J.P.Morgan
Asset Management

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May 2, 2019

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

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

Dear Ms. Countryman:

J.P. Morgan Asset Management ("JPMAM")[1] appreciates the opportunity to provide comments on the Securities and Exchange Commission's (the "SEC" or the "Commission") proposal to streamline and enhance the regulatory framework applicable to funds that invest in other funds.[2]

JPMAM currently offers a significant number of mutual funds organized as "funds of funds." Notably, our SmartRetirement® series of target date funds[3], which invests primarily in other funds advised by JPMAM, has over $54B in assets under management (AUM) across 20 funds as of March 31, making it the 5th largest target date mutual fund complex in the industry.[4] All 8 vintages with a ten-year track record are ranked in the top quintile over a trailing 10 year period, and have a Morningstar gold rating. JPMAM is one of only three target date providers to have earned a gold rating, and the SmartRetirement strategies are the only active and active/passive blend target date funds with such a rating.[5]

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[1] J.P. Morgan Asset Management is a marketing name for the asset management subsidiaries of JPMorgan and its affiliates worldwide. All of the JPMAM funds referenced in this letter are managed by J.P. Morgan Investment Management Inc.

[2] Fund of Funds Arrangements, Proposed Rule, Release Nos. 33-10590, IC-33329 (Dec. 19, 2018), 84 Fed. Reg. 1286 (Feb. 1, 2019) (the "Release").

[3] Target date funds pursue a long-term investment strategy, using a mix of asset classes that the fund provider adjusts to become more conservative over time. *See* Investment Company Institute, Frequently Asked Questions About Target Date or Lifecycle Funds, *available at* https://www.ici.org/pubs/faqs/ci.faqs_target_date.print.

[4] SmartRetirement strategies are also offered in a collective investment trust format, with approximately $36B AUM.

[5] Performance as of March 31, 2019. Morningstar. Analyst rating as of January 30, 2019 applies to the actively-managed JPMorgan SmartRetirement Funds and the active/passive blend JPMorgan SmartRetirement Blend Funds. Percentile

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In addition to the SmartRetirement series, JPMAM manages over $13B AUM in other types of funds of funds that could be impacted by the proposed rule.[6] And, funds of funds advised by other asset managers invest in excess of $2B in mutual funds advised by JPMAM.

We agree with many of the comments on the proposal provided by the Investment Company Institute (ICI), including with respect to eliminating the proposed redemption restriction; support for other proposed conditions to the rule with some modifications; additional exceptions for the restrictions on multi-tier arrangements; the scope of the rule; the need for clarification regarding the rescission of exemptive and no-action relief for fund of funds arrangements; and acquired fund fees and expenses.[7] We write specifically to: illustrate in more detail the substantial negative impact of the proposed redemption restrictions from the perspective of JPMAM's SmartRetirement funds; describe the protections we currently have in place to address large redemptions from all investors, not just funds of funds; suggest that the restrictions are unnecessary, particularly with respect to holdings in mutual funds within the same group of investment companies; and, propose less disruptive alternatives that we believe would achieve the Commission's policy objectives.

While our letter focuses primarily on our funds of funds, we would observe at the outset that there are many other large investors not covered by the proposed rule that could theoretically exercise the influence over acquired funds that concerns the Commission, as described in the Release. These include large financial intermediaries, managed portfolios, and institutional investors. Our existing practices, described in Section III, address the Commission's concerns with respect to all such larger investors. Even if the Commission were to adopt the rule as proposed, advisers to funds that serve such investors would still need practices to address similar conduct from non-fund investors.

I. Background: Target-date funds, their use in the market, and the SmartRetirement Funds

While the fund of funds structure can be used for a range of investment products, by far the most notable, and one of the most important to individual investors, is the target date fund. Target date funds pursue a long-term investment strategy, using a mix of asset classes that the fund provider adjusts to become more conservative over time. This periodic de-risking to achieve the appropriate asset allocation over time makes target-date funds an efficient and cost-effective vehicle for

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ranks provided for R6 share class of each fund as of March 31, 2019. For additional information and disclosures, *see* https://am.jpmorgan.com/us/en/asset-management/gim/adv/products/fund-explorer/smart-retirement.

