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## The IDC No-Action Letter: Rationalizing Mutual Fund Board Responsibilities and Having the Right Oversight Conversations

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On October 12, 2018, the Securities and Exchange Commission's (SEC's) Division of Investment Management (Division) issued a no-action letter to the Independent Directors Council (IDC NAL)<sup>1</sup> as a first step by the SEC and the Division to rationalize the duties and responsibilities of mutual fund directors under the Investment Company Act of 1940 (1940 Act).

The IDC NAL permits a fund's board to rely on quarterly written representations from the chief compliance officer (CCO) that fund transactions effected pursuant to Rules 10f-3, 17a-7, and 17e-1 (each, an Exemptive Rule) complied with written procedures adopted by the board, instead of the board itself making that determination.

This article discusses the advent of the IDC NAL to highlight the policy concerns it implicates and describes the implementation of the IDC NAL by fund boards and advisers.

The IDC NAL is a product of the Divisions' Board Outreach Initiative, which began in 2017. In a speech four days after publication of the IDC NAL, the Division's director observed that an important lesson learned from the Board Outreach Initiative is the idea of having the "*right* conversation" and noted approvingly certain questions from directors that "are part of the *right* oversight

conversation for the boardroom" because such inquiries are more likely to reveal problems. Accordingly, the final section of this article discusses the desirability of an adviser explaining to a fund board how the adviser proposes to operate with respect to each Exemptive Rule, including explaining whether the adviser proposes to forego opportunities to rely on an Exemptive Rule. The factors influencing this portion of the adviser's operations are likely germane to an adviser and a board having the right oversight conversation. When a board understands fully how the adviser operates under each Exemptive Rule, the board is better positioned to conduct a review that can uncover any problems.

### Background

The legislative history of the 1940 Act makes it abundantly clear that, prior to the 1940 Act's enactment, "investment trusts," as they were then called, were frequently managed to benefit fund managers and insiders instead of investors.<sup>2</sup> Indeed, §1(b) of the 1940 Act states:

[I]t is declared that the national public interest and the interest of investors are adversely affected . . . when investment companies are organized, operated, managed, or their

portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons . . . rather than in the interest of all classes of such companies' security holders.

In the intervening years, the concerns about the self-dealing abuses underlying §1(b) have not disappeared. On the 50th anniversary of the 1940 Act, the SEC Chairman commissioned what became known as the Division's "Redbook" study, published in 1992.<sup>3</sup> The purpose of the Redbook study was to re-examine fund regulation to determine whether existing regulations were unnecessarily constraining or left gaps in investor protection. In the Redbook, the Division stated:

The restrictions on affiliated transactions were enacted in 1940 in response to a wide array of abuses that occurred in the 1920's and 1930's. The Division has concluded that these restrictions remain sound and should be preserved in all critical respects. For more than fifty years they have played a vital role in protecting the interests of shareholders and in preserving the industry's reputation for integrity; they continue to be among the most important of the Act's many protections.<sup>4</sup>

Putting a finer point on it, the Division also wrote that, "[f]rom the standpoint of investor protection . . . [the 1940 Act] provisions concerning affiliated transactions are at its heart and continue to serve as a fundamental protection."<sup>5</sup> Today, SEC oversight and enforcement of the 1940 Act's affiliated transaction provisions remain active.<sup>6</sup>

## The Statutory Provisions

The 1940 Act's provisions governing affiliated transactions appear in §§17 and 10 and are intended to prevent a fund from being injured by the self-dealing of persons in a position to overreach the

fund.<sup>7</sup> Broadly speaking, these provisions prohibit or regulate a fund's transactions with the following persons: (1) various fund insiders (for example, the fund's promoter), (2) statutory "affiliated persons"<sup>8</sup> of a fund, and (3) affiliated persons of a statutory affiliated person (each of the persons in (1)- (3), an affiliate).<sup>9</sup>

Section 17(a), with limited exceptions, prohibits an affiliate of a fund, acting as principal, from knowingly selling any security or other property to the fund and from knowingly purchasing any security or other property from the fund. The SEC has noted that §17(a) is intended primarily to proscribe "a purchase or sale transaction when a party to the transaction has both the ability and the pecuniary incentive to influence the actions of the investment company."<sup>10</sup>

