customer funds until such investments are withdrawn from segregation.

4. Section 1.27 is amended by revising paragraphs (a)(4) and (b)(2) to read as follows:

§ 1.27 Record of investments.

(a) * * *

(4) A description of the obligations in which such investments were made, including the CUSIP numbers;

* * * * *

(b) * * *

(2) A description of such documents, including the CUSIP numbers; and

* * * * *

Issued in Washington D.C. on July 28, 1997, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 97–20766 Filed 8–6–97; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release Nos. IC–22775, IS–1095; File No. S7–7–96]

RIN 3235–AG61

Exemption for the Acquisition of Securities During the Existence of An Underwriting or Selling Syndicate

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting amendments to the rule under the Investment Company Act of 1940 that permits an investment company that is related to certain participants in an underwriting to purchase securities during an offering, if certain conditions are met. The amendments increase the percentage of an underwriting that investment companies having the same investment adviser may purchase in reliance on the rule, and expand the scope of the rule to include securities of certain foreign and domestic issuers that are not registered with the Commission under the Securities Act of 1933. The amendments respond to changes in the investment company and underwriting industries that have occurred since the rule last was substantively amended in 1979.

EFFECTIVE DATE: The rule amendments will become effective October 6, 1997.

FOR FURTHER INFORMATION CONTACT: C. Hunter Jones, Special Counsel, Office of Regulatory Policy, or Nadya B. Roytblat, Assistant Director, Office of Investment Company Regulation, Division of Investment Management, at (202) 942–0690, U.S. Securities and Exchange Commission, 450 5th Street, N.W., Mail Stop 10–2, Washington, D.C. 20549.

Requests for formal interpretive advice should be directed to the Office of Chief Counsel at (202) 942–0659, Division of Investment Management, U.S. Securities and Exchange Commission, 450 5th Street, N.W., Mail Stop 10–6, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is adopting amendments to rule 10f–3 (17 CFR 270.10f–3) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the ''Investment Company Act'').

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Executive Summary

The Commission is adopting amendments to rule 10f–3 under the Investment Company Act. Rule 10f–3 provides an exemption from section 10(f), which prohibits any registered investment company (''fund'') from purchasing securities for which an underwriter having certain relationships with the fund (''affiliated underwriter'') is acting as a principal underwriter during the existence of an underwriting or selling syndicate for the securities. The amendments are intended to provide funds with additional flexibility, consistent with the protection of investors, to make investments that may be in the best interests of investors.

The amendments will permit a fund subject to the rule, together with other funds that have the same investment adviser, to purchase, during the existence of an underwriting or selling syndicate:

- Up to 25% of the principal amount of an offering;
- Securities of foreign issuers or of domestic reporting issuers in an ''Eligible Foreign Offering''; and
- Certain securities that are exempt from registration and are eligible for resale pursuant to rule 144A under the Securities Act of 1933 (''Securities Act'').

The Commission is not adopting the amendment that would have permitted a fund subject to the rule to purchase municipal securities in a group sale (*i.e.*, a purchase for which all members of an underwriting syndicate, including the affiliated underwriter, receive credit). Rather, in light of the comments, the Commission has concluded that there is insufficient justification at this time to alter the treatment of group sales of municipal securities under rule 10f–3.

I. Background

A. Introduction

Section 10(f) of the Investment Company Act was designed to address one of the major abuses noted in the period before enactment of the Investment Company Act—the use of funds by underwriters that controlled these funds as a ''dumping ground'' for unmarketable securities.[1] An underwriter could, for example, ''dump'' unmarketable securities on its controlled fund, either by causing the fund to purchase the securities from the underwriter itself, or by encouraging the fund to purchase securities from another member of the underwriting syndicate. Fund assets also could be used to absorb the risks of an underwriting in more subtle ways, such as by facilitating price stabilization in connection with an underwriting.

Section 10(f) prohibits any fund from purchasing any security for which an affiliated underwriter is acting as a principal underwriter,[2] during the existence of an underwriting or selling syndicate for that security.[3] Congress

[1] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 35 (1940) (statement of Commissioner Healy).

[2] ''Principal underwriter'' is defined in section 2(a)(29) of the Investment Company Act [15 U.S.C. 80a–2(a)(29)] to mean (in relevant part) an underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer, (B) acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate, or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

[3] Section 10(f) [15 U.S.C. 80a–10(f)] prohibits a fund from purchasing a security during the

Continued

recognized that section 10(f), by prohibiting all purchases by a fund having the specified relationships with an underwriter (''affiliated fund'') during the existence of the underwriting or selling syndicate, could be overly broad. Thus, Congress gave the Commission specific authority to exempt persons from that prohibition when an exemption would be consistent with the protection of investors.[4]

In 1958, the Commission used its exemptive authority under section 10(f) to adopt rule 10f–3.[5] The rule currently permits a fund to purchase securities in a transaction that otherwise would violate section 10(f) if, among other things, (i) the securities either are registered under the Securities Act or are municipal securities, (ii) the offering involves a ''firm commitment'' underwriting,[6] (iii) the fund and all other funds advised by the same investment adviser do not in the aggregate purchase more than the greater of 4% of the principal amount of the securities being offered or $500,000 (but in no event greater than 10% of the offering) (the ''percentage limit''), (iv) the fund does not use more than 3% of its assets to purchase the securities, (v) the fund purchases the securities from a member of the syndicate other than the affiliated underwriter, (vi) the fund purchases the securities at a price not more than the public offering price prior to the end of the first day on which the securities are offered, and (vii) the fund's directors have adopted procedures for purchases made in reliance on the rule and regularly review fund purchases to determine whether they comply with these procedures.[7] The conditions of rule 10f–3 are designed to ensure that a purchase by a fund from a syndicate in which an affiliated underwriter is participating is consistent with the protection of fund investors.

B. Proposed Amendments to Rule 10f–3

On March 21, 1996, the Commission issued a release proposing amendments to rule 10f–3 (''Proposing Release'').[8] The proposed amendments to rule 10f–3 were intended to respond to concerns that the dramatic growth in the fund industry, combined with increasing concentration in the underwriting industry, and increasing business affiliations between funds and underwriters, had made the percentage limit too restrictive. The Proposing Release also noted that these trends have caused more funds to be subject to the prohibitions of section 10(f).[9]

The proposed amendments were designed to balance these concerns with the need for funds to have more flexibility to purchase securities when their affiliated underwriters are members of syndicates. The proposed amendments would have eased some of the restrictions of the rule to take into account fundamental changes in the industry, while preserving those parts of the rule that continue to protect investors.

The Commission received 18 comment letters on the proposed amendments to rule 10f–3. Commenters were supportive of the direction of the proposed amendments; many urged the Commission to further loosen the restrictions imposed by the rule. The Commission is adopting amendments to rule 10f–3 with a number of changes from the amendments as proposed, in view of the issues raised by commenters.[10]

II. Discussion

A. Quantity Limitations

1. Percentage of Offering Purchased

Rule 10f–3 limits the amount of securities that affiliated funds may purchase during the existence of an underwriting or selling syndicate. As discussed in the Proposing Release, the purpose of the percentage limit is to provide an indication that a significant portion of an offering is being purchased by persons other than a single affiliated fund complex.[11]

The percentage limit in rule 10f–3 currently prohibits funds advised by the same investment adviser from purchasing, in the aggregate, more than 4% of the principal amount of the offering, or $500,000, whichever is greater, but in no event more than 10% of the offering.[12] The Proposing Release noted that the current percentage limit appears to be more restrictive than necessary for the protection of fund investors. As a result, the percentage limit may impose unnecessary costs. Affiliated funds that are limited to purchasing 4% of an offering, if they wish to purchase more than that amount, must wait until the underwriting or selling syndicate terminates, and purchase the securities in the secondary market. This delay can cause these funds to pay a significantly higher price for the securities and incur significant additional transaction costs.[13] Thus, funds that are restricted

existence of an underwriting or selling syndicate if a principal underwriter of the security is an officer, director, member of an advisory board, investment adviser, or employee of the fund, or is a person of which any such officer, director, member of an advisory board, investment adviser, or employee is an affiliated person. As noted above, for purposes of this release, a person that falls within one of these categories is referred to as an ''affiliated underwriter,'' even though the Investment Company Act defines the term ''affiliated person'' to include a broader set of relationships. *See* section 2(a)(3) of the Investment Company Act [15 U.S.C. 80a–2(a)(3)]. Similarly, this release refers to a fund that is subject to section 10(f) as a result of its relationship with an ''affiliated underwriter,'' as an ''affiliated fund.''

