

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 270 and 274

[Release No. IC-25560; File No. S7-20-00]

RIN 3235-AH57

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

**AGENCY:** Securities and Exchange Commission ("Commission").

**ACTION:** Final rule.

**SUMMARY:** The Commission is adopting amendments to the rule under the Investment Company Act of 1940 that permits a registered investment company ("fund") that has certain affiliations with an underwriting participant to purchase securities during an offering. The amendments expand the exemption provided by the rule to permit a fund to purchase U.S. government securities in a syndicated offering. These amendments are intended to respond to recent changes in the method of offering certain U.S. government securities.

**EFFECTIVE DATE:** May 10, 2002.

**FOR FURTHER INFORMATION CONTACT:**

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**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" or "Act").<sup>1</sup>

#### I. Discussion

Section 10(f) of the Investment Company Act prohibits a fund from purchasing any security during an underwriting or selling syndicate if the fund has certain affiliated relationships with a principal underwriter<sup>2</sup> for the security ("affiliated underwriter").<sup>3</sup>

<sup>1</sup> Unless otherwise noted, all our references to "rule 10f-3" or any paragraph of the rule will be to 17 CFR 270.10f-3.

<sup>2</sup> See section 2(a)(29) of the Investment Company Act [15 U.S.C. 80a-2(a)(29)] (definition of principal underwriter).

<sup>3</sup> Section 10(f) [15 U.S.C. 80a-10(f)] prohibits the purchase of a security 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. In this Release, we refer to a person that falls within one

Rule 10f-3 permits a fund to purchase securities in a transaction that section 10(f) would prohibit, if certain conditions are met.<sup>4</sup> The conditions of rule 10f-3 are designed to limit the purchases made under the rule to those that are not likely to raise the concerns that section 10(f) was enacted to address, and are thus consistent with the protection of investors.<sup>5</sup>

When the Commission first adopted rule 10f-3 in 1958, one of the conditions of the rule was that the securities be registered under the Securities Act as part of a public offering.<sup>6</sup> Since then, in response to changes in the methods of offering securities and other developments, we have revised the rule

of these categories as an "affiliated underwriter." Thus, as used in this release, the term includes a narrower set of relationships than "affiliated person," which is defined in section 2(a)(3) of the Investment Company Act [15 U.S.C. 80a-2(a)(3)]. Similarly, in this Release, when we refer to a fund that is subject to section 10(f) as a result of its relationship with an "affiliated underwriter," we use the term "affiliated fund."

<sup>4</sup> Rule 10f-3 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 of 1933 ("Securities Act") [15 USC 77a-aa], are municipal securities with certain credit ratings, or are offered in certain foreign or private institutional offerings; (ii) certain conditions with respect to timing and price are satisfied; (iii) the issuer has been in operation for at least three years prior to the offering; (iv) the offering involves a "firm commitment" underwriting; (v) the underwriters' commission is reasonable and fair; (vi) the fund (together with other funds advised by the same investment adviser) purchases no more than 25 percent of the offering; (vii) the fund purchases the securities from a member of the syndicate other than its affiliated underwriter; (viii) if the securities are municipal securities, the purchase is not a group sale; and (ix) the fund reports the transactions to the Commission and maintains a written record of each transaction; and (x) the fund's directors have approved procedures for purchases under the rule and regularly review the purchases to determine whether they have complied with the procedures. See rule 10f-3(b). The Commission last amended rule 10f-3 in January 2001 to require, as a condition of relief, that a majority of the directors not be interested persons of the fund, that those directors select and nominate other disinterested directors, and that any legal counsel to the disinterested directors be an independent legal counsel. See Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734 (Jan. 16, 2001)].

<sup>5</sup> See, e.g., Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 22775, at text following nn. 6-7 (July 31, 1997) [62 FR 42401 (Aug. 7, 1997)] ("1997 Release").