Section 17(e) prohibits an affiliate of a fund, acting as an agent, from receiving any compensation for the purchase or sale of any property to or for the fund unless the affiliate is a broker acting in the regular course of its business. Section 17(e) was designed to eliminate the potential for self-dealing that exists when an affiliate of a fund, acting as agent, is compensated for purchases of property from, and sales of property to, the fund.<sup>11</sup>

Section 10(f) prohibits a fund, during the existence of any underwriting or selling syndicate, from acquiring any security a principal underwriter of which is an affiliate of the fund. Section 10(f) was intended to prevent a fund from being used to acquire securities during an underwriting to further an affiliate's interests instead of the fund's interests.<sup>12</sup>

## The Exemptive Rules

Provisions of the 1940 Act provide the SEC with authority to exempt, by regulation, persons and transactions from any provision of the 1940 Act. Over the years, the SEC has exercised its authority to promulgate exemptive rules that apply to the 1940 Act's affiliated transaction provisions based on the SEC's recognition that, under prescribed conditions intended to prevent self-dealing by affiliates,

the permitted affiliated transactions would benefit a fund.

The IDC NAL concerns the three Exemptive Rules:

1. Rule 10f-3 permits funds, under prescribed conditions, to purchase securities during the existence of an underwriting syndicate, notwithstanding an affiliation between any such fund and one or more members of the underwriting syndicate.<sup>13</sup>
2. Rule 17a-7 permits certain fund affiliates, subject to prescribed conditions, to purchase securities from, or sell securities to, the fund (that is, cross-trades). These transactions permit the fund and the affiliate, which may be another fund, to avoid transaction costs in the form of brokerage commissions and dealer mark-ups.<sup>14</sup>
3. Rule 17e-1 permits a fund affiliate to serve as the fund's broker to execute fund securities transactions on a securities exchange.<sup>15</sup> Funds relying on an affiliate broker may be able to obtain better execution through reduced transaction costs.

The Exemptive Rules share two attributes. First, each Exemptive Rule requires that the board of directors of a fund, including a majority of the directors who are not interested persons of the fund, to determine “no less frequently than quarterly” that all transactions made pursuant to the Exemptive Rule during the preceding quarter were effected in compliance with board-approved procedures that are reasonably designed to provide that the transactions satisfy the Exemptive Rule's conditions (each a required determination).<sup>16</sup>

Second, the SEC adopted each Exemptive Rule well before it adopted Rule 38a-1 in 2003.<sup>17</sup> Rule 38a-1 requires, among other things, each fund (1) to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws and (2) to designate a CCO, who reports directly to the fund's board, responsible for administering the policies and procedures. However, the adoption of Rule 38a-1 did not affect

the required determination within each Exemptive Rule, resulting in the duplication of some compliance oversight functions performed by, or under the supervision of, the CCO.

## **Board Responsibilities and the CCO: The First Director Outreach Initiative**

In an April 2007 address, Andrew Donohue, then Director of the Division, announced a “Director Outreach Initiative.”<sup>18</sup> He stated that, following the upheaval in 2003 (as the late trading and market timing scandals were exposed), the SEC “experienced the urgency of the situation as it adjusted its regulatory agenda to respond to this event.” Mr. Donohue stated that the Division had returned to “a state of normalcy” and announced the Director Outreach Initiative:

With the increase of regulations requiring action by fund boards, we risk overburdening directors and detracting them from their fundamental activities . . . I am reaching out to fund directors by attending industry meetings they attend and by attending fund board meetings. Through this effort I hope to learn the regulations and guidance that directors believe should be amended or revised that would make a big impact on their work.

In a November 2007 speech, Mr. Donohue shared some of the feedback that he had received in the Director Outreach Initiative, including feedback received on boards delegating oversight functions to CCOs:<sup>19</sup>

A third topic that has garnered director feedback is the role of the chief compliance officer and, in particular, whether the board should be permitted to delegate to the CCO some of the more detailed oversight responsibilities that ultimately rest with the board.

