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Revisiting MassMutual and Section 17(d) under the Investment Company Act

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This article reexamines the simultaneous participation in a negotiated private placement by a registered investment company (Fund) and an account in which an affiliate of the Fund has an interest.

The back-to-back MassMutual no-action letters[1] indicate that simultaneous participation by a Fund and an account in which an affiliate of the Fund has an interest is permitted, provided the only term negotiated by the adviser is the purchase price. However, if a term other than purchase price is negotiated, and the Fund's adviser has a "material pecuniary interest" in an account participating in the private placement, aggregation of the purchase order of the Fund with the purchase order of the account may cause an impermissible conflict under Investment Company Act of 1940 (ICA) Section 17(d) and Rule 17d-1 thereunder.

Unfortunately, there is no clear guidance from the Securities and Exchange Commission (Commission) or its Staff concerning what constitutes a "material pecuniary interest."[2] Consequently, with respect to a private placement of securities in which an adviser negotiates the terms of the offering (Negotiated Private Placement), advisers typically do not permit a Fund and an account in which the adviser has an interest to participate simultaneously.

The interpretive uncertainty left by the MassMutual no-action letters is addressed in this article. It concludes that, for any Negotiated Private Placement in which a Fund and its adviser participate, or in which a Fund and any first-tier or second-tier affiliate of the Fund (Affiliate)[3] participate, there should be no impediment under Section 17(d) and Rule 17d-1, provided that at least one of these three sets of conditions is satisfied:

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1. The Fund's decision to participate is made independently from the Affiliate's decision to participate;
2. If the same portfolio manager exercises investment discretion for the Fund and the account in which the Affiliate has an interest (Affiliate Account), the portfolio manager does not determine the terms of the Negotiated Private Placement; or
3. If the same portfolio manager exercises investment discretion for the Fund and the Affiliate Account, the incentives affecting the portfolio manager to reach bona fide investment decisions are strong, while the incentives affecting the portfolio manager to overreach the Fund are remote.

Assuming that at least one of these three conditions is satisfied, there should be no reason to examine the existence or materiality of pecuniary interests.

Background

Joint Enterprises and Joint Transactions, Generally

The affiliated transaction provisions of the ICA,[4] including Section 17(d), regulate transactions between a Fund and any Affiliate. Section 17(d) and Rule 17d-1 are designed to regulate situations in which persons making the investment decisions for a Fund have a conflict of interest with the Fund and, therefore, there is danger that the Fund may be overreached by the conflicted persons.[5] ICA Section 17(d) prohibits any Affiliate, acting as principal, from effecting any transaction in which the Fund is a joint participant "in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such [Fund] on a basis different from or less advantageous than, that of the other participant."

Rule 17d-1 implements the Commission's Section 17(d) mandate. Specifically, Rule 17d-1 provides that it is unlawful for any Affiliate to participate in, or effect any transaction in connection with, a "joint enterprise or other joint arrangement or profit-sharing plan" in which the Fund participates, unless the transaction has been pre-approved by the Commission. Rule 17d-1(c) defines the phrase "joint enterprise or other joint transaction or profit-sharing plan" broadly to include any written or oral plan, contract, authorization or arrangement, or any practice or understanding concerning an enterprise or undertaking whereby a Fund and any Affiliate have a joint and several participation.

Therefore, the critical issue at the outset of every analysis under Section 17(d) and Rule 17d-1 is whether the facts establish a "joint enterprise or other joint transaction or profit-sharing plan" within the meaning of Rule 17d-1(c).[6]

On this issue, it is clear that an express agreement is not required in order for an Affiliate to violate Rule 17d-1. A joint transaction can be inferred from the parties' behavior. For example, in *SEC v. Midwest Technical Development Corp.,*[7] the directors of a Fund caused the Fund to invest directly in companies that were in need of financing. After the Fund's investment strengthened the financial stability of the portfolio company, the directors made their own investments in the portfolio company. The court found that directors used the Fund's investments to enhance the safety of their personal investments. The court concluded that although:

> parallel action of an investment company and its directors in making investments in portfolio companies is not within the proscription of the Act or the regulations . . . the pattern followed by [the Fund] and its directors in so many instances in making investments in the same portfolio companies should have had the approval of the Commission.