<sup>6</sup> 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) ("1958 Adopting Release"). This condition served to assure that the fund did not purchase the securities through a private placement, and provided the basis for other conditions of the rule concerning the timing and conduct of the public offering.

to permit the purchase of additional types of securities that are not registered under the Securities Act, such as municipal securities and securities offered privately to institutional buyers. We determined that the circumstances in which these securities generally are offered, including the availability of relevant information about the issuer and the establishment of a uniform offering price, would serve to protect funds.<sup>7</sup>

Government securities,<sup>8</sup> such as securities issued by agencies or instrumentalities of the U.S. government,<sup>9</sup> are not included in the types of securities that rule 10f-3 permits affiliated funds to purchase. In the past, there was little need to exempt the purchase of these securities because they generally were not offered through "selling syndicates" or underwritings that invoke the restrictions of the Act. In recent years, however, government-sponsored enterprises ("GSEs") have begun to sell securities through underwriting or selling syndicates, and we received a request to broaden the scope of the rule to permit funds to purchase these securities when, due to

<sup>7</sup> See Exemption for the Acquisition of Securities During the Existence of an Underwriting Syndicate, Investment Company Act Release No. 21838, at nn. 31-51 and accompanying text (Mar. 21, 1996) [61 FR 13620 (Mar. 27, 1996)]. We reasoned that, even though these securities are not registered under the Securities Act, they "would be widely distributed, a wide range of market participants would agree that the offering price of the securities was fair, and that a secondary market for the securities would likely develop." *Id.* at text following n. 33. In addition, the other protections of rule 10f-3 continued to apply to purchases of these types of securities.

<sup>8</sup> The term "government security" is defined by the Investment Company Act as "any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing." 15 U.S.C. 80a-2(a)(16). Government securities are exempt from the registration requirements of the Securities Act and from the reporting and other requirements of the Securities Exchange Act of 1934 ("Exchange Act"). See 15 U.S.C. 77c(a)(2), 78c(a)(12)(A). Offers of or transactions in government securities are subject, however, to the anti-fraud provisions of the Securities Act and Exchange Act. See 15 U.S.C. 77q(c), 78j(b).

<sup>9</sup> Government securities may be issued by government-sponsored enterprises ("GSEs") such as the Federal National Mortgage Association ("FNMA") and by government corporations such as the Federal Deposit Insurance Corporation. See 31 U.S.C. 9101(1) (definition of "government corporation"); Frank J. Fabozzi and Michael J. Fleming, *U.S. Treasury and Agency Securities in The Handbook of Fixed Income Securities* 175, 191-96 (Frank J. Fabozzi, ed., 2001) (discussing "agency" securities issuers, including GSEs and government corporation issuers).

the affiliations of underwriters, the Act would prohibit such a purchase.<sup>10</sup>

In November 2000 we proposed to amend rule 10f-3 to permit the purchase of government securities.<sup>11</sup> We observed in our release that government securities are offered under circumstances that appear to serve, in conjunction with the other conditions of rule 10f-3, to protect funds from the risks that section 10(f) addresses.<sup>12</sup> Commenters supported the proposed amendments.<sup>13</sup> Today we are adopting the amendments as proposed.<sup>14</sup>

When we proposed the amendment to rule 10f-3 concerning government securities, we also proposed to amend the condition of the rule that limits the percentage of securities that an affiliated fund, together with any other fund advised by the affiliated fund's adviser, may purchase in an offering ("percentage limit"). The amendments would have required that the purchases of an affiliated fund, for purposes of meeting the percentage limit, also be aggregated with purchases of any other account over which the fund's adviser had discretionary authority or control.

A number of commenters raised questions about our proposed amendment to the percentage limit of rule 10f-3. These comments raise larger issues of the Commission's regulation of

affiliated transactions, which we discuss in a companion release we are issuing today.<sup>15</sup> Therefore we are not adopting the amendments to rule 10f-3 related to the percentage limit, but are proposing in the companion release to amend the rule to address a number of complex issues arising under that provision of the rule.

## II. Effective Date

The amendments to rule 10f-3 and the instructions to Form N-SAR will be effective May 10, 2002. This effective date is less than 30 days after publication so that funds and advisers may benefit sooner from the rule amendments.<sup>16</sup>

## III. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits that result from its rules. In the Proposing Release, we requested comment and specific data regarding the costs and benefits of the proposed amendments. The comments we received are discussed below.

