

PAPERWORK REDUCTION ACT SUBMISSION
SUPPORTING STATEMENT
Rule 10f-3

A. JUSTIFICATION

1. Information Collection Necessity

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

Rule 10f-3 also conditionally allows managed portions of fund portfolios to purchase securities offered in otherwise off-limits primary offerings. To qualify for this exemption, rule 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.

¹ 15 U.S.C. 80a-10(f).

² 17 CFR 270.10f-3.

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. Information Collection Purpose

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 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. 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.

3. Information Technology Consideration

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 Act permit funds to maintain records electronically.

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

4. 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 the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment company industry through public

⁷ 15 U.S.C. 80a-30(a).

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. 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

The respondents receive no payments or gifts.

10. Assurances of Confidentiality

There is no assurance of confidentiality provided.

11. Sensitive Questions

No issues of a sensitive nature are involved.

12. Information Collection Annual 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 300 funds engage in a total of approximately 3700 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, information about 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 time cost of \$120 per transaction to

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.

document each transaction.¹⁰ Thus, annually funds spend approximately 1850 hours¹¹ at a cost of \$444,000 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 time cost of \$20 per transaction to comply with this part of the rule.¹³ The staff estimates that annually, in the aggregate, funds spend approximately 1233 hours¹⁴ at a cost of \$73,980 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. The staff estimates that it takes a fund 1 hour per quarter at a cost of \$191 per quarter to comply with the maintenance requirement of the rule.¹⁶ Thus annually, in the aggregate, funds spend

¹⁰ Typically, personnel from several departments, including portfolio management and compliance, share this task. The staff estimates that the average hourly rate for a compliance clerk is \$60, the average hourly rate for an assistant compliance director is \$340, and the average hourly rate for a senior portfolio manager is \$322, for a blended average hourly rate of \$240. With the exception of the estimates in footnote 27, all hourly rates for the occupations in this statement are from SIFMA's Management & Professional Earnings in the Securities Industry (2011), 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.

¹¹ This estimate is based on the following calculation: (0.5 hours x 3700 = 1850 hours).

¹² This estimate is based on the following calculation: (3700 transactions x \$120 = \$444,000).

¹³ The wage figure of \$20 is one third of an average compliance clerk's salary of \$60 per hour.

¹⁴ This estimate is based on the following calculations: (20 minutes x 3700 transactions = 74,000 minutes; 74,000 minutes / 60 = 1233 hours).

¹⁵ This estimate is based on the following calculation: (1233 hours x \$60 = \$73,980).

¹⁶ The staff estimates that a compliance clerk spends half an hour, at \$60 per hour, preparing the report and a compliance attorney spends half an hour, at \$322 per hour, reviewing the report for an average wage figure of \$191 per hour.

approximately 1200 hours¹⁷ at a cost of \$229,200 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 \$644¹⁹ per year.²⁰ Thus, annually, in the aggregate, the staff estimates that funds spend a total of approximately 600 hours²¹ at a cost of approximately \$193,200²² on monitoring and revising Rule 10f-3 procedures.

Based on an analysis of fund filings, the staff estimates that approximately 775 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 hours 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 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.²⁴ Assuming that all 775 funds that enter into new subadvisory contracts each year make the

¹⁷ This estimate is based on the following calculation: (1 hour per quarter x 4 quarters x 300 funds = 1200 hours).

¹⁸ This estimate is based on the following calculation: (1200 hours x \$191 = \$229,200).

¹⁹ This estimate is based on the following calculation: (2 hours x \$322 = \$644).

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: (300 funds x 2 hours = 600 hours).

²² This estimate is based on the following calculation: (300 funds x \$644 = \$193,200).

²³ Based on information in Commission filings, we estimate that 44.4 percent of funds are advised by subadvisers.

²⁴ This estimate is based on the following calculation (3 hours ÷ 4 rules = .75 hours).

modification to their contract required by the rule, we estimate that the rule's contract modification requirement will result in 581 burden hours annually, with an associated cost of approximately \$219,618.²⁵

Finally, the staff recognizes that there may be an additional one-time burden for fund boards to review and approve revised procedures designed to ensure compliance with the 2009 amendment to Rule 10f-3.²⁶ Commission staff estimates that each fund board would incur a one-time burden of two hours for a total burden for all fund boards of 600 hours at a cost of \$2.4 million.²⁷ Amortized over three years, this would be an annual burden of 0.67 hours per fund and 201 hours for all funds, at a cost of \$800,000.²⁸

The staff estimates, therefore, that Rule 10f-3 imposes an annual information collection burden of 5665 hours²⁹ at a cost of \$1,737,998.³⁰ 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. Cost Burden to Respondents

²⁵ These estimates are based on the following calculations: (0.75 hours × 775 portfolios = 581 burden hours); (\$378 per hour × 581 hours = \$219,618 total cost).

²⁶ References to Ratings of Nationally Recognized Statistical Rating Organizations IC-28939 (Oct. 2009) [74 FR 52373 (Oct. 9, 2009)]. We do not anticipate the revised procedures would require an increase in the current estimated time the board spends each quarter to review acquisitions of securities for compliance with Rule 10f-3.

²⁷ These estimates are based on the following calculations: 300 fund boards x 2 hours = 600 hours; 600 hours x \$4000 = \$2,400,000. The estimate of the hourly cost for a fund board is based on Commission estimates of an average board size of 8 directors and a cost of \$500 per hour for each director.

²⁸ These estimates are based on the following calculations: 300 fund boards x 0.67 hours = 201 hours; \$2,400,000 ÷ 3 = \$800,000.

²⁹ This estimate is based on the following calculation: (1850 hours + 1233 hours + 1200 hours + 600 hours + 581 hours + 201 hours = 5665 total burden hours).

³⁰ This estimate is based on the following calculation: (\$444,000 + \$73,980 + \$229,200 + \$193,200 + \$219,618 + \$800,000 = \$1,959,998).

There is no annual cost burden associated with complying with the information collection requirements in the rule, aside from the internal cost of the time burden 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. Cost to Federal Government

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. Changes in Burden

The estimated annual burden hours decreased by 787 hours from 6452 hours to 5665 hours. The decrease in hours reflects (i) a one-time burden based on an amendment to Rule 10f-3 the last time the hours were estimated, and (ii) a decrease in the estimated number of funds engaging in Rule 10f-3 transactions each year.

16. Information Collection Planned for Statistical Purposes

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

17. OMB Expiration Date Display

The Commission is not seeking such approval.

18. Exception to Certification Statement

This collection complies with the requirements in 5 CFR 1320.9.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable. The collection of information does not employ statistical methods.