In *SEC v. Talley Industries, Inc.*,[8] the court established what has become the relevant standard. The court held that a transaction must involve "some element of combination," beyond parallel behavior, to create the requisite joint participation prohibited by Section 17(d).[9] In *Talley*, the court upheld a Commission finding of a joint transaction where, in the Commission's judgment, a Fund acted on the recommendation of its Affiliate and, with the Affiliate, both purchased shares of a company with the goal of the Affiliate acquiring control of the company. The Fund and its Affiliate had acted in a way such that the Fund "was no longer a completely free agent."[10]

Finally, in *Bloom v. Bradford*,[11] the court held that the requisite element of combination was not established merely by parallel purchases by Funds in the same complex. In *Bloom*, the plaintiff, an investor in one Fund advised by the defendant adviser, claimed that the adviser violated Section 17(d) by not averaging the price at which the plaintiff's Fund and two other Funds had transacted in shares of the same issuer contemporaneously. As a result, the plaintiff's Fund did not receive prices that were as favorable as prices received by the two other Funds.

The court rejected the plaintiff's claim, stating:

> A prerequisite to liability under [Section 17(d)] is that there be "joint" participation in a transaction. Plaintiff argues that the purchases of the same stock by the three funds, coupled with the interlocking directorates and the fact that the [issuer's] reports mentioned the holdings of all three funds prove that there was a "joint" enterprise.
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> But Section 17(d) requires an intentional act of agreement or at least a consensual pattern. . . Those cases in which liability has been imposed under Section 17(d) have found considerably more in terms of combination than the mere purchase and sale of securities on the open market by distinct investment companies. The opinions have stressed that "some element of 'combination' is required." [Citing *Talley* at 403 and *Midwest Technical* at 94,147].[12]

Aggregated Transactions

Aggregation of a Fund and Affiliate Account's orders, and whether such aggregation is a joint transaction for purposes of Section 17(d), has been the subject of no-action letters.

In the 1995 *SMC Capital, Inc.* no-action letter,[13] the applicant adviser (SMC) sought Staff assurance with respect to SMC aggregating in the secondary market a Fund's orders with the orders of accounts in which SMC insiders had an interest. SMC was concerned that these aggregated orders might violate Section 17(d) and Rule 17d-1. The justification offered by SMC was that larger purchase and sale orders generally may be executed at lower commission costs than smaller orders. SMC offered two explanations for its conclusion that aggregating clients' transactions should not be deemed to violate Section 17(d) or Rule 17d-1:

1. The aggregation of orders does not constitute a combination or enterprise conducted for the purpose of making a profit; and
2. The aggregation of orders resulted solely from a commonality of investment objectives, rather than any collateral motive related to the execution of the orders.

The Staff agreed not to recommend enforcement action against SMC. Citing the *Talley* decision and a decision in a Commission administrative proceeding,[14] the Staff noted that "Some element of combination or profit motive generally must be present for Section 17(d) and rule 17d-1 to apply." Without further analysis, the Staff stated that the mere aggregation of orders for advisory clients including a Fund would not violate Section 17(d) or Rule 17d-1, provided that the Fund participated in the aggregated orders on terms no less advantageous than those received by any other participant.

In 2000, in *MassMutual I*, MassMutual was the adviser to Funds and to other accounts, including proprietary accounts. MassMutual sought the Staff's assurance that MassMutual would not be deemed subject to Section 17(d) and Rule 17d-1 if MassMutual aggregated Fund and proprietary account orders in private placements, provided the only term negotiated by MassMutual in any particular transaction was the purchase price of the securities. MassMutual cited the potential benefits to the Funds from participating in the private placements, including the facts that larger order size would give MassMutual greater bargaining power in negotiating price, and a larger purchase in one private placement could improve MassMutual clients' ability to participate in future private placements.