[4] Section 10(f) authorizes the Commission to exempt, by rule or order, conditionally or unconditionally, ''any transaction or classes of transactions from any of the provisions [of section 10(f)], if and to the extent that such exemption is consistent with the protection of investors.'' By contrast, section 6(c) of the Investment Company Act [15 U.S.C. 80a–6(c)] authorizes the Commission more generally to exempt persons, securities, or transactions from provisions of the Investment Company Act if ''necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions'' of the Investment Company Act.

[5] *See* Adoption of Rule N–10F–3 Permitting Acquisition of Securities of Underwriting Syndicate Pursuant to Section 10(f) of the Investment Company Act of 1940, Investment Company Act Release No. 2797 (Dec. 2, 1958) [23 FR 9548 (Dec. 10, 1958)]. The rule codified the conditions of orders that the Commission had granted prior to 1958 exempting certain funds from section 10(f) to permit them to purchase specific securities.

[6] A ''firm commitment'' underwriting, for purposes of rule 10f–3, is one in which the underwriters are committed to purchase all of the securities being offered, if the underwriters purchase any of the securities being offered. *See* amended rule 10f–3(b)(5) [17 CFR 270.10f–3(b)(5)].

[7] The provisions of rule 10f–3 are similar to provisions permitting limited affiliated transactions by persons subject to section 406 of the Employee Retirement Income Security Act of 1974 (''ERISA'') [29 U.S.C. 1106] and by banks subject to section 23B of the Federal Reserve Act [12 U.S.C. 371c–1]. *See* Prohibited Transaction Class Exemption 75–1 (Oct. 24, 1975) (Department of Labor class exemption permitting purchases in limited circumstances, subject to conditions similar to rule 10f–3); section 23B(b) of the Federal Reserve Act [12 U.S.C. 371c–1(b)] (prohibiting a bank or its subsidiary from purchasing, as principal or fiduciary, securities from underwriting syndicates in which an affiliate of the bank participates, but permitting acquisitions of such securities if a majority of the bank's independent directors have approved the acquisition in advance).

[8] Exemption for the Acquisition of Securities During the Existence of an Underwriting Syndicate, Investment Company Act Release No. 21838 (Mar. 21, 1996) [61 FR 13630 (Mar. 27, 1996)].

[9] *See* Proposing Release, *supra* note 8, at nn.9–20 and accompanying text; *see also* Jack Willoughby, Fortify'*40—or Fight,* **Institutional Investor,** Jan. 1997, at 15–16 (noting increasing affiliation between fund management and securities underwriting firms).

[10] The amendments also add headings to the text of rule 10f–3 in order to make the rule more understandable and usable. In addition, the title of the rule has been changed to ''Exemption for the acquisition of securities during the existence of an underwriting or selling syndicate'' to conform to the language of section 10(f).

[11] *See* Proposing Release, *supra* note 8, at n.14 and accompanying text.

[12] Rule 10f–3(d).

[13] In many instances, particularly in the equity market, the price of a security increases, sometimes dramatically, after an initial public offering. *See, e.g.*, I Louis Loss & Joel Seligman, Securities Regulation 333 n.28 (1989); Jonathan A. Shayne &

by the percentage limit of rule 10f–3 might not be able to purchase desirable securities at prices that would benefit their portfolios.[14] In addition, because compliance with the percentage limit is based on purchases by all funds with the same investment adviser, the percentage limit presents particular problems for fund complexes that have several funds that might have an interest in purchasing the security.[15]

In response to these concerns and changes in the industry, the Commission proposed to amend the percentage limit to permit funds relying on the rule to purchase up to the greater of 10% of the principal amount of an offering, or $1 million, but in no event more than 15% of the offering.[16] Commenters generally agreed with the reasons for raising the percentage limit. Most commenters stated that the percentage limit should be significantly higher than that proposed, and many suggested that the percentage limit be eliminated entirely. No commenter suggested that the current percentage limit be retained or lowered. Commenters differed, however, on the appropriate percentage limit.[17]

The Commission continues to believe that the percentage limit provides assurance that a significant portion of an offering will be purchased by persons other than a single fund complex affiliated with an underwriter, and should continue to be a component of the protections afforded by rule 10f–3. At the same time, the constraints of the percentage limit appear to be more restrictive on funds than they have been in the past, as a result of the growth in the fund industry and the increasing importance of funds as purchasers of securities.[18] These effects have been particularly acute for municipal bond funds.[19]

Subsequent to the Commission's adoption of the current percentage limit in 1979, fund ownership of securities increased substantially, both in absolute levels and as a percentage of total securities owned by all securityholders.[20] Given the consistent, dramatic growth in fund assets, and in light of the Commission's administrative experience with rule 10f–3 as well as the protections provided by the rule's other conditions, the Commission believes that adopting a percentage limit higher than the proposed limit is appropriate.[21]

The Commission has amended rule 10f–3 to provide a 25% limit on the principal amount of an offering that affiliated funds may purchase. A percentage limit of 25% of the principal amount of an offering should provide assurance that a significant portion of the offering is being distributed to investors not affiliated with the funds, while affording significant relief to purchasing funds compared to the percentage limit currently imposed in rule 10f–3. The Commission believes that a 25% limit would prevent a single fund complex affiliated with an underwriter from purchasing the majority of an offering, and should provide some assurance that purchasers other than one or two fund complexes affiliated with the underwriters are purchasing securities in the offering.[22] The Commission recognizes that this limit is significantly below that suggested by many industry commenters. The Commission is unconvinced at this time, however, that the case for raising the percentage limit higher has been made persuasively by commenters.

2. Percentage of Fund Assets

Rule 10f–3 currently prohibits a fund from using more than 3% of its assets to acquire securities in a transaction in reliance on the rule (the ''3% limit'').[23] The Commission proposed to eliminate this limit, noting that the other provisions of rule 10f–3 provide sufficient protections against dumping, and that the diversification provisions of the Investment Company Act provide shareholders of most funds with protections similar to those provided by the 3% limit.[24] Commenters supported the proposed amendment eliminating the 3% limit, which the Commission is adopting.

B. Foreign Offerings and Rule 144A Securities

A fund currently cannot rely on rule 10f–3 to purchase securities of any issuer, including a foreign issuer, unless the securities are registered under the Securities Act or are municipal securities. The proposed amendments would have permitted a fund to purchase securities issued by a foreign issuer that were not registered under the Securities Act if the securities were issued in either an ''Eligible Foreign Offering'' or a ''Foreign Issuer Rule 144A Offering,'' as defined in the proposed amendments. Commenters generally supported extending the rule to purchases of foreign securities that are not registered under the Securities Act. The Commission is adopting the amendments related to foreign

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Larry D. Soderquist, *Inefficiency in the Market for Initial Public Offerings*, 48 Vand. L. Rev. 965 (1995). There are additional potential costs to purchasing securities in the secondary market. In secondary market purchases, for example, funds must pay brokerage commissions that they usually do not pay when purchasing directly in an underwritten offering.

