



tel (212) 482.1600
fax (212) 480.9655
www.adventcap.com
888 Seventh Avenue, 31st Floor
New York, New York 10019

May 1, 2019

VIA ELECTRONIC DELIVERY

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rule Regarding Fund of Funds Arrangements, Investment Company Act Release No. 33329 (File No. S7-27-18)

Dear Mr. Fields:

Advent Capital Management, LLC (“Advent”)¹ appreciates the opportunity to respond to the request by the Securities and Exchange Commission (“SEC” or “Commission”) for comments regarding proposed rule 12d1-4 (“Rule 12d1-4”) under the Investment Company Act of 1940 (“1940 Act”).² Rule 12d1-4 would, in summary and subject to conditions, permit a registered fund³ to acquire shares of another registered fund in excess of the percentage limits in section 12(d)(1) of the 1940 Act without obtaining an exemptive order from the Commission.⁴ In our view, Rule 12d1-4 could create a more consistent and efficient regulatory framework for funds that invest in other funds (“fund of funds” arrangements). Advent supports the concept of a unified approach to protecting registered funds from undue influence, duplicative fees and complex structures that can arise from fund of funds arrangements. We write to address four questions relating to the scope, content and implementation of the proposed rule.

¹ Advent is a registered investment adviser dedicated to providing its clients with superior investment performance. Advent offers long-only and alternative strategies investing in convertible, high yield and equity securities through separately managed accounts, registered investment companies, private funds and other products. Since inception in 1995, Advent has grown into a \$9 billion diversified investment management firm with the ability to capture opportunities globally.

² Fund of Funds Arrangements, 84 FR 1286 (Feb. 1, 2019) [hereinafter, the “Proposing Release”].

³ For these purposes, “registered fund” means a registered investment company (other than a face-amount certificate company) or business development company (“BDC”). See Rule 12d1-4(a)(1). Additionally, references to “closed-end funds” should be understood to include BDCs unless otherwise stated.

⁴ The investment company that acquires shares in a registered fund is called the “acquiring fund”, while the registered fund that issued the acquired shares is called the “acquired fund.” See Proposing Release at 1289.

I. EXECUTIVE SUMMARY

A. The Commission Appropriately Excluded Private Funds From The Scope Of Rule 12d1-4

The Commission asked whether the scope of Rule 12d1-4 should include private funds⁵ as acquiring funds.⁶ Advent supports the decision by the Commission to exclude private funds from the scope of the proposed rule. However, we believe additional Commission action is required in this area because certain hedge fund managers employing an “activist” discount arbitrage strategy routinely exploit a loophole in section 12(d)(1)(A)(i), to the detriment of an acquired closed-end fund. That section prohibits any investment company (the “acquiring company”) and any companies it controls from acquiring more than 3% of the total outstanding voting stock of any registered fund (the “acquired company”). We refer to this as the “3% limitation”.⁷ A manager pursuing this type of activist strategy directs multiple private funds under its control to each acquire up to 3% of the shares of a closed-end fund, accumulating a disproportionate voting stake. The manager then uses proxy contests and other measures to attempt to coerce the closed-end fund into conducting an extraordinary, one-time purchase of its shares at above-market prices. In other cases, the activist manager attempts to force the closed-end fund to outright liquidate, or convert into an open-end fund. These actions can permanently damage or destroy the closed-end fund. Retail, long-term, Main Street shareholders of the closed-end fund are “dragged along” in the process.

The activist’s strategy is a clear circumvention of the 3% limitation and violates section 48(a) of the 1940 Act, which prohibits doing an act indirectly that would be unlawful to do directly.⁸ As in the case of multiple private funds that are collapsed into a single fund under the section 3(c)(1) “integration doctrine”⁹, the multiple private funds that collectively invest in a single closed-end fund in excess of the 3% limitation at the direction of a common manager are not materially different in investment operations or policies, and should be treated as a single fund for purposes of the 3% limitation. Therefore, Advent requests that the Commission make clear in the adopting release for Rule 12d1-4 that it may, pursuant to section 48(a), disregard technical compliance with the 3% limitation and “look through” to the underlying substance of holdings in situations where the collective voting security ownership of a closed-end fund by multiple investment companies – including private funds – sharing the same or affiliated investment advisers exceeds the 3% limitation and an intent to change or influence the

⁵ A “private fund” is an issuer that would be an investment company, as defined in section 3 of the 1940 Act, but for section 3(c)(1) or 3(c)(7) of the 1940 Act. See Proposing Release at footnote 10.

⁶ This topic is covered in Section IV of this letter.

⁷ Section 12(d)(1) also protects registered funds from abuse through imposition of a 5% limitation and a 10% limitation. See 1940 Act §§ 12(d)(1)(A)(ii)-(iii); *infra* footnote 34.

⁸ Section 48(a) is discussed in Section IV.C.i of this letter.

⁹ The integration doctrine is discussed in Section IV.C.i of this letter.

management or control of the closed-end fund has been manifested. We also request that the Commission review past and ongoing examples of these abuses and take appropriate action to remedy violations.

B. The Definition of “Advisory Group” in Rule 12d1-4 Should Be Revised

The Commission asked whether it should require an acquiring fund to aggregate its holdings with its “advisory group” when assessing control of an acquired fund.¹⁰ We believe the definition of advisory group should be revised to require aggregation of the acquired fund’s holdings with both the advisory group and any sub-advisory groups when such groups are affiliated. Separately managed accounts that are advised by the acquiring fund’s adviser, sub-adviser or their respective affiliates should also be included within the applicable advisory group definitions. In our opinion, any final rule (1) should not include a “grandfathering” provision for closed-end funds with a current acquiring fund and advisory group holding in excess of 25%, and (2) should contain an affirmative disposition requirement within a defined period of time.

C. An Acquiring Fund And Its Advisory Group Should Use Only “Mirror Voting” And Should Not Have The Option For “Pass Through Voting”

The Commission asked whether it should require an acquiring fund to vote in the manner prescribed by section 12(d)(1)(E)(iii)(aa) if the acquiring fund and its advisory group hold more than 3% of an acquired fund’s outstanding voting securities.¹¹ That section contains voting options commonly referred to as “pass through” and “mirror” voting. Advent believes Rule 12d1-4 should be revised to require that an acquiring fund and its advisory group use *only* mirror voting (and not have the option for pass through voting) as a condition of reliance unless the investment advisory contract requires pass through voting. In our opinion, pass through voting suffers from a lack of clear guidance in implementation. Worse, it will likely result in an activist acquiring fund and its advisory group voting the way the manager wants, because investors in the activist acquiring fund and its advisory group entities would likely vote lockstep with any recommendation received from the manager. Without amendment, pass through voting is likely to quickly become another loophole – like the one in section 12(d)(1)(A)(i) – that activist hedge funds will exploit to the detriment of a closed-end fund and its retail, long-term, Main Street shareholders.

¹⁰ This request for comment is discussed in Section V of this letter.

¹¹ This request for comment is discussed in Section VI of this letter.