The Staff provided MassMutual with the requested assurance, provided that MassMutual made full disclosure to the Funds' board and subject to procedures designed to assure that the aggregate securities purchased in the private placements were allocated in a manner that is "fair and equitable to, and in the best interests of" the Funds and the other participating accounts.

In its analysis, the Staff first indicated that MassMutual's requested relief had not been raised in *SMC Capital* because SMC had not requested relief with respect to the aggregation of orders in private placements. The Staff noted that a conflict of interest could arise between a Fund and an Affiliate in private placements if an Affiliate "has both a material pecuniary incentive and the ability to cause the investment company to participate with it in an aggregated transaction."[15] In such a situation, the Staff stated, "We believe . . . the aggregated transaction would involve the requisite element of combination or profit motive for Section 17(d) and Rule 17d-1 to apply . . . even if the investment company participates on the same terms as those of the other participants."

As an example, the Staff described a situation in which an adviser desires to participate in a private placement, but does not meet the minimum purchase required by the offeror on its own. Consequently, the Staff reasoned, the adviser would have both a material pecuniary incentive and the ability to cause a Fund to participate in an aggregated order in the private placement, despite the fact that it was not in the Fund's best interest to participate. According to the Staff, this situation differed from the facts in *SMC Capital* in which the reduced execution costs of an aggregated order would be "highly unlikely to provide incentives to an adviser to purchase unsuitable investments for one client account."

The Staff accepted MassMutual's assertion that, if the sole term negotiated by MassMutual in any particular private placement was the purchase price of the securities, a Fund would not be disadvantaged by aggregating the orders of the Fund and an Affiliate Account because MassMutual would be unable to affect the terms of an offering to favor one client over another. Price affects the Fund and any other client equally. In effect, when the only term negotiated is the purchase price, the adviser lacks the material pecuniary incentive to overreach the Fund. Therefore, the Staff concluded:

> [T]he mere aggregation of the orders of an investment company and those of its affiliated persons for the purchase or sale of private placement securities would not violate Section 17(d) and Rule 17d-1 when the aggregation does not involve a conflict of interest between the investment company and its affiliated persons (or the negotiation of any of the terms of the securities), provided that the investment company participates on terms no less advantageous than those of any other participant.

Seven weeks later, in *MassMutual II*, the Staff wrote:

> Since the issuance of [the *MassMutual I*] letter, we have received a number of inquiries regarding the scope of the no-action relief granted to MassMutual. We are writing to clarify that MassMutual did not request no-action relief, and we did not express our views, with respect to aggregated transactions in which a fund's investment adviser: (1) does not participate or have a material pecuniary interest in an entity that does participate; but (2) negotiates the terms of the private placement securities on behalf of the fund and other participants in the aggregated transaction which are affiliated with the fund. If we are requested to do so, we will address this issue separately.

MassMutual II clarified little, except to highlight that, in a negotiated private placement involving a Fund in which multiple terms are negotiated, a necessary prerequisite to a conflict under Rule 17d-1 appears to be the existence of a material pecuniary interest on the part of the Fund's adviser in the transaction. The Staff provided no additional guidance concerning when an adviser will be deemed to have a material pecuniary interest in a party to the transaction. Perhaps, this was unavoidable because, as a matter of policy, the Staff wanted to eschew black-letter pronouncements in order to respond to the facts of each case.

Finally, when considering the MassMutual no-action letters, it is worth noting that MassMutual already was operating under a series of exemptive orders that permitted MassMutual-advised Funds to aggregate Fund and Affiliate Account orders in Negotiated Private Placements.[16] In fact, a proposed amendment to MassMutual's exemptive relief[17] was filed on June 23, 2000, or two weeks after the incoming letter in *MassMutual I* to the Commission. Under the conditions in the exemptive orders dating back to 1971, the aggregation of orders were subject to oversight by the Funds' board. This series of exemptive orders may help to explain why the requested relief in *MassMutual I* was limited to price-only private placements. That is, in the absence of the exemptive orders, MassMutual might have emphasized different facts as the basis for broader no-action relief. Unfortunately, there is no way to know.