For example, some have suggested that the current requirements for the independent directors to determine at least quarterly that purchase and sale transactions among affiliates were effected in compliance with the fund's procedures could be properly monitored by the CCO who in turn could issue an exceptions report to the directors identifying any non-compliant transactions. As part of any recommendation to the Commission, we will examine what functions may be appropriately delegated to the CCO or other party. However, to this statement I would add two cautionary observations. First, the existence of a CCO in the fund hierarchy is relatively new, having only been required since 2004. Given this relatively short track record of experience, we all must be careful not to set up the CCO for failure by heaping too many responsibilities on his or her shoulders. Second, apart from the concern of overloading a CCO, we must be careful to make sure that the CCO is in fact the right person to shoulder a particular responsibility.

The Director Outreach Initiative did not result in immediate changes to board delegation of oversight functions to a CCO. In hindsight, this is not surprising. The Director Outreach Initiative coincided with the July 2007 collapse of two Bear Stearns hedge funds tied to subprime mortgages and, later, the September 2008 bankruptcy filing by Lehman Brothers (followed, the next day, by the Reserve Primary Fund breaking the buck).

Nonetheless, in February 2008, the Independent Directors Council (IDC) wrote a letter to Mr. Donohue regarding the Director Outreach Initiative, stating that certain routine, nondiscretionary regulatory requirements could be better handled by the adviser or the fund CCO.<sup>20</sup> The IDC letter also contained a list of specific recommendations and, leading the list, the IDC recommended that routine

quarterly reports required by the Exemptive Rules should be made to a person designated by the board and not directly to the board. The IDC maintained that, "because the quarterly review is, in essence, a compliance determination, the board might appropriately designate the fund CCO or fund compliance personnel as the appropriate reviewers of the transactions addressed by these rules," with any material compliance matters reported to the board pursuant to Rule 38a-1.

In May 2008, the Mutual Fund Directors Forum (MFDF) wrote a letter to Mr. Donohue regarding the Director Outreach Initiative containing a summary of MFDF members' suggestions regarding how the Division and the SEC could enhance the effectiveness of independent fund directors.<sup>21</sup> The MFDF letter's principal recommendation was that the SEC and the Division clarify their views on delegation to provide directors with more flexibility to delegate oversight activities. The MFDF letter offered several justifications for permitting such delegation, including the fact that "[r]ecent regulatory changes—particularly the requirement that every fund have a [CCO] who reports directly to the board—have made it more likely that boards can delegate certain functions without materially increasing the risk borne by shareholders."

## Developments in 2010

The next board-delegation development was a 2010 Division Staff letter to the IDC and the MFDF (2010 letter) in which the Staff rejected the proposition that a fund board could delegate its responsibility to make the required determinations to a CCO.<sup>22</sup> The Division Staff relied on a sort of *expressio unius* rationale, stating that its conclusion was based on (1) the plain language of each Exemptive Rule mandating a required determination by the board and (2) the fact that, when the SEC had wanted to permit delegation in connection with an Exemptive Rule, "it has done so clearly" (for example, the SEC's statements that boards may delegate to a directorial committee or other persons the task of drafting the

relevant Exemptive Rule procedures for the board's consideration).

Nevertheless, in the 2010 letter, the Division Staff announced that fund boards may, where consistent with the prudent discharge of their fiduciary duties, make the required determinations in reliance on summary quarterly reports from a CCO or other designated person. Thus, the 2010 letter was a step toward the position that the Division Staff ultimately articulated in the IDC NAL. Apparently, at that time, in the area of affiliated transactions, the SEC was unable to permit fund boards to follow the SEC's approach in adopting Rule 38a-1. Arguably, this is not that surprising because, in 2010, there were other competing priorities for the Division. For example, in 2009, the SEC proposed its first round of money market reforms<sup>23</sup> and amendments to the custody rule under the Investment Advisers Act following the Madoff scandal.<sup>24</sup> Moreover, the Division and the SEC, generally, were starting to focus on proposing new rules and rule amendments to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law in July 2010.