[14] Funds in a large fund complex also may find it inefficient to purchase only 4% of an offering, particularly if the total offering amount is small. For these funds, 4% of an offering may be too small an amount to have any significant effect on the funds' portfolios. The portfolio managers of the funds may then decide not to purchase the security at all.

[15] For example, some fund complexes have over fifty funds. Perhaps as many as twenty of the funds might be interested in purchasing a security in a primary offering because investing in the security is consistent with each fund's investment objectives. In that case, those twenty funds must limit their total purchases of the security to the greater of 4% of the offering or $500,000, but in no event more than 10% of the offering.

[16] *See* Proposing Release, *supra* note 8, at nn.21–26 and accompanying text.

[17] Comments ranged from supporting the percentage limit as proposed, to a percentage limit as high as 80%.

[18] As the Proposing Release noted, in 1980 there were 564 funds with total assets of $134.8 billion, and in 1995 there were 5,789 funds with total assets of over $2.8 trillion. Proposing Release, *supra* note 8, at n.10. By December 1996, there were 6,270 funds with total assets of over $3.5 trillion. Investment Company Institute, Press Release (Jan. 28, 1997). Assets invested in funds currently exceed account deposits at commercial banks. *See* Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States (Mar. 14, 1997) (table L.109).

[19] Increases in the demand for municipal bonds by mutual funds have outpaced increases in the supply of new municipal bonds. In 1980, 42 municipal bond funds held under $3 billion in municipal bonds. By 1996, 1,180 municipal bond funds held over $287 billion in municipal bonds. By contrast, the growth in municipal bond supply has grown only modestly: in 1980, approximately $47 billion in municipal bonds were issued; by 1996, issuances had only grown about fourfold, to $184 billion. Investment Company Institute, 1997 Mutual Fund Fact Book 68; Investment Company Institute, 1986 Mutual Fund Fact Book 19; Investment Company Institute, 1981 Mutual Fund Fact Book 77; Investment Company Institute, Press Release (Jan. 28, 1997); Bond Buyer, 1997 Yearbook 11; Bond Buyer, 1990 Yearbook 38; Lipper Closed-End Fund Performance Analysis Service (Jan. 1997), at 78. Some commenters noted that the withdrawal of several investment banks from the municipal bond business has intensified these pressures.

[20] In 1979, funds (not including insurance company separate accounts) owned approximately 2% ($61.6 billion) of outstanding securities (including U.S. government securities); in 1996, funds owned approximately 13% ($2.7 trillion) of outstanding securities, an increase in the percentage of ownership of over 500% compared to 1979. *See* Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, 1979–1988 (Mar. 14, 1997) (tables L.209 through L.214); Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States (Mar. 14, 1997) (tables L.209 through L.214).

[21] *See* amended rule 10f–3(b)(7) [17 CFR 270.10f–3(b)(7)].

[22] With respect to the calculation of the percentage limit in Eligible Rule 144A Offerings, *see infra* note 34 and accompanying text. With respect to the calculation of the percentage limit in multi-class or multi-tranche offerings, *see infra* Section II.B.3.

[23] Rule 10f–3(e).

[24] *See* section 5(b)(1) of the Investment Company Act [15 U.S.C. 80a–5(b)(1)] (limiting a diversified fund to investing, with respect to 75% of its assets, no more than 5% of its assets in the securities of a single issuer).

securities, with certain modifications from the proposal in response to issues raised by commenters, as described below.

In considering the proposed amendments related to offerings of foreign securities, the Commission also focused on similar issues related to domestic issuers that might sell their securities outside the United States or privately in unregistered offerings. The Commission has concluded that rule 10f–3 should be extended to securities of certain domestic issuers that are sold in foreign offerings or that are exempt from registration and eligible for resale pursuant to rule 144A.[25]

1. Eligible Foreign Offerings

The amendments permit an affiliated fund to purchase securities in a public offering that is conducted under the laws of a country other than the United States (''Eligible Foreign Offering'').[26] An Eligible Foreign Offering must be subject to regulation by a foreign financial regulatory authority, as defined in the Investment Company Act, in the country in which the public offering occurs.[27] The rule also requires that financial statements of the issuer of the securities that are prepared and audited in a manner required or permitted by the appropriate foreign financial regulatory authority in the country in which the Eligible Foreign Offering occurs, for the two years prior to the offering, must be made available in connection with the offering.[28]

The rule, as proposed, would have limited Eligible Foreign Offerings to offerings by foreign issuers. The Commission has decided to permit an affiliated fund to purchase a domestic issuer's securities offered in an Eligible Foreign Offering, provided that the domestic issuer is a reporting issuer.[29] This requirement is designed to provide assurance that the issuer is not making a foreign offering in order to avoid the disclosure requirements of the U.S. securities laws to facilitate the dumping of securities on affiliated funds.

2. Rule 144A Offerings

Many fund purchases of foreign issuer securities are made in offerings that are exempt from the registration provisions of the Securities Act and in which the securities are eligible for resale pursuant to rule 144A under the Securities Act (''rule 144A offerings'').[30] Rule 144A is a non-exclusive safe harbor that exempts from the registration provisions of the Securities Act resales of securities to certain institutions, known as Qualified Institutional Buyers (''QIBs'').[31]

A rule 144A offering of a foreign issuer's securities often is part of a larger global offering. Sometimes a global offering is divided into several tranches—one for the issuer's home country, one for the United States, and one or more for other countries. Other times, there is a single home country tranche from which limited amounts of securities may be sold in the United States and elsewhere. In both cases, the price for the securities is uniform to all purchasers, and the issuer prepares an offering document that provides detailed information about the issuer and the offered securities.[32]

The proposed amendments would have permitted a fund to purchase securities in a ''Foreign Issuer Rule 144A Offering,'' subject to the other conditions of rule 10f–3 (except for the Securities Act registration requirement). Most commenters supported this proposal. The Commission is adopting these amendments with a number of changes that should accommodate a greater variety of offering structures, in a manner consistent with the protection of investors.[33]

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[25] 17 CFR 230.144A.

[26] Amended rule 10f–3(a)(2) [17 CFR 270.10f–3(a)(2)].

[27] Amended rule 10f–3(a)(2)(i) [17 CFR 270.10f–3(a)(2)(i)]. ''Foreign financial regulatory authority'' is defined in section 2(a)(50) of the Investment Company Act [15 U.S.C. 80a–2(a)(50)] generally as any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to certain financial activities, or (C) membership organization a function of which is to regulate the participation of its members in such financial activities.

A ''foreign securities authority'' is defined in section 2(a)(49) of the Investment Company Act [15 U.S.C. 80a–2(a)(49)] as any foreign government or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.

[28] Amended rule 10f–3(a)(2)(iii) [17 CFR 270.10f–3(a)(2)(iii)]. The amendments as adopted do not specify the format of the financial statements that must be provided, in recognition that financial reporting standards differ from country to country. Nor do the amendments specify that applicable foreign law must require the issuer to disclose information about itself and the offering to prospective purchasers. The other components of the definition of an Eligible Foreign Offering should make this condition unnecessary. Fund management should determine whether there is sufficient information concerning the issuer and the offering to ensure that the securities are marketable and that the other conditions of the rule, particularly those related to the price and timing of the purchase of the securities, are satisfied.

[29] Amended rule 10f–3(a)(2)(iv) [17 CFR 270.10f–3(a)(2)(iv)] (requiring that the domestic issuer (1) have a class of securities registered pursuant to section 12(b) or 12(g) of the Securities Exchange Act of 1934 (''Exchange Act'') or be required to file reports pursuant to section 15(d) of the Exchange Act, and (2) have filed all the material required to be filed pursuant to section 13(a) or 15(d) of the Exchange Act for the 12 months preceding the offering).