Analysis

Since *MassMutual II*, the uncertainty concerning what constitutes a material pecuniary interest has left many Fund advisers hesitant with respect to Negotiated Private Placements in which it is desirable for both a Fund and an Affiliate Account to participate, even if the terms on which the Fund and the Affiliate Account participate are identical. Therefore, the remainder of this article discusses three hypothetical Fund complexes, each with a different approach to permitting a Fund and an Affiliate Account to participate simultaneously in a Negotiated Private Placement.

Complex A

At Fund Complex A, following industry practice, each Fund's portfolio manager, which may be a distinct team of individuals, has day-to-day responsibility for decisions to buy, hold or sell portfolio securities for the Fund. Each Fund's portfolio manager has the opportunity to decline to participate in any particular Negotiated Private Placement. Some Fund portfolio managers also manage an Affiliate Account that is offered the opportunity to participate in the same Negotiated Private Placement as the Fund (Overlapping Negotiated Private Placement).

Critically, no portfolio manager at Complex A participates in the negotiation of any Negotiated Private Placement. Instead, with respect to a potential Negotiated Private Placement, separate personnel undertake solicitations of interest from the portfolio managers and, assuming there is sufficient interest, the separate personnel negotiate the terms of each Negotiated Private Placement. While there is communication between the portfolio managers and the negotiating personnel from time to time concerning the general desirability of various terms and pricing points in a Negotiated Private Placement, these communications occur outside the negotiation phase of any particular Negotiated Private Placement.[18] Before the portfolio manager decides whether to participate in the Negotiated Private Placement, the portfolio manager is provided with the material terms of the Negotiated Private Placement, as have been negotiated by the separate personnel. In effect, with respect to each Negotiated Private Placement, the portfolio manager is acting on a take-it-or-leave-it basis.

In the case of each Overlapping Negotiated Private Placement, Complex A's adviser documents the fact that the portfolio manager made the determination that participating in the Negotiated Private Placement is in the Fund's best interest, and has written policies and procedures designed to assure that each portfolio manager is able to make an independent investment decision concerning participating in the Overlapping Negotiated Private Placement (for example, the negotiating team may not attempt to influence or interfere with the decisions of a portfolio manager). The participation of a Fund does not depend on the participation of any other Fund or account.

Finally, the Negotiated Private Placement subscription documentation provides that the rights and obligations of each subscriber are several and not joint, and that the placement agent and issuer's rights against any one subscriber in the Negotiated Private Placement shall not be deemed to create any right with respect to any other subscriber.

The portfolio manager cannot affect the terms of the Negotiated Private Placement and, therefore, cannot favor the Affiliate Account over the Fund. In comparison, in *MassMutual I*, price was the only term that could be negotiated. At Complex A, the portfolio manager cannot affect even the purchase price. Therefore, like *MassMutual I*, any Complex A Fund that participates in an Overlapping Negotiated Private Placement participates on identical terms as an Affiliate Account that participates, and no Fund is disadvantaged because, as was the case in *MassMutual I*, there are appropriate trade allocation procedures designed to assure fair and equitable participation in the Negotiated Private Placements. In short, *MassMutual I* appears to cover Complex A's approach to permitting a Fund and an Affiliate Account to participate simultaneously in an Overlapping Negotiated Private Placement. Accordingly, Section 17(d) and Rule 17d-1 should not be implicated.

Complex B

The only material difference between Complex B and Complex A is that Complex B permits its portfolio managers to participate in the negotiation of Negotiated Private Placements, including providing real-time feedback concerning proposed terms and pricing points to the adviser's negotiating personnel.

Normally, the Fund portfolio managers at Complex B are not also responsible for managing an Affiliate Account. However, from time to time, a portfolio manager manages both a Fund and Affiliate Account and, therefore, there are occasions in which this portfolio manager indicates that both a Fund and an Affiliate Account should participate in an Overlapping Negotiated Private Placement. With respect to each Overlapping Negotiated Private Placement, Complex B has additional procedures designed to ensure that the investment decision on behalf of the Fund is made independently from the investment decision on behalf of the Affiliate Account. Specifically, in each Overlapping Negotiated Private Placement, the portfolio manager's decision for the Fund's order to be aggregated is reviewed by a more senior portfolio manager, who is tasked with reaching an independent decision concerning whether Fund participation in the Negotiated Private Placement is in the Fund's best interest. The senior portfolio manager is fully informed about the terms that were negotiated in the Overlapping Negotiated Private Placement and has authority to override the portfolio manager's decision that the Fund should participate.

