GENERAL AMERICAN INVESTORS COMPANY, INC.

May 2, 2019

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-27-18
Release Nos. 33-10590; IC-33329 (the "Release")

Dear Secretary Countryman:

General American Investors Company, Inc. ("General American") is pleased to comment on the fund-of-funds rules proposed in the Commission's Release.

General American applauds the Commission's stated commitment to protecting acquired funds and their shareholders from the pyramiding of control.[1] As a SEC registered closed-end fund, General American is keenly attuned to the harms that can befall closed-end funds and their shareholders when they are exposed to the unduly strong influence of acquiring funds. As such, General American strongly endorses the Commission's decision not to allow private funds to invest in acquired funds in excess of the limits of section 12(d)(1)(A)(i) of the Investment Company Act (the "Act") in reliance on the Proposed Rule.[2] We note, however, that the Proposed Rule would allow advisers to continue to sidestep the 3% investment limitation of

[1] *See* Release, at 9 (noting that Congress enacted the restrictions in section 12(d)(1)(A) of the Investment Company Act because of concerns that "investors in the acquiring fund could control the assets of the acquired fund and use those assets to enrich themselves at the expenses of acquired fund shareholders."), 13 ("We believe that the proposed rule would … protect[] [investors] from the historical abuses described above.").

[2] *See* Release, at 18-20 (noting that private funds are not subject to the proposed reporting requirements on Form N-CEN, the requirements of Form N-Port, or the recordkeeping requirements of the Investment Company Act and that, as such, there may not be "an adequate basis for monitoring compliance with the proposed rule's conditions").

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section 12(d)(1)(A)(i) by structuring their investment in closed-end funds through multiple acquiring funds, and would leave closed-end funds vulnerable to the continued exercise of undue influence by acquiring private funds. We therefore request that the Commission gauge compliance with section 12(d)(1)(A)(i) by employing an aggregation test, pursuant to which funds advised by the same adviser cannot in the aggregate hold in excess of 3% of the outstanding voting securities of a given acquired fund.

Section 12(d)(1)(A) features several critical layers of protection for acquired funds against the encroachment of registered acquiring funds. A registered fund (and companies it controls, including funds) may not acquire more than 3% of another fund's outstanding voting securities, invest more than 5% of its total assets in any fund, or invest more than 10% of its total assets in funds.[3] The purpose of these limitations is to prevent pyramiding of control and the exercise of undue influence.[4]

Section 12(d)(1)(C) buttresses these safeguards by prohibiting any investment company from acquiring securities issued by a closed-end fund when, as a result of such transaction, the acquiring company (together with companies it controls, other investment companies advised by the same investment adviser, and companies that such companies control) owns more than 10% of the outstanding voting shares of the closed-end fund.[5] In tandem, these mechanisms reflect Congress's concern that acquiring funds could utilize their voting power over acquired funds to dominate such funds' decision-making, and that acquiring funds could wield their power to the detriment of acquired fund shareholders. Section 12(d)(1)(C) embodies the additional insight that

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[3] *See* Release at 8.

[4] *See supra*, note 1.

[5] Investment Company Act, Section 12(d)(1)(C).

a single adviser can exercise excessive control over an acquired fund while remaining technically complaint with Section 12(d)(1)(A) by structuring their investment in the acquired fund through multiple vehicles.

While Section 12(d)(1) features robust protections against registered acquiring funds, it is far less effective as against private acquiring funds. Private funds relying on section 3(c)(1) or 3(c)(7) are exempted from the definition of "investment company" and, while subject to the 3% investment limit, are not subject to the 5% or 10% limitations or to Section 12(d)(1)(C)'s aggregation test.[6] The protective impact of the 3% investment limit is severely diluted in the absence of the aggregation test: private fund managers can circumvent the 3% limit by creating multiple funds with substantially similar investment strategies, each of which invests up to the 3% limit in the same acquired fund. In one notable example, at the time that an investment management firm entered into a settlement agreement with Clough Global Equity Fund in 2017, it advised six entities that collectively owned 14.44% of the Clough fund.[7] The manager can then cause the private acquiring funds to act cooperatively to exercise voting control over the acquired fund, and can leverage its significant aggregate holdings to exert undue influence over the acquired fund.