D. The Aggregate Ownership Limit For An Acquiring Fund And Its Advisory Group Under Rule 12d1-4 Should Be Set At 10%

The Commission asked whether the control and voting conditions in Rule 12d1-4 sufficiently protect an acquired fund from the type of coercive behavior on the part of acquiring funds that section 12(d)(1) was intended to prevent.¹² We believe they do not. The Proposing Release states that an acquiring fund and its advisory group's beneficial ownership of up to 25% of the voting securities of an acquired fund would be presumed not to constitute control over the acquired fund. An acquiring fund relying on the proposed rule and its advisory group, therefore, generally could make a substantial investment in an acquired fund (*i.e.*, up to 25% of the acquired fund's shares). In our experience, holdings *below* the 25% level result in the type of undue influence the Commission is seeking to prevent with the conditions of Rule 12d1-4, and can result in an acquiring fund assuring success in compelling an acquired fund to take short-term actions detrimental to retail, long-term, Main Street shareholders. We believe that the aggregate ownership limit for an acquiring fund and its advisory group under Rule 12d1-4 should be set at 10%. We also believe that acquired funds should be free to make a judgment that no risk of undue influence from the acquiring fund exists and enter into a participation agreement with the acquiring fund akin to what the Commission's fund of funds exemptive orders now typically require. In such circumstances, we would expect a participation agreement to be a prerequisite to permitting an acquiring fund to purchase more than 10% of the voting securities of an acquired fund, but in any event not in excess of 25%, and for such participation agreement to require passive investment.

II. BACKGROUND INFORMATION ON CLOSED-END FUNDS

Advent has analyzed Rule 12d1-4 from the perspective of an investment adviser to a closed-end fund¹³ that was once an acquired fund.¹⁴ This requires an appreciation of the market for closed-end funds, the difference between closed-end and open-end funds, and the dynamics of the trading of shares in closed-end funds on public stock exchanges. The closed-end fund market in the United States is comprised of 496 funds and \$236 billion of net assets.¹⁵ An estimated 3.6 million US households own closed-end funds, and 38 percent of those include a person who is retired from their lifeline occupations, compared with 23 percent of households

¹² This request for comment is discussed in Section VII of this letter.

¹³ Advent serves as the investment adviser of Advent Claymore Convertible Securities and Income Fund, which trades on the New York Stock Exchange under the ticker symbol "AVK". See <https://www.guggenheiminvestments.com/cef/fund/avk> (last visited May 1, 2019).

¹⁴ See Advent Claymore Convertible Securities and Income Fund II, Advent/Claymore Enhanced Growth & Income Fund & Advent Claymore Convertible Securities and Income Fund, Definitive Joint Proxy Statement/Prospectus dated May 29, 2018, filed May 30, 2018 (File No. 333-224258), available at <https://www.sec.gov/Archives/edgar/data/1219120/000089180418000253/gug74131-497.htm> (last visited May 1, 2019).

¹⁵ These figures exclude BDCs. See CEF Advisors Provides Data for CEFs, Interval CEFs, and BDCs as of 3/31/19 (Closed-End Fund Advisors, Inc.), available at <http://campaign.r20.constantcontact.com/render?m=1101215570068&ca=2db856ad-213a-4766-b3e0-54095661e3ba> (last visited May 1, 2019) [hereinafter, the "CEF Advisors Study"].

owning open-end funds.¹⁶ Closed-end funds have unique features that are not available from open-end funds. These include the ability to make predictable monthly distributions and the freedom to invest capital for long periods of time without the need to maintain cash reserves or sell securities to meet redemptions. These features make closed-end funds attractive to investors in retirement and to companies seeking capital to fuel growth.

A. Closed-End Funds Differ From Open-End Funds

A closed-end fund is an investment company that has registered with the SEC.¹⁷ The two other types of registered investment companies are open-end funds (“mutual funds”) and unit investments trusts (“UITs”). A closed-end fund and an open-end fund are similar because both invest in portfolios of securities on behalf of shareholders through a professional money manager. These funds differ, however, in the type of shares they sell to investors and in the manner in which investors acquire and dispose of such shares. Open-end funds raise capital from investors through the issuance of “redeemable securities”. An investor in an open-end fund can sell its shares back to the fund through a process called redemption. The fund is required to purchase those shares at the current net asset value (“NAV”) per share.¹⁸ Generally speaking, an open-end fund sells and redeems its shares on a continuous basis.

A closed-end fund, however, generally is not required to buy its shares back from investors upon request, and it does not engage in a continuous offering of securities. Instead, a traditional listed closed-end fund is created by issuing a fixed number of common shares to investors, somewhat like an initial public offering by a corporation.¹⁹ Once issued, shares of a closed-end fund are not purchased or redeemed directly by the fund, although some closed-end funds may adopt stock repurchase programs or periodically tender for shares.²⁰ This can be viewed as a benefit because the money manager does not have to accommodate the capital inflows and outflows that are common with open-end funds. The manager can focus on establishing and maintaining long-term investments.

¹⁶ See 2018 Investment Company Fact Book, at ch.5 (Investment Company Institute 2018), available at www.icifactbook.org (last visited May 1, 2019) [hereinafter, the “ICI FactBook”].

¹⁷ See Glossary, Closed-End Funds, <https://www.investor.gov/additional-resources/general-resources/glossary/closed-end-funds> (last visited May 1, 2019) [hereinafter, the “Glossary”].

¹⁸ “[I]nvestors in mutual funds can redeem their shares on each business day and, by law, must receive approximately their *pro rata* share of the fund’s net assets (or its cash value) within seven calendar days after receipt of a redemption request.” Investment Company Liquidity Risk Management Programs, 81 FR 223 at 82145 (footnote omitted) (Oct. 13, 2016) [hereinafter, the “Liquidity Risk Management Release”].

¹⁹ “Subsequent issuance of common shares can occur through secondary or follow-on offerings, at-the-market offerings, rights offerings, or dividend reinvestments.” See ICI FactBook at ch.5.

²⁰ *Id.* “Interval funds are a category of closed-end funds that differ from traditional closed-end funds because their securities are subject to periodic repurchase offers by the interval fund at net asset value. Interval funds also may differ from traditional closed-end funds by offering their shares continuously at net asset value.” See Fast Answers, Investment Company Registration and Regulation Package, available at <https://www.sec.gov/investment/fast-answers/divisionsinvestmentinvcereg121504htm.html> (last visited May 1, 2019).

Shares of closed-end funds are usually listed and trade on an exchange, such as the New York Stock Exchange or the NASDAQ Stock Market. The price of shares in a listed closed-end fund fluctuates like that of other publicly traded securities and is determined by supply and demand in the marketplace.²¹ At any given time, the shares may trade at a market price that is greater or less than the shares' NAV. Shares that sell at a price higher than the NAV are said to be sold at a premium, and shares that sell at a price lower than the NAV are said to be sold at a discount.²² Because of the limited number of shares and lack of redeemability, the shares of most closed-end funds trade at a discount to NAV.²³ In some cases, this discount is seasonal (popularly known as the "January Effect"), whereas in other cases it varies by type of fund or other factors.²⁴

B. Closed-End Funds Offer Unique Features

Closed-end funds offer unique features that are not available from open-end funds. As discussed below, closed-end funds have an enhanced ability to make distributions to shareholders, a significant capacity to seek higher total returns through long-term investments, and a greater ability to utilize leverage to enhance returns. These features have made closed-end funds attractive to investors who seek regular income payments. They also make closed-end funds attractive to companies that seek flexible long-term capital or financing.

i. Closed-End Funds Have An Enhanced Ability To Make Distributions To Shareholders

Closed-end funds are often attractive to investors that seek regular income in retirement or to support pension payments because they have an enhanced ability to make distributions to shareholders. In 2017, closed-end funds distributed \$16.8 billion to shareholders²⁵; typically, they pay distributions on a monthly or quarterly basis. Closed-end funds may make distributions

²¹ See ICI FactBook at ch.5.