Complex B's adviser documents the manner in which investment decisions are reached independently on behalf of the Fund and the Affiliate Account. In addition, the adviser has written policies and procedures concerning the retention of records that are sufficient to show that, in any Overlapping Negotiated Private Placement, investment decisions on behalf of the Fund and Affiliate Account that have a common portfolio manager are made independently by the senior portfolio manager and the portfolio manager.

Each aggregation of a Fund's order with an Affiliate Account's order is not the result of an agreement or understanding among the portfolio manager, the adviser or any Affiliate. Each Negotiated Private Placement lacks any "element of combination," beyond parallel behavior, and each Fund remains a completely free agent. Under Complex B's facts, Section 17(d) and Rule 17d-1 should not be implicated.

Complex C

Complex C is similar to Complex A and Complex B. Thus, the operations at Complex C with respect to Negotiated Private Placements, on occasion, permit Complex C to follow the same model as Complex A. For another subset of Negotiated Private Placements, Complex C resembles B. Complex C differs from Complex A and Complex B only with respect to the limited number of remaining Negotiated Private Placements.

The remaining Negotiated Private Placements are small, complex, and unique (C-Type Negotiated Private Placements). A portfolio manager is required to analyze a C-Type Negotiated Private Placement but, due to the small size and the significant complexity, Complex C cannot justify the use of a senior portfolio manager in addition to the portfolio manager already assigned. Nevertheless, in a C-Type Negotiated Private Placement, Complex C permits a portfolio manager to aggregate the order of a Fund with the order of an Affiliate Account based on the rationale described below.

In *MassMutual I*, the Staff noted that a conflict of interest could arise between a Fund and an Affiliate in a Negotiated Private Placement if an Affiliate "has both a material pecuniary incentive and the ability to cause the investment company to participate with it in an aggregated transaction." The Staff, citing a 1967 pronouncement by the Commission, elsewhere in *MassMutual I* noted that Section 17(d) and Rule 17d-1, taken together, are intended to regulate transactions "in which persons making the investment decisions for the investment company may have a conflict of interest and the danger exists that the investment company or its controlled company may be overreached by such persons."[19]

With respect to C-Type Negotiated Private Placements, some additional facts will underscore the analysis that permits Complex C to permit a single portfolio manager to determine whether to aggregate the orders of a Fund with the orders of an Affiliate Account without violating Section 17(d) and Rule 17d-1.

Admittedly, there may be a remote incentive for the portfolio manager to cause the Fund and an Affiliate Account to participate in a C-Type Negotiated Private Placement in which the offered securities are not in a Fund's best interest. For example, the portfolio manager has a remote incentive to benefit the adviser-employer (or an Affiliate to benefit the portfolio manager's employer). However, there are incentives in the opposite direction that affect the portfolio manager's decision whether to acquire the securities in the C-Type Negotiated Private Placement. Better performance by the Fund attracts assets, which leads to greater revenue for the adviser. Further, the portfolio manager, who has been trained to seek better performance and to treat all accounts equally, is compensated (including bonus) according to a scheme that rewards the portfolio manager even-handedly with respect to the performance of the Fund and other accounts for which the portfolio manager is responsible.

Finally, Complex C's adviser has written policies and procedures designed to record contemporaneously the manner in which the portfolio manager determined that participation in the C-Type Negotiated Private Placement was in the best interest of the Fund and the Affiliate Account, and has written policies and procedures concerning the appropriate retention of the portfolio manager's analysis. These written policies and procedures are approved by the Fund's board, and provide for Complex C's chief compliance officer (CCO) or a member of the CCO's staff to participate occasionally, by asking questions, in real-time with the portfolio manager in some of the C-Type Negotiated Private Placements. This added degree of oversight is intended to provide the CCO with a basis for concluding that the applicable procedures are followed.

