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SEC PROPOSES EXPANDING SECURITIES ELIGIBLE FOR CROSS TRADING BY REGISTERED FUNDS

On October 9, 2026, the Securities and Exchange Commission (the “SEC”) proposed amendments to Rule 17a-7 under the Investment Company Act of 1940, as amended (the “Investment Company Act”), that would expand the types of securities eligible for cross trading between registered investment companies (“registered funds”) and certain affiliated persons. The proposed amendments are a welcome development for the industry, and effectively serve to reverse an unexpected regulatory development from 2020 that significantly narrowed the scope of securities eligible for Rule 17a-7 cross trading. In addition, the proposal would generally modernize the rule’s requirements (which could result in more efficient portfolio management and reduced transaction costs for registered funds and their shareholders) while maintaining appropriate safeguards against conflicts of interest and affiliated-party overreach. More specifically, the proposed amendments would, among other things, permit cross trading in most securities valued using observable market inputs, including securities classified as Level 2 under the fair value hierarchy established under U.S. generally accepted accounting principles; establish alternative pricing methodologies for cross trades; reallocate the responsibilities of cross trading oversight between registered fund chief compliance officers (“CCOs”) and boards of directors; and require aggregated reporting of cross-trading activity on Forms N-PORT and N-MFP.

The proposal represents a significant change for registered funds, particularly for those that invest in fixed-income securities, as well as for fund complexes that manage multiple registered funds with overlapping investment strategies and trading needs. Below we discuss the proposal and its potential implications in more detail.

Background

Section 17(a) of the Investment Company Act generally prohibits certain principal transactions between a registered investment company and its affiliated persons.¹ These restrictions are intended to protect fund shareholders from overreach and self-dealing in transactions in which an affiliate may have both the ability and the financial incentive to influence the transaction. Rule 17a-7 provides an exemption from these restrictions for qualifying cross trades subject to specified conditions.² Historically, registered funds have

¹ Business development companies (“BDCs”) are also subject to restrictions on affiliated transactions pursuant to Section 57 of the Investment Company Act. This section differs somewhat from Section 17. Unless and until the SEC adopts rules for BDCs under Section 57, BDCs are permitted to rely on Rule 17a-7. Although the proposing release primarily focuses on Section 17 and thus registered funds, the SEC stated that BDCs may rely on Rule 17a-7 unless the SEC adopts BDC-specific rules under Section 57.

² Compliance with Rule 17a-7 does not relieve a party engaging in a cross trade involving an Employee Retirement Income Security Act (“ERISA”) plan from complying with applicable ERISA provisions, and does not relieve an investment adviser from its obligations under the Investment Advisers Act of 1940 (the “Advisers Act”).

relied on Rule 17a-7 to execute cross trades in certain types of both equity and fixed-income securities. Such transactions may allow affiliated funds with complementary investment needs to transact directly, avoiding certain costs associated with open-market transactions, including brokerage commissions, bid-ask spreads and market impact.

However, when Rule 2a-5 under the Investment Company Act, which governs fair value determinations by registered investment companies, was adopted in 2020, it and the SEC's commentary in the adopting release, immediately eliminated the availability of Rule 17a-7 for most fixed-income securities. Rule 2a-5 addresses valuation practices and the role of the board of directors with respect to the fair value of the investments of a registered fund or business development company. The rule also sets out requirements for determining fair value in good faith for purposes of the Investment Company Act. Specifically, the rule defines "readily available market quotations" by reference to reliable, unadjusted quoted prices in active markets for identical investments that the fund can access at the measurement date. Because most fixed-income securities do not trade frequently enough to satisfy this standard, funds could no longer engage in cross trades in many fixed-income securities.³

The SEC's proposal seeks to address these limitations by modernizing Rule 17a-7 to reflect developments in market transparency, electronic trading and pricing methodologies while preserving conflict of interest protections.