### A. Benefits

The amendments to rule 10f-3 to permit the purchase of government securities will enable funds to purchase securities during the existence of a syndicate in which an affiliated underwriter participates, without having to seek an exemptive order from the Commission.<sup>17</sup> We believe that fund investors could benefit from enhanced fund performance as a result of funds' easier access to primary offerings of government securities.<sup>18</sup> A number of commenters confirmed that expanding rule 10f-3 to include government securities would benefit affiliated funds and their shareholders by enhancing the investment opportunities available to them.<sup>19</sup> Certain protective conditions in

rule 10f-3 will serve to safeguard shareholders' interests.<sup>20</sup>

### B. Costs

We received no comments or data on the cost of extending rule 10f-3 to the purchase of government securities. We anticipate that funds will incur and pass on to investors only minimal costs as a result of the amendments that we are adopting. Further, funds will avoid the cost of forgoing investments in government securities sold in syndicates in which an affiliated underwriter is participating or the cost of filing an application for exemptive relief in order to make those purchases.<sup>21</sup> Funds that currently rely on rule 10f-3 to purchase securities<sup>22</sup> will incur costs in adjusting their procedures to allow for the purchase of government securities.<sup>23</sup> Funds also will incur costs of checking each transaction for compliance with the rule's conditions and keeping records of each transaction.<sup>24</sup> The fund's board also will review

<sup>20</sup> These conditions govern, among other things, (i) the timing and price of the purchase; (ii) the length of time that the issuer has been in operation; (iii) the nature of the underwriting, *i.e.*, it must be a "firm commitment" underwriting; (iv) the underwriters' commission; (v) the percentage of the underwriting that is purchased; (vi) the syndicate member from which the securities are purchased; (vii) board oversight of rule 10f-3 transactions; (viii) the composition of the fund's board; and (ix) reporting and recordkeeping. *See* rule 10f-3(b).

<sup>21</sup> *See supra* note 17.

<sup>22</sup> The staff anticipates that in almost all instances, the funds that will purchase government securities also purchase other securities under rule 10f-3 because the underwriters that participate in the sale of government securities also participate in the sale of other types of securities.

<sup>23</sup> The staff estimates, based on telephone interviews with fund representatives, that a compliance attorney would spend approximately eight hours revising the procedures, at a cost of approximately \$496, and the board would spend approximately one hour considering and approving the changes, at a cost of \$2000. Thus, assuming that half of the 410 funds that rely on rule 10f-3 now, purchase government securities under the amended rule, funds will spend a total of \$511,680 revising their procedures. The staff also estimates that funds may spend time retraining fund personnel responsible for rule 10f-3 compliance after the amendment of the rule 10f-3 procedures, but expects that the time spent will be minimal. The hour estimates for various tasks and the cost of fund board meetings used in this Release are based on conversations between the staff and representatives of funds. The hourly rates for fund personnel used in this Release are derived from salaries reported for personnel outside New York City in these publications: Securities Industry Association, *Management and Professional Earnings in the Securities Industry* (2000) and Securities Industry Association, *Office Salaries in the Securities Industry* (2000).

<sup>24</sup> The staff estimates, based on telephone interviews with fund representatives, that fund personnel on average will spend approximately one hour per transaction, at a cost of \$44.87, completing these tasks, and, assuming that there are 205 government securities transactions, funds will annually spend in the aggregate approximately \$9,198.

<sup>10</sup> *See* Memorandum from the law firm of Brown & Wood to the Division of Investment Management, Securities and Exchange Commission (1998) (available to the public in File No. S7-20-00).

<sup>11</sup> *See* Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 24775 (Nov. 29, 2000) [65 FR 76189 (Dec. 6, 2000)] ("Proposing Release").

