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May 2, 2019

Via email to: *rule-comments@sec.gov*

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

RE: File No. S7-27-18—Fund of Funds Arrangements

Dear Ms. Countryman:

I. Introduction

On behalf of Wells Fargo & Company and its subsidiaries, Wells Fargo Asset Management appreciates the opportunity to comment on the proposed amendments to rules governing fund of funds arrangements issued by the Securities and Exchange Commission ("Commission") on December 19, 2018 ("Proposal").[1]

Subsidiaries of Wells Fargo & Company advise and distribute the *Wells Fargo Funds*®. As of February 28, 2019, the *Wells Fargo Funds* had a total of approximately $202 billion in assets under management across a broad spectrum of investments. Our fund family offers a diverse set of funds of funds across multiple distribution platforms that include retail and institutional investors. Assets under management in our 47 advised funds of funds totaled approximately $18 billion as of February 28, 2019.

Funds of funds play a pivotal role in constructing efficient and dynamic portfolios across asset classes that provide investment solutions to shareholders. These arrangements are instrumental in managing target date funds with the greatest potential to achieve successful outcomes while managing the key risks to retirement investors. In managing Wells Fargo funds of funds, we emphasize robust risk management and sophisticated asset allocation to meet our clients' investment objectives such as protecting wealth, creating wealth or generating income.

We are pleased to generally support a number of measures, including the voting and control condition and the duplicative and excessive fee provisions of the Proposal. As described further in this letter, we strenuously oppose, however, the condition that would prohibit certain acquiring funds from redeeming more than 3% of an acquired fund's total outstanding shares in any 30-day period ("Redemption Limit") because it would be highly disruptive to funds of funds

[1] Fund of Funds Arrangements, Investment Company Act Release No. 33329 (December 19, 2018) [84 FR 1286 (February 1, 2019)] ("Release").

and lead to tangible harm to their shareholders.[2] The Redemption Limit would compel many of our funds of funds to restructure their investment strategies and portfolios, leading to significant transaction costs and tax impacts, increased expenses and reduced choices for shareholders. More efficient solutions can achieve the Commission's stated goal of establishing a consistent and efficient regulatory framework for fund of funds arrangements while largely preserving the substantial benefits they produce for shareholders.

II. The Redemption Limit

As discussed below, the Redemption Limit would inflict considerable harms on funds of funds and shareholders. We find it particularly troubling, and lacking a sufficient policy basis, that this restriction extends to an acquiring fund's investments in acquired funds that form part of the same group of investment companies. Given the destructive outcomes that it would precipitate, the Redemption Limit cannot, in our view, reasonably form part of a final regulatory construct, when an alternative approach can achieve a comparable measure of investor protection in a non-disruptive manner.

a. The Redemption Limit would create a liquidity crisis for certain funds of funds that would force harmful and costly restructuring.

Each open-end fund of funds participates in a liquidity risk management program adopted pursuant to Rule 22e-4 under the Investment Company Act of 1940 (the "Investment Company Act" or the "Act"), a regulation that, among other things, imposes a 15% cap on illiquid investments and requires the assessment, management and periodic review of a fund's liquidity risks. By operation of the proposed Redemption Limit, an acquiring fund would be effectively compelled to treat its holdings in excess of 3% of the acquired fund's outstanding securities (the "Illiquid Portion") as illiquid because the acquiring fund could not, due to the prohibition of the Redemption Limit, expect to dispose of the Illiquid Portion in seven calendar days in any manner.

For larger acquiring funds of funds investing in a number of smaller acquired funds in the same group, the Illiquid Portion may comprise a majority or more of the acquiring fund's holding. Across the portfolio, the aggregate percentage holdings in illiquid positions in these arrangements would result in funds of funds holding largely illiquid portfolios in excess of the 15% limit. In these circumstances, a larger fund of funds would face a liquidity crisis instituted by the Redemption Limit and would have no choice but to redeem its shares from the acquired funds at levels that would bring aggregate illiquid holdings below the 15% cap. They would need to effect additional redemptions to ensure that the overall exposures to the Illiquid Portions of holdings could be maintained at levels consistent with the effective management of liquidity risk under the program adopted for the fund pursuant to Rule 22e-4.

