INVESTMENT COMPANY INSTITUTE®

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April 30, 2019

Ms. Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Fund of Funds Arrangements, File No. S7-27-18

Dear Ms. Countryman:

The Investment Company Institute[1] appreciates the Securities and Exchange Commission's efforts to streamline and enhance the regulatory framework applicable to funds that invest in other funds ("fund of funds" arrangements).[2] Funds of funds provide investors with a highly efficient and effective way to meet their investment objectives or their savings goals, such as building and managing assets to and through retirement. As discussed below, although we are generally supportive of the SEC's proposal, we have concerns with certain aspects of the proposed conditions for fund of funds arrangements, most notably with the redemption restriction, because we believe it is unnecessary, will not benefit fund investors, and will disrupt a significant number of existing fund of funds arrangements.

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[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$22.4 trillion in the United States, serving more than 100 million US shareholders, and US$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *See* Investment Company Act Release No. 33329 (December 19, 2018) (the "Release"), available at https://www.sec.gov/rules/proposed/2018/33-10590.pdf. In 2008, the SEC proposed, but never adopted, a fund of funds rule for investment companies investing in ETFs. *See* Investment Company Act Release No. 28193 (March 11, 2008) ("2008 proposal"). ICI filed a comment letter that supported the 2008 proposal. *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission May 19, 2008 , available at https://www.ici.org/pdf/22543.pdf.

The SEC's new rule would, under specified circumstances, permit a fund to acquire shares of another fund in excess of the limits of Section 12(d)(1) of the Investment Company Act of 1940 without obtaining an exemptive order from the Commission. In connection with the proposed rule, the SEC proposes to rescind Rule 12d1-2 under the Investment Company Act and most exemptive orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Investment Company Act. The Commission also is proposing related amendments to Rule 12d1-1 under the Investment Company Act and Form N-CEN.

I. Background

Funds increasingly invest in other funds as a way to achieve asset allocation, diversification, or other investment objectives. As of year-end 2018 more than 1,500 fund of funds mutual funds, those defined as investing more than half of their assets in other funds, had $2.1 trillion in assets, up from about 800 funds of funds with about $0.5 trillion in assets a decade ago.[3] The Commission's proposal, however, affects a larger and broader range of funds of funds because it captures those arrangements operating outside the parameters of Section 12(d)(1). Much of the growth in funds of funds stems from investor interest in target date mutual funds, especially individuals saving for retirement in 401(k) plans and individual retirement accounts (IRAs).[4] Target date mutual funds (also known as lifecycle funds) usually invest through a fund of funds structure, meaning they primarily invest in and hold shares of other mutual funds—95 percent of target date mutual funds are funds of funds, and 43 percent of funds of funds are target date mutual funds. The target date is the year in which the fund's investors expect to retire. These funds are designed to rebalance over time as the fund approaches and passes the target date, which is typically included in the fund's name. To do this, they are typically constructed as a "hybrid" fund that follows a predetermined allocation of risk, with a changing mix of asset classes over the lifetime of the investment, and are therefore an excellent way to help investors meet their investment objectives related to retirement.

As the Commission has recognized, funds of funds can provide main street investors with the same benefits as separate direct investments in several underlying funds, without the increased monitoring and recordkeeping of investing in each underlying fund. For example, in the case of target date fund of funds arrangements, an investor seeking to implement such a strategy outside of a fund of funds arrangement would have to monitor and reallocate assets over time. A fund of funds also can provide an investor with exposure to an asset class or fund that may not otherwise be available to that investor. Some funds also invest in other funds, and

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[3] *See* Table 49 of Data Section 5, in *2019 Investment Company Factbook*, available at www.icifactbook.org.

[4] At year-end 2018, target date mutual fund assets totaled $1.1 trillion. Retirement accounts held the bulk (86 percent) of target date mutual fund assets, with 67 percent held through defined contribution retirement plans and 19 percent held through IRAs. *See* Investment Company Institute, "Quarterly Retirement Market Data," available at https://www.ici.org/research/stats/retirement.

particularly in ETFs, to allow for efficient exposure to certain asset classes or investment strategies, often as a complement to direct investments in other securities.

Section 12(d)(1) of the Investment Company Act limits the ability of a fund to invest substantially in shares of another fund. Congress enacted these restrictions because it was concerned about "pyramiding"—a practice under which investors in the acquiring fund could control the assets of the acquired fund and use those assets to enrich themselves at the expense of acquired fund shareholders. Congress also was concerned that fund of funds arrangements could result in excessive fees and the formation of overly complex structures that could be confusing to investors.

As the potential benefits of these arrangements became more apparent over the years, Congress and the SEC facilitated the development of funds of funds and imposed additional investor protections for shareholders of acquiring funds and acquired funds. Notably, Congress created a number of statutory exceptions to permit different types of fund of funds arrangements.[5] Importantly, when Congress enacted Section 12(d)(1)(G), it also empowered the SEC with explicit authority to permit additional types of fund of funds arrangements as structures evolved. Specifically, Section 12(d)(1)(J) of the Act allows the Commission to exempt any person, security, or transaction, or any class or classes of transactions from Section 12(d)(1) if the exemption is consistent with the public interest and the protection of investors. This is a notable direction from Congress, given that the Commission already had extensive exemptive authority under Section 6(c). Indeed, recognizing that fund of funds arrangements would continue to evolve over time, Congress urged the Commission to use this exemptive authority in a "progressive way," particularly noting that the Commission should use its exemptive authority under appropriate circumstances so that "the benefits of [funds of] funds … are available to investors through a variety of different types and sizes of investment company complexes."[6]

For more than 20 years, the SEC has used its exemptive authority to adopt rules[7] and to issue exemptive orders permitting fund of funds arrangements when the SEC found those

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[5] Section 12(d)(1)(E) of the Investment Company Act allows an acquiring fund to invest all of its assets in a single fund so that the acquiring fund is, in effect, a conduit through which investors may access the acquired fund. Section 12(d)(1)(F) of the Act permits a registered fund to invest any amount of its assets in other funds, as long as the acquiring fund and its affiliated persons do not purchase more than 3 percent of another fund's securities. Section 12(d)(1)(G) allows a registered open-end fund or UIT to invest in other open-end funds and UITs that are in the same "group of investment companies."

[6] Comm. On Commerce, Securities Amendments of 1996, H.R. Rep. No. 104-662 (1996), 104th Cong., 2nd Sess., at 43-45.

[7] Rule 12d1-1 allows funds to invest in shares of money market funds in excess of the limits of Section 12(d)(1). Rule 12d1-2 provides funds relying on Section 12 d (1 (G) with greater flexibility to invest in other types of

arrangements to be consistent with the public interest and the protection of investors. This regime has permitted investors to enjoy the benefits of funds of funds while protecting investors from the abuses against which Section 12(d)(1) was directed.

Although the current regulatory framework has been successful in addressing the relevant policy concerns, the SEC proposes to replace Rule 12d1-2 and certain fund of funds exemptive orders with a more comprehensive fund of funds framework. While we commend the SEC for its efforts to streamline its regulatory approach and to eliminate the need for fund groups to obtain individual fund of funds exemptive orders, it is important that the SEC be aware that its proposed approach will disrupt a significant number of existing arrangements and deprive investors of investment opportunities that have served investors both efficiently and successfully for many years. Indeed, we note that the basis of this rulemaking does not appear related to any specific issue raised by investors in funds of funds.[8] In addition, because the restrictions of Section 12(d)(1) do not apply to several other forms of pooled investment vehicles, we are concerned that if a new rule significantly impairs the operations of existing fund of funds arrangements, asset managers and investors will seek alternative products. In that circumstance, the rule would cause disruption, unnecessary costs, and a shift of assets that would frustrate the Commission's goals.

ICI conducted a survey of its members to assess the extent to which funds of funds operating under the current statutory and regulatory regime would be affected by the proposal. Fifty complexes reported a total of 1,359 funds of funds with $2.8 trillion in assets under management (referred to as "reporting funds of funds").[9] Thirty-one percent (423 out of 1,359) of the reporting funds of funds with $829 billion in assets would not be affected by the proposal because they are structured solely in reliance on the statutory exemptions in Section 12(d)(1)(E), Section 12(d)(1)(F), or Section 12(d)(1)(G). The remaining 69 percent (936 out of 1,359) of reporting funds of funds with $2.0 trillion in assets would need either to comply with the new conditions outlined in the proposal or restructure their products. As illustrated by these numbers, the proposal does not simply streamline the regulation of funds of funds, but rather will cause significant operational changes. As a result, and because we do not believe this was the Commission's intent, we urge the SEC to modify some aspects of the proposed rule and

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securities. Rule 12d1-3 allows acquiring funds relying on Section 12 d (1)(F) to charge sales loads greater than 1.5 percent.

[8] For example, in proposing to rescind Rule 12d1-2, the Commission does not identify any issue presented by the existing regulatory approach. As discussed below, we generally support the proposed rule as a replacement for Rule 12d1-2 to the extent that it streamlines regulation and expands the relief to closed-end funds and business development companies (BDCs . In the absence of any policy concerns about the current regulation, however, we believe that it is important that the new rule does not introduce novel regulatory restrictions that disrupt well-functioning investment vehicles.

[9] To establish a baseline for the survey, we defined a fund of funds as a fund that invests in at least one other fund in excess of the limits of Section 12 d (1)(A) of the Investment Company Act (excluding funds whose only investments are in money market funds).

be guided by a principle of "do no harm" to avoid unnecessarily upsetting the fund of funds arrangements that investors are using today to help them meet their financial goals.