²² See Glossary.

²³ As of December 31, 2018, 91 percent of listed closed-end funds (excluding BDCs) traded at a discount to NAV. See Lipper FundMarket Insight Report (Dec. 31, 2018) (© Refinitiv 2019). As of March 31, 2019, 83 percent traded at a discount. See Lipper FundMarket Insight Report (Mar. 31, 2019) (© Refinitiv 2019). The median discount was 8.53 percent to NAV, and trading prices ranged from a maximum discount of 30 percent to a maximum 56 percent premium to NAV. *Id.*

²⁴ "Historically, fourth quarter tax loss selling of closed-end funds ('CEFs') has been prevalent in the market. CEFs may be more susceptible to tax loss selling given they trade on a stock exchange and market prices can deviate from underlying net asset values ('NAVs'). A 'discount' arises when a Fund's market price is below the NAV. When discounts widen (market price under-performs NAV), investors may choose to realize a capital loss by selling the fund (tax loss selling), which results in additional supply and may further widen a fund's discount. Discount widening may be amplified in asset classes that experience elevated levels of under-performance in a given year. Based on historical trends, investors that have purchased CEFs in the latter part of the fourth quarter have generally realized the benefits of tax loss selling through the short-term effect of discount narrowing (market price outperforms NAV) most prevalent in the month of January. Notably, CEF discounts have narrowed in January in 16 out of the last 20 years. This consistency may be attributed to the 'January Effect'. According to this theory, pent up demand following tax loss selling may be the factor driving the out-performance as investors re-enter the market after selling positions in prior months to harvest taxes and re-balance their portfolios." See Looking to buy assets at a discount? Consider closed-end funds (Nov. 21, 2018), BlackRock, available at <https://www.nasdaq.com/article/looking-to-buy-assets-at-a-discount-consider-closed-end-funds-cm1059196> (last visited May 1, 2019).

²⁵ See ICI FactBook at ch.5.

to shareholders from three possible sources: (1) income from interest and dividends; (2) realized capital gains; and (3) return of capital.²⁶ The Commission has issued exemptive orders under section 19(b) of the 1940 Act permitting closed-end funds to make multiple distributions per year of long-term capital gains under a managed distribution plan, and closed-end funds have implemented plans to pay fixed quarterly or monthly distributions.²⁷ The ability of closed-end funds to make capital gain distributions throughout the course of their fiscal years allows for smoother income payments and more predictability, which is generally more in line with investor expectations.

ii. Closed-End Funds Have A Significant Capacity To Seek Higher Total Returns Through Long-Term Investments

Because a closed-end fund does not need to maintain cash reserves or sell securities to meet redemptions, the fund has much greater flexibility than an open-end fund to make long-term investments in private, restricted and other illiquid securities.²⁸ In fact, the Commission prohibits an open-end fund from investing more than 15% of its assets this way.²⁹ Closed-end funds are not subject to this limit and are therefore well suited to make long-term investments, such as municipal bonds that are not widely traded, private equity, leveraged corporate loans, venture capital, or securities traded in countries that do not have fully developed markets. These types of specialized investments may have the potential for substantially greater total return than comparable investments in publicly traded securities.³⁰ The manager of a closed-end fund is able to focus on making investments where trading liquidity and maturity date may not be paramount concerns. This is highly attractive to businesses, some of which desire to raise capital and deploy the proceeds to support expansion, plant development, hiring, equipment purchases and other activities that require many years to realize value. Thus, closed-end funds play an important role in the efficient allocation of capital in the United States and across the globe.

²⁶ Id.

²⁷ See <https://www.sec.gov/rules/icreleases.shtml#distributions> (last visited May 1, 2019). See also, e.g., BlackRock Science and Technology Trust, Form N-CSR filed Mar. 8, 2019, at 3 (File No. 811-22991) (in a combined annual report with eight other closed-end funds, describing such funds' fixed monthly distribution policies implemented in accordance with applicable exemptive relief).

²⁸ An "illiquid" security generally is considered to be a security that cannot be sold within seven days at the approximate price used by the fund in determining NAV. See Glossary.

²⁹ See Liquidity Risk Management Release at 82146.

³⁰ Investments in illiquid securities also come with special risks.

iii. Closed-End Funds Have A Greater Ability To Use Leverage

Closed-end funds have a greater ability to use leverage than open-end funds. In fact, most closed-end funds borrow money for investment purposes.³¹ Use of leverage creates an opportunity for increased income and capital appreciation.³²

III. THE PURPOSE AND PROTECTIONS OF SECTION 12(D)(1) AND RULE 12D1-4

Section 12(d)(1) of the 1940 Act protects closed-end funds and other registered investment companies from undue influence, duplicative fees and complex structures that can arise from fund of funds arrangements. Congress enacted this section to address the “pyramiding” of investment companies, which it determined can unduly concentrate control of registered funds in the hands of other companies to the detriment of the registered funds. This control could be exercised either directly (such as through the voting power of a controlling interest) or indirectly (such as coercion through the threat of large-scale redemptions).³³

The protections Congress afforded to registered funds include, among other things, a percentage limit on the acquisition of a registered fund’s shares by certain investors. Section 12(d)(1)(A)(i) of the 1940 Act prohibits any investment company and any companies it controls from acquiring more than 3% of the total outstanding voting stock of any registered fund. For purposes of the 3% limitation, a private fund – such as a hedge fund – relying on the exclusion from the definition of “investment company” in sections 3(c)(1) or 3(c)(7) of the 1940 Act is nonetheless considered an “investment company” subject to the 3% limitation in respect of investments in registered funds.³⁴ An acquiring company that is a private fund may not exceed the 3% limitation without obtaining an exemptive order from the Commission.³⁵ An acquiring company that is a registered fund may either seek an exemptive order or rely on a statutory exemption contained in section 12(d)(1).³⁶

³¹ See ICI FactBook at ch.5. “At year-end 2017, at least 341 funds, accounting for 64 percent of closed-end funds, were using structural leverage, types of portfolio leverage (tender option bonds or reverse repurchase agreements), or both as part of their investment strategy.” Id.

³² Use of leverage also creates special risks and can increase operating costs.

³³ See Proposing Release at 1293.

³⁴ See 1940 Act §§ 3(c)(1); 3(c)(7)(D). Private funds are also considered “investment companies” for purposes of section 12(d)(1)(B)(i) of the 1940 Act, which prohibits a registered open-end fund (the “acquired company”), any principal underwriter therefor, or any broker or dealer registered under the Securities Exchange Act of 1934, from knowingly selling or otherwise disposing of any security issued by the acquired company to any other investment company (the “acquiring company”) or any company or companies controlled by the acquiring company, if immediately after such sale or disposition more than 3% of the total outstanding voting stock of the acquired company is owned by the acquiring company or any company or companies controlled by it. Acquiring companies that are registered funds are also subject to the limits contained in sub-sections 12(d)(1)(A)(ii)-(iii) of the 1940 Act, which provide that securities issued by the acquired company cannot have an aggregate value in excess of 5% of the total assets of the acquiring company (the “5% limitation”), and that securities issued by the acquired company and all other registered funds cannot have an aggregate value in excess of 10% of the value of the total assets of the acquiring company (the “10% limitation”).

³⁵ See 1940 Act § 12(d)(1)(J); Proposing Release at 1291.