Based on these additional facts, Complex C should be able to determine reasonably that the incentives affecting the portfolio manager to seek better Fund performance far outweigh the remote incentives affecting the portfolio manager to overreach the Fund by making a decision that the portfolio manager believes is not in the Fund's best interest.[20] In light of the direction of the incentives affecting the portfolio manager, these facts present a situation in which it appears reasonable to conclude that the purpose of Section 17(d) is not offended by Complex C in permitting a portfolio manager to aggregate the order of a Fund with the order of an Affiliate Account. Under Complex C's facts, Section 17(d) and Rule 17d-1 should not be implicated.

Conclusions

The three Fund complexes described here are discussed separately to underscore that there is more than one way to avoid the interpretive uncertainty left by the MassMutual no-action letters. In the real world, it may be possible for a Fund adviser to address this uncertainty by following the approach of one or more of the three complexes, as the facts warrant.

Thus, for any Negotiated Private Placement in which a Fund and an Affiliate Account participate, there should be no impediment under Section 17(d) and Rule 17d-1, provided that at least one of the following sets of conditions is satisfied:

1. The Fund's decision to participate is always made independently from the Affiliate's decision to participate (for example, Complex B);
2. If the same portfolio manager exercises investment discretion for the Fund and the Affiliate Account, the portfolio manager does not determine the terms of the Negotiated Private Placement (for example, Complex A); or
3. If the same portfolio manager exercises investment discretion for the Fund and the Affiliate Account, the incentives affecting the portfolio manager to reach bona fide investment decisions are strong, while the incentives affecting the portfolio manager to overreach the Fund are remote (for example, Complex C).

Critically, each of these three alternatives assumes that there are no additional facts that would tend to undercut the analysis supporting the alternative.

To generalize from these three alternatives, for any approach to Negotiated Private Placements, counsel should undertake a fact-intensive analysis in which the incentives at work are evaluated and cataloged. Unbridled incentives to overreach, after all, are more likely to be scrutinized by the Staff more closely. However, as the Complex C example demonstrates, based on such a fact-intensive analysis, it should be possible to design and follow written policies and procedures to mitigate conflicting incentives and thereby avoid offending Section 17(d).

NOTES

1. Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (pub. avail Jun. 7, 2000) [hereinafter, *MassMutual I*]; Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (pub. avail. Jul 28, 2000) [hereinafter, *MassMutual II*].

2. In Gardner Russo & Gardner, SEC No-Action Letter (pub. avail. Jun. 7, 2006), the Staff agreed with an investment adviser that Section 206(3) of the Investment Advisers Act of 1940 (IAA) would not apply to a cross transaction between a client account and a private account of which the adviser and controlling persons owned no more than 25 percent in aggregate. Section 206(3) is intended to preclude self-dealing, which can occur when an adviser acts as principal in transactions with clients, such as dumping securities and price manipulation. It is unclear that the no-action letter's 25 percent threshold under the IAA necessarily is the same as a "material pecuniary interest" for purposes of ICA Section 17(d).

3. For brevity, in this article, a Fund's principal underwriter and affiliates of the underwriter each is an Affiliate. *See* Rule 17d-1.

4. The ICA's affiliated transaction provisions are contained within Sections 17(a), 17(d), and 17(e) and 10(f). These provisions, which protect investors from a Fund's insiders using the Fund to benefit themselves at the expense of the Fund, have been described as being at the heart of the ICA. *See* Securities and Exchange Commission, Division of Investment Management, Protecting Investors: A Half-Century of Investment Company Act Regulation 483 (1992).

5. *See* Rel. No. IC-5128 (Oct. 13, 1967) (proposing amendments to Rule 17d-1). *See also* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3rd Sess. 256 (Apr. 9, 1940) (statement of David Schenker, Chief Counsel, Securities and Exchange Commission, Investment Trust Study) (indicating that the purpose of Commission rules to be promulgated under Section 17(d) (originally drafted as Section 17(a)(4)) is to "insure fair dealing and no overreaching").