Expansion of Eligible Securities

Under the proposed amendments, a security would be eligible for cross trading if there are "readily available market quotations" for the security or the security is valued using "observable inputs." The latter category would expressly include securities valued using Level 2 inputs under the fair value hierarchy, such as many fixed-income securities priced using observable market data, including prices for similar securities and other market-based inputs.⁴ Securities valued using significant unobservable inputs (such as Level 3 measurements) would remain outside the expanded eligibility framework. This change could restore cross-trading opportunities for a substantial portion of registered funds' fixed-income portfolios. It may be particularly relevant to fixed-income funds, municipal bond funds and other funds that hold securities for which pricing is supported by observable market information but that do not trade in active markets with "readily available quotations."

³ The release proposing Rule 2a-5 did not discuss Rule 17a-7, but offered a proposed definition of "readily available market quotations." Commenters on the proposal raised the concern that proposed definition of readily available market quotations could impact then-current practices on cross trades under Rule 17a-7.

The commenters stated that funds and their affiliates regularly engage in cross trades of certain fixed-income securities that they believed would not qualify as having readily available market quotations under the proposed definition, and asked that the SEC clarify that the proposed definition was not meant to disrupt current cross-trading practices. Rather than revising the defined term, the SEC instead recognized that market participants would need to conform their practices and further that certain securities that had been previously viewed as having readily available market quotations and being available to cross trade under Rule 17a-7 may not meet the new definition and thus would not be available for Rule 17a-7 cross trades.

⁴ For purposes of the proposed rule, the SEC would consider a security to be valued based on inputs that are observable, either directly or indirectly, only to the extent that Level 2 inputs are the lowest level of inputs that are significant to the entire measurement.

The proposal does not eliminate the need for reliable pricing or appropriate valuation controls. Instead, it would expand the universe of eligible securities while continuing to rely on objective, market-based information as an important investor protection. Once the amendments become effective, the guidance on cross-trading contained in various no-action letters would be superseded by the amendments.

Modernized Pricing Requirements

The rule will continue to require that the cross trade be effected at the “independent current market price” of the security, but the SEC proposes to replace the existing, prescriptive pricing framework under the rule with two alternative approaches: NAV pricing and current market pricing.

- **NAV pricing.** Under this approach, a cross trade would be priced based on the value of the security used in the registered fund’s next computation of its net asset value (“NAV”) on the day of the cross trade. This approach would allow funds to use established valuation methodologies and pricing sources, potentially reducing the operational burden associated with obtaining separate pricing information for each cross trade.
- **Current market pricing.** Alternatively, a fund’s investment adviser could determine a price that reasonably represents the security’s current market price using one or more unaffiliated pricing sources. The adviser would be required to periodically review the reasonableness of the prices determined under this approach.

The proposed framework is intended to recognize that market pricing may be established through multiple data sources and valuation techniques rather than solely through readily available quotations for identical securities.

For fund complexes, these alternatives could provide greater flexibility in pricing fixed-income and other less frequently traded securities. However, the “current market pricing” approach would require advisers to establish and consistently apply appropriate methodologies, assess the reliability and timing of pricing information, and maintain adequate documentation supporting their pricing determinations, although these processes are often already in place for fair value and other pricing determinations.

Transaction Fees

The proposal would retain restrictions on compensation paid in connection with cross trades while expressly permitting certain “de minimis” payments to unaffiliated parties related to the clearing, settlement, custody, recording or reporting of the cross trade. Permitted payments would need to satisfy certain conditions, including applicable limitations concerning customary and de minimis amounts.⁵ The

⁵ According to the SEC, a de minimis amount for these purposes would depend on the facts and circumstances and the overall context. In general, the amounts would need to be “small relative to the size of the transaction—and below what a fund would pay in brokerage commissions, bid-ask spreads, mark-ups and mark-downs or otherwise if the fund were to purchase or sell the security in the market.” The SEC expects a registered fund’s policies and procedures to address how the fund will determine whether a given fee is de minimis and whether it is being incurred for a permissible purpose.

proposal would also retain the general requirement that the transaction involve cash payment against prompt delivery of the security.