<sup>12</sup> *See id.* at text accompanying nn. 17-20. The amendments we adopt today should not be interpreted to confer on securities issued by GSEs a greater level of federal government backing than is afforded to them by law. *See, e.g.*, The Federal Housing Enterprises Safety and Security Act of 1992, Pub. L. No. 102-550, § 1302, 106 Stat. 3941 ("neither [the Federal National Mortgage Association nor the Federal Home Loan Mortgage Corporation] \* \* \*, nor any securities or obligations issued by the enterprises \* \* \*, are backed by the full faith and credit of the United States."). *See generally* Fabozzi and Fleming, *supra* note 9, at 188 ("Agency securities are not typically backed by the full faith and credit of the U.S. government, as is the case with Treasury Securities.").

<sup>13</sup> The commenters included one individual, three trade associations, two investment advisers, and three law firms. The comment letters are available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington DC (File No. S7-20-00).

<sup>14</sup> We are also amending the instructions to Form N-SAR to correspond with the rule. Sub-Item 770 of the instructions, which governs the reporting of rule 10f-3 transactions on Form N-SAR, refers to "the determination described in paragraph (h)(3) of rule 10f-3." A technical amendment to this Sub-Item will update the instruction to refer instead to "the determination described in paragraph (b)(10)(iii) of rule 10f-3."

<sup>15</sup> *See* Transactions of Investment Companies with Portfolio and Subadvisory Affiliates, Investment Company Act Release No. 25557 (April 30, 2002).

<sup>16</sup> *See* 5 U.S.C. 553(d)(1) (permitting a rule to become effective less than 30 days after publication if it "grants or recognizes an exemption or relieves a restriction").

<sup>17</sup> The staff estimates, based on conversations with representatives of funds, that the average cost of filing an exemptive application can range from \$20,000 to \$80,000, depending on the complexity of the issues addressed in the application.

<sup>18</sup> Although the staff is unable to determine what percentage of mutual fund assets are currently invested in government securities, in calendar year 2000, assets in long-term U.S. government bond funds totaled \$309,446,000,000. *See* Investment Company Institute, *Mutual Fund Fact Book* at 71 (2001).

<sup>19</sup> The amendments may contribute to the competitiveness and efficiency of the government securities market by expanding the pool of potential buyers.

government securities purchases as part of its quarterly review of rule 10f-3 transactions, and the fund will report these purchases along with other rule 10f-3 transactions to the Commission on Form N-SAR, but these tasks are unlikely to measurably increase costs.

#### IV. Consideration of Promotion of Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. The Commission has considered these factors.

As discussed above, the Commission anticipates that the new rule will expand funds' opportunities to invest in government securities by permitting funds to purchase these securities from affiliated underwriters without obtaining an exemptive order. This change could enhance competition in the sale of government securities and have a positive effect on efficiency in the government securities markets. The amendments are unlikely to have a measurable effect on capital formation.

#### V. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of the amendments to rule 10f-3 contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501-3520] ("PRA"). We submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is "Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The OMB control number for rule 10f-3 is 3235-0226.

As discussed above, today we are adopting only the proposed amendments to rule 10f-3 that will expand the rule's exemptive relief to permit a fund to purchase government securities under the conditions of the rule.<sup>25</sup> None of the commenters

addressed the Paperwork Reduction Act burden associated with these amendments.

As part of a general review of the information collection burdens in rule 10f-3,<sup>26</sup> we have updated our burden estimate with respect to the amendments that we are adopting today. It is the staff's belief that half of the 410 funds that currently rely on the rule may rely on rule 10f-3 to purchase government securities.<sup>27</sup> We estimate, based on the relatively limited number of government securities issuances, that each of these funds will engage in an average of one purchase of government securities per year. We estimate that fund personnel will spend thirty minutes before and thirty minutes after each transaction compiling a record of the transaction.<sup>28</sup> Thus, we anticipate that funds annually will expend a total of approximately 205 hours on recordkeeping in connection with purchases of government securities under rule 10f-3.<sup>29</sup> The staff does not believe that there would be any additional information collection burden attributable to these amendments.<sup>30</sup> The staff further estimates that there will be no cost burden associated with these amendments, apart from the cost associated with the hourly burden identified above.

