May 1, 2019

Ms. Vanessa Countryman
Acting Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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

Dear Ms. Countryman:

Allianz Investment Management LLC ("AIM") submits this letter in response to the Commission’s request for comment on proposed new rule 12d1-4 under the Investment Company Act of 1940 (the “Act”), as well as the related rule amendments, rescissions of rule 12d1-2 and prior orders and other matters addressed in the Release (together, the “Proposal”). AIM appreciates this opportunity to express our views on the Proposal, which would significantly impact several funds of funds managed by AIM.

I. Executive Summary

AIM generally supports the Commission’s objective of streamlining the regulatory framework for funds of funds investing in both affiliated and unaffiliated acquired funds beyond the limits in section 12(d)(1)(A) of the Act. However, AIM requests that the Commission:

(i) retain rule 12d1-2 and the related exemptive orders (described below); and

(ii) except acquiring funds in the same group of investment companies as the acquired fund from the 3% redemption limit under proposed rule 12d1-4.

AIM respectfully submits that these aspects of the Proposal are not necessary to prevent any abuses that section 12(d)(1) was designed to address, and instead may create operational inefficiencies, increase costs to shareholders, and/or frustrate shareholders’ ability to pursue their intended investment strategies.

II. Background

AIM is a registered investment adviser (CRD No. 111925), which serves as investment manager to the Allianz Variable Insurance Products Trust (SEC File No. 811-09491) and the Allianz Variable Insurance Products Fund of Funds Trust (SEC File No. 811-21624) (together, the “Trusts”). The Trusts are open-end management investment companies organized as Delaware

business trusts of the series type, and the Trusts currently are comprised of a total of 34 separate series, or funds (together, the “AZL Funds”). The AZL Funds are available, directly or indirectly, only as investment options under variable annuity contracts and variable life insurance policies offered by the separate accounts of two life insurance companies affiliated with AIM, Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York.²

Currently, 13 AZL Funds (the “AZL Funds of Funds”), representing approximately $11.1 billion in assets, rely on section 12(d)(1)(G) of the Act to invest in affiliated acquired funds.³ Three of the AZL Funds of Funds currently invest only in affiliated acquired funds and, therefore, may rely solely on the statutory exemption in section 12(d)(1)(G). However, the other ten AZL Funds of Funds (known as the “AZL MVP Funds”), representing approximately $9.0 billion in assets, include a volatility management strategy, which under normal market conditions allocates approximately 5% of the assets of each AZL MVP Fund to equity or fixed income futures to reduce the volatility of the AZL MVP Funds over time. The remaining 95% of assets ordinarily are invested in affiliated acquired funds. Accordingly, the AZL MVP Funds currently rely on section 12(d)(1)(G), rule 12d1-2 under the Act and an exemptive order⁴ received by AIM, the Trusts, and the Trusts’ distributor (Allianz Life Financial Services, LLC), permitting the AZL Funds to invest in other financial instruments (e.g., futures) which may not be securities within the meaning of section 2(a)(36) of the Act.

III. Expected Impact of the Proposal on the AZL Funds

a. Impact on Investment Strategy and Operations

The Proposal would impact the AZL MVP Funds primarily due to the proposed rescission of rule 12d1-2 and the Exemptive Order. To continue using futures (or any other securities or financial instruments) to support the volatility management strategy, the AZL MVP Funds would be required to rely on proposed rule 12d1-4. However, the AZL MVP Funds, as currently structured, likely could not be effectively managed under the conditions in proposed rule 12d1-4. In particular, as described below, AIM submits that the limit in proposed rule 12d1-4 on redemptions of more than 3% of any acquired fund’s total outstanding shares in any 30-day period (the “3% redemption limit”) likely would cause significant issues for ongoing management of the AZL MVP Funds and require restructuring in order for those Funds to continue under rule 12d1-4.

² AIM and Allianz Life Insurance Company of New York are subsidiaries of Allianz Life Insurance Company of North America, which is an indirect, wholly-owned subsidiary of Allianz SE, headquartered in Munich, Germany, one of the world’s largest insurance and financial services companies.

³ In this letter, “affiliated” funds of funds and acquired funds refer to funds that are part of the “same group” of investment companies under section 12(d)(1)(G) of the Act, and “unaffiliated” funds of funds and acquired funds refer to funds that are not part of the “same group.” For the AZL Funds of Funds, all of the acquired funds (other than money market funds) currently are part of the same group of investment companies because they either are AZL Funds managed by AIM or are funds managed by Pacific Investment Management Company LLC (“PIMCO”), which is another subsidiary of Allianz SE and under common control with AIM.

