

CLIENT ALERT

SEC Proposes Expanding Securities Eligible for Cross Trading by Registered Funds

October 22, 2026

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On October 9, 2026, the Securities and Exchange Commission (the “SEC” or the “Commission”) proposed amendments to Rule 17a-7 under the Investment Company Act of 1940, as amended (the “Investment Company Act”), the “cross-trading rule” that permits registered funds and business development companies (“BDCs”) to buy and sell securities with certain affiliates under specified conditions (the “Rule”).¹ The proposed amendments (the “Proposal”) would restore the ability of registered funds to cross trade fixed-income securities, which was effectively restricted following the adoption of Rule 2a-5 in 2020.² The Proposal would also modernize the Rule’s pricing, fee, and oversight conditions and would require aggregated reporting of trading and cross-trading activity on Form N-MFP for money market funds and Form N-PORT for other registered funds.³

¹ Press Release, SEC Proposes Expanding Securities Eligible for Cross Trading by Registered Funds (Oct. 9, 2026), available [here](#).

² Investment Company Cross Trading, Investment Company Act Release No. 36358, at 13 (Oct. 9, 2026) (“Proposing Release”). See the Proposing Release [here](#).

³ See *id.* at 1, 20–22.

Key Takeaways

The Proposal would expand the universe of securities eligible for cross trading, while replacing the Rule's current pricing mechanics and board-centric oversight with a framework built around existing valuation processes, adviser determinations, and chief compliance officer ("CCO") review. Its principal components are:

- **Expanded Eligible Securities.** Securities valued based on directly or indirectly observable inputs ("level 2" securities under U.S. GAAP) would become eligible for cross trading, in addition to securities with readily available market quotations ("level 1" securities). Level 3 and non-leveled securities would remain ineligible.⁴ This change should expand the ability to rely on the Rule to effect cross trades in a large universe of fixed-income securities, including securities that are valued using "evaluated" prices under Rule 2a-5.⁵
- **Two Pricing Methods.** Cross trades would be priced either at (i) the value determined in the fund's next net asset value ("NAV") computation on the business day of the trade date ("NAV pricing") or (ii) a price that the adviser determines reasonably represents the current market price using one or more unaffiliated pricing sources ("current market pricing"), including intraday pricing.⁶
- **Oversight.** Advisers would be required to make a best interest determination for each cross trade prior to effecting a transaction, and the fund's CCO, rather than the board, would conduct quarterly compliance reviews and annual back-testing, reporting the results to the board.⁷ Boards would continue to be required to comply with Rule 0-1(a)(7), including (among other things) that a majority of the fund's board be comprised of directors who are not interested persons of the fund.
- **New Reporting Requirements.** Funds that cross trade would report, by asset class, their aggregate purchases and sales and their aggregate cross-trade purchases and sales on Form N-PORT or Form N-MFP, as applicable.⁸
- **Clarified Fee Treatment.** The Rule's limit on transaction fees to "customary transfer fees" would be amended to expressly permit *de minimis* payments to unaffiliated parties for clearing, settlement, custody, recording, or reporting.⁹

Background

Section 17(a) of the Investment Company Act generally prohibits an affiliated person of a registered fund (or an affiliated person of such a person), acting as principal, from knowingly selling securities to, or purchasing securities

⁴ Proposing Release, *supra* note 2, at 20, 22–27.

⁵ The Proposal, in part, relies on the implementation of Rule 2a-5 with respect to fund pricing. *See id.* at 29–31.

⁶ *See id.* at 29.

⁷ *See id.* at 21, 61–63. The Commission staff has permitted boards since 2018 to rely on a written CCO representation that cross trades complied with board-approved procedures. *See* Independent Directors Council, SEC Staff No-Action Letter (pub. avail. Oct. 12, 2018), available [here](#).

⁸ *See id.* at 22, 76.