The collections of information in rule 10f-3 are necessary to facilitate review of transactions that proceed under the rule by fund boards and by the Commission. Information required to be filed with Form N-SAR is public and therefore will not be kept confidential.

<sup>26</sup>In compliance with the Paperwork Reduction Act and the OMB's implementing regulations, the staff conducts triennial reviews of the information collection burdens in its rules.

<sup>27</sup>This estimate is based, in part, on the fact that each of the GSEs that currently sells securities in syndicated offerings has identified a large group of dealers to serve as underwriters, many of which are affiliated underwriters of one or more fund families.

<sup>28</sup>These estimates are based on telephone interviews with fund representatives about rule 10f-3 transactions in other types of securities.

<sup>29</sup>When the Commission proposed the amendments, the staff estimated that the annual recordkeeping burden would increase for each of the estimated seventy funds that would purchase government securities under the rule by approximately 0.25 hours per fund per year and for all funds by approximately 17.5 hours (70 funds x 0.25 = 17.5 hours).

<sup>30</sup>Specifically, the staff does not believe that the addition of government securities would increase the time fund personnel and fund boards would spend compiling and reviewing quarterly reports or reporting rule 10f-3 transactions on Form N-SAR. Although funds would have to modify their rule 10f-3 procedures to accommodate government securities transactions, periodic modifications in response to rule and policy changes are already reflected in the staff's current PRA estimate for rule 10f-3.

If any other records required to be kept under 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.

#### VI. Final Regulatory Flexibility Analysis

The Commission has prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604. A summary of the Initial Regulatory Flexibility Analysis ("IRFA"), which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release. We did not receive any comments on the IRFA or on the effect on small entities of the amendments that we are adopting today.

##### A. Need for Rule 10f-3 and the Amendment

Section 10(f) prohibits affiliated funds from purchasing securities during the existence of an underwriting or selling syndicate for the securities, and authorizes the Commission to exempt transactions by rule or order from the prohibition. The Commission adopted rule 10f-3 to permit a fund to purchase securities from an unaffiliated member of an underwriting or selling syndicate when an affiliated underwriter is a member of the underwriting or selling syndicate. The amendments to rule 10f-3, in response to the decision by certain GSEs to sell their securities through syndicated underwritings, permit funds to rely on the rule to purchase government securities.<sup>31</sup>

##### B. Significant Issues Raised by Public Comment

Commenters did not raise any significant issues in response to the IRFA.

##### C. Small Entities Subject to the Rules

A small business or small organization (collectively, "small entity") for purposes of the Investment Company Act is a fund that, together with other funds in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>32</sup> Of approximately 3,650 active funds, approximately 200 are small entities. We believe that the amendments would increase flexibility for all funds, including small entities, and would not unduly burden small entities.<sup>33</sup>

<sup>31</sup> See *supra* Section I.

<sup>32</sup> Rule 0-10 [17 CFR 270.0-10].

<sup>33</sup> The number of small entities that will rely on the amended rule to purchase government securities depends on many factors, including the

<sup>25</sup> The revised burden estimates contained in this release, therefore, do not include any burden attributable to the proposed changes in the percentage limit.

**D. Projected Reporting, Recordkeeping, and Other Compliance Requirements**

A fund that relies on the exemption in rule 10f-3 to purchase securities (including government securities) must comply with the conditions in the rule, regardless of whether the fund is a small entity. The fund board must approve procedures under which rule 10f-3 transactions will be effected and amend those procedures as necessary. Compliance personnel and portfolio managers must determine whether a proposed purchase will comply with the rule's conditions, collect and retain for six years certain information about each rule 10f-3 transaction, and report each rule 10f-3 transaction on Form N-SAR. Quarterly, the fund's board must review all rule 10f-3 transactions, including purchases of government securities, that have taken place.

**E. Agency Action To Minimize Effect on Small Entities**

The Commission has considered alternatives to the amendments that would accomplish the objectives of the rule and minimize the impact on small entities. These include: (i) The establishment of differing compliance requirements that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance requirements under the rule for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part of the rule, for small entities.

