

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 affiliated 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 under the Act 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. In 2016, Rule 10f-3 was amended to eliminate the requirement that registered investment companies 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>). As of June 1, 2018, all registered investment companies became subject to Form N-CEN’s reporting requirements, including the requirement to report whether a fund (series) relied on Rule 10f-3 during the reporting period.

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 its conditions for exemptive 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, which are used by fund directors to evaluate transactions executed pursuant to the rule, may be reviewed by Commission staff as part of the Commission's compliance and examination program.

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 when transactions take place in reliance on the rule. Rule 10f-3 also requires the board of directors to adopt procedures for

⁴ 17 CFR 270.12d3-1.

⁵ 17 CFR 270.17a-10.

⁶ 17 CFR 270.17e-1.

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 of 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 of 1995 (“PRA”) (44 U.S.C. 3501 et seq.). The estimates are not derived from a comprehensive or even a representative survey or study of the costs of Commission rules. The information provided under Rule 10f-3 will not be kept confidential.

The staff estimates that approximately 953 funds engage in at least one Rule 10f-3 transaction each year, for a total of 953 such transactions.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 estimates that it takes an average fund approximately 30 minutes per transaction at a time cost of \$112 per transaction to document each transaction.⁹ Thus, annually funds spend approximately 477 hours¹⁰ at an internal cost of \$106,736 documenting these transactions.¹¹

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 \$24 per transaction to comply with this part of the

⁸ These estimates are based on data from Form N-CEN filings with the Commission for fiscal year 2020, in which registrants collectively reported that 930 open-end funds (series) and 23 closed-end funds relied on Rule 10f-3 ($930 + 23 = 953$ funds). Although BDCs may also rely on Rule 10f-3, they do not file on Form N-CEN, so our estimates for purposes of this PRA exclude BDCs.

Due to the amendments to Rule 10f-3 reporting requirements, we have changed our methodology for estimating burdens. Although most open-end registrants offer multiple series, Form N-SAR did not require registrants to identify which funds (series) relied on Rule 10f-3, so the staff's previous estimates for the number of funds that engaged in a Rule 10f-3 transaction were based on the number of registrants that filed a Form N-SAR report that included a Rule 10f-3 attachment, and the number of Rule 10f-3 transactions per fund (registrant) was estimated by applying a multiplier to the number of Form N-SARs with a Rule 10f-3 attachment. In contrast, Form N-CEN requires registrants that offer multiple series to identify each series that relied on the rule, which allows greater precision in estimating the number of funds likely to rely on Rule 10-3. However, because it does not require any specific information about Rule 10f-3 transactions, we assume for purposes of this PRA that that each fund reported to have relied on Rule 10f-3 engaged in one such transaction annually.

⁹ The staff estimates that this task is shared between a compliance clerk (\$72/hour) and a compliance attorney (\$373/hour), for a blended hourly wage rate of \$223 ($\$72 + \$373 \div 2 = \223), and a half-hour blended wage rate of \$112 ($\$223 \div 2 = \112). All hourly wage rates are derived 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.

¹⁰ This estimate is based on the following calculation: $(0.5 \text{ hours} \times 953 \text{ transactions} = 477 \text{ hours})$.

¹¹ This estimate is based on the following calculation: $(953 \text{ transactions} \times \$112 = \$106,736)$.

rule.¹² The staff estimates that annually, in the aggregate, funds spend approximately 318 hours¹³ at a cost of \$22,896 to comply with this aspect of Rule 10f-3's recordkeeping requirements.¹⁴

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 \$223 per quarter to comply with the maintenance requirement of the rule.¹⁵ Thus annually, in the aggregate, funds spend approximately 3,812 hours¹⁶ annually at a total internal cost of \$850,076 to comply with this recordkeeping requirement.¹⁷

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 \$746¹⁸ per year.¹⁹ Thus, annually, in the aggregate, the staff

¹² The wage figure of \$24 is one third of an average compliance clerk's hourly wage rate of \$72 ($\$72 \div 3 = \24).