Summary of Comments and Recommendations

In summary, we support the Commission's goal to streamline the regulation of funds of funds and our comments and recommendations, reflecting that shared goal, include the following:

- *Redemption Restriction*. The proposed restriction on the ability of acquiring funds to redeem shares of acquired funds should be removed from the rule. This restriction is not consistent with the manner in which Congress and the SEC successfully have regulated funds of funds for more than 20 years and would significantly disrupt existing fund of funds arrangements without any justification. Among other issues, the proposed redemption restriction would harm investors in funds of funds by imposing arbitrary liquidity constraints on investments that otherwise offer daily redemptions to all other types of investors and by treating them differently than if they were direct investors in the underlying funds. It also seems to ignore the responsibilities and obligations of funds and advisers under Investment Company Act Rule 22e-4, the liquidity risk management rule. We suggest adopting a regulatory approach similar to the approach that Congress and the SEC have previously taken and that has been serving investors very effectively for decades.

- *Other Conditions*. We generally support other proposed conditions to the rule. We believe, however, that some of the requirements relating to the voting of shares of underlying management investment companies should be revised to align with the tested and familiar approach in the current exemptive orders. We also believe that the finding that an acquiring fund adviser would be required to make regarding the complexity and aggregate fees of a fund of funds arrangement should be more specific, and that an acquiring fund should not be required to obtain a certification regarding separate account fees from an insurance company. Finally, we believe that the restrictions on multi-tier arrangements should include additional exceptions, including an exception that would specifically permit funds of funds to use short-term bond funds for cash management purposes consistent with current practice.

- *Scope of Proposed Rule*. With respect to the scope of the relief, we support, as proposed, expanding the relief to include all types of registered investment companies and BDCs as either acquiring funds or acquired funds. We also believe that the SEC should consider further expanding the scope of the relief to permit private funds and foreign funds to rely on the rule to invest in registered funds or BDCs.

- *Changes to Existing Regulatory Regime*. With respect to the proposal to rescind all orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Investment Company Act, with the exception of interfund lending orders, we believe that the SEC should clarify that the types of orders that would be rescinded are only those relating to fund of funds arrangements addressed by the proposed rule. Similarly, the SEC indicates that the Division of Investment Management is considering withdrawing all staff interpretive and no-action relief that would be moot, superseded, or otherwise inconsistent with the rule. Given that such guidance and no-action relief are extensive and have been provided over many decades, we believe that the SEC and/or the Division of Investment Management should retain certain letters as discussed below or incorporate the staff interpretive and no-action relief into the rule. We believe such an approach is fully consistent with the Commission's goal of streamlining fund of funds regulation.

- *Acquired Fund Fees and Expenses and Investing Related Expense Disclosure.* We recommend that the SEC permit funds to exclude BDCs from the definition of "acquired fund" for purposes of the prospectus fee table presentation. This would allow funds to treat BDCs in the same manner as investments in operating companies for expense presentation purposes. We also recommend that the SEC require funds to disclose investing related expenses in the fund's Statement of Additional Information (SAI) and financial statements rather than in the prospectus fee table.

- *Legislative Changes to Address Private Fund Investments in Closed-End Funds*. In conjunction with the rulemaking, we urge the SEC to work with Congress to introduce legislation that prohibits private funds from exceeding the Section 12(d)(1) restrictions when investing in closed-end funds. Contrary to the statutory intent of the section, some private funds are able to exert undue influence over closed-end fund operations to the detriment of long-term shareholders. Amendments to Section 12(d)(1) would limit private fund acquisitions in a manner consistent with the intended goals of the statute.

We will discuss each of these items in greater detail below.

II. Redemption Restriction

The most disruptive aspect of the proposed rule, and the least consistent with prior regulation of fund of funds arrangements as well as Rule 22e-4 under the Investment Company

Act (the new liquidity risk management rule) [10] is the proposed restriction on the ability of acquiring funds to redeem shares of acquired funds.

Currently, many acquiring funds own in excess of 3 percent of one or more acquired funds. Based on ICI's survey, 41 complexes reported that a total of 516 funds of funds with $1.8 trillion in assets regularly held more than 3 percent of an underlying fund's shares.[11] To assess the likely impact of the proposed redemption limit, the ICI survey asked how many times in the past three years (2016, 2017, and 2018) had these funds of funds redeemed more than 3 percent of the shares of an underlying fund (excluding money market funds) within any 30-day period. Of the 41 responding complexes, 30 complexes with a total of 394 funds of funds with $1.7 trillion in assets provided partial or complete information in response to this question.[12] Only 9 complexes with 37 funds of funds having a total of $54 billion in assets reported no redemptions in any of their funds of funds greater than 3 percent in the past three years. In contrast, 21 complexes with 357 funds and $1.6 trillion in assets reported that 228 of their funds of funds had a total of 1,399 redemption transactions that exceeded 3 percent in the past three years.[13] The most commonly cited reasons for these transactions were reallocation or rebalancing among asset classes, followed by shareholder redemptions at the acquiring fund level and liquidations of the acquired fund.

A. Redemption restriction is not consistent with the modern regulation of funds of funds

To address the concern that an acquiring fund could threaten an acquired fund with large-scale redemptions as a means of exerting control over the acquired fund, proposed Rule 12d1-4 includes a condition that would prohibit an acquiring fund that acquires more than 3 percent of the outstanding voting securities of an acquired fund from redeeming, submitting for redemption or tendering for repurchase more than 3 percent of an acquired fund's total outstanding shares in any 30-day period.[14] This redemption limit, which is not included in the

[10] For an overview of this rule, *see* Investment Company Liquidity Risk Management Program Rules: A Small Entity Compliance Guide, https://www.sec.gov/divisions/investment/guidance/secg-liquidity.htm.

[11] This total excludes funds of funds whose only investments are in money market funds.

[12] Eleven complexes with 122 funds of funds and $147 billion in assets were not able to provide this detail.

[13] This is likely an underestimate of redemption activity because some complexes were able to analyze only some of their funds *e.g.*, largest or affiliated), while other complexes were able to analyze only a shorter time frame *e.g.*, one quarter or one year rather than the past three years).

[14] This limit would not prevent or otherwise limit an acquiring fund from selling acquired fund shares in secondary market transactions (such as ETFs or exchange-listed closed-end funds).

statutory provisions, rules or exemptive orders, could have a significant adverse effect on many fund of funds arrangements.[15]

To justify the proposed redemption limits, the SEC cites the legislative history of the 1970 amendments to the Investment Company Act (which added the current limits in Section 12(d)(1)(A) and (B)), particularly Congress's concern about an acquiring fund's ability to indirectly control or otherwise unduly influence an acquired fund through the threat of large-scale redemptions. For more than 20 years, however, Congress and the SEC have addressed this concern through different regulatory approaches.

With respect to acquiring funds that invest in funds within the same group of investment companies, Congress enacted Section 12(d)(1)(G) in 1996 to permit such arrangements without any limits on redemptions by the acquiring funds. Section 12(d)(1)(G) codified the framework that the SEC itself had adopted in similar exemptive orders issued before 1996.[16] This approach reflects the fact that where the acquired fund is part of the same group of investment companies as the acquiring fund, the risk of undue influence through the threat of large-scale redemptions is mitigated. Since the enactment of Section 12(d)(1)(G), the SEC has issued hundreds of exemptive orders to provide exemptions for same-group fund of funds arrangements without requiring any redemption limits. Similarly, when the SEC adopted Rule 12d1-2 in 2006 to permit funds relying on Section 12(d)(1)(G) to invest in additional types of securities, the SEC did not impose redemption restrictions. More recently, the SEC did not include redemption restrictions when it proposed expanding Rule 12d1-2 in 2008 to permit funds to invest in other assets that were not securities.

In sum, for more than 20 years, same-group fund of funds arrangements have operated without a redemption restriction. The proposed redemption restriction conflicts with the intent of Congress in enacting Section 12(d)(1)(G), as well as with Rule 12d1-2 and hundreds of SEC exemptive orders. The Release itself acknowledges that same-group fund of funds arrangements "do not raise the concerns of undue influence that underlie section 12(d)(1)" when it excludes such arrangements from the voting and control conditions in the rule.[17] In

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[15] We note that although Section 12 d (1)(F) does include a redemption limit, it is permissive *i.e.*, acquired funds have the option to limit redemptions to only 1 percent of the acquired fund's total outstanding securities during a 30-day period), while the proposed condition in Rule 12d1-4 is not.

[16] In a few of the first SEC exemptive orders to permit funds to invest in other funds within the same group of investment companies, the SEC granted the relief subject to a condition that limited the ability of the acquiring fund to redeem shares of the acquired fund. Later, the SEC issued orders superseding those original orders and eliminating the redemption restrictions before the enactment of Section 12(d)(1)(G). *See* T. Rowe Price Spectrum Fund, Inc., Investment Company Act Release No. 21424 (October 18, 1995) (order superseding a prior order from 1989, as amended in 1992); Norwest Bank Minnesota, N.A., Investment Company Act Release No. 22120 (August 6, 1996) (order superseding a prior order from 1994).

[17] *See* Release at 38.

light of the minimal risk of undue influence by an acquiring fund over an acquired fund within the same-group of investment companies, the SEC should exclude these arrangements from the redemption restriction.

With respect to investments by an acquiring fund in funds from different groups of investment companies, the SEC suggests that the redemption restriction could replace various conditions to the exemptive orders permitting such investments. These conditions normally require certain procedures and board findings to prevent undue influence by the acquiring fund and its affiliates over the underlying other group fund. The conditions have been standard in hundreds of exemptive orders issued by the SEC since the SEC first granted this relief in 1999.[18] The Release does not suggest that these conditions have failed to address the policy concern of undue influence, but instead generally indicates that the redemption restriction would streamline the conditions to enhance compliance and strengthen investor protections, even though this restriction is not currently in operation. Accordingly, although the SEC states that the proposed rule reflects decades of experience with fund of funds arrangements, the proposed rule actually would replace an accepted and effective regulatory framework with a new approach that could be disruptive to existing fund of funds arrangements.