³⁶ See, e.g., §§ 12(d)(1)(E)-(G).

Rule 12d1-4 would, under specified circumstances, permit a registered fund to purchase shares of another registered fund in excess of the percentage limitations set forth in section 12(d)(1), and without regard to compliance with a statutory exception contained in section 12(d)(1), without obtaining an exemptive order from the Commission. The proposed rule, however, would subject such purchases to a tailored set 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).³⁷ For example, under the proposed rule, an acquiring fund and its advisory group would be required to use pass-through or mirror voting when they hold more than 3% of the acquired fund's outstanding voting securities.³⁸ In addition, an acquiring fund's ability to quickly redeem or tender a large volume of acquired fund shares would be restricted. Importantly, Rule 12d1-4 as proposed would not be available to private funds.

IV. THE COMMISSION APPROPRIATELY EXCLUDED PRIVATE FUNDS FROM THE SCOPE OF RULE 12D1-4

The Commission asked whether the scope of Rule 12d1-4 should include private funds as acquiring funds.³⁹ We emphatically agree with the Commission that "it is appropriate for private funds to request relief from sections 12(d)(1)(A) and (B) of the [1940] Act through our exemptive application process, and for the Commission to weigh these policy considerations in the context of the facts and circumstances of each particular applicant."⁴⁰ According to the Proposing Release, the Commission's position is based on the unregistered nature of private funds, which would escape the conditions of Rule 12d1-4 that require ongoing reporting to the Commission and recordkeeping.⁴¹ The Proposing Release appears to reflect the Commission's belief that the exemptive rule process would enable the Commission to ensure that private funds seeking to exceed the 3% limitation would not exercise undue influence over registered funds or participate in the other abuses that led Congress to enact section 12(d)(1).

We agree with the Commission's conclusions in this regard. We would add particular emphasis to several other observations aside from private funds' lack of record keeping and Commission reporting obligations comparable to registered funds. Private fund managers generally have closer business relationships with the investors in their private funds than registered funds have with their shareholders – many of whom own registered fund shares through a broker or other financial intermediary in "street name." This close business relationship arises from the one-on-one nature of the private placement process traditionally used

³⁷ See Proposing Release at 1287.

³⁸ *Id.* at 1294.

³⁹ *Id.* at 1291.

⁴⁰ Proposing Release at 1291.

⁴¹ Private funds are not subject to the Form N-CEN reporting requirements that would apply to acquiring funds under Rule 12d1-4, would not report information regarding their acquired fund holdings on Form N-PORT, and are not subject to the 1940 Act's recordkeeping requirements. *Id.* at 1290-91.

to raise capital for private funds.⁴² Rule 12d1-4, as proposed, would require acquiring funds to use either mirror voting or pass-through voting if they invest beyond the 3% limitation.⁴³ If private funds were able to rely on the rule and use pass-through voting, we believe this dynamic would provide insufficient protection to registered funds, especially given the closeness of the private fund manager's relationship with its private fund investors. Pass-through voting would essentially allow a private fund manager, though its influence with its private fund investors, to effectively direct the voting of registered fund shares. Typically, investors in private funds pursuing activist discount arbitrage strategies desire exposure to the types of abusive practices implemented by those funds, as described below, and via pass-through voting those investors would vote lockstep with implementation of these strategies. This would give rise to the very harms Rule 12d1-4 is trying to avoid: "*investors in the acquiring fund [controlling] the assets of the acquired fund and [using] those assets to enrich themselves at the expense of acquired fund shareholders.*"⁴⁴ If the Commission were to reverse course and permit private funds to rely on Rule 12d1-4 – which we strongly urge against – we believe that the minimum level of protection needed for the public interest and the retail, long-term, Main Street shareholders of registered funds would entail the following measures: (1) identical N-PORT and N-CEN reporting requirements for private funds' holdings that rely upon Rule 12d1-4 (either on a new form, or answering only specific items on existing forms); (2) identical recordkeeping requirements for private funds as they relate to Rule 12d1-4; and (3) either reporting of the private fund's investors (inclusive of percentage ownership of the private fund) or a requirement to use only mirror voting if relying on Rule 12d1-4.

While we welcome the Commission's conclusion that private funds should be excluded from relying on Rule 12d1-4, we believe additional Commission action is required in this area because, as discussed below, certain investment advisers routinely use a group of controlled private funds to evade the 3% limitation in violation of section 48(a) of the 1940 Act.⁴⁵ In this respect, including private funds within the scope of permitted acquiring funds under Rule 12d1-4 would expand and exacerbate an already existing loophole in section 12(d)(1)(A)(i) that has proved to be highly disruptive and detrimental to closed-end funds and their retail, long-term, Main Street shareholders.

⁴² Most managers of private funds solicit investors on an individual basis to avoid engaging in a general solicitation or general advertising within the meaning of rule 502(c) of Regulation D under the Securities Act of 1933.

⁴³ Rule 12d1-4(b)(1)(ii). Rule 12d1-4 references voting in accordance with section 12(d)(1)(E)(iii)(aa) of the 1940 Act, which contains voting options commonly referred to as "pass through" and "mirror" voting. In pass through voting, the acquiring fund must "seek instructions from its security holders with regard to the voting of all proxies with respect to [the acquired fund] and to vote such proxies only in accordance with such instructions." In mirror voting, the acquiring fund must "vote the [acquired fund] shares held by it in the same proportion as the vote of all other holders of such security."

⁴⁴ Proposing Release at 1287 (emphasis added).

⁴⁵ Section 48(a) makes it "unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this title or any rule, regulation, or order thereunder."

A. The 3% Limitation Has a Loophole

The 3% limitation, on its face, applies only to an individual “investment company” and to any companies that it controls. Unlike section 12(d)(1)(C) of the 1940 Act, section 12(d)(1)(A)(i) does not require aggregation of the positions of multiple “sister” funds controlled by a common investment adviser for purposes of testing the 3% limitation.⁴⁶ The result is that an unlimited number of private funds can each acquire up to (but not more than) 3% of the voting shares of any closed-end fund. For example, six private funds could each acquire exactly 3% of the voting shares of the same closed-end fund. In a vacuum, each private fund will have achieved technical compliance with the 3% limitation. Despite this technical compliance, we believe section 12(d)(1)(A)(i) would be violated if such acquisitions are coordinated by a common investment adviser that then directs the private funds to use their collective voting power over an aggregate 18% position in the closed-end fund to exert undue control or influence over the closed-end fund to enrich themselves at the expense of the closed-end fund’s shareholders. This end-run around compliance with the 3% limitation frustrates the policy preference expressed by Congress and cited time and again by the Commission. This is precisely the type of scenario that section 48(a) of the 1940 Act is meant to guard against – doing an act indirectly that would be unlawful to do directly.