The acquired funds held by the AZL MVP Funds are predominately AZL Funds. The acquired AZL Funds can be purchased only by the affiliated insurance company separate accounts or by the AZL Funds of Funds (which are held solely by the affiliated separate accounts). Some of the acquired AZL Funds were formed specifically for, and currently are available only to, the AZL Funds of Funds. Seven of the AZL MVP Funds hold five or fewer acquired funds. As a result, the 13 AZL Funds of Funds as a group hold significant percentages of the acquired AZL Funds, ranging from approximately 25% to 100% of the total outstanding shares of each acquired AZL Fund. Six of the AZL MVP Funds, individually, hold more than 25% of the total outstanding shares of at least one acquired AZL Fund. Since December 31, 2016, at least seven of the AZL MVP Funds have redeemed more than 3 percent of the shares of an acquired fund within a 30-day period at least once, and most of those have done so on a number of occasions.

Therefore, the 3% redemption limit can be expected to significantly restrict the ability of the AZL MVP Funds to redeem shares of acquired AZL Funds, as might be necessary in the ordinary course of business to satisfy AZL MVP Fund shareholder redemptions, to rebalance underlying investments in response to market movements or to effect changes in investment strategy or investment allocation that AIM or the Board of Trustees have determined to be necessary and in the best interests of a Fund.

The Commission acknowledges in the Proposal “that it could take up to 10 months for an acquiring fund that fully unwinds its investment in an acquired fund, if that fund holds 25% of the outstanding shares of the acquired fund.” However, the Commission’s estimate does not appear to contemplate the fact that if other investors are seeking to redeem from an acquired fund during the same period, resulting in net outflows from the acquired fund, the 3% redemption limit could cause a fund of funds’ exit period to extend much longer than 10 months. As noted above, six of the AZL MVP Funds own at least 25% of one or more acquired AZL Funds. We respectfully submit that 10 months (or longer, for larger holdings or for acquired funds experiencing net outflows) is an unreasonably long period of time to effect changes in strategy or allocation and ultimately may prevent an acquiring fund from maintaining the intended allocation of the fund or its investment strategy. The 3% redemption limit also could prevent an acquiring fund from timely participating in certain transactions, such as liquidations or mergers of the acquiring fund, even where such transactions have been approved by the acquiring fund’s board and/or its shareholders as in the best interests of that Fund.

Further, we note that where one or more affiliated acquiring funds own all, or substantially all, of the shares of an affiliated acquired fund, it may be impossible for the acquiring fund(s) to ever fully redeem the shares and exit the acquired fund due to the 3% redemption limit.

b. Possible Restructuring of the AZL Funds

The Release solicits comment regarding whether funds would be required to, or would, alter investment strategies or holdings as a result of the proposed changes. If the Proposal is adopted, the AZL MVP Funds may be compelled to restructure to avoid the most challenging aspects of the Proposal. Certain potential restructuring options are discussed below, but AIM submits

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5 For seven of the AZL MVP Funds, all of the acquired funds are AZL Funds; for the other three, the acquired funds currently are AZL Funds and three acquired funds managed by AIM’s affiliate, PIMCO.
that each may result in significant changes to the investment strategies and/or holdings of the funds, potentially frustrating the investment expectations of shareholders, and impose unnecessary expenses on the funds and fund shareholders.\footnote{Although the affiliated separate accounts are the record owners of all of the shares of the AZL Funds of Funds, the term "shareholders" here will refer to the contract holders who have allocated variable contract value to the Funds.}

If rule 12d1-2 and the Exemptive Order are rescinded, the AZL MVP Funds could discontinue the volatility management strategy. Without the associated futures for volatility management, the AZL MVP Funds would invest only in affiliated acquired funds, permitted by section 12(d)(1)(G), and, in some cases, unaffiliated money market funds permitted under proposed amended rule 12d1-1. However, AIM submits that the volatility management strategy is an important aspect of the overall investment strategy of the AZL MVP Funds and that removing the volatility management may frustrate the investment expectations and objectives of shareholders who selected those investment options.