Further, as described below, the redemption restriction seems to ignore the responsibilities and obligations of registered investment companies regarding their management of a fund's liquidity, especially the Commission's own recent work on liquidity management. It was only in 2016 that the Commission adopted new Rule 22e-4, the liquidity risk management rule. The Commission spent years on the design and adoption of this rule in an effort to promote effective liquidity risk management. Funds, advisers, boards of directors, and third-parties have dedicated substantial time and resources to the implementation of Rule 22e-4. As such, the proposed redemption restriction is not consistent with the modern regulation of fund

[18] *See, e.g.*, Schwab Capital Trust, et al., Investment Company Act Release Nos. 24067 (October 1, 1999) (notice) and 24113 (October 27, 1999) (order). Before 1999, acquiring funds could have invested in funds from other groups of investment companies in reliance on Section 12 d)(1)(F), which Congress enacted in 1970. Section 12 d (1)(F) contains a provision that permits, but does not require, an underlying fund to restrict redemptions by an acquiring fund to an amount not exceeding 1 percent of the underlying fund's shares during any period of less than 30 days. In developing the conditions for the orders to permit investments in other group funds beyond the limits of Section 12(d)(1)(F), the SEC clearly did not assume that large redemptions were necessarily motivated by a desire of the acquiring fund to exercise undue influence over acquired funds. Rather than imposing either permissive or required restrictions on redemptions, the orders instead take a more progressive approach by including conditions that require the review of services and transactions between the underlying fund and the fund of funds and certain of its affiliates—*i.e.*, the services and transactions that could be subject to undue influence.

of funds, including the liquidity risk management rule. Indeed, Rule 22e-4's adopting release calls redeemability a "defining feature" of open-end funds.[19]

B. Redemption restriction would be disruptive and would harm investors

As noted in the Release, funds of funds have become a popular and efficient means for investors to obtain exposure to various asset classes and investment strategies through investment in a single fund that invests in other investment companies. Investors in funds of funds that are management companies rely on the investment adviser to the fund of funds to exercise its investment discretion, consistent with its fiduciary obligations and subject to board oversight, in furtherance of the best interests of the fund and its shareholders. The proposed redemption limits would frustrate and interfere arbitrarily with the managerial discretion of an acquiring fund's investment adviser, thereby preventing the fund from investing in a manner that its portfolio manager deems necessary and appropriate. For example, redemption limits could prevent the portfolio manager from replacing within a reasonable period of time a poor performing acquired fund with a different acquired fund or another investment if the portfolio manager believes it is in the best interest of the acquiring fund and its shareholders.[20] Indeed, the SEC notes that, as proposed, if an acquiring fund holds 25 percent of the outstanding shares of the acquired fund, it could take the acquiring fund 10 months to fully unwind its investment in the acquired fund.[21] Similarly, a redemption restriction could impede the ability of a target date fund to reposition its portfolio in accordance with its prescribed schedule for rebalancing.

The situation could be even worse if there were actually an issue with an underlying mutual fund that called into question the appropriateness of the investment (*e.g.*, portfolio manager turnover; significant market downturn in an asset class; an investment guideline change in the acquired fund).[22] Whereas every other type of investor in the acquired fund

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[19] *See* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (January 17, 2017) ("Liquidity Risk Management Programs Release") at 5.

[20] Members report that particularly for same-group funds of funds, the investment adviser and portfolio managers of the respective acquiring and acquired funds are able to manage such transitions in a way that avoids portfolio disruption for the acquired fund. In addition, the redemption restriction also fails to take into account the ability of an acquired mutual fund to redeem in kind to avoid potential disruption from large-scale redemptions. *See, e.g.*, Signature Financial Group, SEC Staff No-Action Letter (December 22, 1999).

[21] *See* Release at note 260. This 10 month redemption process is especially shocking considering that an underlying mutual fund otherwise stands ready to provide daily redemptions. In addition, we note that it may take considerably longer to fully unwind an investment if the acquired fund is experiencing large-scale redemptions by other investors that increase the acquiring fund's position in the acquired fund.

[22] One event that could cause an acquired fund to become an inappropriate holding under the proposed rule would occur if the acquired fund itself becomes an acquiring fund. In such a situation, the proposed rule could require the original acquiring fund to redeem its holdings of the underlying fund shares. If such redemptions were restricted by the proposed rule, the rule could force the original acquiring fund to hold the underlying acquiring

would be free to redeem shares, the proposed rule would prevent the fund of funds from making a similar necessary investment change, to the detriment of the investors in the fund of funds.[23] In addition, if other investors were leaving the acquired fund for similar reasons (thereby reducing the number of outstanding shares), the acquiring fund's percentage ownership could increase notwithstanding the fund's efforts to redeem shares. Under this scenario, an acquiring fund may never be able to exit the acquired fund due to the redemption restriction.

As yet another example of the difficulties created by a redemption restriction, to the extent that an acquiring fund must satisfy a large redemption (*e.g.*, if a retirement plan, collective investment trust, or other institutional investor redeems a high percentage of an acquiring fund's outstanding shares with little advance notice), the redemption limit could prevent the acquiring fund from maintaining the adviser's intended allocation among the various acquired funds and other assets. Such a situation could occur if the investor's redemption required the acquiring fund to begin redeeming more than 3 percent of the shares of one particular acquired fund. In that case, the acquiring fund would begin to experience an over-allocation to one acquired fund (from which it could not fully exit), and an under-allocation to the remaining acquired funds and other assets, contrary to the portfolio manager's investment intent.[24]

The proposed redemption limits also may pose challenges under the SEC's new liquidity risk management rule. Rule 22e-4 requires open-end funds to treat securities that cannot be sold or disposed of in seven calendar days or less as "illiquid."[25] Since proposed Rule 12d1-4 would restrict the redemption of holdings above 3 percent of the acquired fund's shares within a 30-day period, depending on facts and circumstances, an acquiring fund might consider such holdings to be wholly or partially illiquid. Moreover, Rule 22e-4 precludes a fund from acquiring an illiquid investment if the acquisition would cause the fund to have invested

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fund and potentially violate the provisions of the proposed rule relating to complex fund structures. In this circumstance, the rule provisions would be internally inconsistent.

[23] Such a scenario highlights the highly discriminatory nature of the redemption restriction on acquiring funds (and therefore on the shareholders of the acquiring funds) as compared to other shareholders in the acquired fund. In this regard, the redemption restriction seems contrary to the public policy behind provisions of the Investment Company Act that are designed to ensure that open-end mutual funds issue redeemable securities and that shareholders of an open-end mutual fund should have equal economic rights.

[24] In the case of a UIT that invests in other funds, redemptions by investors in the UIT would normally be funded by pro rata redemptions of shares of the underlying funds to maintain the fixed portfolio of the UIT. A redemption restriction by one of the underlying funds could thwart the ability of the UIT to maintain its fixed portfolio, contrary to the expectations of the UIT investors and Section 4(2) of the Investment Company Act.

[25] An illiquid investment is an investment that the fund reasonably expects cannot be sold in current market conditions in seven calendar days or less without significantly changing the market value of the investment.

more than 15 percent of its net assets in illiquid investments. To the extent that the proposed redemption restriction would "artificially" increase an acquiring fund's percentage of illiquid investments, this would further limit the acquiring fund's investment flexibility (and could have the perverse effect of limiting the acquiring fund's purchase of otherwise highly liquid acquired fund shares).

Of course, an open-end acquired fund is itself subject to the liquidity risk management provisions of Rule 22e-4. In that regard, Rule 22e-4 was adopted, in part, to "reduce the risk that a fund will be unable to meet its redemption obligations."[26] Because the new requirements under Rule 22e-4 would appear to mitigate at least some of the concerns associated with the threat of a large-scale redemption for an acquired fund, it is puzzling that the SEC would find it necessary to add redemption limits to fund of funds regulation at this time. We do not believe that it is necessary or appropriate for the SEC to effectively adopt a new liquidity approach for acquired funds that would apply only to investments from funds of funds. [27]

In light of the concerns the proposed rule would create regarding ownership of shares of acquired funds, it is foreseeable that the redemption restriction would negatively impact newly launched or small acquired mutual funds. Fund of funds arrangements often provide the acquired funds with more scalable asset levels, resulting in greater efficiencies and reduced operating expenses for an acquired fund's shareholders. If the SEC's policy concern is the adverse impact on other acquired fund shareholders that may result from large-scale redemptions by acquiring funds, imposing redemption limits will likely lead to lower investment. With redemption limits, certain acquired funds will cease to be attractive investment options for fund of funds arrangements, thereby reducing investment in the underlying fund to the disadvantage of other shareholders that could benefit from greater economies of scale.[28] Indeed, many current fund of funds arrangements will need to reconsider whether they can or want to own more than 3 percent of any one acquired fund. Prompted

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[26] *See* Liquidity Risk Management Programs Release at 8.

[27] Acquiring funds that invest in closed-end funds that make periodic tender offers or that operate as interval funds under Rule 23c-3 under the Investment Company Act may face similar unnecessary constraints because the proposed redemption restriction also would apply to shares tendered for repurchase to underlying closed-end funds. Although Rule 22e-4 does not apply to such closed-end funds, the regulatory framework that applies to repurchases ensures that the underlying closed-end funds are able to satisfy repurchase requests from all shareholders, including acquiring funds. *See, e.g.,* Rule 23c-3(b)(10) (requiring interval funds to maintain assets equal to the repurchase amount in assets that can be sold in the ordinary course of business at approximately the price at which the fund values them). Again, it does not seem necessary or appropriate to cause a new fund of funds regulatory approach to complicate a repurchase process that is already subject to well-established and protective regulatory parameters.