Moreover, this incongruity in section 12(d)(1) is a classic loophole in the law that has been exploited time and again by hedge fund managers with the effect of harming the retail, long-term, Main Street shareholders that own closed-end funds. This loophole is exacerbated by the inexplicable anomaly that private funds are not “investment companies” for purposes of section 12(d)(1)(C). That subsection limits collective investment in closed-end funds by investment companies under the common management of one investment adviser and seemingly recognizes the abuses that could be wrought on closed-end funds and their investors by the collective action of funds under the common management of one investment adviser.⁴⁷ However, because private funds are not “investment companies” for purposes of section 12(d)(1)(C), this limit applies only to acquiring registered funds, while the activities of private funds is left unchecked. This is quite surprising given that the public policy concern ought to focus on private funds, which are, for the most part, unregulated under the 1940 Act.⁴⁸ Registered funds are subject to numerous safeguards, disclosure requirements and recordkeeping

⁴⁶ Section 12(d)(1)(C) of the 1940 Act prohibits any investment company (the “acquiring company”) and any company or companies controlled by the acquiring company to purchase or otherwise acquire any security issued by a registered closed-end investment company, if immediately after such purchase or acquisition the acquiring company, other investment companies having the same investment adviser, and companies controlled by such investment companies, own more than 10% of the total outstanding voting stock of such closed-end company. A private fund is not an “investment company” for purposes of section 12(d)(1)(C). See 1940 Act § 12(d)(1)(J); Proposing Release at 1291.

⁴⁷ As noted, section 12(d)(1)(C) imposes a 10% aggregated ownership limit in any one closed-end fund for registered funds with a common investment adviser.

⁴⁸ It appears that the Commission’s Division of Investment Management has broadly agreed with the proposition that all of section 12(d)(1)’s limitations on investments in registered funds should apply to private funds. See Protecting Investors: A Half Century of Investment Company Regulation, SEC Division of Investment Management, at 105 (May 1992) (“In order to protect the public shareholders of registered investment companies, however, the restrictions of section 12(d)(1) should apply to all investments by private issuers in registered investment companies.”).

obligations under the 1940 Act. Simply stated, “checking” the collective action of private funds under the common management of one investment adviser ought to be the bigger concern vis-a-vis closed-end funds, yet the 1940 Act does not address that concern but rather imposes this “check” only on registered funds.⁴⁹

B. Certain Activist Private Fund Managers Are Exploiting The Loophole In Section 12(d)(1)(A)(i) To Abuse Closed-End Funds In Violation of Section 48(a)

The potential for an investor to exploit the loophole in the 3% limitation is not merely a theoretical possibility. Rather, it is a real-world investment strategy perpetuated by private fund managers that has harmed, and continues to harm, many closed-end funds and their retail, long-term, Main Street shareholders. The strategy is run as follows.

i. The Activist Manager Uses A Controlled Group Of Private Funds To Accumulate A Disproportionately Large Position In A Listed Closed-End Fund

A private fund manager employing an activist discount arbitrage strategy directs multiple private funds under its control to each acquire up to 3% of the voting shares of a closed-end fund whose shares are traded on an exchange. This is done at a time when the market price of the shares represent a substantial discount to NAV. The controlled private funds often employ substantially the same investment strategy and frequently act in concert to engage in activist strategies at the coordination and direction of the manager. The resulting fund of funds arrangement gives the activist manager voting power and dispositive authority over a combined position much larger than the 3% limitation.⁵⁰ Indeed, the Commission itself recognizes in the Proposing Release the dangers that an end-run of the percentage limitations in section 12(d)(1) can have on registered funds: “We believe requiring an acquiring fund to aggregate its holdings with its advisory group would prevent a fund or adviser from circumventing the control condition by investing in an acquired fund through multiple controlled entities, *e.g.*, other funds in the fund complex.”⁵¹ The Commission also recognizes in the Proposing Release that closed-

⁴⁹ Indeed, the Commission even recognizes this in the Proposing Release in declining to apply Rule 12d1-4 to private funds. See Proposing Release at 1290-91 (describing how private funds are not subject to the Form N-CEN reporting requirements that would apply to acquiring funds under Rule 12d1-4, would not report information regarding their acquired fund holdings on Form N-PORT, and are not subject to the 1940 Act’s recordkeeping requirements).

⁵⁰ “For example, six entities advised by Saba Capital Management, L.P. owned in the aggregate 14.44 percent of Clough Global Equity Fund at the time it entered into a settlement agreement with that fund. As part of that settlement, the activist agreed to withdraw its nominees for directorships on the fund board in exchange for the fund’s agreeing to tender for 37.5 percent of its shares at 98.5 percent of net asset value and paying a dividend over the following two years equal to 10 percent of the fund’s average net asset value.” Rose F. DiMartino, *Protecting Closed-End Fund Investors: A Call to Amend 1940 Act Section 12(d)(1)(A)*, *The Investment Lawyer*, Jan. 2019, at 24 (footnotes omitted) [hereinafter, the “Investment Lawyer”].

⁵¹ Proposing Release at 1295.

end funds are subject to a special danger of encountering undue influence from activists acquiring voting positions in excess of 3%.⁵²

ii. The Activist Manager Coerces The Acquired Closed-End Fund Into Conducting A One-Time Liquidity Event To Benefit The Acquiring Private Funds At The Expense Of The Closed-End Fund's Retail, Long-Term, Main Street Shareholders

The private fund manager then uses actual or threatened proxy contests and other measures (such as changes in the board of directors or investment adviser) to pressure the closed-end fund into creating a one-time liquidity event at or near NAV. This enables the manager and its controlled private funds to improperly profit from the substantial discount at which they purchased the closed-end fund's shares. In the normal course, a retail, long-term, Main Street shareholder that buys shares in a listed closed-end fund has the opportunity to benefit from the income or total return generated by the fund and, if the shares were acquired at a discount, may also benefit from a natural narrowing of the discount as the forces of supply and demand gradually close the gap between market price and NAV over time. The process by which a discount narrows may take time and is not assured because shares of closed-end funds are not redeemable, but are traded on an exchange at market prices, like common stock. Managers of activist private funds, however, are not content with a buy-and-hold approach to profiting from investments in closed-end funds. Instead, they seek to force the fund to create a single extraordinary liquidity event at or near NAV, which requires special corporate action by the closed-end fund's board of directors.

The liquidity event could take the form of a large tender offer, which could significantly drain the fund's assets and increase its expense ratio, an outright liquidation of the closed-end fund, or the conversion of the closed-end fund into an open-end fund. In other circumstances, the private fund manager seeks termination of the closed-end fund's advisory contract as a means to achieve its aims, often without any regard for the chaos that would ensue for retail, long-term, Main Street shareholders without careful and thoughtful planning. All of these actions could permanently damage or destroy the closed-end fund.⁵³ They are often pursued by

⁵² See *id.* at 1295-96 ("We also believe that requiring acquiring funds to utilize mirror voting or pass-through voting whenever their holdings exceed the statutory limit in section 12(d)(1)(A)(i) is appropriate to protect the acquired fund (and ultimately its investors) from undue influence through shareholder votes. A 3% threshold for the voting condition is particularly important because our proposal would allow funds to acquire shares of closed-end funds under proposed rule 12d1-4. Closed-end funds historically have been the target of proxy contests.").