Bringing the story forward nearly to the present, in April 2013, Mary Jo White became the 31st Chair of the SEC, shortly before the SEC announced its second money market reform release.<sup>25</sup> In July 2015, Chair White issued a Statement on the Anniversary of the Dodd-Frank Act, in which she noted that the SEC "has taken action to address virtually all of the mandatory rulemaking provisions of the Dodd-Frank Act, and at the same time we have focused on additional measures to bolster our financial infrastructure."<sup>26</sup> Chair White provided a glimpse of what some of those "additional measures" might be in a December 2014 speech titled, "Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry."<sup>27</sup> In her December 2014 speech, she announced five elements on the SEC's agenda to address systemic risks posed by the asset management industry: (1) enhancing portfolio reporting to the SEC, (2) enhancing control of

open-end fund liquidity risk management, (3) limiting risks from investment company use of derivatives, (4) requiring adviser business continuity and transition planning, and (5) requiring annual stress testing by large investment advisers and large funds, as required by the Dodd-Frank Act.

During Chair White's tenure, which ended in January 2017, the SEC proposed Rule 18f-4, concerning investment companies' use of derivatives, in 2015.<sup>28</sup> In 2015 and 2016, the SEC proposed and adopted Rule 22e-4 (fund liquidity risk management (LRM) programs),<sup>29</sup> as well as modernized investment company reporting requirements.<sup>30</sup>

The 2013 money market reforms (effective in 2014) and the 2016 LRM program requirements (fully effective June 1, 2019), and other developments,<sup>31</sup> added incrementally to the burdens of fund boards.

## The 2017 Board Outreach Initiative

In June 2017, the MFDF wrote a letter to Jay Clayton,<sup>32</sup> the new SEC Chairman, to express the MFDF's concern that, in recent years, the SEC had placed too many burdens on fund directors and to request that the SEC carefully and systematically analyze and define the role it intends for directors to play. The MFDF letter highlighted certain of these burdens, including the facts that boards "[c]ontinue to oversee routine compliance matters, such as compliance with many of the affiliated transaction rules . . . [and the] staff has been wary of allowing boards to delegate these oversight functions to the fund CCO and other appropriate fund personnel."

In October 2017, the IDC wrote a letter to Dalia Blass,<sup>33</sup> whom the SEC, months earlier, had named as Director of the Division. The overarching purpose of the IDC letter was to request that the Division undertake a comprehensive review of fund directors' responsibilities for the purpose of modernizing the regulatory responsibilities of fund directors. To this end, the IDC letter highlighted industry and regulatory developments that had led to a larger and more complex workload for fund boards and maintained

that Rule 38a-1 had created an important and robust framework resulting in enhanced fund compliance, while assisting boards in meeting their compliance oversight responsibilities. Therefore, among other things, the IDC letter recommendations included:

[S]ome regulatory responsibilities imposed on directors before the adoption of rule 38a-1 were of a compliance nature and may be more appropriate for the CCO. Indeed, some of those responsibilities have become ritualistic and duplicate work already being performed by the fund's CCO or other advisory personnel, who are in much better positions than the fund's directors to fulfill those responsibilities. (See Appendix B for examples of suggested changes to these types of responsibilities.)

The IDC's Appendix B, "Recommendations to Eliminate Ritualistic Requirements," included the Exemptive Rules and five additional 1940 Act rules. With respect to the Exemptive Rules, the IDC recommended that the quarterly required determinations should be eliminated.

The recommendations in the 2017 letters from the MFDF and the IDC fell on receptive ears. At an industry conference in December 2017, Ms. Blass announced the Division's new "Board Outreach Initiative" "aimed at reviewing and reevaluating what we ask fund boards to do."<sup>34</sup> She noted that fund boards "have been central to managing the conflicts that may arise between funds and their service providers" and that, to this day, "shareholders rely on directors to help ensure that funds are managed in their best interests." However, Ms. Blass noted that, while the importance of the board has not changed, "the list of responsibilities has grown significantly in 77 years."