[28] SEC Division of Investment Management Director Dalia Blass recently echoed similar concerns about industry consolidation and investors continued ability to access small and mid-sized advisers "who do not have the scale of large advisers." *See* Keynote Address: ICI Mutual Funds and Investment Management Conference, Dalia Blass, Director, Division of Investment Management (March 18, 2019), available at https://www.sec.gov/news/speech/speech-blass-031819.

solely by this new regulatory requirement if adopted, such funds may determine to invest only in large acquired funds (thus harming smaller funds), funds listed on an exchange (*i.e.*, closed-end funds or ETFs), or a greater number of acquired funds even if such "diversification" is sub-optimal from a performance or strategy perspective. This does not seem to be the outcome sought by the Commission.

C. Alternatives to the redemption restriction

As reflected in the examples above, the redemption restriction could cause meaningful harm to shareholders of a fund of funds on the basis of theoretical concerns about undue influence. We believe that these undue influence concerns could be addressed through alternate approaches that are more consistent with the SEC's traditional regulation of fund of funds arrangements.

For funds that invest in funds within the same group of investment companies in reliance on Section 12(d)(1)(G), the fact that the funds are in the same group has been a satisfactory means of addressing undue influence concerns. We would suggest the same approach under the proposed rule. This approach would mean that a fund of funds that is relying on Section 12(d)(1)(G) without any redemption restriction could continue to invest in funds within its same group without a redemption restriction if the fund of funds begins to rely on Rule 12d1-4. This result would help to achieve one of the Commission's goals of providing consistent regulation of similar fund of funds structures.

For example, if a fund of funds decides to invest in a financial instrument in addition to other funds within its same group, the fund of funds would need to rely on Rule 12d1-4 instead of Section 12(d)(1)(G).[29] In this situation, the relationship between the acquiring fund and the acquired fund would be exactly the same after the investment in the financial instrument. The investment in the financial instrument would not introduce any new potential for undue influence by the acquiring fund over the acquired fund. Accordingly, a new redemption restriction would serve no regulatory purpose. Eliminating the redemption restriction from the rule also would be consistent with the now tested approach that the SEC adopted in Rule 12d1-2 in 2006 and its prior exemptive orders. The Release gives no indication that the existing approach has failed to address the policy concerns underlying Section 12(d)(1).

With respect to investments by an acquiring fund in the shares of acquired funds from other groups of investment companies, an approach consistent with the existing exemptive orders for such relief is appropriate, with some modifications to allow for a more streamlined

[29] Purchasing financial instruments can provide several benefits, including the ability to: (i) "equitize" late-day cash flows by investing in futures contracts on a broad stock index, instead of leaving cash uninvested overnight; (ii) avoid negatively impacting an underlying fund with short-term purchases and redemptions by maintaining some holdings in highly liquid assets such as futures at the acquiring fund level; (iii) invest directly in certain asset classes rather than through investment in an underlying fund; and (iv) create a managed volatility overlay to combine with holdings of other funds.

framework. Specifically, we believe that a simplified participation agreement should be an appropriate way for an acquiring fund to notify an underlying fund from another group of its intention to make an initial investment in excess of the 3 percent limit in Section 12(d)(1)(A)(i). The underlying fund would then have the opportunity to consider any potential benefits and risks of the investment before executing the simplified participation agreement and agreeing to the investment. Similar participation agreements have been an accepted element of hundreds of existing exemptive orders and, as such, a tested approach. The agreements have been a successful mechanism for ensuring that underlying funds are willing to accept large investments from acquiring funds and that the respective acquiring funds and acquired funds have appropriate compliance measures in place. In addition, the Commission has offered no evidence that this method, used by hundreds of funds of funds, has failed or is inconsistent with the public interest and the protection of investors.

Consistent with existing SEC exemptive orders, the simplified participation agreement would be executed by both the acquiring fund and acquired fund before the acquiring fund's ownership in an acquired fund exceeded 3 percent of the acquired fund's shares in reliance on the rule.[30] Under the rule, the simplified participation agreement could be a straightforward, industry standard document that identifies the acquiring fund(s) and acquired fund(s) subject to the agreement and that represents that the investment(s) would be made in compliance with Rule 12d1-4. In this regard, the simplified participation agreement would be a more streamlined approach than current participation agreements required under the orders, which generally convey the detailed conditions of the specific exemptive orders. Because fund of funds arrangements would comply with the generally applicable provisions of Rule 12d1-4, the simplified participation agreements would not need to describe the specific provisions contained in the rule and should not require negotiation.

To address further the concern of undue influence, the rule could require the simplified participation agreement to contain a basic representation from the acquiring fund that it would not cause any of its existing or potential investment to influence the terms of any services or transactions between the acquired fund and the acquiring fund (or their investment advisers, sponsors, promoters, principal underwriters, or any persons controlling, controlled by, or under common control with such persons).[31] In addition to protecting against undue influence, the simplified participation agreement would serve a valuable compliance purpose by alerting an

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[30] Requiring the acquired fund to agree to (and then terminate, if desired) the investment by an acquiring fund from a different group of investment companies would give the acquired fund a critical tool for protecting the interests of its shareholders. This protection could be particularly important for acquired funds that are closed-end funds and that may be more susceptible to efforts by acquired funds to influence their operations. *See infra* note 39.

[31] This representation is similar to one of the standard conditions in the existing SEC exemptive orders that addresses undue influence.

acquired fund to the fact that an acquiring fund would be investing in the acquired fund in reliance on the rule.[32] Because investments under the rule would be subject to limitations on the acquired fund's ability to purchase shares of other investment companies, it would be particularly important for both the acquiring fund and acquired fund to have a common awareness of the applicability of the rule limitations.

As another means of addressing potential undue influence in lieu of a redemption restriction, the acquiring fund's adviser could represent to the acquiring fund's board of directors that it would not cause the acquiring fund's existing or potential investment in the acquired fund to influence the terms of any services or transactions between the acquiring fund (or its investment advisers promoter, principal underwriter, or any person controlling, controlled by, or under common control with such persons) and the acquired fund (or its investment advisers, sponsor, promoter, principal underwriter, or any person controlling, controlled by, or under common control with such persons).[33] The acquiring fund adviser could include this representation in the initial and periodic reports to the acquiring fund board of directors as currently envisioned by the rule.[34]

As another alternative to the redemption restriction, before an acquired fund knowingly would accept an initial investment from an acquiring fund in reliance on the rule, the investment adviser to the acquired fund could evaluate the potential benefits and risks of such an investment, and find that accepting the investment is in the best interest of the acquired fund.[35] The acquired fund's investment adviser could then report its finding and the basis for the finding to the acquired fund's board of directors.[36] After the initial investment in reliance on the rule, and with such frequency as the acquired fund's board deems reasonable and

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[32] In particular, without the simplified participation agreement, closed-end funds and ETFs would not necessarily know that an acquiring fund would be acquiring their shares in reliance on the rule through secondary market transactions. Acquisitions by funds of funds through omnibus accounts might similarly be undetected by acquired funds in the absence of the simplified participation agreement.

[33] This representation is similar to one of the standard conditions in the existing SEC exemptive orders that addresses undue influence.

[34] *See* proposed Rule 12d1-4(b) 3 i). In the case of an acquiring fund that is a UIT, the UIT's principal underwriter or depositor could make a similar finding in conjunction with the finding contemplated by Rule 12d1-4(b)(3 ii).

[35] Among other items, the acquired fund investment adviser would have the opportunity to consider any potential risks that might be created by an abrupt redemption by the acquiring fund. The acquired fund adviser also could consider any future limitations that the acquired fund might have with respect to its own ability to invest in other funds as a result of becoming an acquired fund under the rule. If the SEC includes the simplified participation agreement as one of the rule requirements, the adviser could make its finding in conjunction with the execution of the simplified participation agreement.

[36] In the case of an acquired fund that is a UIT, the principal underwriter or depositor could make a similar initial finding.

appropriate, but in any case, no less frequently than annually, the acquired fund's adviser could provide the board with a similar report for the duration of the investment in reliance on the rule.

The alternative approaches suggested above are not only consistent with the current regulation of funds of funds, but also consistent with the approaches the SEC has followed in other contexts where procedures, judgment, assessments of fund-specific factors, and board oversight have been deemed acceptable alternatives to more prescriptive requirements.[37]

III. Other Conditions for Reliance on Proposed Rule 12d1-4

In addition to the redemption restriction, proposed Rule 12d1-4 includes a number of conditions designed to prevent the abuses that historically were associated with fund of funds arrangements and that led Congress to enact Section 12(d)(1). We are generally supportive of these conditions (which are largely analogous to conditions included in the current exemptive orders), with some suggested modifications. We agree that the presence of these conditions in exemptive orders, in some cases for more than 20 years, provides strong evidence as to their ability to meet the Commission's goals.

A. Control and voting

We support the Commission's general approach of using the concept of "control" as defined under the Investment Company Act to guard against potential coercive behavior by an acquiring fund.[38] The proposed rule would incorporate a rebuttable presumption that an acquiring fund and its advisory group's beneficial ownership of up to 25 percent of the voting securities of an acquired fund in another group of investment companies does not constitute control over that fund. This condition generally is consistent with the conditions of existing exemptive relief and the Commission's 2008 proposal.