⁵³ The board of trustees of the Franklin Limited Duration Income Trust was quite explicit in describing the coercive and harmful effect the activist discount arbitrage strategy can have on a closed-end fund: "Saba has a clear goal for a one-time gain leaving . . . behind a diminished fund, which is clearly not aligned with the interests of long-term shareholders. Saba has suggested an unlimited tender offer, which could cause a forced fire sale of the Fund's strategic assets, limit future income earnings, and increase its expense ratio. This would also likely make it impossible to continue operating as a closed-end fund, especially with reduced or no leverage. Additionally, Saba wants the Fund to either be open-ended or liquidated, if more than 50% of the Fund's shares are tendered. This plan makes Saba's proposed tender offer a complete waste of [the] Fund's resources and, ultimately, would end the Fund's existence as a closed-end fund." See Franklin Limited Duration Income Trust, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, Definitive Additional Materials (Oct. 6, 2016), available at <https://www.sec.gov/Archives/edgar/data/1233087/000168035916000024/flditdefa14a10062016.htm> (last visited May 1, 2019).

such private fund managers without regard to the costs or consequences involved. These effects are amplified when different groups of activist managers informally coordinate or synchronize their attacks on a single closed-end fund, and then use the concentrated voting stakes of perhaps a dozen or more controlled private funds to unduly influence the targeted closed-end fund.

iii. Coerced Liquidity Events Harm Closed-End Funds And Their Long-Term Shareholders

Coerced liquidity events can inflict substantial harm on closed-end funds and their retail, long-term, Main Street shareholders. These events can lead to fire sales of portfolio securities by closed-end funds to generate the required cash, and can leave such funds with less liquid, harder-to-value portfolios. Moreover, as noted above, most closed-end funds use some form of leverage. The risks and harms of these liquidity events can then be exacerbated by the need to not only raise cash to fund the liquidity event, incurring transaction costs, but also to de-lever to maintain required asset coverage ratios under section 18 of the 1940 Act and any bank documents governing the leverage financing. These bank documents may also require the closed-end fund to pay breakage fees to reduce outstanding borrowings.

The result of activist managers' "take-the-money-and-run" strategy can be especially harmful to smaller closed-end funds, as well as those that hold substantial amounts of less liquid and/or potentially higher yielding securities. As a result of the activist's demands, some closed-end funds may be forced to abandon successful long-term strategies. Nonparticipating shareholders are "dragged along" in the process and bear any resulting legal fees, transaction costs and other expenditures of the closed-end fund in defending against this coercive activity and in eventually implementing a large and unnecessary tender offer, converting into an open-end fund, or liquidating. The retail, long-term, Main Street shareholders who decline to participate in the liquidity event⁵⁴ will experience additional harm because the partially collapsed closed-end fund will exhibit a much higher expense ratio, due to negative economies-of-scale from its fixed expense base, and lower trading liquidity of the shares on exchanges. Closed-end funds that conduct tender offers also realize capital gains sooner than they otherwise would. The resulting capital gains taxes are allocated to remaining shareholders, which can force them to make cash tax payments they likely never intended when they first bought shares in the fund. The retail, long-term, Main Street shareholders who decide to participate in the tender (perhaps because they fear the trading price will decline, performance will lag or expenses will increase after the tender) are exposed to the difficult and highly undesirable situation of realizing capital gains taxes on what could be a low-cost-basis investment, and may be forced to reinvest in the

⁵⁴ There are many reasons why a long-term shareholder may not want to participate any such liquidity event. As a long-term holder, s/he may like the fund, its strategy and the income it produces. S/he may not want to realize a taxable disposition of his/her investment at that particular time. Divesting the fund may be inconsistent with his/her overall investment strategy and allocations. S/he may not like the prospect of reinvesting the proceeds in a higher cost or lower yielding investment.

fund or some other investment at a higher cost and have their holding periods reset back to short-term ordinary income rates.

Shareholders of many closed-end funds are decidedly retail in nature, and often retired from their lifetime occupations. They have a median household income of \$100,000 and median household financial assets of \$250,000.⁵⁵ This is far cry from the “qualified purchaser” standard of sophistication under section 2(a)(51) of the 1940 Act needed to invest in a typical hedge fund relying on section 3(c)(7) of the 1940 Act – *i.e.*, owning \$5,000,000 in “investments.” In this respect it could be said that the super high net worth investors who finance these private funds’ activist discount arbitrage strategies are exploiting their less affluent neighbors who hold closed-end funds – in a significant number of cases, as part of their hard-earned retirement portfolios.

The cumulative effect of a decade’s worth of activist managers evading the 3% limitation and coercing closed-end funds to liquidate, merge, or convert into an open-end fund, has been noteworthy. The population of closed-end funds is in steep decline, having fallen from a peak of 655 in 2007 to 496 in 2019,⁵⁶ thereby limiting choice in the marketplace.

To make matters even worse for retail, long-term, Main Street shareholders, the closed-end fund and its adviser have no legal recourse to address these blatant abuses of the 1940 Act because the few courts to have ruled in relevant cases have concluded that no private right of action exists to enforce the 3% limitation.⁵⁷ These abusive practices therefore continue unchecked, leaving closed-end funds (and their shareholders) unprotected by section 12(d)(1)(A)(i).

⁵⁵ See ICI FactBook at ch.5.

⁵⁶ See Morningstar DirectSM; CEF Advisors Study.

⁵⁷ See Gabelli Global Multimedia Trust, Inc. v. Western Investment LLC, 700 F. Supp. 2d 748 (D. Md. 2010); meVC Draper Fisher Jurettson Fund I, Inc. v. Millennium Partners, L.P., 260 F. Supp. 2d 616 (S.D.N.Y. 2003).

C. The Commission Should Stop Violations Of The 3% Limitation By Private Fund Managers That Use An Activist Discount Arbitrage Strategy

The Commission has statutory authority to stop this abuse by enforcing sections 12(d)(1)(A)(i) and 48(a) of the 1940 Act.⁵⁸

i. Section 48(a) Applies to Violations of Section 12(d)(1)(A)(i)

The 3% limitation contained in section 12(d)(1)(A)(i) and section 48(a) makes it unlawful for a person to do indirectly through another person what would be unlawful to do directly. The Commission staff has applied section 48(a) to disregard technical compliance with the 1940 Act by private funds when such technical compliance masks an underlying sham or conduit for circumvention of a substantive requirement. For example, in the case of private funds that seek to rely on the exception from the definition of investment company provided by section 3(c)(1) of the 1940 Act, the Commission staff has integrated separate private funds into a single fund for purposes of determining compliance with the 100 investor limit contained in section 3(c)(1) where it appears that the separate offerings do not present investors with materially different investment opportunities.⁵⁹ In our view, section 48(a) is violated when a private fund manager causes multiple private funds under its control to each acquire up to 3% of the voting shares of a closed-end fund in technical compliance with section 12(d)(1)(A)(i) but then uses their collective voting power and dispositive authority to coerce, or attempt to coerce, the closed-end fund into a large and unnecessary liquidity event for their own short-term benefit, as described above. As in the case of the section 3(c)(1) integration doctrine, these multiple private funds collectively investing in a single closed-end fund in excess of the 3% limitation are not materially different in investment operations or policies, and therefore should be treated as a single fund for purposes of the 3% limitation.

We recognize that the Commission staff has, in the past, interpreted section 12(d)(1)(A)(i) in accordance with its plain text, and asserted that the 3% limitation, by its terms, applies only to an individual investment company and does not require one investment company to aggregate its holdings with any other investment company, including an investment company in the same fund complex or advised by the same adviser.⁶⁰ We wish to point out to the Commission that this interpretation has not considered the impact of section 48(a) in the particular factual context of a private fund adviser seeking to use its private funds to exert undue control or influence over a closed-end fund to enrich the private funds at the expense of the closed-end fund's shareholders. Rather, these interpretations deal with the relatively mundane observation that closed-end funds, for example, can provide open-end funds inexpensive and comparatively liquid access to otherwise inaccessible or illiquid asset classes – a factual scenario

⁵⁸ 1940 Act § 42.

⁵⁹ See, e.g., Cornish & Carey Commercial, Inc., SEC Staff No-Action Letter (Jun. 21, 1996).