These provisions are intended to accommodate certain operational costs without permitting transaction-related payments that undermine the protections against affiliated-party overreach. Fund complexes would need to evaluate their existing cross-trading arrangements, including use of intermediaries, electronic trading platforms and third-party service providers, to determine whether associated fees would be permissible under the proposed framework.

Best Interest Determinations⁶

The proposed amendments would require the adviser to determine that the cross trade is in the best interest of each participating registered fund.⁷ In this regard, the SEC stated that if an adviser can obtain a more favorable outcome for a fund by trading in the open market (including if more favorable pricing is available in the open market), buying or selling a different security, or not transacting at all, the cross trade is not in the fund's best interest (i.e., each fund would need to be at least as well off as it would be under reasonably available market alternatives).⁸ The SEC provided examples of factors to consider, including: (1) the investment rationale for the cross trade and its expected effect on the fund's performance; (2) the characteristics of the cross-traded security, including its liquidity; (3) the method of pricing the cross trade, whether more favorable pricing appears to be available in the open market, and any cost savings associated with the cross trade; (4) the execution method, quality and speed, and any associated costs; (5) the timing and urgency of the transaction; (6) the size of the trade and its expected effect on the price of the security if that volume were purchased or sold in the open market; (7) the characteristics of the eligible affiliate, including its expense and fee structure; and (8) current market conditions, especially if markets are stressed.

The proposed standard would place additional emphasis on documenting the rationale for individual transactions and demonstrating that each transaction benefits each participating fund.

This requirement is intended to address the conflicts inherent in transactions between affiliated funds, where an adviser may have competing obligations to funds with different investment objectives, liquidity needs or portfolio exposures. Accordingly, advisers would need to consider the interests of each participating fund separately rather than treating the overall benefits to the fund complex as sufficient justification for a cross trade.

⁶ Separate from the best interest requirement, the transaction would also need to be consistent with the stated investment policies and strategies of each participating fund, which is consistent with the current rule.

⁷ The SEC stated that in order to satisfy Rule 38a-1, a registered fund's policies and procedures should address how the adviser would determine whether a cross trade is in the best interest of the fund, including the process and factors that lead to the determination. The proposal does not specify particular investment adviser personnel who should make these determinations. In this regard, the SEC advised that, in determining which personnel are appropriate for making the best interest determinations, the adviser should "carefully consider potential conflicts of interest between potential personnel and each of the funds involved in the transaction."

⁸ The SEC stated that an adviser could not determine that a cross trade is in the best interest of a registered fund simply because the other conditions of the rule are met, and that the best interest determination is a separate condition. However, the SEC acknowledged that other conditions of the rule relate to topics that are relevant and could inform the best interest determination, and offered a few examples. In one example, the SEC stated if a trade would be in such volume as to move the market price, conducting the trade as a cross trade may require a heightened level of review of price before the investment adviser determines that it is in the best interest of the fund because such cross-trade price would not incorporate the market moving price effects.

Re-Allocation of Compliance Responsibilities

The proposal would revise the allocation of cross trading responsibilities between a fund's CCO and its board of directors. The rule currently requires the board to adopt, and make and approve changes to, the fund's cross-trade policies and procedures, and to review cross trades quarterly. Under the proposal, the quarterly review requirement would be transferred from the board to the CCO, with board oversight being maintained through CCO reporting to the board. Specifically, under the proposal, the CCO would be required to:

- Review cross trades at least quarterly to determine whether they comply with the proposed rule;
- Conduct at least annually a back-testing review, which must include an analysis of the ultimate prices realized when any security purchased by a fund through a cross trade is ultimately sold, to determine whether any cross trade or pattern of cross trades may have disadvantaged the fund relative to an eligible affiliate; and
- Report the results of the quarterly and annual reviews to the fund's board.

The annual back-testing review could include an examination of other transactions and relevant information including the timing and price of subsequent sales of securities acquired through cross trades to assess whether the fund may have been disadvantaged.