⁹ *See id.* at 49–51.

from, the fund.¹⁰ The prohibition includes trading between two funds with the same adviser or advisers under common control. This prohibition attempts to address the concern that cross trades can raise conflicts of interest, including the potential for an affiliate to cherry-pick securities, misprice trades or attempt to force a fund to purchase unwanted securities. The Commission also noted that the lack of public information about cross trades may negatively affect price discovery in the market.¹¹

Conversely, cross trades can benefit funds by avoiding brokerage commissions, bid-ask spreads, and other open market transaction costs. In light of these benefits, the Commission adopted Rule 17a-7 in 1966 to conditionally permit certain cross trades of equity securities that were traded on a national securities exchange.¹² In 1981, the Rule was expanded from exchange-traded equity securities to include any security for which “market quotations are readily available,” opening the possibility to rely on the Rule for some fixed-income cross trades, if they could be priced under the Rule’s “reasonable inquiry” standard.¹³

Rule 2a-5, adopted in December 2020, defined “readily available market quotations” as a quoted price (unadjusted) in active markets for identical investments, consistent with a U.S. GAAP level 1 input, and applied that definition throughout the Investment Company Act, including to Rule 17a-7.¹⁴ Most fixed-income securities generally have been ineligible for cross trading since then because they trade infrequently and are typically classified as level 2.¹⁵

Key Provisions of the Proposal

A. Expansion of Eligible Securities

Under current Rule 17a-7, only securities with readily available market quotations may be cross traded. As noted above, the SEC provided guidance in connection with Rule 2a-5 that limited “readily available market quotations” to level 1 securities. Citing several developments since 2020 that support permitting cross trading for some types of fixed-income securities, the Proposal would extend eligibility to securities that the fund values based on inputs that are observable, either directly or indirectly, and would include “evaluated” prices, such as pricing service prices, which track the definition of a level 2 input in the U.S. GAAP fair-value hierarchy.¹⁶ Observable inputs are those

¹⁰ Investment Company Act § 17(a), 15 U.S.C. § 80a-17(a); Proposing Release, *supra* note 2, at 5–6.

¹¹ Proposing Release, *supra* note 2, at 18–19.

¹² 15 U.S.C. § 80a-17(b); Proposing Release, *supra* note 2, at 6–7, 10.

¹³ Proposing Release, *supra* note 2, at 10–11. The Proposing Release cited United Municipal Bond Fund, SEC Staff No-Action Letter (July 30, 1992), as an example of funds satisfying the pricing requirements by gathering multiple bids and offers, and certain other staff letters addressed the use of independent pricing service prices for cross trades of municipal securities. *See id.* at 12 n.16.

¹⁴ 17 C.F.R. § 270.2a-5(c); *see Good Faith Determinations of Fair Value*, Investment Company Act Release No. 34128, 86 Fed. Reg. 748 (Jan. 2, 2021) (codified at 17 C.F.R. pt. 270) at 89.

¹⁵ Proposing Release, *supra* note 2, at 13–14.

¹⁶ An adviser considering prices from a pricing service, including intraday evaluated prices for securities without readily available market quotations, would be expected to evaluate the service and its methodologies to determine whether its prices can reasonably be determined to represent current market value. The Proposal suggests factors an adviser could consider, including: (i) the qualifications, experience, and history of the pricing service, particularly in providing intra-day pricing; (ii) the pricing methods, inputs, and assumptions used for different classes of holdings and how they are affected by changing market conditions; (iii) the quality and timing of the pricing information relative to the cross trade; (iv) the service’s process for considering pricing challenges; (v) the service’s actual and potential conflicts of interest and mitigation steps; and (vi) the service’s testing processes. These factors are similar to those discussed in the Rule 2a-5 adopting release, and a fund using the same pricing service for NAV computation and cross-trade pricing may combine its due diligence for both

developed using market data, such as publicly available information about actual events or transactions, and those that reflect the assumptions market participants would use in pricing the security.¹⁷ Level 2 inputs include, for example, quoted prices for similar securities in active markets, quoted prices for identical or similar securities in non-active markets, and other observable inputs such as credit spreads, interest rates, and yield curves observable at commonly quoted intervals. In practice, evaluated prices for these securities are typically produced by third-party pricing services using matrix- or model-based methodologies that incorporate trade data (including TRACE and MSRB RTRS reported transactions), broker-dealer quotes, yield curves, spreads, and comparable-bond data. A security would be treated as level 2 for purposes of the Proposal only if level 2 inputs are the lowest level of inputs significant to the entire fair-value measurement. This change would permit cross-trading of fixed-income securities while limiting eligibility to securities with an independent basis for pricing, with the goal of reducing the risk of subjectivity, bias, or error.¹⁸ Level 3 and non-leveled securities would remain ineligible.¹⁹

B. Alternative Pricing of Cross Trades

The Proposal would replace the current Rule's asset-specific pricing hierarchy (e.g., last sale price for listed equities or the average of the highest current independent bid and lowest current independent offer for over-the-counter securities) with two methods, either of which would constitute the "independent current market price." A fund could use different methods for different cross trades.²⁰