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[2] *See* Proposed Investment Company Act Rule 12d1-4(b)(2).

While the precise extent of portfolio restructuring would vary based on the amount of Illiquid Portion for each acquiring fund's investment, at the significant end of the spectrum, these redemptions would undeniably harm fund shareholders on multiple fronts. Substantial transaction costs would be incurred to raise cash to satisfy redemptions, which would decrease investor returns.[3] Fund shareholders would also eventually bear their portion of capital gains or losses recognized by these redemptions. As the assets of the acquired funds contract with the redemptions triggered by the Redemption Limit, advisory fees of the acquired funds that benefited from the operation of breakpoints prior to the redemptions may tick up as the asset base declines below one or more breakpoints, leading to increases in gross expenses for shareholders. Smaller acquired funds that are used primarily or exclusively by funds of funds may no longer be able to maintain a minimum size necessary for the effective implementation of their investment strategies, or may no longer be viable for the sponsor to operate, and would be compelled to liquidate and cease operations, eliminating an investment strategy designed to benefit the shareholders of the acquired funds.

We manage eight funds of funds, totaling $4.5 billion in assets under management, that, if the Proposal were adopted, would, as of February 28, 2019, have total illiquid holdings, comprised solely of the Illiquid Portion of acquired fund holdings, in excess of the 15% cap. As a result, these funds of funds would be forced to make significant redemptions to reduce illiquid holdings below the 15% cap ("forced redemptions"). As an example of the extent of the impacts, one of these funds, having $2.1 billion in assets under management, would have approximately 80% of its holdings in Illiquid Portions as a result of the Redemption Limit. The impacts of the forced redemptions on the acquired funds in which they invest would be considerable. If the rule were in effect as of February 28, 2019, we expect that 11 acquired funds, with $2.5 billion in assets under management, would lose more than 25% of their respective assets solely as a result of the forced redemptions.

Alternatively, a fund of funds might be forced to restructure to conform to one of the available statutory exemptions in Section 12 of the Act that would be unaffected by the Proposal. Implementation of this course may entail the impacts described above, and also would involve material modifications to the investment strategies and techniques that the fund of funds employs. Alterations of a fund's investment program could have the impact over time of impairing fund performance because available investments would be limited only to those permitted within the statutory exemptions, and the menu of such alternatives would not present the full range of options that otherwise are needed to support a more optimized investment strategy for the fund of funds. The effect of these modifications would be to impose a different kind of investment program on an investor than she selected, and, in the aggregate, to limit the choices available to investors.

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3 Significant redemption activity, in turn, may also exert downward pricing pressure on portfolio holdings for other shareholders in the acquired fund.

In sum, the damage to funds and shareholders that would ensue from the Redemption Limit is extensive and incommensurate with the regulatory benefits that the Proposal seeks to achieve.

b. Imposing the Redemption Limit with respect to investments in same-group acquired funds would be disruptive and unnecessary to achieve investor protection.

Acquiring funds of funds normally redeem from same-group acquired funds in connection with portfolio re-balancing, to implement tactical and strategic asset allocation investment decisions, and, as needed, to raise cash to fund redemptions. We have no experience with an affiliated fund of funds seeking to exert undue influence on an affiliated acquired fund through the threat of large redemptions or otherwise. For the reasons stated above, while we are opposed to the Redemption Limit in the first instance, the broad application of its restrictions to even affiliated structures reveals fundamental flaws in the condition's design. There is no basis in investor protection concerns for failing to provide an exemption to the Redemption Limit for funds in the same group of investment companies. The policy reasons supporting such an exemption from the voting and control condition[4] apply with equal logic and force in support of the Redemption Limit. The adviser has a common fiduciary duty to both the acquiring and acquired funds with an obligation to protect the best interests of each fund and the operations of both funds are overseen by an independent board of directors. These legal obligations and governance principles provide adequate measures of protection to funds that are advised and operated under a common framework of oversight. Whatever alternative condition or measures the Commission finally adopts to address these concerns—which, as discussed below, we believe should take the form of participation agreements—should exempt funds that are part of the same group of investment companies, consistent with the design of the statutory exemption for affiliated funds of funds enacted by Congress in Section 12(d)(1)(G) of the Act. The common predicate of prior Congressional legislative activity and the Commission's past rulemaking and exemptive orders in this area is that same-group fund of funds arrangements simply do not present the kind of undue influence concerns that the restrictions of Section 12(d)(1) are designed to abate.

