SEC Issues Guidance on Affiliated Transactions by Series Investment Companies

In June 2014, the Securities and Exchange Commission’s (SEC) Division of Investment Management published a Guidance Update addressing the application of the affiliated transactions rules under the Investment Company Act of 1940 (1940 Act) as they relate to series investment companies. The Guidance Update informs registrants that, under the affiliated transaction rules, each series of an investment company is considered a separate investment company for purposes of evaluating potential affiliated transactions.

A mutual fund may be organized as a “series company,” in which multiple investment portfolios are offered to investors as separate series or funds. The SEC has consistently viewed each series as a separate investment company when applying the 1940 Act and the rules thereunder. The Guidance Update serves to remind mutual funds organized as series investment companies of the importance of reviewing the fund’s compliance policies and procedures to ensure that they are reasonably designed to prevent violations of the federal securities laws on a series-by-series basis.

In the Guidance Update, the SEC notes that mutual funds should give particular attention to policies and procedures regarding identifying affiliated persons. Section 17(a) of the 1940 Act prohibits or restricts “affiliated persons” or “affiliated person[s] of such a person” from knowingly selling any security or other property to the investment company. The classification of each series as an investment company is significant in the affiliated transactions context because an affiliated person includes, among others, a person that owns 5 percent or more of the outstanding securities of any series of the investment company. In calculating the percentage ownership of the series, the shareholder base is limited to the shares of the series and does not include the shares of the entire fund complex. Thus, while an investor may not qualify as an affiliated person of the series investment company, they might nevertheless trigger Section 17(a) because they might be an affiliated person of a series of the investment company, and thus an affiliated person of an affiliated person of the investment company.

Because of the potentially significant impact to shareholders, financial institutions and other affiliates (including affiliates of affiliates) associated with a series of a series investment company, it is critical that the investment company’s compliance policies not only include procedures by which affiliated persons of the series investment company may be identified, but also include procedures by which affiliated persons of the separate series may be identified.

FOR MORE INFORMATION

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