⁶⁰ See Mutual Series Fund Inc., SEC Staff No-Action Letter (Nov. 7, 1995).

that certainly does not raise the investor protection concerns raised by the activist discount arbitrage strategies employed by certain private fund managers.

ii. Request for Commission Action

Therefore, Advent requests that the Commission make clear in the adopting release for Rule 12d1-4 that it may, pursuant to section 48(a) of the 1940 Act, disregard technical compliance with the 3% limitation and “look through” to the underlying substance of holdings in situations where the collective voting security ownership of a closed-end fund by multiple investment companies – including private funds – sharing the same or affiliated investment advisers exceeds the 3% limitation and an intent to change or influence the management or control of the closed-end fund has been manifested.⁶¹ We believe that such a statement is appropriate and necessary given the above described abuses wrought on retail, long-term, Main Street shareholders in closed-end funds, and the Commission’s own view that mirror or pass-through voting is a necessary condition of Rule 12d1-4 as a means to protect closed-end funds from undue influence when acquiring funds exceed the 3% limitation. We also request that the Commission review past and ongoing examples of these abuses and take appropriate action to remedy violations.

V. THE DEFINITION OF “ADVISORY GROUP” IN RULE 12D1-4 SHOULD BE REVISED

The Commission asked whether it should require an acquiring fund to aggregate its holdings with its advisory group when assessing control of an acquired fund.⁶² We believe such aggregation should be required and that the definition of “advisory group” should be revised to close significant loopholes that could be abused.⁶³

As proposed, Rule 12d1-4 would not require an acquiring fund to aggregate the ownership of an acquiring fund advisory group with an acquiring fund sub-advisory group.⁶⁴ While we acknowledge that this is consistent with past exemptive orders, we believe that it provides insufficient protection to registered funds in a context where activist fund managers may seek to mine Rule 12d1-4 for every advantage possible, even if it means featuring registered funds more prominently in their abusive discount arbitrage strategies. Activist managers often coordinate with each other in attacking closed-end funds. Under the proposed definition of

⁶¹ Examples of this manifestation could be the filing of a Schedule 13D under the Securities Exchange Act of 1934, or other objective actions that demonstrate an intent to influence the management or control of the closed-end fund – *i.e.*, letter writing campaigns, proxy contests, withhold campaigns or other oral or written communications with management or shareholders. It is important that such intent be judged on substance, and not only based on a securities law filing.

⁶² See Proposing Release at 1297.

⁶³ As proposed to be defined in Rule 12d1-4, the advisory group includes either the adviser or the sub-adviser and any person or persons controlling, controlled by or under common control with such entity.

⁶⁴ See Proposing Release at 1294.

“advisory group”, Activist A could create a registered fund and hire like-minded Activist B and Activist C as sub-advisers. If this acquiring fund owned 5% of an acquired fund, private funds controlled by Activist A, Activist B and Activist C could each own up to 20% of the acquired fund – making use of the section 12(d)(1)(A)(i) loophole already described. The result is that these like-minded activists now collectively control 65% of the acquired fund, can clearly dictate to the acquired fund what to do, and have arguably complied with Rule 12d1-4 because no one “advisory group” owns more than 25% of the acquired fund. This cannot be the result the Commission intends; but it is a very real possibility under the rule as proposed and in light of the historical lack of application of section 48(a) to abusive practices such as this.

Perhaps an even bigger loophole is the exclusion of separately managed accounts from the definition of “advisory group”. Separately managed accounts generally are not viewed as being “controlled” by the adviser because they are not “companies”.⁶⁵ Just like with a controlled entity, such as a private fund, an adviser is often delegated voting discretion and dispositive power over separately managed account assets. And with that authority, the adviser can exert undue influence on an acquired fund in the same manner. This loophole also gives rise to obvious scenarios in which an activist manager could seek to end-run the requirements of Rule 12d1-4 as proposed. For example, the acquiring registered fund and the activist manager’s private funds could collectively own up to 25% of an acquired fund. But if that manager also advises separate accounts that collectively own another 30% of the acquired fund, the manager controls 55% of the acquired fund’s vote and can similarly dictate to the acquired fund what to do. This is very much a real possibility for smaller closed-end funds without large market capitalizations. This is yet another example of a result the Commission cannot have intended. We therefore believe that the definition of “advisory group” should be revised to require aggregation of the acquired fund’s holdings with both the advisory group and any sub-advisory groups, when such groups are affiliated, and to include separately managed accounts advised by the acquiring fund’s adviser, sub-adviser or their respective affiliates within the applicable “advisory group” definitions.

Additionally, we believe that any final rule (1) should not include any “grandfathering” provision for closed-end funds with a current acquiring fund and advisory group holding in excess of 25%, and (2) should contain an affirmative disposition requirement to come within the confines of the final rule within a defined period of time. At best, allowing these positions to remain will subject the unlucky closed-end funds to the risk of continuing undue influence to the detriment of their retail, long-term, Main Street shareholders. At worst, this will incentivize advisory groups seeking control or influence to increase their holdings of targeted closed-end funds to above the permitted threshold prior to the effectiveness of the final rule.

⁶⁵ See 1940 Act §§ 2(a)(8)-(9).

VI. AN ACQUIRING FUND AND ITS ADVISORY GROUP SHOULD USE ONLY “MIRROR VOTING” AND SHOULD NOT HAVE THE OPTION FOR “PASS THROUGH VOTING”

The Commission asked whether it should require an acquiring fund to vote in the manner prescribed by section 12(d)(1)(E)(iii)(aa) if the acquiring fund and its advisory group hold more than 3% of an acquired fund’s outstanding voting securities.⁶⁶ Section 12(d)(1)(E)(iii)(aa) of the 1940 Act contains voting options commonly referred to as “pass through” and “mirror” voting. In pass through voting, the acquiring fund must “seek instructions from its security holders with regard to the voting of all proxies with respect to [the acquired fund] and to vote such proxies only in accordance with such instructions.” In mirror voting, the acquiring fund must “vote the [acquired fund] shares held by it in the same proportion as the vote of all other holders of such security.” The Commission has explained that section 12(d)(1)(E)(iii) is an “attempt to minimize the influence that an acquiring fund’s adviser, among others, may exercise over an underlying fund through voting.”⁶⁷ With respect to pass through voting, the Commission’s position has been that the “seek instructions” requirement necessitates the pass through of an acquired fund’s proxy material to the acquiring fund’s investors, and the acquiring fund obtaining instructions from its investors with respect to voting.⁶⁸ Standing instructions from an acquiring fund’s investors to its adviser to vote in its discretion do not satisfy the requirements of pass through voting.⁶⁹ While little further guidance exists on how to implement pass through voting in the context of funds of unaffiliated funds, at least one well-known activist closed-end fund investor has disclosed that it implements the following procedure: “Fund stockholders may provide [] proxy voting instructions on the Fund’s website. The Fund will vote its shares of its shares of such closed-end fund as determined by a plurality of the proxy voting instructions received on the Fund’s website.”⁷⁰

We believe that pass through voting provides insufficient protection to acquired funds and their shareholders, especially when the acquiring fund is an activist closed-end fund investor, particularly when holdings in excess of 3% will be permitted. Presumably, investors in the activist’s acquiring fund want exposure to the activist’s abusive discount arbitrage strategy and will accommodate the adviser’s desire to unduly influence the acquired closed-end fund to the detriment of that fund’s long-term shareholders.⁷¹ The Commission has even seen and

⁶⁶ Proposing Release at 1298.