We recommend, however, that the Commission adopt a more narrow definition of "advisory group." As proposed, "advisory group" would include persons that are controlling or under common control with the acquiring fund's investment adviser or depositor, even though

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[37] *See, e.g.*, Exchange-Traded Funds, Investment Company Act Release No. 33140 (June 28, 2018), available at https://www.sec.gov/rules/proposed/2018/33-10515.pdf (proposing a framework for ETF regulation that codifies the relief and conditions contained in the exemptive orders previously granted to various ETFs, and proposing a principles-based approach that allows ETFs the flexibility to use custom creation/redemption baskets subject to policies and procedures) ("ETF rule proposal") and Investment Company Act Rule 22e-4 (providing a broad and flexible set of factors for conducting annual liquidity risk assessments and excluding certain open-end funds from the bucketing and/or highly liquid investment minimum requirements because of their differing liquidity risk profiles).

[38] The control and voting conditions would not apply to (i) an acquiring fund that is part of the same "group of investment companies" as the acquired fund; or (ii) an acquiring fund that has a sub-adviser that acts (or whose control affiliate acts) as adviser to the acquired fund. The SEC explains that these proposed exceptions are designed to exclude arrangements that do not raise concerns of undue influence.

the acquiring fund's investment adviser or depositor does not direct the investments of these affiliates, and in fact could be unaware of investments by such affiliates. This issue is particularly problematic for large financial services organizations that may have many affiliates that are under common control but that operate independently, including pursuant to firewall restrictions that prevent the affiliates from coordinating their investments. Accordingly, we suggest that the advisory group definition be restricted to an acquiring fund's investment adviser or depositor and any person controlled by the investment adviser or depositor. Modifying the definition in this manner would focus the control condition in the rule on the advisory group that is most relevant to the Commission's policy concern. Similarly, with respect to any acquiring fund investment sub-adviser, the definition of "advisory group" should include only the investment sub-adviser and any person controlled by such investment sub-adviser.

With respect to voting, the rule would require that if an acquiring fund and its advisory group, in the aggregate, hold more than 3 percent of an acquired fund's outstanding voting securities, the acquired fund and each other member of the advisory group must vote those securities in the manner prescribed by Section 12(d)(1)(E) of the Investment Company Act. Under Section 12(d)(1)(E), an acquiring fund must either (i seek instructions from its shareholders as to the voting of all proxies with respect to the acquired fund shares and vote such proxies only in accordance with their instructions (*i.e.*, "pass-through" voting); or (ii) vote the shares held by the acquiring fund in the same proportion as the vote of all other shareholders (*i.e.*, "mirror" voting). According to the Release, this limitation is designed to minimize the influence that an acquiring fund and its advisory group may exercise over an acquired fund.

Although the exemptive orders also include voting requirements for funds not within the same group of investment companies, the requirements differ based on the type of acquired fund. For example, when an acquiring fund invests in a closed-end fund in reliance on an order, it must vote shares of the closed-end fund in the manner prescribed by Section 12(d)(1)(E), while non-fund entities within the advisory group are required to use mirror voting. For acquired open-end funds or UITs, the exemptive orders require the acquiring fund and its advisory group to vote their shares using mirror voting only if the acquiring fund and its advisory group become holders of more than 25 percent of the acquired fund's outstanding voting securities due to a decrease in the outstanding securities of the acquired fund.

To simplify and streamline this requirement, proposed Rule 12d1-4 would subject all acquiring funds that do not fall under the control exceptions noted above to the same voting condition. The Release notes that a 3 percent threshold is particularly important for closed-end funds because historically they have been the target of proxy contests.[39] We agree, and note that the conditions in the current exemptive orders, including the 3 percent threshold, have reduced the possibility that an acquiring fund could exert undue influence on an acquired closed-end fund by voting a large block of its shares.[40] Other than for simplification, however, the Release provides no policy reason for imposing a more onerous voting requirement with respect to other types of acquired funds.

In their role as issuers of securities, funds prepare proxy solicitation materials in connection with meetings of their shareholders. In general, open-end funds do not hold annual shareholder meetings; rather, a meeting is held when a shareholder vote on a particular matter is required, such as the election of fund directors or approval of a merger. Most closed-end funds are exchange-traded and are required to hold annual shareholder meetings by the rules of the exchange on which the closed-end fund's shares are listed.

When fund investment advisers vote proxies on behalf of a fund, they must do so in a manner consistent with their fiduciary duty to manage the fund in the best interests of the fund and its shareholders.[41] In some cases replicating the voting preferences expressed by the underlying fund's other shareholders through mirror voting or utilizing pass through voting may be in the best interests of the acquiring fund and its shareholders. In other situations, however, this may not be the case. For example, there may be specific categories of proposals, such as non-routine matters including mergers and changes in a fundamental investment strategy, where an adviser does not believe that splitting the fund's vote to proportionally mirror other shareholders is in the fund and its shareholders' best interest. In some situations, the expense and logistical challenges of pass through voting also may be undesirable.

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[39] Unlike open-end funds, shares of closed-end funds typically trade on a stock exchange at prices that can change throughout the market day. When the market price of a fund's shares is lower than its net asset value, it is referred to as trading at a discount. Discounts can widen or shrink based on demand for the shares on the exchange. Large discounts may attract activist investors seeking an arbitrage opportunity. For example, an activist manager may acquire shares of a closed-end fund by purchasing them on an exchange at a significant discount. The activist manager will then seek to cause the fund to take actions that provide liquidity, such as tender offers (where the fund purchases its shares at or close to its net asset value), liquidations, or open-ending of the closed-end fund. Such actions can disrupt a fund's long-term investment strategy, contrary to the interests of long-term shareholders who purchased the fund shares without expectation of short-term liquidity.

[40] We note that, in certain cases, requiring acquiring funds to pass through or mirror vote their shares could effectively increase the voting power of other shareholders.

[41] Pursuant to SEC rules, a fund and/or its adviser must adopt policies and procedures designed to ensure that proxies for portfolio securities are voted in the best interests of the fund and its shareholders and to address conflicts that may arise between the interests of the adviser and those of fund shareholders with respect to proxy voting decisions. *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Investment Company Act Release No. 25922 (January 31, 2003).

Accordingly, although we do not oppose the proposed 3 percent threshold for mirror or pass through voting of shares of acquired closed-end funds held by acquiring funds given the competing policy concerns, we believe that reducing the voting threshold to 3 percent for other types of acquired funds is simply unnecessary and may frustrate an adviser's ability to vote shares in the best interests of the acquiring fund and its shareholders.

In addition, we believe that mandating mirror or pass through voting for all the members of the advisory group rather than just for the acquiring fund could be inconsistent with the voting arrangements between an adviser and its other clients. In such cases, it seems inappropriate for the voting conventions of Rule 12d1-4 to supersede arrangements that may be in place for an adviser's non-fund clients simply because an acquiring fund has elected to rely on the rule with respect to its acquisition of shares of an acquired fund.[42] For example, an affiliate that is a trustee or other fiduciary of an employee benefit plan could be in violation of its fiduciary duties under Sections 404(a)(1)(A) and (B) of the Employee Retirement Income Security Act of 1974 if forced to adhere to the rule's voting conventions.[43] These fiduciary duties require that, in voting proxies, the trustee "consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives."[44] Accordingly, it is important that the mirror and pass through voting requirements apply only to the acquired fund relying on Rule 12d1-4.

B. Duplicative and excessive fees

To address concerns regarding duplicative and excessive fees in fund of funds arrangements, the proposed rule would require the acquiring fund's investment adviser to evaluate the fee structure, which would vary depending on the type of acquiring fund. For example, investment advisers to management companies would be required to evaluate the complexity of the structure and the aggregate fees associated with the acquiring fund's investment in the acquired fund, and to find that it is in the best interest of the acquiring fund to invest in the acquired fund. The acquiring fund's investment adviser would need to report to the acquiring fund's board its finding and the basis for the finding before investing in any acquired fund in reliance on proposed Rule 12d1-4.

We generally support this approach and agree that it is unnecessary to impose the conditions from existing exemptive orders. Specifically, current conditions require the acquiring fund adviser to waive the part of its fee equal to any compensation received from the

[42] In Section 12 d (1 (F), even though the acquiring fund and its affiliated persons cannot own more than 3 percent of an acquired fund, the mirror voting and pass through voting requirements apply only to the acquiring fund and not to the affiliated persons.

[43] 29 U.S.C. §1104(a)(1)(A) – (B).

[44] Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 29 C.F.R. §2509.2016-01.

acquired fund in connection with the acquiring fund's investment in that fund, and require the acquiring fund board to make a specific finding that its advisory fees are for services that are in addition to, rather than duplicative of, the services provided by the adviser to the acquired fund. Fund boards are already obligated to evaluate the terms of advisory agreements, which should encompass these findings. In addition, because acquiring funds calculate their performance results net of acquired fund fees, as well as other operating expenses, investors receive sufficient information to assess whether the fund's overall performance, taking such fees and expenses into account, is consistent with their investment objectives.

We would suggest, however, that because the purpose of this requirement is to cause the acquiring fund adviser to evaluate the complexity and aggregate fees of the fund of funds structure, the adviser's required finding should relate to that information. Accordingly we suggest that the rule require an acquiring fund adviser to find that "the investment is appropriate for the acquiring fund in light of the complexity and aggregate fees of the investment" rather than require a broad best interest finding.

In addition, we urge the SEC to reconsider including the provisions that would require an acquiring fund to obtain a certification from an insurance company offering a separate account that invests in the acquiring fund regarding the aggregate fees borne by the separate account, acquiring fund, and acquired fund. The separate account and sponsoring insurance company are subject to the requirement in Section 26 of the Investment Company Act that the fees and charges deducted under a variable insurance contract, in the aggregate, are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company. As a result, because of Section 26 the SEC does not need an acquiring fund to pursue such a certification.[45] The acquiring fund adviser also may have limited ability to obtain or compel this type of certification from an unrelated insurance company to comply with the rule.