Separate from the conditions included in rule 10f–3, Regulation S under the Securities Act [17 CFR 230.901–.904] contains certain limitations on the availability of its safe harbor from registration for foreign offers and sales by domestic issuers. Rule 10f–3 exempts certain transactions only from the prohibitions contained in section 10(f) of the Investment Company Act. Nothing in this release should be interpreted to suggest that the requirements and limitations of Regulation S do not apply to transactions permitted under rule 10f–3. See Offshore Offers and Sales, Securities Act Release No. 6863 (Apr. 24, 1990) [55 FR 18306 (May 2, 1990)]. The Commission recently proposed amendments to Regulation S that would, if adopted, treat equity securities of domestic issuers and equity securities of foreign issuers with primary trading markets in the United States as restricted securities for purposes of rule 144 under the Securities Act [17 CFR 230.144]. *See* Offshore Offers and Sales, Securities Act Release No. 7392 (Feb. 20, 1997) [62 FR 9258 (Feb. 28, 1997)].

[30] 17 CFR 230.144A. In 1993, funds purchased more foreign equity securities in rule 144A offerings than did any other type of purchaser. *See* Securities and Exchange Commission, Staff Report on Rule 144A 15 (1994) (''Staff Report'').

[31] Under rule 144A, the seller must reasonably believe that the purchaser is a QIB. A QIB is an institution of a type listed in rule 144A that owns or invests on a discretionary basis at least $100 million of certain securities. *See* 17 CFR 230.144A(a)(1). Many funds qualify as QIBs in their own right, and others qualify because they are part of a ''family'' of funds that owns, in the aggregate, at least $100 million of certain securities. 17 CFR 230.144A(a)(1)(iv).

[32] Although most foreign rule 144A placements appear to be priced the same as concurrent foreign offerings, there is no regulatory requirement that the securities be priced in this manner. *See* Staff Report, supra note 30, at 26. It has been suggested, however, that most securities eligible for resale pursuant to rule 144A are sold in underwriting arrangements with terms and conditions substantially similar to those applicable to registered public offerings. *See* 1 Edward Greene et al., U.S. Regulation of the International Securities Markets: A Guide for Domestic and Foreign Issuers and Intermediaries 141 (1993); *see also* Report of The Advisory Committee on the Capital Formation and Regulatory Processes, Appendix A at 39–42 (1996) (stating that rule 144A offerings bear increasing resemblance to public offerings, and that, due to the active participation of mutual funds as buyers and sellers of rule 144A debt securities, ''liquidity is readily available, even without subsequent registration.'' (footnote omitted)). Rule 144A requires an issuer to provide certain information about itself that the purchaser of the securities may request, including financial information for its two most recent fiscal years of operation. *See* 17 CFR 230.144A(d)(4). The rule exempts from this information requirement foreign governments and foreign private issuers that furnish information to the Commission pursuant to rule 12g3–2(b) under the Exchange Act [17 CFR 240.12g3–2(b)]. *See* 17 CFR 230.144A(d)(4)(i).

[33] The adopted amendments define the phrase ''Eligible Rule 144A Offering'' in lieu of the phrase ''Foreign Issuer Rule 144A Offering'' because, as discussed further below, the amendments permit the purchase of securities of both foreign and domestic issuers in Rule 144A offerings. Amended rule 10f–3(a)(4) [17 CFR 270.10f–3(a)(4)]. In order to clarify the nature of an Eligible Rule 144A Offering, the definition specifies that the securities must be sold in certain types of transactions exempt from the registration requirements of the Securities Act. Amended rule 10f–3(a)(4)(i) [17 CFR 270.10f–3(a)(4)(i)]. The amended rule provides that the fund may reasonably rely on the written statements of

The proposed amendments would have required that securities offered in a Foreign Issuer Rule 144A Offering also be offered in a concurrent Eligible Foreign Offering. The Proposing Release stated that the concurrent public offering requirement was designed to provide assurance that there would be a widespread distribution of securities that are fungible with the securities purchased by the fund. One commenter specifically supported this approach, but several commenters opposed it, stating that rule 144A offerings often do not involve a concurrent foreign public offering of securities of the same class. In response to a request for comment, several commenters also suggested that the rule should permit affiliated funds to purchase securities of domestic issuers in rule 144A offerings. The Commission has decided to amend rule 10f–3 to permit the purchase of securities in rule 144A offerings of foreign and domestic issuers, subject to the other conditions of the rule.

The Commission is making two additional changes that are reflected in the definition of ''Eligible Rule 144A Offering.'' The proposed amendments would have required that securities purchased in an Eligible Rule 144A Offering be purchased ''in the United States.'' This requirement has been eliminated. Second, the proposed amendments would have required that the offer or sale be made ''exclusively'' to QIBs. Several commenters suggested that the sale of a portion of the offering to non-QIBs should not prevent an affiliated fund from purchasing securities in the offering. The amended rule therefore does not include the exclusivity requirement because, as suggested by commenters, it may be unnecessarily limiting. The percentage limit as applied to an Eligible Rule 144A Offering, however, would be measured with respect to the portion of the offering sold to QIBs.[34]

3. Calculation of Percentage Limit in Global Offerings

Several commenters recommended that the Commission clarify that the percentage limit in the context of a global offering applies to the entire global offering rather than to the U.S. portion of the offering. The Commission staff has stated that in a global, multi-tranche offering of securities with identical terms at an identical offering price, with various closings that are conditioned upon each other, calculation of the percentage limit may properly be based on the total amount of the entire global offering.[35]

The Commission believes that this approach is consistent with the purpose of section 10(f) and rule 10f–3, and with the protection of investors. This method of calculating the percentage limit would not be appropriate, however, in an offering of different classes or series of a security when each class or series has different terms, whether conducted in one country or in many countries.[36]

C. Price and Timing of the Purchase

Rule 10f–3 currently requires that a security purchased in reliance on the rule be ''purchased at not more than the public offering price prior to the end of the first full business day after the first date on which the issue is offered to the public.'' [37] This provision is intended to provide assurance that the price paid by the affiliated fund is no higher than that paid by similarly situated but unaffiliated purchasers, and that the purchase occur before the underwriters know if the offering is fully subscribed.[38]

The amended rule clarifies this language and provides that the securities must be purchased ''prior to the end of the first day on which any sales are made, at a price that is not more than the price paid by each other purchaser of securities in that offering or in any concurrent offering of the securities.'' [39] The provision should be applied to offerings registered under the Securities Act, municipal offerings, and to Eligible Foreign Offerings in the same way as the pre-amendment provision.[40] With regard to Eligible Rule 144A Offerings, this provision requires funds purchasing securities to pay no more than the public offering price in any concurrent public offering of the same securities. In addition, the price that funds pay for securities in the Eligible Rule 144A Offering must not be higher than that paid by other purchasers (other than underwriters or members of the selling syndicate) in the same offering.

D. Group Sales

The proposed amendments to rule 10f–3 would have permitted the purchase of municipal securities in ''group sales.'' [41] A ''group sale'' is a sale of municipal securities resulting from a ''group order,'' which is an order for securities for the account of all members of a syndicate in proportion to their respective participations in the syndicate.[42] Rule 10f–3 currently prohibits a fund from purchasing a security, directly or indirectly, from its affiliated underwriter. This provision of the rule permits a purchase from a syndicate manager, but not if the purchase is through a group sale.[43] This

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the issuer or an underwriter in determining whether this condition has been satisfied. *See* amended rule 10f–3(b)(3) [17 CFR 270.10f–3(b)(3)].

The amendments in no way affect the determination that must be made by a fund's board of directors whether a security purchased by the fund in a rule 144A placement is deemed a liquid security for purposes of the fund's liquidity policies. *See* Resale of Restricted Securities, Securities Act Release No. 6862 (Apr. 23, 1990) [55 FR 17933 (Apr. 30, 1990)].