This loophole allows a single manager to effect precisely the sorts of harms that the 3% limit was designed to prevent. In particular, private fund managers can harm shareholders of closed-end funds through a discount arbitrage strategy. The majority of closed-end funds trade at

[6] *See* Investment Company Act Amendment of 1996, Sec. 208(a), Pub. L. 104-290, 110 Stat. 3416.

[7] *See* Schedule 13D/A filed by Saba Capital Management, L.P., dated July 11, 2017 (attaching Standstill Agreement).

a discount to net asset value ("NAV"). [8] Private funds employing a discount arbitrage strategy acquire a position in a closed-end fund whose shares trade at a discount to NAV, and then attempt to force a one-time liquidation event at or near NAV, such as a large-scale tender offer, liquidation, or open-ending, so that they can recover the discount. In the absence of a meaningful investment limit, private managers can amass a sufficiently sizable aggregate position in closed-end funds to pressure the board of directors into acceding to their demand for a liquidation event, even when doing so detrimentally affects the closed-end fund's shareholders.

Premature liquidation events can deprive long-term shareholders of the continued benefits of the closed-end fund's investment strategy: forced liquidations cause shareholders to terminate their investment and potentially be forced to recognize an untimely tax liability; large tender offers can drastically diminish a fund's size, scale, and flexibility; tender offers can force untimely sales of securities, resulting in lost opportunities or earnings; and forced liquidations necessitate substantial shifts in, or limit, a fund's investment activities. Large tender offers can also deplete a fund's resources and increase its expense ratio. Further, extraordinary liquidation events may involve significant legal and transactional costs, which are generally borne by shareholders. We therefore express our grave concern that, without more robust checks against private acquiring funds exercising undue influence over closed-end funds, the Commission's laudable policy commitments will remain unrealized.

To better protect closed-end funds and their shareholders against the overreach of private funds, General American suggests that the Commission apply section 12(d)(1)(A)(i) to reflect an aggregation test: in calculating the compliance of a given fund (and the companies it controls)

[8] As of March 31, 2019, 83% of listed closed-end funds (excluding business development companies) traded at a discount to NAV, with a median discount of 8.53% to NAV. *See* Lipper Fund*Market* Insight Report (March 31, 2019).

with the 3% limit, the holdings of other funds advised by the same adviser (and the companies that such funds control) should be taken into account. The Commission enjoys statutory authorization to enforce sections 12(d)(1)(A)(i) and 48(a) of the Act. Section 48(a) makes it unlawful for any person to commit unlawful actions by performing those acts indirectly through another person. The Commission staff has previously taken the position that "Section 48(a) of the Act gives the Commission the authority to look through a transaction ... if it is a sham or conduit formed or operated for no purpose other than circumventing the requirements of Section 3(c)(1) or any other provision of the Act."[9] In this light, the Commission could establish the position that private fund advisors violate section 48(a) when they utilize separate funds to invest in closed-end funds in excess of the 3% limit.

As such, we request that the Commission announce in the adopting release that, in reliance in section 48(a), it plans to assess a given private fund's compliance with section 12(d)(1)(A)(i) by looking through to such fund's actual capacity for exercising voting control, as well as indirect forms of influence, over an acquired closed-end fund. The Commission should do so by considering the aggregate holdings of the acquiring private fund (together with the companies it controls) and companies advised by the same adviser (and companies that they control): for the acquiring fund to comply with section 12(d)(1)(A)(i), such aggregate holdings cannot exceed 3% of the outstanding voting securities of the acquired fund. Alternatively, the Commission could provide in the final rule that the holdings of "investment compan[ies]" (including private and non-U.S. funds exempted from the definition of "investment company"

[9] *Cornish & Carey Commercial, Inc.*, SEC Staff No-Action Letter (June 21, 1996), at 2 (internal quotations omitted). For instance, "for purposes of counting beneficial owners, the staff will require integration of ostensibly separate 3(c)(1) Entities if it appears that the separate offerings do not present investors with materially different investment opportunities." *Id.* (internal quotations omitted).

under section 3(c)(1) or 3(c)(7) of the Act) under common control will be aggregated for the purposes of the 3% test of section 12(d)(1)(A)(i). This bright-line rule would eliminate the need for case-by-case inquiry into the economic substance of a private fund's holdings in acquired closed-end funds.

We again thank the Commission for the opportunity to provide comment on the Release. We would be pleased to provide further information or to answer any questions at the convenience of the Commission's staff.

Sincerely,

Jeffrey W. Priest
President & Chief Executive Officer