The amendments to rule 10f-3 are designed to enhance the ability of funds, including small entities, to purchase government securities during the existence of an underwriting or selling syndicate in which an affiliated underwriter participates without subjecting funds to requirements other than those already in the rule. Compliance with the rule's conditions is voluntary; small entities (like other funds) that do not rely on the rule may instead apply for an individual exemptive order from the Commission.

The establishment of different compliance or reporting requirements for small entities would conflict with the principles underlying section 10(f), which was intended primarily to prohibit the dumping of otherwise unmarketable securities on funds by

investment objectives of the small entities, the availability of alternative investments, and the frequency with which government securities are offered through affiliated underwriting syndicates. We did not receive any comments in response to our request in the Proposing Release for comment on the number of small entities that would be affected by the proposed amendments.

their affiliated underwriters, and rule 10f-3, which was designed to permit securities transactions under conditions in which such dumping would not occur. Because a fund of any size could potentially be the object of dumping, small entities should be subject to the rule's protective conditions along with other funds.<sup>34</sup> Likewise, the Commission could not further clarify, consolidate, or simplify the compliance requirements of rule 10f-3 for the benefit of small entities without compromising the protection for the investors in these entities.<sup>35</sup> The amendments embody performance standards because they expand the availability of rule 10f-3 to a class of securities that are offered under circumstances that appear to serve, in conjunction with the other conditions of rule 10f-3, to protect funds from the risks that section 10(f) addresses. Further use of performance standards would be inconsistent with rule 10f-3, which employs carefully crafted safeguards to prevent abuses. Because rule 10f-3 permits transactions to take place that otherwise would be prohibited, small entities benefit from being able to take advantage of the rule, and the regulatory alternative of exempting small entities from the rule's coverage is not applicable.

**VII. Statutory Authority**

The Commission is amending rule 10f-3 under 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)].

**List of Subjects in 17 CFR Parts 270 and 274**

Investment companies, Reporting and recordkeeping requirements, Securities.

**Text of Rule Amendments**

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-34(d), 80a-37, 80a-39, unless otherwise noted;

\* \* \* \* \*

<sup>34</sup> These protective conditions are set forth above. See *supra* note 4.

<sup>35</sup> The Commission intends, however, to issue a small business compliance guide, which should assist funds that are small entities in complying with the rule.

2. Section 270.10f-3 is amended by revising paragraphs (b)(1) and (b)(4) to read as follows:

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

\* \* \* \* \*

(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)) will be exempt from the provisions of that 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) Part of an issue of government securities, as defined in section 2(a)(16) of the Act (15 U.S.C. 80a-2(a)(16));

(iii) Eligible Municipal Securities;

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

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

\* \* \* \* \*

(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, are government securities (as defined in section 2(a)(16) of the Act (15 U.S.C. 80a-2(a)(16))), or are purchased pursuant to an Eligible Foreign Offering or an Eligible Rule 144A Offering, the issuer of the securities must have been in continuous operation for not less than three years, including the operations of any predecessors.

\* \* \* \* \*

**PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940**

3. The authority citation for part 274 continues to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, and 80a-29, unless otherwise noted.

4. Form N-SAR (referenced in § 274.101) is amended by revising the Instruction for Sub-Item 770 to read as follows:

**Note:** The text of Form N-SAR does not and these amendments will not appear in the Code of Federal Regulations.

**Form N-SAR**

\* \* \* \* \*

**Instructions to Specific Items**

\* \* \* \* \*

SUB-ITEM 77O: Transactions effected pursuant to Rule 10f-3

Rule 10f-3 (17 CFR 270.10f-3) provides a limited exemption from section 10(f) of the Act, provided, *inter alia*, that all transactions effected pursuant to the rule are reported on Form N-SAR. If any such transactions were effected during the reporting

period, this item should be checked and an exhibit attached 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 rule 10f-3 was made.

\* \* \* \* \*

By the Commission.

Dated: April 30, 2002.

**Jill M. Peterson,**

*Assistant Secretary.*

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