6. *See* Joseph W. Bartlett & Stephen P. Dowd, "Section 17 of the Investment Company Act—An Example of Regulation by Exemption," 8 *Del. J. Corp. L.* 449, 457–458 (1983).

7. SEC v. Midwest Technical Development Corp., [1961–1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,252 (D. Minn. 1963) [hereinafter, *Midwest Technical*].

8. SEC v. Talley Indus., Inc., 399 F.2d 396 (2d Cir. 1968), *cert. denied*, 393 U.S. 1015, 89 S. Ct. 615 (1969) [hereinafter, *Talley*].

9. *Id.* at 403.

10. *Id*. at 404.

11. Bloom v. Bradford, 480 F.Supp. 139 (E.D.N.Y. 1979).

12. *Id*. at 145.

13. SMC Capital, Inc., SEC No-Action Letter (pub. avail. Sept. 5, 1995) [hereinafter, *SMC Capital*].

14. The decision was In the Matter of Steadman Security Corp., SEC Admin. Proc. [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,038 at 84,848 (Dec. 20, 1974). In the decision, which included multiple securities law violations, the administrative law judge held that Rule 17d-1 was not violated where the Enforcement Division could not show a nexus between the movement of Funds' assets to a new bank custodian and personal loans from the bank to the respondents: "[A]t most, it could be found that the 'joint participants' made separate transactions or contracts with the same bank for distinct kinds of banking services."

15. The Staff had already noted that Section 17(d) and Rule 17d-1, taken together, are intended to regulate transactions "in which persons making the investment decisions for the investment company may have a conflict of interest and the danger exists that the investment company or its controlled company may be overreached by such persons." *Citing* Rel. No. IC-5128 (Oct. 13, 1967).

16. *See Massachusetts Mutual Life Insurance Company*, Rel. No. IC-6634 (Jul. 22, 1971) (notice) and Rel. No. IC-6690 (Aug. 19, 1971) (order). *See also Massachusetts Mutual Life Insurance Company,* Rel. No. IC-20381 (Jun. 30, 1994) (notice) and Rel. No. IC-20427 (Jul. 26, 1994) (order).

17. *Massachusetts Mutual Life Insurance Company*, Rel. No. IC-24557 (Jul. 13, 2000) (notice) and Rel. No. IC-24595 (Aug. 8, 2000) (order).

18. *Compare* Karrie H. McMillan, "Don't Ask, Don't Tell: The Proper Scope of Joint Transactions under Section 17(d)," *The Investment Lawyer*, Vol. 8 No. 6 (Jun. 2001). Ms. McMillan suggested that formal informational barriers between Fund portfolio managers and portfolio managers of other accounts would avoid the element of combination required to violate Section 17(d).

19. *Citing* Rel. No. IC-5128 (Oct. 13, 1967). Similarly, the Commission has noted that Section 17(a) is intended primarily to proscribe "a purchase or sale transaction when a party to the transaction has both the ability and the pecuniary incentive to influence the actions of the investment company." *See* Rel. No. IC-10886 (Oct. 2, 1979), *citing* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., at 256–259 (1940).

20. The approach described here is congruent with the approach the Staff follows with respect to Section 17(a) and Section 2(a)(19). In a series of no-action letters, the Staff indicated that it would not collapse affiliated entities in order to turn second-tier affiliates into first-tier affiliates. *See* Salomon Brothers Inc. (pub. avail. May 26, 1995); GT Global Growth Series (pub. avail. Feb. 2, 1996); First Financial Fund, Inc. (pub. avail. Jun. 5, 1997). *Salomon Brothers* and its progeny are discussed thoroughly in David M. Geffen, "Classifying Affiliates under the Investment Company Act," *The Investment Lawyer*, Vol. 16 No. 2 (Feb. 2009). The Staff indicated that its retreat from its automatic collapse doctrine was based on the lack of "substantial policy reasons." Presumably, the lack of substantial policy reasons in the no-action letters means that the facts presented insufficient incentive or opportunity to overreach a Fund to justify the limitations that result from application of Section 17(a) or Section 2(a)(19).

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