Alternatively, AZL MVP Funds with a limited number of acquired funds (perhaps up to four or five) might restructure to a “sleeved” approach, under which a fund historically organized as a fund of funds would stop investing in acquired funds and instead hire various subadvisers to directly manage specified assets of the fund. However, hiring subadvisers to manage assets directly in the AZL MVP Funds likely would produce the expense of shareholder approvals, additional administrative and accounting expenses, and the inefficiencies of requiring a subadviser to manage the same strategy in various separate funds/sleeves, rather than in a single acquired fund held by multiple funds of funds.

Alternatively, the AZL MVP Funds could alter their investment strategies and invest in different affiliated or unaffiliated acquired funds to avoid owning more than 3% of any acquired fund. However, this, too, may significantly alter the investment strategy of the Funds, potentially frustrating the investment expectations of shareholders, and may increase the costs and complexity of those Funds, which AIM submits is one of the concerns that section 12(d)(1) is intended to avoid.\footnote{AIM also notes that a shareholder who does not wish to remain in a restructured Fund has limited options, as a contract owner must either elect a new investment option from the menu of available options in his or her contract or incur the costs (surrender charges, potential taxes, etc.) associated with surrendering the contract to move assets elsewhere.}

As described below, AIM submits that the Proposal can be modified to avoid these costs and harms and still meet the Proposal’s overall goal of streamlining and enhancing the regulatory framework applicable to funds of funds generally.

IV. AIM’s Specific Recommendations

a. Allow rule 12d1-2 and the Related Exemptive Orders to Remain in Place

AIM respectfully recommends that the Commission not rescind rule 12d1-2 or the Exemptive Order (or other similar orders),\footnote{Hereinafter, the Exemptive Order and other similar orders permitting investments under rule 12d1-2 in other financial instruments are referred to as the “Exemptive Orders.”} because funds complying with rule 12d1-2 and the Exemptive Orders do not present the concerns that section 12(d)(1) was designed to address.
We submit that the enactment of section 12(d)(1)(G) in 1996 reflects a Congressional determination that affiliated fund of funds arrangements, where the acquired fund is part of the same group of investment companies as the acquiring fund, do not present the risks that section 12(d)(1) was designed to address. The subsequent adoption of rule 12d1-2 in 2006 reflects the Commission’s determination, as stated in the proposing release, that investments in additional types of securities do not present any additional concerns that section 12(d)(1)(G) was intended to address. Finally, we submit that the issuance of numerous Exemptive Orders since 2006 reflects the Commission’s further determination that permitting affiliated funds of funds to invest in other investments which may not be securities would not raise any of the concerns that the requirements of section 12(d)(1) were designed to address.

AIM also notes that the Proposal does not contend or provide any evidence that the arrangements permitted by rule 12d1-2 and the related Exemptive Orders have resulted in any of the problems that section 12(d)(1) was designed to address. Accordingly, AIM respectfully submits that, with respect to the proposed rescission of rule 12d1-2 and the related Exemptive Orders, the economic costs of the Proposal are not justified by any corresponding benefit to investors.

For these reasons, AIM submits that rule 12d1-2 and the Exemptive Orders should not be rescinded.

Should the Commission nevertheless elect to rescind rule 12d1-2 and the Exemptive Orders, AIM requests that funds currently relying on section 12(d)(1)(G), rule 12d1-2 and/or the Exemptive Orders be “grandfathered” and allowed to continue to operate under the rules existing today. AIM submits that the AZL MVP Funds were established and structured in compliance with, and reliance on, the existing regulatory structure. As described above, the rescission of rule 12d1-2 and the Exemptive Orders likely would require the AZL MVP Funds to either restructure or change investment strategies. AIM submits that either of these alternatives would result in increased costs and operational inefficiencies and may frustrate the investment expectations of shareholders who have invested in the Funds as they are currently structured. AIM respectfully suggests that the AZL MVP Funds, as currently structured, do not present any of the concerns which section 12(d)(1) was designed to address.

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9 See Investment Company Act Release No. 26198 (Oct. 1, 2003) (Rule 12d1-2 Proposal); Investment Company Act Release No. 27399 (June 27, 2006) (Rule 12d1-2 Final Rule); see also the Release at pg. 88 ("The Commission stated that the investments permitted under rule 12d1-2 did not raise additional concerns under section 12(d)(1)(G) because: (i) they were not investments in funds; or (ii) they represented fund investments that are limited in scope . . . or amount . . . .").