[34] A purchasing fund under the rule need not be a QIB. If there is a concurrent Eligible Foreign Offering with respect to an Eligible Rule 144A Offering, the percentage limit may be calculated by reference to the securities sold in both offerings. *See* amended rule 10f–3(b)(7)(ii) [17 CFR 270.10f–3(b)(7)(ii)].

[35] *See* Rowe Price-Fleming International Inc., SEC No-Action Letter (Apr. 12, 1996).

[36] For example, if an issuer offers multiple classes, series or tranches of a security, with each class, series or tranche having different maturity dates, interest rates and yields, it would be inappropriate to calculate the percentage limit with respect to the total value of all of the securities offered. Rather, the percentage limit would be calculated with respect to each class, series or tranche of the issue. With respect to municipal securities, the Commission has stated in the past that a single offering of municipal securities would not be deemed to be separate classes of securities for purposes of the percentage limit solely by virtue of differing maturity dates. *See* Exemption of Acquisition of Securities During the Existence of Underwriting Syndicate, Investment Company Act Release No. 10592 (Feb. 13, 1979) [44 FR 10580 (Feb. 21, 1979)] at n.21.

[37] Rule 10f–3(a)(2).

[38] *See* Investment Company Acquisition of Securities Underwritten by an Affiliate of That Company, Investment Company Act Release No. 14924 (Jan. 29, 1986) [51 FR 4386 (Feb. 4, 1986)] at n.17 and accompanying text.

[39] Amended rule 10f–3(b)(2)(i) [17 CFR 270.10f–3(b)(2)(i)]. As proposed, the amended rule provides an exception from the pricing requirement in an Eligible Foreign Offering if rights to purchase the securities are offered as ''required by law to be granted to existing security holders of the issuer.'' *Id.*

[40] The change in language from referring to the day on which the securities are ''offered to the public'' to referring to the day on which ''any sales are made'' is not intended to make a substantive change to this condition; rather, it is intended to reflect the development of shelf registration as well as current business practice and usage of the terms. Sales would be made on the first day on which the underwriter accepts orders to purchase the securities—not the day on which the underwriter purchases the securities from the issuer. The amended requirement that the purchase must occur ''prior to the end of the first day'' conforms the rule text to the Commission's long-standing interpretation of this condition. *Id.*

[41] Rule 10f–3 currently defines ''municipal securities'' by reference to section 3(a)(29) of the Exchange Act [15 U.S.C. 78c(a)(29)]. *See* rule 10f–3(a)(1)(ii).

[42] *See* Municipal Securities Rulemaking Board (''MSRB'') Rule G–11(a)(iii), MSRB Manual (CCH) ¶ 3551; *see also* The Galaxy Fund *et al.*, Investment Company Act Release No. 20660 (Oct. 26, 1994) [59 FR 54665 (Nov. 1, 1994)] (Notice of Application).

[43] By contrast, an affiliated fund may, under rule 10f–3, purchase a municipal security through an order in which the fund designates one or more of

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provision is designed to ensure that a purchase permitted by rule 10f–3 does not violate section 17(a) of the Investment Company Act, which prohibits a fund from purchasing securities from an affiliate or from an affiliate of an affiliate.[44]

According to Municipal Securities Rulemaking Board rules, a syndicate that is offering municipal securities must establish a priority by which orders for the securities will be filled.[45] The proposed amendments related to group sales were based on the assumption that group orders frequently receive first priority,[46] and that the prohibition in rule 10f–3 on group sales therefore could act to the detriment of affiliated municipal bond funds by preventing them from purchasing municipal bonds in oversubscribed offerings in which only group orders are filled. The proposed amendments would have permitted group sales if (1) the syndicate were to establish that orders designated as group orders would have first priority, or that only group orders would be filled and (2) at the time of sale, the affiliated underwriters were not committed to underwrite more than 50% of the principal amount of the offered securities.

Two commenters disagreed with the factual premise of the proposed group sale provision. These commenters stated that group orders typically do *not* receive first priority in offerings, but rather that ''designated orders'' (orders in which the purchaser designates one or more members of the syndicate to receive credit for the sale) often receive first priority. One commenter suggested that the proposed amendment could have the unintended effect of encouraging syndicate managers to give group orders first priority in municipal offerings when they otherwise would not.

Under the current rule, an affiliated fund may purchase municipal securities through a designated order, as long as the fund does not designate its affiliated underwriter as the recipient of the credit. In view of the availability of this option, the Commission has determined not to adopt the proposed group sale amendments.[47] The Commission considered permitting group sales if the offering were oversubscribed and only group orders would be filled in the offering, but concluded that it would be impracticable to include such a condition in the rule at the present time. To the extent that the prioritization of group orders poses an impediment to the purchase of municipal securities under rule 10f–3, funds may seek exemptive relief from sections 10(f) and 17(a) as they have in the past, on a case-by-case basis.

E. Role of Fund Board of Directors

Rule 10f–3 currently requires fund boards of directors to adopt procedures pursuant to which a fund may purchase securities in reliance on the rule. The Commission proposed to amend the requirement related to directors' duties to clarify that the directors must *approve*, rather than *adopt*, procedures for the purchase of securities pursuant to rule 10f–3, in order to reflect more accurately the role of the board in approving policies and procedures developed by fund management.[48] Two commenters specifically supported this proposed amendment. The Commission is adopting the amendment as proposed.[49]

The Commission also requested comment on the role of fund directors in determining compliance with the proposed foreign securities provisions, and whether the existing requirements for the establishment and review of procedures are sufficient to cover the proposed amendments. Several commenters responded that the existing requirement concerning board duties is sufficient. The Commission has determined not to adopt any substantive change in the requirement concerning board duties. Fund boards are reminded, however, that changes in procedures will likely be required to accommodate purchases made under the amendments to rule 10f–3, including procedures concerning the reasonableness of commissions, spread or profit received by principal underwriters.[50]

The Commission continues to recognize the important role played by the fund directors in safeguarding the interests of fund investors.[51] A fund's board should be vigilant in reviewing the procedures and transactions as required by rule 10f–3 as well as in conducting any additional reviews that it determines are needed to protect the interests of investors, particularly if the fund purchases significant amounts of securities in reliance on rule 10f–3. For example, the board should consider monitoring how the performance of securities purchased in reliance on rule 10f–3 compares to securities not purchased in reliance on the rule, or to a benchmark such as a comparable market index. Such monitoring would enable the board to determine not only whether existing procedures are being followed, but also whether the procedures are effective in fulfilling the policies underlying section 10(f).[52]

F. Reporting and Recordkeeping

The proposed amendments would have eliminated the current requirement in rule 10f–3 that a fund report any transactions under rule 10f–3 to the Commission in its semi-annual report on Form N-SAR and attach to that form certain written records of those transactions.[53] In view of the increase in the percentage limit and the other amendments the Commission is adopting today, the Commission believes that the current reporting

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the syndicate participants to receive credit for the sale (also known as a ''designated order''), provided that the fund does not designate its affiliated underwriter as one of the recipients of the credit.

[44] 15 U.S.C. 80a–17(a).

[45] *See* MSRB Rule G–11(e), MSRB Manual (CCH) ¶ 3551.

[46] *See* Proposing Release, *supra* note 8, at n.57 and accompanying text (citing Public Securities Association, Fundamentals of Municipal Bonds 80 (1990)).

[47] In order to clarify that a purchase of municipal securities in a group sale proposed to be permitted by rule 10f–3 also would be exempt from the prohibition against affiliate transactions contained in section 17(a) of the Investment Company Act, the Commission proposed new rule 17a–10, to exempt any purchase of municipal securities in a group sale that complied with rule 10f–3 from section 17(a)(1). This rule is not being adopted.

[48] Proposing Release, *supra* note , at n.52.

[49] Amended rule 10f–3(b)(10) [17 CFR 270.10f–3(b)(10)].