Ms. Blass emphasized that the purpose of revisiting board responsibilities was not that responsibilities should simply be shifted away from the board to somewhere else. Instead, she said, "we are asking if

funds could benefit from recalibrating the 'what' and the 'how' of board responsibilities." She concluded her discussion of the Board Outreach Initiative by noting that, as the Division gathers information, "we will be thinking about whether to recommend any recalibration of board duties."

In the following months, members of the Division Staff met with individual boards to solicit input from directors. The IDC NAL is an evident product of the Board Outreach Initiative.

## The IDC NAL

IDC NAL stated that the Division Staff will not recommend enforcement action "if a fund's board of directors receives, no less frequently than quarterly, a written representation from the [CCO] that transactions effected in reliance on [the Exemptive Rules] complied with the procedures adopted by the board pursuant to the relevant Exemptive Rule, instead of the board itself determining compliance."<sup>35</sup>

In the IDC NAL, the Division Staff also said that Rule 38a-1 was adopted to enhance the effectiveness of a fund's compliance program by, among other things, "assigning the responsibility for the administration of the program to the CCO." The Division Staff also expressed its agreement with the IDC's positions (stated in its incoming letter<sup>36</sup>) that (1) in adopting Rule 38a-1, the SEC "expressed a view that the proper role of the board with respect to compliance matters is to oversee the fund's compliance program without becoming involved in the day-to-day administration of the program" and (2) the no-action assurances requested by the IDC were "consistent with the [SEC's] approach in adopting Rule 38a-1 and would allow boards to avoid duplicating certain functions commonly performed by, or under the supervision of, the CCO."

In a footnote, the Division Staff stated that the 2010 letter, described above, could be disregarded.

Finally, the Division Staff stated that the IDC NAL will enhance directors' ability to focus on

conflict of interest concerns inherent to affiliated transactions, “including whether a fund engaging in the types of affiliated transactions permitted by the Exemptive Rules is in the best interest of that fund and its shareholders.” The IDC NAL also stated that the Division Staff’s position does not change the board’s oversight role with respect to a fund’s overall compliance program.

## Implementing the IDC NAL

The IDC NAL has two requirements: (1) a *written* representation from the CCO to the board that transactions made in reliance on an Exemptive Rule complied with procedures adopted by the board for each relevant Exemptive Rule and (2) the representation must be made no less frequently than quarterly. The Division Staff did not specify the form of written representation. In the underlying incoming letter from the IDC, the IDC asserted that the written representation may be in “whatever form the board determines in consultation with the CCO” and, as examples, posited that some boards may prefer a stand-alone document, while others may prefer a written representation within a CCO’s quarterly written report to the fund board concerning compliance issues. Both forms of written certifications should suffice. However, recall that the IDC NAL contains a reminder that it does not change the board’s oversight role concerning a fund’s overall compliance program.

Advisers and boards that rely on the IDC NAL should consider any necessary amendments to existing written policies and procedures related to the Exemptive Rules to reflect the quarterly representations that will be required from CCOs. Removing the longstanding quarterly item from a board’s calendar gives rise to a risk of an unforced error by the CCO; that is, what happens if, one quarter, a CCO failed to deliver the required written representation? Therefore, until delivery of the quarterly CCO representations is thoroughly ingrained in the memory of compliance and legal professionals (as the required determinations are now ingrained),

a quarterly agenda item, calling for receipt of the quarterly representations from the CCO regarding the Exemptive Rules, could help avoid considerable pain.

The required determinations do not consume a great deal of time in the boardroom. Therefore, boards that choose to rely on the IDC NAL should see only a small reduction in their workloads and only incrementally more flexibility to focus on matters in which they believe they have a meaningful role to play.

The IDC NAL is clearly a positive step forward in rationalizing the duties of a mutual fund board. As the SEC continues to develop responses based on the results of the Board Outreach Initiative, it will be interesting to see if the SEC or its Staff takes further actions to rationalize the responsibilities of mutual fund boards.