The proposed changes are intended to align cross-trading oversight more closely with the allocation of compliance responsibilities under the Investment Company Act more generally, and reduce duplicative governance requirements. Nevertheless, the CCO's expanded responsibilities would make effective review procedures, adequate resources and appropriate escalation mechanisms particularly important.

Compliance Policies and Procedures

Given the requirements of Rule 38a-1, the current compliance procedures requirement in Rule 17a-7 is largely duplicative, and thus, as mentioned above, the proposal would eliminate this requirement from Rule 17a-7. According to the SEC, instead, the board would approve Rule 17a-7 policies and procedures under Rule 38a-1. In the SEC's view, at a minimum, these policies and procedures should:

- address how the fund and adviser will effect cross trades to satisfy the conditions of the proposed rule;
- describe how the CCO would conduct the quarterly review to determine compliance with the requirements of the proposed rule (e.g., examining portfolio manager input in determining whether a security is eligible for cross trading, reviewing the adviser's best interest determination for any irregularities, and confirming that the cross trade is consistent with the fund's other policies and investment strategies as stated in its registration statement); and
- describe how the CCO would conduct the annual review (e.g., by describing the review of other transactions or information, the disposition price, any relevant factors, and any appropriate testing to determine that a cross trade did not disadvantage a fund).

In determining whether to approve cross trading policies and procedures, the SEC suggested that the board could consider the fund's circumstances and use of cross trades (e.g., based on the fund's investment objective and strategies, risk and liquidity profile, conflicts of interest with eligible affiliates, potential cost savings and market conditions), and advised that the policies and procedures be tailored to each registered fund. In terms of tailoring, the SEC provided an example that for a registered fund that only occasionally cross trades exchange-traded equity securities, using NAV pricing may not require the same level of CCO review or detailed reporting to the board as a registered fund that frequently cross trades fixed-income securities using "current market pricing."

The SEC also discussed policies and procedures that set levels of deviation (e.g., tolerance levels) to trigger further review, and provided an example that registered funds might set a tolerance level for differences between the cross-trade price and the valuation price, which may automatically trigger additional review. As another example, policies and procedures could set a minimum holding period for cross-traded securities, which may trigger additional review to address any parking or dumping concerns.

Lastly, the SEC discussed policies and procedures that describe specific circumstances and conditions that prohibit or prevent a cross trade from occurring (e.g., through pre-trade compliance blocks), require additional investigation, or give a CCO or investment adviser personnel complete discretion to prevent a cross trade (e.g., pre-trade compliance testing to determine if the trade is consistent with a registered fund's investment policies or other compliance requirements, with trade blocks for outliers). The SEC also discussed policies and procedures that could describe actions to be taken if a cross trade is found to disadvantage a registered fund relative to an eligible affiliate (e.g., depending on the facts and circumstances, including applicable law, reversing a trade or the adviser making the disadvantaged registered fund whole, together with additional monitoring going forward).

For funds that currently rely on Rule 17a-7 or plan to rely on the rule in the future, the proposed amendments will require updates to compliance manuals, trade-approval processes, pricing controls, recordkeeping systems and board reporting practices. Fund complexes seeking to expand cross trading to Level 2 securities may also need to assess whether their existing pricing infrastructure and valuation controls are sufficient to support the proposed requirements.

Enhanced Regulatory Reporting

The SEC proposes to amend Forms N-PORT and N-MFP to require aggregated reporting of cross-trading activity and related trading activity. The proposed reporting would provide information concerning the aggregate value of portfolio investments purchased and sold through cross trades, together with related trading activity, organized by asset class. Registered funds other than money market funds would report on Form N-PORT while money market funds would report on Form N-MFP.

The SEC expects the additional information to improve transparency for regulators, investors and other market participants by making cross-trading activity more readily comparable across funds and over time. Registered funds would therefore need to assess whether their existing systems can capture and aggregate the required information accurately and consistently. Depending on the fund's current infrastructure,

implementation may require coordination among portfolio management, trading, compliance, fund accounting and regulatory reporting teams.

