Proskauer

SEC Proposes Expanded Fund Cross Trading Under Rule 17a-7

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On October 9, 2026, the Securities and Exchange Commission (the "SEC") proposed amendments to Rule 17a-7 under the Investment Company Act of 1940 (the "Investment Company Act") that would expand the securities eligible for cross trading by registered investment companies and business development companies ("regulated funds"). The proposal would permit cross trading of many fixed-income securities, while revising pricing and transaction conditions and adding compliance review, board reporting, recordkeeping and regulatory reporting requirements.

Background on Rule 17a-7 and Cross Trading

Cross trades are transactions in which a regulated fund sells a portfolio investment to, or purchases a portfolio investment from, another fund or other person that is an affiliated person of the regulated fund (or an affiliated person's affiliated person). The Investment Company Act generally prohibits cross trades between a regulated fund and its first- and second-tier affiliates in order to shield the fund and its shareholders against overreaching or self-dealing. Recognizing that cross trades can benefit funds and their shareholders by avoiding costs associated with open-market transactions, the SEC adopted Rule 17a-7 to allow cross trades under specified conditions.

Regulated funds historically relied on Rule 17a-7 to cross trade both equity and fixed-income securities. In December 2020, the SEC adopted Rule 2a-5, which addresses fund valuation practices and defines "readily available market quotations," a term used in Rule 17a-7 to determine which securities are eligible for cross trading. However, that definition has, in practice, resulted in the exclusion of most fixed-income securities. Since Rule 2a-5's compliance date, fixed-income securities previously cross traded under Rule 17a-7 generally have not been eligible for cross trading.

Key Proposed Amendments

The proposal would expand cross-trading eligibility to include securities that a regulated fund values using inputs that are observable, either directly or indirectly. As a result, assets valued using level 1 or level 2 of the GAAP fair value hierarchy would be eligible for cross trading. The SEC explained that, given the conflicts of interest implicated by cross trades and the importance of the transaction price to ensure that a cross trade is fair and reasonable to each participating regulated fund and does not involve overreaching, level 3 assets and assets that are not valued using the fair value hierarchy would not be eligible for the relief.

While funds trading many "traditional" fixed-income securities would be able to engage in cross trades, funds trading private credit and private equity assets, which are generally either level 3 or not valued using the fair value hierarchy, would be left out. The proposal indicates that the SEC understands that this includes interests in underlying private funds that are valued using the underlying fund's NAV as a practical expedient. This is notable given that the stated justification for leaving these assets out of the scope of the relief, conflicts of interest, would presumably be lessened when relying on a NAV set by a third-party underlying fund manager. The SEC specifically requests comments on whether additional securities should be eligible for cross trading.

Two Permitted Pricing Methods

In addition to the expansion of the scope of eligible securities, the proposal would replace the rule's prescriptive price conditions with two permitted alternative pricing methods. A cross trade could be priced using either:

- **The security's value in the fund's next net asset value calculation:** A pricing determination based on the value of the security determined in the regulated fund's next computation of net asset value on the day of the cross trade.
- **An adviser-determined current market price:** A price that the regulated fund's investment adviser determines reasonably represents the security's current market price, using unaffiliated pricing sources. If the fund uses this method, its adviser would have to periodically review the reasonableness of those prices.

The SEC states that the pricing changes are designed to recognize market developments in pricing and the adoption of Rule 2a-5. When using either of the above two methods, advisers could use evaluated prices, intraday vendor data, indications from electronic platforms and other observable inputs reflecting contemporaneous market conditions instead of being limited to broker-dealer quotes.

Transaction Conditions, Compliance Oversight, Reporting and Recordkeeping

Transaction Conditions

Beyond expanding the scope of eligibility and changes to pricing methods, the proposal would also add or modify the transaction conditions that cross trades must satisfy under the rule. These include:

- **Pre-trade best-interest determination:** Before effecting a cross trade, the regulated fund's investment adviser would have to determine that the proposed trade is in the best interest of each regulated fund involved.[1] This condition is intended to help ensure that the adviser puts the interests of each fund and its shareholders above its own and does not favor one client over another.
- **Payments to unaffiliated service providers:** The proposal would expressly permit *de minimis* payments to unaffiliated parties for services such as clearing, settlement and custody, as an exception to the rule's restrictions on remuneration in connection with a cross trade. The SEC states that this would permit administrative fees where necessary to effect a transaction.
- **Consistency with fund policies and investment strategies:** A cross trade would have to be consistent with the regulated fund's policies and investment strategies.

CCO Reviews and Board Reporting

The proposal would add new compliance burdens on chief compliance officers ("CCOs"). The proposal would replace the board's quarterly compliance determination under Rule 17a-7 with reviews by the CCO and reports to the board and add annual back testing. Although existing SEC staff no-action relief already permits boards to rely on CCO compliance representations as to compliance with the rule, the proposal would impose additional requirements on the CCO that do not exist under the current rule.

The proposal would require the CCO to perform the following duties:

- **Quarterly compliance reviews:** The CCO would review cross trades to determine compliance with the rule and report the results to the fund's board.
- **Annual back testing:** The CCO would conduct back testing at least annually to identify any patterns suggesting disadvantages to the fund relative to affiliates and report the results to the board. The testing would have to include analyses of the prices realized when any security purchased by the fund through a cross trade is subsequently sold.

Recordkeeping

Regulated funds would have to maintain and preserve records of each cross trade, the information and materials used by the CCO to make the required determinations in the quarterly and annual reviews, and the reports provided to the board.

Regulatory Reporting

The proposal would also amend Form N-PORT and Form N-MFP to require regulated funds that engage in cross trading to report aggregate information, by asset class, about the value of securities traded during the preceding month and corresponding information about cross-trading activity.

Looking Ahead

The public comment period will remain open for 60 days after the proposing release is published in the Federal Register. Advisers, particularly advisers to funds holding level 3 assets, may be interested in commenting on this proposal. Please contact Proskauer's Private Investment Funds Regulation team if you are interested in submitting a comment on the proposal.

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[1] The proposal identifies several illustrative factors an adviser could consider, including: the investment rationale and expected effect on fund performance; the cross-traded security's characteristics, including liquidity; the pricing method; execution method, quality, speed and costs; timing and urgency; trade size and potential market impact; the eligible affiliate's characteristics, including its expense and fee structure; and current market conditions, especially if the markets are stressed. See Investment Company Cross Trading, SEC Release No. IC-36358 (Oct. 9, 2026), pp. 56–58.

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