## Other Potential Implications

In a speech four days after publication of the IDC NAL,<sup>37</sup> the Director of the Division, Dalia Blass, summarized some of the lessons or “take-aways” that the Division Staff had learned through the Board Outreach Initiative. Ms. Blass stated that a “significant takeaway is the idea of having the *right* conversation.” She cited the requirement that boards make a quarterly determination that all Rule 17a-7 cross-trades by a fund were made in compliance with compliance procedures adopted pursuant to Rule 17a-7 and noted that directors question the value of a board’s trade-by-trade review. Instead, she said, directors want to focus on inquiries that are more likely to uncover problems (“Why is a fund crossing? How does that compare to similar funds in the complex? When the trade-by-trade data is analyzed as a whole, do we see a change or a trend that’s noteworthy?”). Ms. Blass noted approvingly that directors responding to the Board Outreach Initiative “argued that questions like these are part of the *right* oversight conversation for the boardroom” because they believe such inquiries are more likely to reveal problems.

Ms. Blass' statement is an invitation for a board to understand, and for an adviser to explain, how the adviser proposes to operate under each of the Exemptive Rules.<sup>38</sup> Thus, continuing with the Rule 17a-7 example, understanding why a fund is crossing also requires an understanding of why a fund is *not* crossing. After all, there are fund complexes for which Rule 17a-7 transactions number only in the tens each quarter, and there are other complexes for which the number of these transactions is significantly greater.

Multiple factors, both objective and subjective, can affect the number of Rule 17a-7 transaction opportunities, including:

- **Objective.** All other things equal, the number of Rule 17a-7 transaction opportunities increases as the size (assets under management) of the relevant complex increases.
- **Objective.** Complexes managing fixed-income securities in multiple portfolios with different average maturities tend to have more opportunities for Rule 17a-7 transactions.<sup>39</sup>
- **Subjective.** In two no-action letters,<sup>40</sup> the Division Staff agreed not to recommend enforcement action if a municipal bond fund effected Rule 17a-7 transactions in municipal fixed-income securities for which market prices were not readily available at prices provided by an independent pricing service. Some advisers rely on these no-action letters with respect to fixed-income securities other than municipal fixed-income securities, thereby affecting the number of potential Rule 17a-7 transactions.
- **Subjective.** Each Rule 17a-7 transaction imposes incremental compliance costs borne by a fund's adviser, as well as exposing the adviser to potential reimbursement costs (among other potential costs), if it fails to meet the requirements of Rule 17a-7, even if inadvertently. Advisers can reasonably reach different estimates of the risks that Rule 17a-7 transactions present to the adviser based on their different circumstances. This, too,

will affect the number of potential Rule 17a-7 transactions.

Each of these factors, as well as others not listed here for brevity,<sup>41</sup> are likely germane to an adviser and a board when having the right oversight conversation. Many advisers have already had this conversation with fund boards and, of course, the conversation does not have to be repeated quarterly. Instead, the point is that, if a board understands how the adviser operates under Rule 17a-7, the board is better positioned—in narrow reviews under Rule 17a-7 that focus on the number and trend of Rule 17a-7 transaction—to conduct a review likely to reveal any problems. As always, context matters. The same is true for the other Exemptive Rules.

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#### NOTES

- <sup>1</sup> Independent Directors Council, SEC No-Action Letter (pub. avail. Oct. 12, 2018).
- <sup>2</sup> See, e.g., Sen. Comm. on Banking and Currency, 76th Cong. 3d Sess., S. Rep. No. 1775, at 7 (1940) ("The representatives of the investment trust industry were of the unanimous opinion that 'self-dealing'—that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated—presented opportunities for gross abuse by unscrupulous persons, through unloading of securities upon the companies, unfair purchases from the companies, the obtaining of unsecured or inadequately secured loans from the companies, etc.").
- <sup>3</sup> *Protecting Investors: A Half Century of Investment Company Regulation*, Division of Investment Management, SEC (May 1992), at iv, available at <https://www.sec.gov/divisions/investment/guidancelicreg50-92.pdf>.

