

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
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) 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 (ii) 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

¹ 15 U.S.C. 80a-10(f).

² 17 CFR 270.10f-3. On June 1, 2018, Rule 10f-3 was amended to eliminate the requirement that funds provide the Commission with reports on Form N-SAR regarding any transactions effected pursuant to the rule. See *Investment Company Reporting Modernization*, Rel. No. IC-32314 (Oct. 13, 2016) (<https://www.sec.gov/rules/final/2016/33-10231.pdf>).

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 and Use 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 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. Consideration Given to 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 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 Not Conducting Collection

Records of transactions subject to Rule 10f-3 are created only when transactions take place in reliance on the rule. The rule also requires the board of directors to adopt procedures

⁴ 17 CFR 270.12d3-1.

⁵ 17 CFR 270.17a-10.

⁶ 17 CFR 270.17e-1.

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 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

⁷ 15 U.S.C. 80a-30(a).

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

Not applicable.

10. Confidentiality

Not applicable.

11. Sensitive Questions

No information of a sensitive nature, including social security numbers, will be required under this collection of information. The information collection does not collect personally identifiable information (PII). The agency has determined that a system of records notice (SORN) and privacy impact assessment (PIA) are not required in connection with the collection of information.

12. Burden of Information Collection

The following estimates of average internal 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 236 funds engage in a total of approximately 2,928 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

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

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 \$123 per transaction to document each transaction.¹⁰ Thus, annually funds spend approximately 1464 hours¹¹ at a cost of \$360,144 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 \$22 per transaction to comply with this part of the rule.¹³ The staff estimates that annually, in the aggregate, funds spend approximately 976 hours¹⁴ at a cost of \$65,392 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 \$210 per quarter to comply with the

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.

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 \$67, the average hourly rate for an assistant compliance director is \$353, and the average hourly rate for a senior portfolio manager is \$317, for a blended average hourly rate of \$246. All hourly rates for the occupations in this statement are from SIFMA's Management & Professional Earnings in the Securities Industry (2013), modified by Commission staff to account for an 1800-hour work-year and inflation and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

¹¹ This estimate is based on the following calculation: $(0.5 \text{ hours} \times 2,928 = 1,464 \text{ hours})$.

¹² This estimate is based on the following calculation: $(2,928 \text{ transactions} \times \$123 = \$360,144)$.

¹³ The wage figure of \$22 is one third of an average compliance clerk's salary of \$67 per hour.

¹⁴ This estimate is based on the following calculations: $(20 \text{ minutes} \times 2,928 \text{ transactions} = 58,560 \text{ minutes}; 58,560 \text{ minutes} / 60 = 976 \text{ hours})$.

¹⁵ This estimate is based on the following calculation: $(976 \text{ hours} \times \$67 = \$65,392)$.

maintenance requirement of the rule.¹⁶ Thus annually, in the aggregate, funds spend approximately 944 hours¹⁷ at a cost of \$198,240 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 \$704¹⁹ per year.²⁰ Thus, annually, in the aggregate, the staff estimates that funds spend a total of approximately 472 hours²¹ at a cost of approximately \$166,144²² on monitoring and revising Rule 10f-3 procedures.

Based on an analysis of fund filings, the staff estimates that approximately 299 new 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 \$67 per hour, preparing the report and a compliance attorney spends half an hour, at \$352 per hour, reviewing the report for an average wage figure of \$210 per hour.

¹⁷ This estimate is based on the following calculation: (1 hour per quarter x 4 quarters x 236 funds = 944 hours).

¹⁸ This estimate is based on the following calculation: (944 hours x \$210 = \$198,240).

¹⁹ This estimate is based on the following calculation: (2 hours x \$352 = \$704).

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: (236 funds x 2 hours = 472 hours).

²² This estimate is based on the following calculation: (236 funds x \$704 = \$166,144).

²³ Industry data provides that on average, 808 new fund portfolios were created each year for the past 3 years. Based on information in Commission filings, we estimate that 37 percent of funds are advised by subadvisers. Assuming that the number of new funds that use the services of subadvisers is proportionate to the number of funds that currently use the services of subadvisers, approximately 299 new funds enter into subadvisory agreements each year. We understand that existing funds may also enter into new subadvisory agreements, but in many cases would benefit from having previously drafted rule 10f-3 clauses in prior or existing subadvisory contracts.

²⁴ The staff estimates that the average hourly rate for an attorney is \$401.

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 299 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 224 burden hours annually, with an associated cost of approximately \$89,824.²⁶

The staff estimates, therefore, that Rule 10f-3 imposes an annual information collection burden of 4,080 hours²⁷ at a cost of \$879,744.²⁸

13. Cost to Respondents

Cost burden is the cost of services purchased to comply with rule 10f-3, such as for the services of compliance personnel or counsel. The cost burden does not include the cost of the internal hour burden discussed in Item 12 above. The Commission currently attributes no external cost burden to rule 10f-3.

14. Cost to the 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.

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 × 299 portfolios = 224 burden hours); (\$401 per hour × 224 hours = \$89,824 total cost).

²⁷ This estimate is based on the following calculation: (1,464 hours + 976 hours + 944 hours + 472 + 224 hours = 4,080 total burden hours).

²⁸ This estimate is based on the following calculation: (\$360,144 + \$65,392 + \$198,240 + \$166,144 + \$89,824 = \$879,744).

15. Changes in Burden

The estimated annual burden hours increased by 20 hours (from 4,060 hours to 4,080 hours). The increase in hours reflects revised estimates, including an increase in the estimated number of new fund portfolios entering into subadvisory agreements each year.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to Omit OMB Expiration Date

No applicable.

18. Exception to Certification Statement for Paperwork Reduction Act

Submission

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.