- **NAV Pricing.** A cross trade could be effected at the value the fund ascribes to the security in its next NAV computation on the business day of the transaction, using its existing Rule 2a-4 and Rule 2a-5 valuation processes. Where two registered funds are involved, they must share the same valuation processes so that they arrive at the same price; otherwise, current market pricing must be used. Funds that do not compute NAV daily could use this method only on days they compute NAV, and money market funds could not use amortized cost values permitted under Rule 2a-7.²¹
- **Current Market Pricing.** A trade could be effected at a price the adviser determines reasonably represents the current market price using one or more unaffiliated²² pricing sources (such as prices from pricing services, broker-dealer quotes, or electronic trading platforms), provided that the adviser periodically reviews the reasonableness of such prices.²³ This method may be used at any time, including intraday.²⁴

purposes. The adviser would also be expected to apply its pricing methodologies consistently and periodically review the reasonableness of the resulting prices, for example by investigating approaches that consistently over- or under-price securities relative to observed transactions or NAV valuations. *See id.* at 38–42.

¹⁷ *See id.* at 25 n.50.

¹⁸ *See id.* at 20–23.

¹⁹ *See id.* at 26 n.55.

²⁰ *See id.* at 29–31.

²¹ *See id.* at 32–33.

²² "Unaffiliated" would exclude first- and second-tier affiliates of the fund. *See id.* at 35–37.

²³ The Proposal would not prescribe the method or frequency of these reviews, and the Proposing Release states that such reviews should be specific to the circumstances of the fund's cross trading, the type of security being cross traded and the frequency and volume of cross-trading activity.

²⁴ Proposing Release, *supra* note 2, at 35.

The intraday flexibility is also a meaningful departure from current practice. Under the existing Rule 17a-7 framework, a contemporaneous price for an over-the-counter security generally could be established only by soliciting multiple bids and offers from broker-dealers that would not execute the trade, which commenters described as increasingly difficult, if not impossible, as dealers have grown unwilling to provide non-actionable quotes solely to support internal cross trades.²⁵ Current market pricing would instead allow advisers to rely on intraday evaluated prices from pricing services and observable inputs from electronic trading platforms. A cross trade would be able to be executed at the same time the adviser makes its other trading decisions and at a price reflecting prevailing market conditions, rather than waiting for the fund's end-of-day NAV computation.²⁶

C. Transaction Fees

The Proposal would retain the requirement that no consideration other than cash payment against prompt delivery of the security be involved in the cross trade and would continue to generally prohibit remuneration in connection with a cross trade.²⁷ It would, however, replace the current exception for “customary transfer fees” with an express exception for *de minimis* payments to unaffiliated parties for clearing, settlement, custody, recording, or reporting. This would cover, for example, settlement or administrative fees charged by custodians, broker-dealers, or trading platforms, mandatory charges in certain non-U.S. markets such as stamp duties and transaction taxes, and equivalent payments on a blockchain or other distributed ledger.²⁸ The Proposal does not define a specific *de minimis* threshold; the Commission states that amounts generally should be small relative to the transaction and below what the fund would pay to trade the security in the open market.

D. Best Interest Determination and Consistency With Fund Policies

The Proposal would add a new requirement that the fund's adviser makes a pre-trade best interest determination. Before effecting each cross trade, the fund's adviser would be required to determine that the trade is in the best interest of the fund, considering factors such as:

- The investment rationale for the cross trade and the expected effect of the cross trade on the fund's performance;
- The characteristics of the securities;
- 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 conducting a cross trade;
- The execution method, quality, and speed, and any associated costs;

²⁵ See *id.* at 176 n.228.

²⁶ See *id.* at 35.

²⁷ See *id.* at 49–52.

²⁸ See *id.* at 51–52 & n.84.

- The timing and urgency of the transaction;
- The size of the trade and the expected effect on the price of the security if that volume of securities were purchased or sold on the open market;
- The characteristics of the eligible affiliate, including its expense and fee structure; and
- Current market conditions, especially if the markets are stressed.