¹³ This estimate is based on the following calculations: (20 minutes x 953 transactions = 19,060 minutes; 19,060 minutes / 60 = 318 hours).

¹⁴ This estimate is based on the following calculation: (318 hours x \$72 = \$22,896).

¹⁵ The staff estimates that a compliance clerk spends half an hour preparing the report and a compliance attorney spends half an hour reviewing the report, for a blended hourly wage rate of \$223 per hour. *See, supra* note 9.

¹⁶ This estimate is based on the following calculation: (1 hour per quarter x 4 quarters x 953 funds = 3,812 hours).

¹⁷ This estimate is based on the following calculation: (3,812 hours x \$223 = \$850,076).

¹⁸ This estimate is based on the following calculation: (2 hours x \$373 = \$746).

¹⁹ 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.

estimates that funds spend a total of approximately 1,906 hours²⁰ at a cost of approximately \$710,938²¹ on monitoring and revising Rule 10f-3 procedures.

Based on an analysis of Form N-CEN filings, the staff estimates that approximately 146 new funds enter into sub-advisory agreements each year.²² Based on discussions with industry representatives, the staff estimates that it will require approximately 0.75 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-3.²³ Assuming that all 146 new funds that enter into new subadvisory contracts each year make the modification to their subadvisory contracts required by the rule, we estimate that Rule 10f-3's subadvisory contract requirement will require a total of 110 burden hours annually for new funds, with an associated aggregate internal cost of approximately \$46,750.²⁴

As reflected in the table below, the staff estimates that complying with Rule 10f-3's requirements imposes an internal burden of 6,623 hours at an internal cost of approximately \$1,739,302. This estimate does not include the time spent to report a fund's reliance on Rule 10f-3 on Form N-CEN, which is subject to a separate PRA information collection.

²⁰ This estimate is based on the following calculation: (953 funds x 2 hours = 1,906 hours).

²¹ This estimate is based on the following calculation: (953 funds x \$746 = \$710,938).

²² Based on information in Form N-CEN filings, we estimate that approximately 139 new open-end funds and 7 new closed-end funds, or a total of 146 new funds enter into new subadvisory agreements each year (139 + 7 = 146 new funds). 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.

²³ Because such 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 (3 hours ÷ 4 rules = .75 hours/rule). The staff further estimates that the average hourly wage rate for an attorney to perform this service is \$425/hour.

²⁴ These estimates are based on the following calculations: (0.75 hours × 146 new funds = 110 burden hours); (\$425 per hour × 110 hours = \$46,750 total cost).

Rule 10f-3	Annual No. of Responses			Internal Annual Time Burden (Hrs.)			External Annual Cost Burden (\$)		
	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>
Document each 10f-3 transaction per fund		953		1,464	477	-987			
Maintain records for each 10f-3 transaction per fund		953		976	318	-658			
Maintain board materials for each quarterly review of a fund's 10f-3 transactions		3,812		944	3,812	+2,868			
Annually review and revise funds' procedures for 10f-3 transactions		953		472	1,906	+1,434			
Draft 10f-3-related clause for new funds' subadvisory contracts		146		224	110	-114			
TOTAL:	3,692	6,817	+3,125	4,080	6,623	+2,543	\$0	\$0	\$0

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. As reflected in the table above, the Commission continues to attribute 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.

15. Changes in Burden

The estimated annual burden hours increased by 2,543 hours (from 4,080 hours to 6,623 hours). The increase in hours reflects a change in methodology in estimating burdens due to changes in Rule 10f-3 reporting requirements, coupled with revised estimates, including an increase in the estimated number of funds that rely on Rule 10f-3 each year.²⁵ We continue to estimate no external cost associated with this information collection.

²⁵ See, *supra* note 8.

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.