 burden hours from the current allocation of 1935 burden hours. This increase of 1698 hours is primarily due to changes in our methodology for estimating burden hours. In particular, based on conversations with fund representatives, we have included additional estimates for the hourly burden related to developing and adopting policies and procedures, and to board of director determinations when companies engage in rule 17a-7 transactions.

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

Not applicable.

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

Not applicable.

**18. Exceptions to Certification Statement**

Not applicable.

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

Not applicable.