C. Complex structures

Proposed Rule 12d1-4 includes conditions that would limit the ability of other funds to acquire an acquiring fund that relies on Rule 12d1-4 and the ability of an acquired fund to itself invest in other funds including private funds, except in limited circumstances (*e.g.*, as part of a master-feeder arrangement, for short-term cash management purposes, certain interfund lending or borrowing transactions, or investments in funds that are wholly owned and controlled subsidiaries). These conditions, which are designed to limit unduly complex structures, would significantly limit the ability to structure a three-tiered fund of funds arrangement and affect currently available arrangements offering benefits to investors.

[45] The original fund of funds orders did not require this certification, although the SEC staff has added this requirement to fund of funds orders in recent years.

According to ICI's survey, 16 complexes reporting having a total of 198 funds of funds with $287 billion utilizing a multi-tier structure (not including structures using third-tier money market funds). To this end, we strongly encourage the Commission to consider expanding the list of permitted multi-tier fund of fund arrangements to structures that could be beneficial to shareholders and that do not implicate the policy concerns that underlie Section 12(d)(1).

First, we note that in the 2008 proposal, the SEC recognized that it is important that acquired funds retain the flexibility to invest a limited amount in other funds and ETFs. In that proposal, ETFs could invest up to 10 percent of their assets in other investment companies in reliance on Section 12(d)(1)(F) or Section 12(d)(1)(G) of the Investment Company Act. More recently, the SEC staff issued two no-action letters permitting three-tier arrangements created for the purpose of efficient portfolio management, subject to certain conditions, including that the middle-tier funds would not invest more than 10 percent of their assets in the third-tier funds and other funds while relying on Section 12(d)(1)(G).[46] We urge the SEC to restore the exception that it proposed in the 2008 proposal insofar as it would permit an acquired fund to invest up to 10 percent of its assets in other investment companies in reliance on Section 12(d)(1)(F), Section 12(d)(1)(G), or Rule 12d1-4 (for purposes of this calculation, investments by acquired funds pursuant to the other exceptions provided under the proposed rule would not be included). Allowing for this exception generally would permit the structures contemplated by the recent no-action letters and the 2008 Commission proposal, and permit acquired funds to have additional limited ability to invest in other funds when such investments would not exceed the basic 10 percent limit included in Section 12(d)(1)(A)(iii) to protect against overly complex structures.

Second, we believe that the SEC should not limit the ability of an acquired fund to invest in private funds. Section 12(d)(1) itself does not include such a limitation.[47] Accordingly, when the proposed rule indicates that, other than the specified exceptions, an acquired fund must not acquire the securities of another investment company *or a private fund* in excess of the limits of Section 12(d)(1)(A), the SEC is effectively expanding the reach of Section 12(d)(1) to the acquisition of private funds in a way that Congress did not intend. Acquired funds should have the same ability as any other registered fund to invest in private funds without regard to the limits of Section 12(d)(1). If the SEC does not follow this recommendation, we suggest that the SEC at least create another exception so that acquired funds may invest in entities that are structured finance vehicles, such as collateralized debt

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[46] *See* Thrivent Financial for Lutherans and Thrivent Asset Management, LLC, SEC Staff No-Action Letter (September 27, 2016)("Thrivent Letter") and Franklin Templeton Investments, SEC Staff No-Action Letter (April 3, 2015)("Franklin Letter").

[47] Sections 3(c)(1) and 3(c)(7) limit the ability of a private fund to acquire more than 3 percent of a registered fund, but do not apply 12(d) 1) limits to the ability of a registered fund to acquire private funds.

obligations, and other entities not traditionally considered pooled investment vehicles, that may rely on Sections 3(c) 1) or 3(c)(7).[48]

Finally, we would suggest rephrasing exception 12d1-4(b)(4)(iii)(B) to delete the phrase "short-term cash management purposes," since there could be a variety of reasons that an acquired fund would invest in reliance on Rule 12d1-1 that do not raise any additional fund of funds concerns. Further, it is unclear whether investments in short-term bond funds, which the SEC has permitted under cash management exemptive orders for decades and are used extensively for efficient cash management, would be permitted under this exception in the proposed rule. Indeed, numerous fund companies have created large central funds for cash management purposes in reliance on these exemptive orders. The Thrivent Letter also provides no-action relief that permits investment of cash by an acquired fund in a short-term bond fund under conditions similar to prior exemptive relief. Such funds provide a clear benefit for shareholders.

As proposed, the rule would provide an exception permitting an acquired fund to invest in another fund "pursuant to [Rule 12d1-1] *or exemptive relief from the Commission*" (emphasis added). Historically, the SEC has permitted acquired funds to invest in money market funds under Rule 12d1-1 and, as noted above, short-term bond funds under exemptive and no-action relief. Given the SEC's proposal to rescind all orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Investment Company Act, with the exception of interfund lending orders, it is not clear what the Commission intended by the phrase "or exemptive relief from the Commission."

To clarify this point, we would urge the SEC to add an exception to the rule that would specifically permit acquired funds to use short-term bond funds (*i.e*., funds with a dollar-weighted average portfolio maturity of no more than 3 years, or similar private funds) for cash management purposes consistent with current regulatory practice.[49] As proposed, the rule appears to only allow investments in money market funds, which would severely limit portfolio management flexibility in managing cash. Additionally, the Release specifically notes "proposed

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[48] The staff of the Division of Investment Management previously has indicated that disclosure of Acquired Fund Fees and Expenses by an acquiring fund does not need to include expenses associated with investments in structured finance vehicles, collateralized debt obligations, or other entities not traditionally considered pooled investment vehicles, that rely on Sections 3(c)(1) and 3(c)(7). *See* Staff Responses to Questions Regarding Disclosure of Fund of Funds Expenses at https://www.sec.gov/divisions/investment/guidance/fundfundfaq.htm. In addition, SEC Chair Clayton has advocated for more access to private funds for retail investors. *See, e.g*., https://www.investmentnews.com/article/20190409/FREE/190409922/clayton-wants-retirement-investors-to-have-more-access-to-private; https://www.wsj.com/articles/sec-chairman-wants-to-let-more-main-street-investors-in-on-private-deals-1535648208; and https://markets.businessinsider.com/news/stocks/sec-wants-to-let-retail-investors-in-on-private-companies-2018-8-1027498229.

[49] *See, e.g.,* Putnam American Government Income Fund, Investment Company Act Release Nos. 26200 (October 1, 2003) (notice) and 26414 (April 9, 2004) (order). When the SEC adopted Rule 12d1-1 in 2006, the SEC did not rescind such orders.

rule 12d1-4 would permit arrangements where an acquired fund invests in another fund beyond the statutory limits for short-term cash management purposes" without mentioning if the SEC proposes to narrow the types of vehicles that they have permitted in the past. Furthermore, if the SEC's intent is to permit short-term cash management vehicles other than money market funds only under newly designed exemptive relief, the Release does not explain how existing funds using these short-term bond funds for such purposes could expeditiously obtain such relief without adversely impacting existing shareholders or whether these new orders would contain conditions that differ from current requirements. Finally, the Release strangely does not explain why a rule that is seeking to simplify existing requirements and rescind existing orders would require new exemptive orders for a practice that does not raise any of the policy concerns underlying Section 12(d)(1). Accordingly, the SEC should ensure that these types of investments by acquired funds can continue because they have proven to be an efficient and effective means of managing cash.

IV. Scope of Proposed Rule 12d1-4

Proposed Rule 12d1-4 would permit a registered investment company or BDC to acquire the securities of any other registered investment company or BDC in excess of the limits in Section 12(d)(1). As a result, open-end funds, UITs, closed-end funds (including BDCs), ETFs, and exchange-traded managed funds (ETMFs) could rely on the rule as both acquiring and acquired funds.

On the other hand, the proposal would exclude foreign funds and companies that rely on Sections 3(c)(1) or (7) of the Investment Company Act as acquiring funds because they are not registered with the Commission, would not be subject to the proposed reporting requirements on Form N-CEN regarding reliance on the rule, would not report information regarding their acquired fund holdings on Form N-PORT, and would not be subject to recordkeeping requirements under the Investment Company Act.[50]

We agree with the Commission that expanding the permissible fund of funds arrangements would provide funds covered by the rule with flexibility to meet their investment objectives and also level the playing field by allowing each of these entities to invest in the same universe of acquired funds in excess of the Section 12(d)(1) limits without obtaining individualized exemptive relief from the Commission.[51] To this end, we also believe it is not

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[50] A non-US fund that meets the definition of "investment company" under Section 3(a)(1)(A) of the Investment Company Act is generally subject to Section 12(d (1). Furthermore, the SEC has taken the position that a foreign fund that uses US jurisdictional means in the offering of the securities it issues and that relies on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act would be a private fund. *See* Dechert LLP, SEC Staff No-Action Letter (August 24, 2009) ("2009 Dechert Letter").

[51] Although the Release does not identify a policy reason for rescinding Rule 12d1-2, in the interest of expanding the relief and arriving at a single fund of funds rule, we support replacing Rule 12d1-2 with proposed Rule 12d1-4

necessary to exclude private or foreign funds from investing in registered investment companies, including BDCs, beyond the existing limits of Section 12(d)(1).[52] We believe conditions in the proposed rule designed to prevent the abuses that led Congress to enact Section 12(d)(1) generally would be adequate for all investment companies (including foreign funds) and private funds subject to Section 12(d)(1) if the participation agreement requirement is included, as described above.