[50] *See* amended rule 10f–3(b)(6) [17 CFR 270.10f–3(b)(6)].

[51] *See., e.g., Burks* v. *Lasker*, 441 U.S. 471, 484 (1979) (noting the importance of fund directors in ''furnishing an independent check upon management''); Division of Investment Management, U.S. Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Regulation 251–260 (1992) (describing the important functions of fund directors as required by the Investment Company Act and the rules thereunder).

[52] *See* amended rule 10f–3(b)(10)(ii) [17 CFR 270.10f–3(b)(10)(ii)] (requiring the board to make and approve ''such changes to the procedures as the board deems necessary''). *See also* Exemption of Acquisition of Securities During the Existence of Underwriting Syndicate, Investment Company Act Release No. 10736 (June 14, 1979) [44 FR 36152 (June 20, 1979)] (stating that the ''Commission expects that investment company directors, in establishing procedures under [rule 10f–3] and determining compliance with such procedures, will address the concerns embodied in section 10(f) of the Act against overreaching and the placing of otherwise unmarketable securities with an investment company'').

[53] Rule 10f–3(g) currently requires that a fund attach to its report on Form N-SAR ''a written record of each [rule 10f–3] transaction, setting forth from whom the securities were acquired, the identity of the underwriting syndicate's members, the terms of the transaction, and the information or materials'' upon which the board determined that the purchases were made in accordance with the fund's procedures concerning compliance with rule 10f–3. Reports on Form N-SAR are available for public inspection from the Commission in hard copy, and through the Commission's Electronic Data Gathering, Analysis and Retrieval (''EDGAR'') database, which is accessible through the Commission's Internet Web site (http://www.sec.gov).

requirement will provide useful information to the Commission in monitoring compliance with the amended rule. The Commission has decided to retain the Form N-SAR reporting requirement of rule 10f–3.[54]

As noted above, rule 10f–3 requires that the information attached to Form N–SAR include, among other things, the terms of the transaction and the information or materials upon which the board of directors makes a determination that all transactions during the preceding quarter were effected in accordance with the fund's procedures for ensuring compliance with the rule. The information reported pursuant to these provisions generally should include the date of the purchase, the maturity date and interest rate of any series purchased, the number and value of securities purchased (specific as to each series if applicable), and the aggregate number and value of securities offered through the underwriting or selling syndicate.

G. U.S. Government Securities

The Proposing Release requested comment whether rule 10f–3 should be amended to permit the purchase of other types of securities, such as U.S. government securities, that rule 10f–3 currently does not address, and the extent to which the conditions of the rule should apply to such purchases. In requesting comment, the Commission noted that it might not be necessary for rule 10f–3 to permit the purchase of U.S. government securities because the arrangements among distributors of these securities may not always constitute underwriting or selling syndicates for purposes of section 10(f).[55] Two commenters suggested that section 10(f) should not be interpreted to prohibit fund purchases of securities issued by agencies or instrumentalities of the U.S. government if a fund affiliate is a dealer in the primary distribution of the securities and that, in the alternative, the Commission should amend rule 10f–3 to permit such purchases.

The Commission has determined not to adopt amendments to rule 10f–3 related to additional types of securities. As noted above and in the Proposing Release, section 10(f) does not apply to certain types of offerings of U.S. government securities.[56] The Commission has not received any applications for exemptive relief with respect to offerings of U.S. government securities to which the section does apply, which suggests that relief may not be necessary at this time. Moreover, in light of the variety of these types of offerings and securities, and the unique issues they may present under section 10(f), it may be more appropriate to address these offerings of securities on a case-by-case basis in connection with individual requests for exemption.

III. Cost-Benefit Analysis

The amendments to rule 10f–3 would increase the flexibility for funds to purchase securities during the existence of a syndicate in which an affiliated underwriter participates. These amendments should benefit funds, which will be able to (i) purchase securities of foreign and domestic issuers in Eligible Foreign Offerings and Eligible Rule 144A Offerings in reliance upon rule 10f–3, without having to seek an exemptive order from the Commission and (ii) in many cases, purchase more desirable quantities of securities at advantageous prices. The potential benefits to fund investors of these proposed amendments are better investment performance and lower costs to the funds.

The costs of the amendments to funds and investors are likely to be minimal. Fund investment advisers and boards of directors will be required to determine whether purchases of securities in foreign offerings and rule 144A offerings comply with the standards in the amended rule. Rule 10f–3, however, currently has standards that must be met for purchases permitted under the rule. Thus, the additional cost of complying with the standards related to purchases of securities in foreign offerings and rule 144A offerings are likely to be minimal.[57]

Similarly, with respect to costs of reporting rule 10f–3 transactions on Form N–SAR, the increased opportunities to purchase greater quantities and types of securities may result in an increased aggregate cost of reporting for funds that purchase in reliance on the rule. At the same time, however, due to the increased number of securities that are likely to be purchased, the average compliance costs (per security purchased) of reporting rule 10f–3 transactions will probably diminish.

The increased risk of the dumping of unmarketable securities on affiliated funds appears to be minimal. The amendments are designed to loosen the restrictions of rule 10f–3 while maintaining those features of the rule that protect investors. The Commission is not aware of any evidence that dumping has been problematic under the current conditions of the rule, and the Commission intends to monitor transactions undertaken in reliance on rule 10f–3 after the amendments become effective.

Comment letters on the Proposing Release did not provide empirical data quantifying the dollar benefits of amending the rule. Therefore, it is difficult to estimate what effect, if any, the rule amendments will have on the prices of securities, on issuers' capital costs, or on the securities markets generally. However, the amendments are likely to increase efficiency in the securities markets because the amendments remove unnecessary restrictions on certain market participants. Funds with affiliated underwriters likely will purchase a larger proportion of their portfolios through primary offerings and a smaller proportion in the secondary market. Conversely, other investors likely will purchase a smaller proportion of their portfolios in primary offerings and larger proportions in the secondary market.

IV. Paperwork Reduction Act

As set forth in the Proposing Release, rule 10f–3 contains ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[58] Accordingly, the collection of information requirements contained in the rule amendments were submitted to the Office of Management and Budget (''OMB'') for review pursuant to section 3507(d) of the PRA. No comments were received on the proposal with respect to the PRA. The collection of information requirements are in accordance with section 3507 of the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency displays a valid OMB control number. OMB approved the PRA request and assigned a control

[54] Amended rule 10f–3(b)(9) [17 CFR 270.10f–3(b)(9)]. The Commission intends to monitor reports concerning rule 10f–3 transactions and take appropriate action in response to any problems that arise.

[55] *See* Proposing Release, *supra note*, at n.684 (citing Institutional Liquid Assets, SEC No-Action Letter (Dec. 16, 1981) (granting no-action relief under section 10(f) to Goldman, Sachs, which had sought relief in order to act as one of a limited number of broker-dealers participating in a distribution of Federal Home Loan Bank notes, arguing that it should not be considered a member of an ''underwriting or selling syndicate'' for purposes of section 10(f))).

[56] *See* Institutional Liquid Assets, SEC No-Action Letter (Dec. 16, 1981).

[57] Purchases of securities in foreign offerings and rule 144A offerings, of course, are voluntary. If a fund were to determine that the costs of a purchase would outweigh the benefits, it could decide not to purchase.

[58] 44 U.S.C. 3501–3520.

number of 3235–0226, with an expiration date of May 31, 1999.

The collections of information under rule 10f–3, and as required to be reported on Form N–SAR, are necessary for investment companies to obtain the benefit of exemption from section 10(f) of the Investment Company Act that rule 10f–3 provides. As described in more detail in the Proposing Release and in this release above, the collections of information are necessary to provide the Commission with information regarding compliance with rule 10f–3. The Commission may review this information during periodic examinations or with respect to investigations. Except for the information required to be kept under paragraph (b)(11)(ii) of rule 10f–3 as amended, none of the information required to be collected or disclosed for PRA purposes will be kept confidential. If the records required to be kept pursuant to these rules are requested by and submitted to the Commission, they will be kept confidential to the extent permitted by relevant statutory and regulatory provisions.