- <sup>4</sup> *Id.* at 473.
- <sup>5</sup> *Id.* at 483.
- <sup>6</sup> *See, e.g., In the Matter of Cushing Asset Management, LP*, Admin. Proc. No. 3-18767 (Sept. 14, 2018) (§17(a) violation); Mutual of America Capital Management LLC, SEC No-Action Letter (pub. avail. Oct. 26, 2017) (cautioning adviser that proposed fund of funds arrangement would violate Rule 17d-1).
- <sup>7</sup> *United States v. Deutsch*, 451 F.2d 98, 108 (1971), *cert. den.* 404 U.S. 1019 (1972). *See* S. Rep., *supra* n.2, at 6-7; Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 3580, 76th Cong., 3d Sess., at 130-131 (1940) (Senate Hearings).
- <sup>8</sup> A person's "affiliated persons" are defined in §2(a)(3) of the 1940 Act.
- <sup>9</sup> *See generally* David M. Geffen, "Classifying Affiliates under the Investment Company Act," 16 *The Investment Lawyer* 16 (Feb. 2009).
- <sup>10</sup> *See* Rel. No. IC-10886 (Oct. 2, 1979), *citing* Senate Hearings, *supra* n.7, at 256-259.
- <sup>11</sup> *See id.* at 262; Hearings Before a House Subcomm. of the House Comm. on Interstate and Foreign Commerce on H.R. 10065, 76th Cong., 3d Sess., at 98 (1940).
- <sup>12</sup> The abuses included "dumping" unmarketable securities by an underwriter that controlled the fund. *See* Rel. No. IC-21838 (Mar. 21, 1996); Senate Hearings, *supra* n.7, at 35.
- <sup>13</sup> Rule 10f-3, in its original form adopted in 1958 as Rule N-10-3, was based on experience gained by the SEC in its consideration of requests for exemptive orders. *See* Rel. No. IC-2797 (Dec. 2, 1958).
- <sup>14</sup> In 1966, the SEC adopted Rule 17a-7 to eliminate filing and processing exemptive applications under §17(b) of the 1940 Act where there was little likelihood that the statutory finding for a specific exemption under that section could not be made. *See* Rel. No. IC-4697 (Sept. 8, 1966).
- <sup>15</sup> The advent of Rule 17e-1 in 1979 followed a convoluted path. Section 17(e)(2) permits a fund affiliate to serve as broker for the fund with respect to securities exchange transactions. In such transactions, §17(e)(2)(A) limits the affiliate-broker's compensation to the "usual and customary broker's commission." In 1975, the SEC adopted Rule 19b-3 under the Exchange Act prohibiting fixed commission rates established by national securities exchanges, resulting in negotiated commission rates. *See* Rel. No. 34-11203 (Jan. 23, 1975) (codified in certain respects by §6(e)(1) of the Exchange Act). In turn, negotiated commission rates made it impracticable to determine the "usual and customary broker's commission" with respect to any brokerage transaction on a securities exchange. *See* Rel. No. IC-10605 (Feb. 27, 1979). Rule 17e-1 was adopted to resolve this problem. *See id.*
- <sup>16</sup> *See* Rules 10f-3(c)(10)(iii), 17a-7(e)(3) and 17e-1(b)(3).
- <sup>17</sup> *See* Rel. No. IC-26299 (Dec. 17, 2003).
- <sup>18</sup> Andrew J. Donohue, Keynote Address at the Practising Law Institute Investment Management Institute 2007 (Apr. 12, 2007), available at <https://www.sec.gov/news/speech/2007/spch041207ajd.htm>.
- <sup>19</sup> Andrew J. Donohue, Keynote Address at the Investment Company Directors Conference (Nov. 6, 2007), available at <https://www.sec.gov/news/speech/2007/spch110607ajd.htm>.
- <sup>20</sup> Letter from Robert W. Uek, Chair, IDC Governing Council, to Andrew J. Donohue, Director, Division of Investment Management, SEC (Feb. 26, 2008), available at <http://www.ici.org/pdf/22275.pdf>.
- <sup>21</sup> Letter from David B. Smith, Jr., MFDF Executive Vice President, to Andrew J. Donohue, Director, Division of Investment Management, SEC (May 2, 2008), available at [https://mfdf.org/images/DirResPDFs/Director\\_Duties\\_MFDF\\_Letter\\_May\\_2\\_2008.pdf](https://mfdf.org/images/DirResPDFs/Director_Duties_MFDF_Letter_May_2_2008.pdf).
- <sup>22</sup> Independent Directors Council and Mutual Fund Directors Forum, SEC No-Action Letter (pub. avail. Nov. 2, 2010).