In light of the unique issues faced by closed-end funds discussed above, however, we recommend that any SEC exemption to permit private funds to invest in closed-end funds beyond the 3 percent limit in Section 12(d)(1)(A)(i) be conditioned on compliance by the private fund with the limitations of Section 12(d)(1)(C), so that any acquiring private fund and other investment companies and private funds having the same investment adviser, and companies controlled by such investment companies and private funds, do not own more than 10 percent of the total outstanding voting stock of the closed-end fund.

To the extent that the SEC remains concerned about reporting and recordkeeping by private funds and foreign funds that would invest in registered investment companies in reliance on the proposed rule, the SEC could consider limiting the relief to private funds and foreign funds whose investment advisers are registered as investment advisers under the Investment Advisers Act of 1940, or are control affiliates of such a registered investment adviser, or who have a placement agent, underwriter, or similar functioning entity that is a broker or dealer registered under the Securities Exchange Act of 1934 or are control affiliates of such a broker or dealer. For purposes of the rule, an acquiring private fund or foreign fund advised by the same investment adviser as the acquired registered fund, or by an investment adviser that is controlling, controlled by, or under common control with that investment adviser, should be treated as being in the same group of investment companies as the acquired registered fund.

V. Exemptive Relief from Section 17(a) of the Investment Company Act

We support the proposed relief from restrictions on transactions between acquiring funds and affiliated acquired funds. As the SEC acknowledges, the utility of the proposed rule would be limited if it did not exempt fund of funds arrangements from the affiliated transaction prohibitions in Section 17(a), and existing orders have provided similar relief for

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if the regulatory treatment of fund of funds arrangements is similar and the redemption restriction is eliminated. The Commission's interest in simplifying and standardizing the regulatory framework should not cause the Commission to lose sight of the fund of funds policy decisions by Congress and the Commission that have allowed funds of funds to flourish without abuse for more than 20 years.

[52] We note that the SEC similarly included private funds as acquiring funds in Rule 12d1-1.

many years.[53] We note that the Release suggests that, consistent with the orders, the rule would provide Section 17(a) relief for the delivery or deposit of in-kind assets in instances where an acquiring fund invests in an affiliated ETF, as well as for in-kind redemptions from the affiliated ETF to the acquiring fund. The rule text, however, simply refers to relief to permit the purchase and sale of investment company shares between the acquiring fund and acquired fund. We believe that the Commission should clarify that the Section 17(a) relief also covers corresponding in-kind transactions when an acquiring fund is purchasing and redeeming shares of an acquired ETF.[54]

As a technical matter, we believe that it also would be helpful if the SEC provided relief, or clarified that relief was not necessary, from Section 17(a) when funds invest in affiliated funds within the statutory limits of Section 12(d)(1)(A) or in reliance on Section 12(d)(1)(F).[55] We note that the Commission indicated in the Release that Section 12(d)(1)(G) implies relief under Section 17(a).[56] We believe that the policy arguments for relief in these other circumstances are the same, and restrictions on such transactions frustrate the Congressional intent behind the adoption of these other Section 12(d)(1) provisions.

VI. Amendments to Form N-CEN

Item C.7. of Form N-CEN requires management companies to report whether they relied on certain rules under the Investment Company Act during the reporting period. We

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[53] As indicated in the Release, the fact that the affiliated acquired fund would sell its shares to and purchase its shares from an acquiring fund at the same price as for all other investors is a key safeguard. The Release also suggests that the proposed redemption restriction would prevent an acquiring fund from threatening to redeem shares as a means of exerting influence over an acquired fund. We note that the Section 17(a) relief in fund of funds orders has not been subject to a redemption restriction. In fact, because the relief is intended to permit the acquired fund *as affiliated person* to transact with the acquiring fund, it would be contrary to the traditional public policy behind Section 17(a) to include protections for the affiliated person in an affiliated transaction with a registered investment company.

[54] More broadly, as noted in our recent comment letter on the ETF rule proposal, we believe that the Commission should grant Section 17 relief to permit other affiliates, including broker-dealer affiliates of the ETF's adviser, to transact in-kind with ETFs through the creation and redemption process. Increasing the number of market participants permitted to transact directly with ETFs could benefit investors by leading to improvements in the arbitrage mechanism for ETFs. *See* Letter from Susan Olson, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, Securities and Exchange Commission (September 21, 2018), available at https://www.sec.gov/comments/s7-15-18/s71518-4403410-175592.pdf.

[55] *See, e.g.* T. Rowe Price Associates, Inc., SEC Staff No-Action Letter (July 10, 2008) (no-action relief from Section 17(a) permitting a fund to invest in an affiliated fund within the limits of Section 12(d 1) A)); Matrix Unit Trust, Investment Company Act Release Nos. 25668 (July 19, 2002) (notice) and 25700 (August 14, 2002) (order) (exemptive relief from Section 17(a) permitting a UIT to invest in an affiliated fund within the limits of Section 12(d)(1)(F)).

[56] Release at note 70.

support the SEC's proposal to add to Form N-CEN a requirement that funds report if they are relying on Rule 12d1-4 or Section 12(d)(1)(G).

VII. Changes to Existing Regulatory Regime

To create a more consistent and efficient framework for the regulation of fund of funds arrangements, the SEC is proposing to rescind Rule 12d1-2. In addition, the SEC is proposing an amendment to Rule 12d1-1 to provide funds relying on Section 12(d)(1)(G with continued flexibility to invest in money market funds outside of the same group of investment companies if they rely on Section 12(d)(1)(G).

As part of this proposal, the SEC also would rescind (one year following the effective date of any final rule) the exemptive orders permitting fund of funds arrangements, including all orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Investment Company Act (other than exemptive relief related to interfund lending arrangements), as well as the portions of ETF and ETMF exemptive orders providing relief from Sections 12(d)(1)(A) and (B).

Subject to our proposed recommendations discussed above, we do not object to streamlining the fund of funds regulatory regime. We request, however, that the SEC clarify that the rescission of the orders would be limited to orders or portions of exemptive orders that permit funds to invest in same-group funds and/or other-group funds as described in the Release, as we believe that is the SEC's intention, but is not explicitly stated in the Release. We are aware of other orders, such as orders for investment of securities lending cash collateral, that contain relief from various provisions of Section 12(d)(1), but that are not described in the Release. If the SEC's intention is, in fact, to rescind all orders that grant relief from Sections 12(d)(1)(A), (B), (C), and (G), but that are not discussed in the Release, we question whether the applicants to those orders have received adequate notice of that intention.[57] In addition, we note that some orders that include exemptive relief for funds of funds arrangements also

[57] We note that the SEC traditionally has not rescinded orders in connection with its exemptive rulemaking. For example, when Rule 12d1-1 was adopted in 2006, the SEC did not rescind previous cash sweep orders. When the SEC adopted Rule 2a-7 in 1983 the SEC did not rescind previous money market fund orders. The adoption of Rule 11a-3 in 1989 marked an exception to this approach, but even in that instance, the SEC originally issued a separate notice specifying the orders that would be rescinded by the rule, and the Division of Investment Management then sent each individual order holder a letter to remind them of the opportunity to comment on the rulemaking. *See* Offers of Exchange Involving Registered Open-end Investment Companies, Investment Company Act Release No. 17097 (August 3, 1989) at note 17. As such, there was no confusion as to which orders were subject to rescission. Although the SEC's recently proposed ETF rule would rescind most ETF exemptive orders, that proposed rule effectively codified most existing orders, with some additional flexibility and without more restrictive conditions. *See* ETF rule proposal.

include relief for other matters. Again, we believe that the SEC should clarify that only the fund of funds aspects of such orders would be rescinded.[58]

Similarly, the Release indicates that the Division of Investment Management is reviewing staff no-action and interpretive letters relating to Section 12(d)(1) to determine whether any such letters should be withdrawn in connection with any adoption of the proposal. The SEC notes that if the rule is adopted, some of the letters may be moot, superseded, or otherwise inconsistent with the rule and, therefore, would be withdrawn.

There is an extensive amount of SEC staff guidance and no-action relief relating to Section 12(d)(1) that has been provided over many decades, and it is not clear what letters might be withdrawn based on the broad statements in the Release. For example, it may be foreseeable that the SEC staff no-action letter that permits a fund relying on Section 12(d)(1)(G) and Rule 12d1-2 to invest in financial instruments in addition to same group funds would become unnecessary if Rule 12d1-2 is rescinded and if Rule 12d1-4 would permit such investments.[59] The SEC staff no-action letter relating to the treatment of closed-end funds under Rule 12d1-2 also would seem unnecessary if Rule 12d1-2 is rescinded.[60] Similarly, if an SEC staff no-action letter relates to an exemptive order that is rescinded, it seems apparent that such letter would no longer be necessary.[61]

Other letters relating to Section 12(d)(1) could continue to serve as valuable guidance or no-action relief for fund groups. The Franklin Letter and Thrivent Letter provide a useful means for an acquired fund to engage in efficient portfolio management under conditions that address the traditional concerns under Section 12(d)(1). As discussed above, we suggested that such relief could be incorporated into the rule as an additional exception for an appropriate third-tier investment. If the SEC concludes that the rule should not be expanded to include specific reference to such exceptions, however, we would encourage the SEC staff to allow such letters to remain in force because the policy concerns underlying Section 12(d)(1) are still fully addressed by the letters. As is often the case with SEC staff guidance and no-action letters, the facts and circumstances may be too specific or complex to be included in statutory or rule provisions, and yet the terms and conditions of the guidance or relief can address the relevant policy concerns and permit structures that are beneficial to shareholders.

We also recommended that the SEC permit foreign investment companies to invest in registered funds in reliance on Rule 12d1-4. If the SEC does not provide such relief in the context of the rulemaking, however, the SEC staff no-action letter that allows foreign funds to

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[58] For example, the Release is clear that with respect to orders that grant ETF relief in addition to fund of funds relief, only the fund of funds relief would be rescinded by the current rulemaking.