The amendments to rule 10f–3 as adopted do not impose a greater paperwork burden upon respondents than that estimated and described in the Proposing Release. The retention of the reporting requirement on Form N–SAR will not increase the estimated burden for respondents, because the proposed elimination of this reporting requirement was not calculated as a reduction in burden for purposes of the proposed amendments.

V. Summary of Regulatory Flexibility Analysis

A summary of the Initial Regulatory Flexibility Analysis (''IRFA'') was published in the Proposing Release. No comments were received on the IRFA. The Commission has prepared a Final Regulatory Flexibility Analysis (''FRFA'') in accordance with 5 U.S.C. 604 regarding amendments to rule 10f–3 under the Investment Company Act.

The FRFA discusses the need for, and objectives of, the rule amendments. The FRFA states that rule 10f–3 permits funds to purchase securities notwithstanding section 10(f) of the Investment Company Act if certain conditions are met. The amendments to rule 10f–3 expand the circumstances in which funds subject to section 10(f) may purchase securities. The FRFA further states that the amendments are designed to increase the flexibility of funds to purchase (i) quantities of securities that are in the interest of fund investors and (ii) certain domestic and foreign securities that are not registered under the Securities Act, while minimizing the risk of abuses that section 10(f) was enacted to address.

The FRFA estimates that out of approximately 3,850 active investment companies registered with the Commission as of December 31, 1996, a total of approximately 800 would be considered small entities. The amendments to rule 10f–3 would apply to approximately 40 of these 800 small entities. The FRFA indicates that the proposed amendments would affect small entities in the same manner as other entities subject to section 10(f), but that the amendments increase flexibility for all funds.

Finally, the FRFA states that in adopting the amendments the Commission considered: (a) The establishment of differing compliance requirements that take into account the resources available to small entities; (b) simplification of the rule's requirements for small entities; (c) the use of performance rather than design standards; and (d) an exemption from the rule for small entities. The FRFA states that the Commission concluded that different requirements for small entities are not necessary and would be inconsistent with investor protection, and that the amended rule incorporates performance standards to the extent practicable. Cost-benefit information reflected in the ''Cost-Benefit Analysis'' section of this Release also is reflected in the FRFA. The FRFA is available for public inspection in File No. S7–7–96, and a copy may be obtained by contacting C. Hunter Jones, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 10–2, Washington, D.C. 20549.

VI. Statutory Authority

The Commission is adopting amendments to rule 10f–3 pursuant to the authority set forth in sections 10(f), 31(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a–10(f), 80a–30(a), 80a–37(a)].

Text of Rule

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–37, 80a–39 unless otherwise noted;

* * * * *

2. Section 270.10f–3 is revised to read as follows:

§ 270.10f–3. Exemption for the acquisition of securities during the existence of an underwriting or selling syndicate.

(a) *Definitions.*—(1) *Domestic Issuer* means any issuer other than a foreign government, a national of any foreign country, or a corporation or other organization incorporated or organized under the laws of any foreign country.

(2) *Eligible Foreign Offering* means a public offering of securities, conducted under the laws of a country other than the United States, that meets the following conditions:

(i) The offering is subject to regulation by a ''foreign financial regulatory authority,'' as defined in section 2(a)(50) of the Act [15 U.S.C. 80a–2(a)(50)], in such country;

(ii) The securities are offered at a fixed price to all purchasers in the offering (except for any rights to purchase securities that are required by law to be granted to existing security holders of the issuer);

(iii) Financial statements, prepared and audited in accordance with standards required or permitted by the appropriate foreign financial regulatory authority in such country, for the two years prior to the offering, are made available to the public and prospective purchasers in connection with the offering; and

(iv) If the issuer is a Domestic Issuer, it meets the following conditions:

(A) It has a class of securities registered pursuant to section 12(b) or 12(g) of the Securities Exchange Act of 1934 [15 U.S.C. 78*l*(b) or 78*l*(g)] or is required to file reports pursuant to section 15(d) of the Securities Exchange Act of 1934 [15 U.S.C. 78o(d)]; and

(B) It has filed all the material required to be filed pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 [15 U.S.C. 78m(a) or 78o(d)] for a period of at least twelve months immediately preceding the sale of securities made in reliance upon this (or for such shorter period that the issuer was required to file such material).

(3) *Eligible Municipal Securities* means ''municipal securities,'' as defined in section 3(a)(29) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(29)], that have received an investment grade rating from at least one NRSRO; *provided,* that if the issuer of the municipal securities, or the entity supplying the revenues or other payments from which the issue is to be paid, has been in continuous operation

for less than three years, including the operation of any predecessors, the securities shall have received one of the three highest ratings from an NRSRO.

(4) *Eligible Rule 144A Offering* means an offering of securities that meets the following conditions:

(i) The securities are offered or sold in transactions exempt from registration under section 4(2) of the Securities Act of 1933 [15 U.S.C. 77d(2)], rule 144A thereunder [§ 230.144A of this chapter], or rules 501–508 thereunder [§§ 230.501–230.508 of this chapter];

(ii) The securities are sold to persons that the seller and any person acting on behalf of the seller reasonably believe to include qualified institutional buyers, as defined in § 230.144A(a)(1) of this chapter; and

(iii) The seller and any person acting on behalf of the seller reasonably believe that the securities are eligible for resale to other qualified institutional buyers pursuant to § 230.144A of this chapter.

(5) *NRSRO* has the same meaning as that set forth in § 270.2a–7(a)(14).

(b) *Conditions.* Any purchase of securities by a registered investment company prohibited by section 10(f) of the Act [15 U.S.C. 80a–10(f)] shall be exempt from the provisions of such section if the following conditions are met:

(1) *Type of Security.* The securities to be purchased are:

(i) Part of an issue registered under the Securities Act of 1933 [15 U.S.C. 77a–aa] that is being offered to the public;

(ii) Eligible Municipal Securities;

(iii) Securities sold in an Eligible Foreign Offering; or

(iv) Securities sold in an Eligible Rule 144A Offering.

(2) *Timing and Price.*

(i) The securities are purchased prior to the end of the first day on which any sales are made, at a price that is not more than the price paid by each other purchaser of securities in that offering or in any concurrent offering of the securities (except, in the case of an Eligible Foreign Offering, for any rights to purchase that are required by law to be granted to existing security holders of the issuer); and

(ii) If the securities are offered for subscription upon exercise of rights, the securities shall be purchased on or before the fourth day preceding the day on which the rights offering terminates.

(3) *Reasonable Reliance.* For purposes of determining compliance with paragraphs (b)(1)(iv) and (b)(2)(i) of this section, an investment company may reasonably rely upon written statements made by the issuer or a syndicate manager, or by an underwriter or seller of the securities through which such investment company purchases the securities.

(4) *Continuous Operation.* If the securities to be purchased are part of an issue registered under the Securities Act of 1933 [15 U.S.C. 77a—aa] that is being offered to the public or are purchased pursuant to an Eligible Foreign Offering or an Eligible Rule 144A Offering, the issuer of the securities shall have been in continuous operation for not less than three years, including the operations of any predecessors.

(5) *Firm Commitment Underwriting.* The securities are offered pursuant to an underwriting or similar agreement under which the underwriters are committed to purchase all of the securities being offered, except those purchased by others pursuant to a rights offering, if the underwriters purchase any of the securities.

(6) *Reasonable Commission.* The commission, spread or profit received or to be received by the principal underwriters is reasonable and fair compared to the commission, spread or profit received by other such persons in connection with the underwriting of similar securities being sold during a comparable period of time.