- <sup>23</sup> See Rel. No. IC-28807 (Jun. 30, 2009).
- <sup>24</sup> See Rel. No. IA-2876 (May 20, 2009).
- <sup>25</sup> See Rel. No. IC-30551 (Jun. 5, 2013).
- <sup>26</sup> Mary Jo White, Public Statement (Jul. 16, 2015), available at <https://www.sec.gov/news/statement/statement-on-the-anniversary-of-the-dodd-frank-act.html>.
- <sup>27</sup> Mary Jo White, Speech to The New York Times DealBook Opportunities for Tomorrow Conference (Dec. 11, 2014), available at <https://www.sec.gov/news/speech/2014-spch121114mjw>.
- <sup>28</sup> See Rel. No. IC-31933 (Dec. 11, 2015).
- <sup>29</sup> See Rel. No. IC-32315 (Oct. 13, 2016).
- <sup>30</sup> See Rel. No. IC-32314 (Oct. 13, 2016).
- <sup>31</sup> See, e.g., Division of Investment Management, SEC, IM Guidance Update (Jan. 2016) (enhancing board oversight of fund payments for services to financial intermediaries), available at <https://www.sec.gov/investment/im-guidance-2016-01.pdf>.
- <sup>32</sup> Letter from Susan F. Wyderko, MFDF President, to Jay Clayton, Chairman, SEC (Jun. 20, 2017), available at <https://mfdf.org/images/uploads/newsroom/Clayton2017.pdf>.
- <sup>33</sup> Letter from Amy B.R. Lancellotta, IDC Managing Director, to Dalia Blass, Director, Division of Investment Management, SEC (Oct. 16, 2017), available at <https://www.ici.org/pdf/30912a.pdf>.
- <sup>34</sup> Dalia Blass, Keynote Address: ICI Securities Law Developments Conference (Dec. 7, 2017), available at <https://www.sec.gov/news/speech/blas-keynote-ici-securities-law-developments-conference-2017>.
- <sup>35</sup> Independent Directors Council, SEC No-Action Letter (pub. avail. Oct. 12, 2018).
- <sup>36</sup> Letter from Amy B.R. Lancellotta, IDC Managing Director, to Paul Cellupica, Deputy Director and Chief Counsel, Division of Investment Management, SEC (Oct. 12, 2018), available at <https://www.sec.gov/divisions/investment/noaction/2018/independent-directors-council-101218-incoming.pdf>.
- <sup>37</sup> Dalia Blass, Director, Division of Investment Management, Remarks at the IDC 2018 Fund Directors Conference (Oct. 16, 2018), available at <https://www.sec.gov/news/speech/speech-blass-101618>.
- <sup>38</sup> This assumes that there is an affiliate institutional broker to handle funds' Rule 17e-1 transactions and an affiliate securities underwriter that would implicate Rule 10f-3.
- <sup>39</sup> As the securities held by a long-term bond fund move towards maturity, the adviser may rely on Rule 17a-7 to move the securities to an intermediate-term fund and, subsequently, to a short-term fund. With respect to a debt instrument that is either a §2(a)(16) "government security" or a Rule 2a-7(a)(11) "eligible security," the adviser may rely on Rule 17a-7 to acquire the instrument for a money market fund. Similarly, the debt of an issuer that has its credit rating lowered may be the subject of Rule 17a-7 transactions where the acquiring fund is permitted to hold the lower quality instrument.
- <sup>40</sup> See Federated Municipal Funds, SEC No-Action Letter (pub. avail. Nov. 20, 2006); United Municipal Bond Fund, SEC No-Action Letter (pub. avail. Jan. 27, 1995).
- <sup>41</sup> See, e.g., Fidelity Management & Research Co., SEC No-Action Letter (pub. avail. June 13, 1988) (permitting funds to rely on Rule 17a-7 to purchase and sell currencies between themselves).

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