[59] *See* Northern Lights Fund Trust, SEC Staff No-Action Letter (June 29, 2015).

[60] *See* Dechert LLP, SEC Staff No-Action Letter (January 25, 2017).

[61] *See, e.g.,* FQF Trust, SEC Staff No-Action Letter (December 13, 2011).

invest in registered funds to the same extent as private funds still would be necessary and appropriate.[62] As described in the 2009 Dechert Letter, the concerns under Section 12(d)(1) would continue to be appropriately addressed. In other words, the fact that relief is not included in the rule should not lead to an SEC staff conclusion that the relief is inconsistent with the rule. Similarly, other SEC staff no-action letters have addressed investments in US registered funds by a variety of foreign funds or entities that could be considered foreign investment companies and should be retained to the extent such relief is not provided by the rule.[63]

As noted, there are many other examples of SEC staff guidance and no-action letters that have been issued under Section 12(d)(1).[64] In light of the volume and complexity of the guidance and letters over many years, a comment letter on this rulemaking is not an ideal way to address all of the specific facts and policy arguments included in the guidance and letters. Accordingly, we would encourage the SEC staff to proceed cautiously in its review of its guidance and no-action relief, recognizing that many fund groups may rely on such guidance and no-action letters in addition to the groups that may have originally requested the relief. From a process perspective, we would suggest that the SEC staff publicly indicate which specific letters could be withdrawn so that fund groups may have an opportunity to comment and address possible SEC staff concerns through more focused engagement.

VIII. Acquired Fund Fee and Expense Disclosure and Investing Related Expense Disclosure

Under current disclosure requirements, an acquiring fund is required to disclose in its prospectus fee table the fees and expenses it incurs indirectly from investing in other funds. The Commission required this disclosure as part of the fund of funds rules adopted in 2006. These fees and expenses are known as "acquired fund fees and expenses" (AFFE). The SEC is requesting comments on AFFE disclosures. ICI members have expressed concerns about AFFE disclosures for funds' investments in BDCs. In this regard, we recently recommended that the Commission permit funds to exclude BDCs from the definition of "acquired funds" for purposes of the required fee table presentation because of the nature of their fundamental investment objectives, manner of operating, and associated expenses.[65] This would allow funds

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[62] *See* 2009 Dechert Letter.

[63] *See, e.g.,* Dechert LLP, SEC Staff No-Action Letter (March 8, 2017); Principal Investors Fund Inc., SEC Staff No-Action Letter (May 13, 2005).

[64] For example, the SEC website lists 25 letters issued since 1995 under the categories of "Funds of Funds – Affiliated" and "Funds of Funds – Foreign Investment Companies" at https://www.sec.gov/divisions/investment/im-noaction.shtml#funds.

[65] *See* Letter from Susan Olson, General Counsel, Investment Company Institute to Brent Fields, Secretary, Securities and Exchange Commission (October 24, 2018), available at https://www.sec.gov/comments/s7-12-

to treat BDCs in the same manner as investments in operating companies for expense presentation purposes.

The Commission also requests comment on whether interest expense should be excluded from the fund's expense ratio. Item 3 of Form N-1A currently requires funds to disclose interest expense in the "other expenses" line item of the fee table and instructs that the amount depicted should be the same as the amount shown as expenses in the fund's statement of operations.[66] We recently recommended that the Commission require funds to disclose investing related expenses (*e.g.,* interest expense and dividends paid on short sales) in the fund's SAI (similar to specified information about brokerage costs) and financial statements rather than in the prospectus fee table, which instead, should focus on a fund's recurring operating expenses.[67]

IX. Legislative Changes to Address Private Fund Investments in Closed-End Funds

As noted above, Section 12(d)(1) of the Investment Company Act is intended to address concerns that an acquiring fund could control the assets of an acquired fund and use those assets to enrich its investors to the detriment of the acquired fund shareholders. To limit an acquiring fund's ability to control an acquired fund's assets, Section 12(d)(1)(A) restricts an acquiring fund from obtaining acquired fund shares in amounts that exceed certain thresholds, including restricting an acquiring fund (and any companies the acquiring fund controls) from obtaining more than 3 percent of an acquired fund's outstanding voting securities ("3 percent limit"). In this regard, Congress clearly intended to subject private funds to the 3 percent limit as private funds (investment companies relying on Section 3(c)(1) or 3(c)(7)) were specifically subjected to this provision.

Section 12(d)(1)(C) of the Investment Company Act similarly limits an acquiring fund's ability to control the assets of an acquired closed-end fund by restricting an acquiring fund, investment companies having the same investment adviser as the acquiring fund, and companies controlled by the acquiring fund to obtaining no more than 10 percent of the total outstanding voting securities of an acquired closed-end fund. Unlike Section 12(d)(1)(A), however, Congress did not subject private funds relying on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act to Section 12(d)(1)(C).

18/s71218-4932121-178430.pdf (regarding SEC's Request for Comment on Fund Retail Investor Experience and Disclosure (File No. S7-12-18)).

[66] *See* Item 3 of Form N-1A, Instruction 3(c)(i) "include all expenses not otherwise disclosed in the table that are deducted from the [f]und's assets or charged to all shareholder accounts. The amount of expenses deducted from the [f]und's assets are the amounts shown as expenses in the [f]und's statement of operations ….").

[67] *See supra* note 65.

We do not believe that the Section 12(d)(1)(A) and (C) limits are working as originally intended to limit private acquiring funds from improperly controlling acquired fund assets, particularly in the context of investments in closed-end funds. The Section 12(d)(1)(A) restrictions apply on a fund-by-fund basis, looking at whether a particular acquiring fund (and companies it controls) exceeds the 3 percent limit, not at whether the acquiring fund and its *other* affiliates, such as funds controlled by the acquiring fund's adviser, exceed the 3 percent limit. Many private fund managers therefore have created multiple private funds that each invest up to the 3 percent limit to take advantage of closed-end funds.[68] Although each private fund's holdings do not exceed the 3 percent limit individually, the private funds' holdings in aggregate exceed the 3 percent limit and enable the private fund manager to circumvent the limit and exert undue influence over the acquired closed-end funds.[69]

The Section 12(d)(1)(C) limit does aggregate an acquiring fund's investments in an acquired closed-end fund with the investments of other affiliated funds but, as noted above, does not apply to private fund investments. Accordingly, private fund managers can obtain large interests in an acquired closed-end fund that exceed the Section 12(d)(1)(C) limit through their private funds' investments.

To this end, the limits in Sections 12(d)(1)(A) and 12(d)(1)(C) as applied to private funds create issues that Congress intended Section 12(d)(1) to address—allowing private fund managers to use the aggregate ownership of their private funds to exert excessive influence over an acquired closed-end fund's policies and operations to the benefit of the acquiring fund and to the detriment of long-term closed-end fund shareholders. For example, a private fund manager through multiple private funds could acquire a large stake in a registered closed-end fund, purchasing shares on the open market at a significant discount. The private fund manager may then seek to use its influence to cause the closed-end fund to engage in a tender offer to purchase its shares at or close to net asset value. If the fund tenders the shares at a price close to net asset value, tendering shareholders (including the acquiring private fund investors) will realize the difference in price between the discounted purchase price and the tender price. Long-term closed-end fund shareholders, however, may be harmed as the fund liquidates assets

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[68] Although private fund managers also can invest in open-end funds in this manner, those seeking to exert control are less likely to do so in that context, because open-end funds by their definition are transacted at net asset value and there are less mechanisms for the private fund manager to exert its influence and extract value (*e.g.*, through forcing tender offers or share repurchases).

[69] *See*, *e.g.*, Rose DiMartino, *Protecting Closed-End Fund Investors: A Call to Amend 1940 Act Section 12(d)(1)(A)*, 26 The Investment Lawyer 1 (January 2019) ("DiMartino Article") (further detailing how private funds can circumvent the 3 percent limit). To the extent that each private fund is operated in a substantially similar manner, such an arrangement could violate Section 48(a) of the Investment Company Act (prohibiting a person from doing indirectly through another person what would be unlawful to do directly).

to meet the tender offer, which can disrupt the fund's long-term investment strategy and shrink its size, potentially impacting returns negatively.[70]

We strongly recommend that the Commission work with Congress to introduce legislation that would better address the goals of Section 12(d)(1). For example, the Commission could, at the very least, recommend legislation amending Sections 3(c)(1) and 3(c)(7) to deem any private fund investing in a registered fund and any other private funds controlled by the private fund's manager to be an "investment company" for purposes of Section 12(d)(1)(C). Amending the statute in this manner would level the playing field and subject private funds controlled by the same manager to the Section 12(d)(1)(C) limit.[71] More importantly, it would close a gap that many private funds are using to bypass the statutory restrictions and would help to protect acquired funds from acquiring private funds in a manner akin to the way they are protected from registered investment companies under the statute.

ICI and its members appreciate the opportunity to comment on the SEC's proposed rule for funds of funds. We remain firmly committed to assist the SEC in any way that we can. If you have any questions, please contact me ([redacted] or [redacted]; Susan Olson, General Counsel ([redacted] or [redacted]; or Jane Heinrichs, Associate General Counsel ([redacted] or [redacted]).

Sincerely

/s/ Paul Schott Stevens

Paul Schott Stevens
President and CEO

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

Dalia Blass
Director, Division of Investment Management

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[70] *See* DiMartino Article (further describing how a typical private fund manager might exert control over a registered closed-end fund unduly).

[71] Consistent with our other recommendations, private funds that exceed the 3 percent limit could be permitted to rely on proposed Rule 12d1-4, subject to the rule's conditions.