The fund would be required to maintain records documenting each best interest determination, including the factors considered, and the CCO's quarterly review would confirm that the determination was made for each cross trade. The Proposal would also require that each cross trade be consistent with the fund's policies and investment strategies.²⁹

E. CCO Oversight

The Proposal would replace the current requirement that the board determine at least quarterly that all cross trades complied with the fund's procedures. Instead:

- The fund's CCO (not the adviser's CCO) would review all cross trades at least quarterly for compliance with the Rule, including confirming that the adviser made the required best interest determination for each cross trade, and report the results to the board;³⁰
- The CCO would conduct at least annual reviews, including back-testing of the prices ultimately realized when securities purchased in cross trades are later sold, to identify whether any trade or pattern of trades may have disadvantaged the fund relative to its eligible affiliates, and report the results to the board; and
- The board would approve policies and procedures under Rule 38a-1 that address how the fund and adviser would effect cross trades to satisfy the conditions of the proposed rule, including how the CCO would conduct the quarterly review to determine compliance with the requirements of the Proposal. For example, the Proposal states the CCO could examine any portfolio manager's input in determining whether a security is eligible for cross trading, review the adviser's best interest determination for any irregularities, and confirm that the cross trade is consistent with the fund's other policies and investment strategies as stated in its registration statement.³¹

Additionally, fund boards would continue to be required to satisfy the fund governance standards in Rule 0-1(a)(7). In practice, the quarterly CCO review largely codifies the approach permitted under the 2018 Independent Directors Council no-action letter, which allowed a board to rely on a written CCO representation that cross trades complied

²⁹ See *id.* at 21–22, 91.

³⁰ See *id.* at 61–64.

³¹ See *id.* at 21, 64, 90 n.129.

with board-approved procedures. The Proposal goes further, however, by adding annual disposition-based back-testing by the CCO and the adviser's pre-trade best interest determination.

F. Reporting

Funds that engaged in cross trades in reliance on Rule 17a-7 during the preceding 12 months would be required to report on Form N-PORT or Form N-MFP, for each asset type (or category of investment) and in U.S. dollars, four data points for the reporting period:

- The aggregate value of portfolio investments purchased under Rule 17a-7;
- The aggregate value of all portfolio investments purchased;
- The aggregate value of portfolio investments sold under Rule 17a-7; and
- The aggregate value of all portfolio investments sold.³²

Reporting would continue for 12 months after any cross trade, even for months without cross trades, and would follow each form's existing filing and publication schedule.³³ Business development companies ("BDCs") and small business investment companies, which do not file these forms, would not be subject to this requirement.³⁴

G. Recordkeeping

Funds would continue to maintain records of each cross trade for six years from the end of the fiscal year in which a Rule 17a-7 transaction occurred (the first two in an easily accessible place), including a description of the security, the identity of the eligible affiliate, and the terms of the trade.³⁵ Records relating to board oversight would be replaced with records of the information and materials the CCO used for the quarterly and annual reviews, including the purchase and sale dates and prices of securities acquired in cross trades, and copies of the CCO's reports to the board. The requirement to permanently preserve the fund's written cross-trading procedures would be removed as duplicative of Rule 38a-1.

H. Staff No-Action Letters, Defined Terms, and Transition

The Commission noted that, if the Proposal is adopted, any inconsistent staff views would be superseded.³⁶ The Proposal would also add defined terms for "fund" and "eligible affiliate," which the Commission states would not change the scope of the current Rule.³⁷ "Fund" would mean a registered investment company, including a separate series thereof.³⁸ "Eligible affiliate" would replace the current Rule's reference to "the person" on the other side of a

³² See *id.* at 76, 156.

³³ See *id.* at 79.

³⁴ See *id.* at 76 n.111, 156.

³⁵ See *id.* at 87–92.

³⁶ See *id.* at 96. For a list of staff letters addressing topics covered by the Proposal (noting the list may not be exhaustive), see *id.* at 96–98.

³⁷ See *id.* at 22, 95.

³⁸ See *id.* at 94 for definitions of "fund" and "eligible affiliate."

transaction and would cover an affiliated person of the fund, or an affiliated person of such a person, that is another registered fund (including a separate series), another series of the same fund, or a person whose affiliation is solely by reason of a common investment adviser (or affiliated advisers), common directors, and/or common officers. The Proposal would also define “unaffiliated” for purposes of pricing sources and permitted payments to mean a person other than a first- or second-tier affiliate of the fund. BDCs could continue to rely on Rule 17a-7 pursuant to Section 57(i).³⁹

The Commission proposed a tiered transition period of 12 months for fund groups with net assets of \$10 billion or more and 18 months for fund groups with net assets of less than \$10 billion.⁴⁰ Funds could comply voluntarily before the compliance date, but only by relying on the amended rule in its entirety.⁴¹

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³⁹ 15 U.S.C. § 50a-56(i); Proposing Release, *supra* note 2, at 9.

⁴⁰ Proposing Release, *supra* note 2, at 98.

⁴¹ *See id.* at 99.

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