⁶⁷ See In the Matter of Special Opportunities Fund, Inc., 1940 Act Rel. No. 31213 (Aug. 15, 2014) [hereinafter, the “SPE Order”]; see also In the Matter of Special Opportunities Fund, Inc., 1940 Act Rel. No. 30647 (Aug. 8, 2013) [hereinafter, the “SPE Notice”].

⁶⁸ See Investment Company Amendments Act of 1970 Relating to Exemptions for Certain Companies, Pyramiding of Investment Companies, Regulation of Fund Holding Companies and Rescission of Rule 11b-1, 1940 Act Rel. No. 6440 (Apr. 6, 1971); accord SPE Notice; SPE Order.

⁶⁹ See SPE Order.

⁷⁰ Special Opportunities Fund, Inc., Definitive Prospectus dated Jul. 15, 2016, at 14 (File No. 333-208280), available at https://www.sec.gov/Archives/edgar/data/897802/000089418916010432/specialopps_497c.htm (last visited May 1, 2019).

⁷¹ Private fund managers generally have closer business relationships with the investors in their private funds than registered funds have with their shareholders – many of whom own registered fund shares through a broker or other financial intermediary in “street name.” This close Footnote continued on next page

considered an example of this very dynamic. In 2014 a well-known activist registered closed-end fund – Special Opportunities Fund, Inc. (“SPE”) – requested relief from the Commission that would have accommodated a pass through voting procedure inconsistent with section 12(d)(1)(E)(iii)(aa).⁷² While the Commission ultimately denied this request, it did so after a shareholder of SPE filed a hearing request supporting SPE’s position.⁷³ This is an obvious demonstration of how an activist fund’s investors are aligned with the adviser’s strategy of seeking short-term profits at the expense of the acquired closed-end fund’s long-term investors. Moreover, allowing the pass through of a larger-than-3% voting stake to an activist acquiring fund’s investors would give rise to the very harms Rule 12d1-4 is trying to avoid: “*investors in the acquiring fund [controlling] the assets of the acquired fund and [using] those assets to enrich themselves at the expense of acquired fund shareholders.*”⁷⁴

Pass through voting suffers from a lack of clear guidance in implementation and will likely result in an activist acquiring fund and its advisory group voting the way the manager wants given that investors in the acquiring fund and its advisory group entities would likely vote lockstep with recommendations received from the activist adviser. We believe that pass through voting will do little to protect retail, long-term, Main Street closed-end fund shareholders from an activist agenda focused on short-term profits through coercive techniques that will harm the long-term viability of the acquired closed-end fund, and therefore will ultimately result in the types of abuses that led to the creation of section 12(d)(1) in the first place.

Therefore, we respectfully submit that paragraph (b)(1)(ii) of Rule 12d1-4 should be revised to require that an acquiring fund and its advisory group use *only* mirror voting as a condition of reliance on the rule, unless the investment advisory contract requires pass through voting.⁷⁵

business relationship arises from the one-on-one nature of the private placement process traditionally used to raise capital for private funds. See supra footnote 42. Pass-through voting would essentially allow a private fund manager, though its influence with its private fund investors, to effectively direct the voting of registered fund shares.

⁷² See SPE Notice.

⁷³ See SPE Order.

⁷⁴ Proposing Release at 1287 (emphasis added).

⁷⁵ In our view, pass through voting should only be available as an option if the person investing in the private fund retains sole voting rights for purposes of compliance with Rule 12d1-4.

VII. THE AGGREGATE OWNERSHIP LIMIT FOR AN ACQUIRING FUND AND ITS ADVISORY GROUP UNDER RULE 12D1-4 SHOULD BE SET AT 10%

The Commission asked whether the proposed control and voting conditions sufficiently protect an acquired fund from the type of coercive behavior on the part of acquiring funds that section 12(d)(1) was intended to prevent.⁷⁶ We believe they do not.

The Proposing Release states that “an acquiring fund and its advisory group’s beneficial ownership of up to 25% of the voting securities of an acquired fund would be presumed not to constitute control over the acquired fund.”⁷⁷ An acquiring fund relying on the proposed rule and its advisory group, therefore, generally could make a substantial investment in an acquired fund (*i.e.*, up to 25% of the acquired fund’s shares).⁷⁸ In our experience, holdings *below* the 25% level result in the type of undue influence the Commission is seeking to prevent with the conditions of Rule 12d1-4, and can result in an acquiring fund assuring success in compelling an acquired fund to take short-term actions detrimental to its retail, long-term, Main Street shareholders. As we have noted, closed-end funds have an uncommon preponderance of individual and retail shareholders who are not mandated like institutional investors to vote in proxy affairs. The resulting lower retail voting participation amplifies the voting power of a large acquiring fund and its lockstep advisory group, and results in undue influence with holdings below the 25% level. Holdings above approximately 15% of a closed-end fund along with initiation of a proxy contest frequently result in the large holder being able to dictate various events that are most commonly not in the interest of the closed-end fund’s other shareholders.⁷⁹

As a result, we believe that the aggregate ownership limit for an acquiring fund and its advisory group under Rule 12d1-4 should be set at 10%.⁸⁰ We also believe, however, that acquired funds should be free to make a judgment that no risk of undue influence from the acquiring fund exists and enter into a participation agreement with the acquiring fund akin to what the Commission’s fund of funds exemptive orders now typically require. In such circumstances we would expect such a participation agreement to be a prerequisite to acquiring an acquired fund’s voting securities in an amount exceeding such limit but in any event not in excess of 25%, and for such participation agreement to require passive investment.

⁷⁶ *Id.* at 1297.

⁷⁷ *Id.* at 1294.

⁷⁸ *Id.*

⁷⁹ “For example, six entities advised by Saba Capital Management, L.P. owned in the aggregate 14.44 percent of Clough Global Equity Fund at the time it entered into a settlement agreement with that fund. As part of that settlement, the activist agreed to withdraw its nominees for directorships on the fund board in exchange for the fund’s agreeing to tender for 37.5 percent of its shares at 98.5 percent of net asset value and paying a dividend over the following two years equal to 10 percent of the fund’s average net asset value.” *See* Investment Lawyer.

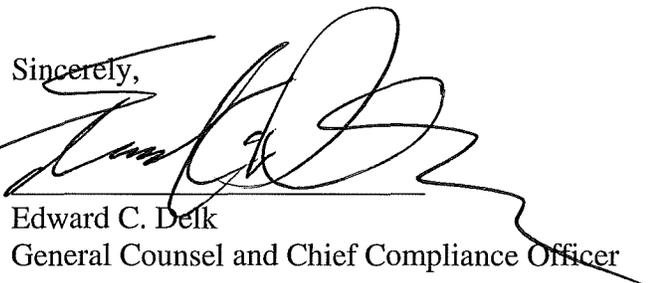
⁸⁰ As previously discussed, section 12(d)(1)(C) of the 1940 Act appears to represent a long-standing Congressional judgment on what level of collective closed-end fund ownership (10%) is appropriate to prevent the abusive practices against which section 12(d)(1) guards.

Brent J. Fields
May 1, 2019
Page 22 of 22

* * * * *

Advent would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "E. Delk", is written over a horizontal line. The signature is stylized and extends to the left and right of the line.

Edward C. Delk
General Counsel and Chief Compliance Officer

cc: The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
Dalia Blass, Director, Division of Investment Management