10 The Proposal does assert that the rescission of rule 12d1-2 and the Exemptive Orders would serve to “harmonize the overall regulatory structure.” However, AIM submits that it would create inconsistencies in the regulation of the AZL Funds of Funds (as well as other similarly situated fund complexes). As described above, the only relevant difference between the ten AZL MVP Funds and the other three AZL Funds of Funds is the 5% allocation to futures in the AZL MVP Funds, yet the Proposal would subject the two groups to different regulatory requirements, under rule 12d1-4 and section 12(d)(1)(G), respectively. AIM submits that the mere addition of futures to a portfolio of affiliated acquired funds does not raise any of the concerns that section 12(d)(1) was designed to address and does not warrant this differing regulatory treatment.

11 Alternatively, rule 12d-2 could be revised to permit investments in other financial instruments which may not be securities within the meaning of section 2(a)(36) of the Act. This change would eliminate the need for the Exemptive Orders. To the extent that there is concern with respect to investments by affiliated funds of funds in unaffiliated acquired funds, under existing rule 12d1-2, we suggest that rule 12d1-2 could be revised to remove 12d1-2(a)(1) or to provide in substance that investments in unaffiliated acquired funds must comply with the conditions in proposed new rule 12d1-4.
b. Except Investments in Affiliated Acquired Funds from the 3% Redemption Limit

AIM respectfully requests that the Commission except investments in the shares of affiliated acquired funds from the 3% redemption limit, just as they are excepted from the control and voting conditions, because redemptions of an affiliated acquired fund do not raise concerns of undue influence that underlie section 12(d)(1).

AIM submits that neither Congress nor the Commission has historically found that the policy concerns underlying section 12(d)(1) arise under circumstances where acquiring funds invest in affiliated acquired funds. For example, AIM notes that affiliated fund of funds arrangements are not currently subject to any redemption restrictions in section 12(d)(1)(G). Similarly, the Commission did not include any redemption restrictions in rule 12d1-2 or in the Exemptive Orders.

In the Release, the Commission appears to acknowledge the policy basis for not imposing redemption restrictions on certain affiliated acquired funds by excepting such funds from the voting and control provisions in proposed rule 12d1-4. Specifically, the Commission noted in the Release that:

In circumstances where the acquiring fund and acquired fund share the same adviser, the adviser would owe a fiduciary duty to both funds, serving to protect the best interests of each fund. In addition, in cases where the arrangement involves funds that are advised by advisers that are control affiliates, we do not believe that the acquiring fund adviser generally would seek to benefit the acquiring fund at the expense of the acquired fund (nor do we believe that the acquiring fund would seek to influence the acquired fund through its ownership interest in the acquired fund). (Citations omitted.)

AIM agrees and notes that the Commission also stated in the Release that “the proposed rule’s other conditions, such as the redemption condition described below, would mitigate against the risks of undue influence when the arrangement involves funds that have advisers that are control affiliates.” However, this statement would not support imposing a redemption restriction where the acquiring fund and acquired fund share the same adviser. AIM submits that in view of the historical views and experience expressed by Congress and the Commission noted above, imposing a 3% redemption limit on acquiring funds investing in acquired funds in the same group would be unnecessary and inappropriate.

Further, by not imposing a new redemption restriction as part of the rule, the Commission would allow for a consistent and appropriate regulatory framework that would avoid subjecting substantially similar affiliated fund of funds arrangements to different conditions, which is one of the stated goals of the Proposal.

V. Conclusion

Subject to the comments and suggestions above, AIM generally supports the Commission’s goals of streamlining the regulatory framework for funds of funds and providing an exemptive rule permitting funds of funds to invest, beyond the limits in section 12(d)(1)(A) of the Act, in unaffiliated acquired funds. From time to time, AIM has considered potential new fund investment strategies, to include investments in unaffiliated acquired funds; however, the requirement to comply with the limits in section

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12 The Release at pg. 41.

13 Id.
12(d)(1)(A) or to obtain exemptive relief has been a deterrent. We agree generally with the Proposal to permit all funds of funds to invest in unaffiliated acquired funds beyond the limits in section 12(d)(1)(A), on the same terms, without the expense of obtaining exemptive relief. AIM agrees generally that this should enhance competition and ultimately benefit investors by allowing more options in the mutual fund marketplace.

AIM appreciates the opportunity to comment on the Proposal and is committed to assist the Commission in any way that we can. If you have any questions or would like further information, please contact me at [redacted] or [redacted].

Sincerely,

Erik T. Nelson
Chief Legal Officer

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