c. An alternative framework based on participation agreements would be superior to the Redemption Limit because it would provide opportunities for acquired funds to protect their interests while preserving the benefits of existing fund of fund structures for shareholders.

To address concerns of undue influence in fund of funds arrangements outside of the same group, the regulatory framework should leverage the framework of participation agreements contemplated in existing exemptive orders issued by the Commission. Such agreements have widespread and long-standing use throughout the industry and have been effective in addressing the policy concerns of undue influence underlying Section 12(d)(1) of the

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4 *See* Proposed Investment Company Act Rule 12d1-4(b)(1)(ii) and (iii) and Release at pg. 41.

Act. With respect to investments outside of the same group, the acquiring fund and acquired fund could each be required to execute a standard form of participation agreement as a condition to completing an investment in excess of the three percent limit in Sections 12(d)(1)(A)(i) and 12(d)(1)(B)(i) of the Act. This mechanism would effectively provide the acquired fund, or its adviser, an opportunity to evaluate the benefits and risks of such an investment, and the terms on which it would be made, in determining whether the investment would be in the best interests of the acquired fund. The standard representations, compliance policies and other conditions accompanying the use of participation agreements in Commission exemptive orders establish an effective framework of checks and balances that has successfully governed fund of funds investment activities outside of the same group. For this reason, and because it would be broadly compatible with the existing fund of funds framework, we believe that the Commission should adopt this alternative requirement instead of the Redemption Limit.

d. *The Redemption Limit inappropriately undermines competition by establishing a framework that favors investments in exchange-traded funds.*

As discussed above, the requirements of the Redemption Limit may compel certain funds of funds to make significant redemptions from acquired mutual funds to, among other things, ensure that it complies with the limit on total illiquid positions and other conditions of Rule 22e-4 that are imposed on non-money market, open-end funds. In contrast, an acquiring fund that relies on the Proposal to invest in an acquired fund that lists shares on an exchange, including exchange-traded funds (“ETFs”), would not be similarly impacted by the Proposal because a reduction or elimination of exposure to the acquired fund is effected through secondary market transactions, without a redemption transaction. Instead, the Proposal would permit such an acquiring fund to continue to sell shares in the secondary market without regard to the volume limit. Taken together, the impacts that the Redemption Limit would produce on acquired mutual funds in comparison to the absence of any constraints on secondary market transactions in exchange-listed funds like ETFs would contribute to a competitively imbalanced framework that, in effect, would favor the use of ETFs as acquired funds and place acquired mutual funds at a comparative regulatory disadvantage. The economic analysis of the Release fails to fully consider or even acknowledge these important impacts, suggesting that the Commission should further assess the Proposal’s effects on competition before adopting the Redemption Limit.[5]

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We appreciate the opportunity to comment on the Proposal. We applaud the Commission’s objective to create a consistent and efficient regulatory regime for the operation of funds of funds, given their significant growth and the many and diverse investment benefits they generate for shareholders. We believe that most elements of the Proposal, combined with adopting the long-standing framework of participation agreements, would operate in a manner that would be broadly accommodative of existing funds of funds and strike a more rational

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[5] *See* Section VI.C.2.b. of the Release at pgs. 158-159.

balance between the benefits and burdens necessary to achieve a consistent regulatory framework. The Redemption Limit would be an unprecedented and destructive measure that we urge the Commission to eliminate as part of a final regulatory action.

Very truly yours,

/s/ Andrew Owen
Andrew Owen
President
Wells Fargo Funds Management, LLC

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