Implications for Registered Funds and Their Advisers

If adopted, the proposed amendments would provide meaningful operational and economic benefits to registered funds, particularly those with substantial fixed-income portfolios. By expanding the universe of eligible securities and permitting more flexible pricing methodologies, the proposal could enable funds to reduce certain transaction costs and execute portfolio transactions more efficiently.

At the same time, the expanded flexibility would not eliminate the underlying conflicts of interest associated with cross trading. Advisers would remain responsible for ensuring that each participating fund is treated fairly, that transactions satisfy the applicable pricing and best-interest requirements and that appropriate records and compliance controls are maintained.

Even though this rulemaking is only at the proposal stage, registered funds and their advisers might wish to consider evaluating existing fund cross-trading activity and identifying potential implementation tasks, including evaluating:

- **Trading opportunities:** whether additional fixed-income or other securities could qualify for cross trading under the proposed eligibility standard.
- **Pricing infrastructure:** whether and to what extent existing pricing vendors, valuation and pricing methodologies and related controls support NAV pricing or current market pricing for eligible securities.
- **Conflict management:** whether and to what extent existing policies, procedures and controls adequately evaluate the interests of each participating fund and document a best interest determination, including reasonably available alternatives.
- **Compliance oversight:** needed changes to CCO resources (including the proposed reviews) and board reporting processes.
- **Regulatory reporting:** whether and to what extent existing systems can efficiently and accurately capture the information required for the proposed amendments to Forms N-PORT and N-MFP.
- **Policies and procedures:** needed changes to existing compliance policies and procedures and related compliance documentation.⁹

Investment advisers should also continue to consider their fiduciary obligations under the Advisers Act. As mentioned above, compliance with Rule 17a-7 does not independently provide relief from the Advisers

⁹ The proposed amendments also would require registered funds to maintain and preserve records of: (1) each cross trade; (2) the information and material used by the CCO to make the required determinations as part of the quarterly and annual reviews; and (3) reports provided to the board.

Act's requirements including applicable obligations concerning principal transactions. Similarly, cross trades involving assets of plans subject to the ERISA, remain subject to applicable ERISA requirements.

Next Steps

The proposed amendments are subject to public comment and may be modified before the SEC considers and adopts final rules. As proposed, there would be tiered compliance dates following adoption of any final amendments, with a 12-month compliance period for registered funds, together with other investment companies in the same "family of investment companies,"¹⁰ have net assets of \$10 billion or more as of the end of the most recent fiscal year, and an 18-month compliance period for registered funds that, together with other investment companies in the same family of investment companies, have net assets of less than \$10 billion as of the end of the most recent fiscal year.

We will continue to monitor developments relating to the proposed amendments and their potential implications for registered funds and their investment advisers.

Requests for Comments

The proposal contains requests for comments on various aspects of the proposed amendments including the expansion of eligible securities, the proposed pricing alternatives, the conditions governing cross trades, the allocation of compliance responsibilities between fund CCOs and boards of directors and the proposed reporting requirements.

Comments are due 60 days after publication of the proposing release in the *Federal Register*. For additional information, see the SEC's [press release](#) and the related [proposing release](#).



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¹⁰ As this term is defined in Item B.5 of Form N-CEN.

CONTACTS

For more information about the topics raised in this Legal Update,
please contact any of the following lawyers.

COUNSEL
LESLIE CRUZ

WASHINGTON DC +1 (202) 263-3337
LCRUZ@MAYERBROWN.COM

PARTNER
BRIAN HIRSHBERG
NEW YORK +1 (212) 506-2176
BHIRSHBERG@MAYERBROWN.COM

PARTNER
ADAM KANTER

WASHINGTON DC +1 (202) 263-3164
AKANTER@MAYERBROWN.COM

PARTNER
ANNA PINEDO
NEW YORK +1 (212) 506-2275
APINEDO@MAYERBROWN.COM

AMERICAS | ASIA | EMEA

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