(7) *Percentage Limit.* The amount of securities of any class of such issue to be purchased by the investment company, or by two or more investment companies having the same investment adviser, shall not exceed:

(i) If purchased in an offering other than an Eligible Rule 144A Offering, 25 percent of the principal amount of the offering of such class; or

(ii) If purchased in an Eligible Rule 144A Offering, 25 percent of the total of:

(A) The principal amount of the offering of such class sold by underwriters or members of the selling syndicate to qualified institutional buyers, as defined in § 230.144A(a)(1) of this chapter, plus

(B) The principal amount of the offering of such class in any concurrent public offering.

(8) *Prohibition of Certain Affiliate Transactions.* Such investment company does not purchase the securities being offered directly or indirectly from an officer, director, member of an advisory board, investment adviser or employee of such investment company or from a person of which any such officer, director, member of an advisory board, investment adviser or employee is an affiliated person; *provided,* that a purchase from a syndicate manager shall not be deemed to be a purchase from a specific underwriter if:

(i) Such underwriter does not benefit directly or indirectly from the transaction; or

(ii) In respect to the purchase of Eligible Municipal Securities, such purchase is not designated as a group sale or otherwise allocated to the account of any person from whom this paragraph prohibits the purchase.

(9) *Periodic Reporting.* The existence of any transactions effected pursuant to this section shall be reported on the Form N–SAR [§ 274.101 of this chapter] of the investment company and a written record of each such transaction, setting forth from whom the securities were acquired, the identity of the underwriting syndicate's members, the terms of the transaction, and the information or materials upon which the determination described in paragraph (b)(10)(iii) of this section was made shall be attached thereto.

(10) *Board Review.* The board of directors of the investment company, including a majority of the directors who are not interested persons of the investment company:

(i) Has approved procedures, pursuant to which such purchases may be effected for the company, that are reasonably designed to provide that the purchases comply with all the conditions of this section;

(ii) Approves such changes to the procedures as the board deems necessary; and

(iii) Determines no less frequently than quarterly that all purchases made during the preceding quarter were effected in compliance with such procedures.

(11) *Maintenance of Records.* The investment company:

(i) Shall maintain and preserve permanently in an easily accessible place a written copy of the procedures, and any modification thereto, described in paragraphs (b)(10)(i) and (b)(10)(ii) of this section; and

(ii) Shall maintain and preserve for a period not less than six years from the end of the fiscal year in which any transactions occurred, the first two years in an easily accessible place, a written record of each such transaction, setting forth from whom the securities were acquired, the identity of the underwriting syndicate's members, the terms of the transaction, and the information or materials upon which the determination described in paragraph (b)(10)(iii) of this section was made.

By the Commission.

Dated: July 31, 1997.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–20747 Filed 8–6–97; 8:45 am]

BILLING CODE 8010–01–P

SOCIAL SECURITY ADMINISTRATION

20 CFR Part 416

[Regulations No. 16]

RIN 0960–AD86

Deeming in the Supplemental Security Income (SSI) Program When an Ineligible Spouse or Parent is Absent From the Household Due Solely to Active Military Service

AGENCY: Social Security Administration.

ACTION: Final rule.

SUMMARY: We are adding a rule on how the income and resources of ineligible spouses or parents affect the eligibility and benefit amounts of Supplemental Security Income (SSI) claimants and recipients when those spouses or parents are absent from their households due solely to a duty assignment as a member of the Armed Forces on active duty. We are adding this rule because the current rules do not reflect the provision of the Social Security Act (the Act), as amended by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), that addresses this situation.

DATES: This rule is effective September 8, 1997.

FOR FURTHER INFORMATION CONTACT: Daniel T. Bridgewater, Legal Assistant, Division of Regulations and Rulings, Social Security Administration, 6401 Security Boulevard, Baltimore, MD 21235, (410) 965–3298 for information about this rule.

For information on eligibility or claiming benefits, call our national toll-free number, 1–800–772–1213.

SUPPLEMENTARY INFORMATION:

Regulations at § 416.1167(a) state that a ''temporary'' absence, for SSI deeming purposes, occurs when an SSI claimant/recipient, an ineligible spouse or parent, or an ineligible child leaves the household but intends to, and does, return in the same month or the month immediately following. If the absence is temporary, we continue to consider the person a member of the household for deeming purposes.

Under our policy prior to October 1, 1993, an ineligible spouse or parent who was absent from an SSI claimant's or recipient's household for any reason, including active duty military service, and whose absence was not temporary (§ 416.1167(a)), was not considered to be a member of the household for deeming purposes effective with the first day of the month following the month the spouse or parent left the household.

Section 13733(a) of OBRA 1993 (Pub. L. 103–66) changed SSI policy, effective October 1, 1993, on the treatment of ineligible spouses and parents who are absent from deeming households solely because of active duty military assignments. Under this legislation, which added paragraph (4) to section 1614(f) of the Act, the service member continues to be considered a member of the household, absent evidence to the contrary, for income and resources deeming purposes. Current regulations do not specifically address this situation.

The change in the deeming rules made by section 13733(a) of Public Law 103–66 was intended to prevent an absent deemor's active military service from adversely affecting an SSI claimant's or recipient's benefits. Prior to the change in the deeming rules, and under certain circumstances, it was possible for an individual to receive a smaller SSI benefit—or no benefit at all—as a result of a spouse's or parent's absence from the household due to military service.

For SSI purposes, the treatment of an ineligible spouse's or parent's earnings differs depending on whether the spouse or parent is considered to be living in the same household as the SSI recipient. If the spouse or parent is considered to be living in the same household as the SSI recipient, the earnings are treated as earned income. If the spouse or parent is not considered to be living in the same household, any earnings that are made available to the household are treated as unearned income. In the SSI program, more generous exclusions apply to earned income than to unearned income.

For example, under prior policy, if an absent military member whose income and resources were no longer deemed sent wages home, or his or her wages were directly deposited into a bank account held jointly with other family members, income so received by household members was considered to be *unearned* for SSI eligibility and payment computation purposes. In contrast, wages received while the military deemor resided in the household were considered to be *earned* income for program purposes. Accordingly, prior policy had the effect of disadvantaging certain SSI claimants and recipients.

As a result of section 13733(a) of OBRA 1993, a military spouse's or parent's absence from the SSI household because of an active duty assignment is generally not considered for program purposes; the same deeming rules that apply to ''at home'' spouses and parents will generally apply to spouses and parents who are temporarily absent from the household due to active duty military service. Therefore, we are amending our regulations at § 416.1167 to reflect section 13733(a) of OBRA 1993.

The statute and the rule recognize that circumstances may change, and an absent service member who originally intended to continue to live in the deeming household may decide not to do so. Taking this into consideration, under the final rule, we provide that if an absent service member's intent to continue to live in the household changes, deeming stops beginning with the month following the month in which the intent changed.

We assume, absent evidence to the contrary, that the absent service member intends to return to the deeming household upon conclusion of the military assignment. ''Evidence to the contrary'' is evidence indicating that the service member does not intend to return to the deeming household upon conclusion of the military assignment. Evidence to the contrary includes (but is not limited to) a signed statement by the ''at home'' spouse or parent, or by the absent service member, indicating that the service member does not intend to return to the deeming household. Other examples of evidence to the contrary are evidence of divorce or legal separation that will result in the service member not returning to the deeming household. Also, diminished support from the absent service member to the household—e.g., an absent spouse who no longer makes his or her military wages available to the deeming household—may be evidence that the absent service member no longer intends to return to the deeming household.

On January 24, 1997, we published this final rule as a proposed rule in the **Federal Register** at 62 FR 3633 with a 60-day comment period. We received no comments during the public comment period. Therefore, we are publishing the final rule unchanged from the proposed rule.

Regulatory Procedures

Executive Order 12866

We have consulted with the Office of Management and Budget and determined that this rule does not meet