[6] While the concerns articulated in this letter are shared by these funds, the proposed rule is likely to be significantly more problematic for the SmartRetirement funds, in part because periodic risk adjustments may necessitate large transactions that are more likely to be impacted by the three percent redemption restriction.

[7] *See* Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission, dated April 30, 2019.

individuals saving for retirement. They are a popular option for 401(k) plans and other retirement savings vehicles.

As of year-end 2017, target date strategies (including both mutual funds and collective investment trusts) held approximately $1.4T in assets, equating to over a quarter of 401(k) assets.[8] A 2017 JPMAM survey of retirement plan sponsors indicates that a majority of plans included target date funds in their investment lineups; indeed, 78 percent of responding sponsors with qualified default investment alternatives (QDIAs) designated target date funds as their default investment.[9] Target date funds are also commonly used in individual retirement accounts (IRAs).

JPMAM's SmartRetirement target date funds are structured as mutual funds that invest primarily in other mutual funds and exchange-traded funds (ETFs). JPMAM offers two options for implementing the target date "glide path."[10] The Active series invests its assets primarily in JPMAM's actively managed mutual funds. The Blend series offers the same level of asset allocation and diversification, but employs passive vehicles (JPMAM funds, or third-party market cap weighted index ETFs when a JPMAM fund is not available) in certain asset classes – generally those that are widely regarded as having efficient markets – to provide a similar glide path at a lower fee.

The SmartRetirement investment process incorporates three critical pillars: strategic asset allocation, fund selection, and tactical asset allocation. The strategic component is implemented through the construction of an asset allocation glide path. We continually monitor our strategic asset allocation and related inputs. We renew our capital markets assumptions annually and our participant behavior research every two to three years, and incorporate changes into our glide path design when warranted by changes in participant behavior, capital markets, or the regulatory environment. In addition to these episodic changes, each of the funds "rolls down" the glide path, or de-risks (*e.g.,* out of equity and into fixed income), on an annual basis. Historically, we have rolled down through a series of trades over a few weeks between November and January, during which time we execute a number of sizeable trades in acquired funds.

[8] *See* The Cerulli Report – US Defined Contribution Distribution 2018. Of these assets, approximately $1.1T are held in mutual funds (*see* Morningstar, 2018 Target-Date Fund Landscape), although collective investment trusts are growing in size and share. *See infra* note 14.

[9] J.P. Morgan Plan Sponsor Research, 2017, *available at* https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/plan-sponsor-research-findings. The survey did not distinguish between funds structured as mutual funds and those structured as collective investment trusts (CITs). *See also infra* note 14.

[10] A "glide path" is the asset allocation path a target date fund follows to become more conservative over time. *See* Investment Company Institute, Frequently Asked Questions About Target Date or Lifecycle Funds, *available at* https://www.ici.org/pubs/faqs/ci.faqs_target_date.print.

As to fund selection, we select underlying funds in each asset class that the portfolio managers believe will outperform their benchmarks[11] (or, for the Blend series, a combination of actively managed and passive funds). SmartRetirement funds typically invest in between 10 and 25 underlying JPMAM funds, with a current median of 18. The investment team uses quantitative and qualitative methods to analyze the underlying managers, understand their unique styles, and balance exposures within the SmartRetirement portfolios across a variety of factors to maximize an appropriate level of risk-adjusted return.

Finally, our tactical allocation pillar incorporates short and intermediate term market views, such as reactions to significant market movements, to temporarily adjust the asset allocation of our portfolios, using mutual funds, ETFs, and direct investments, including derivatives such as futures. This allows us to react to significant market movements in order to rebalance or maintain overweight or underweight positions in certain asset classes.

SmartRetirement funds rely on these three pillars in an effort to deliver consistent excess returns, net of fees, over their internal customized benchmarks, which are developed based on their glide paths. We generally expect the majority of the excess return to come from fund selection, and the balance from our use of tactical allocation shifts. As discussed in more detail below, the proposed redemption restriction threatens our ability to continue with these alpha-generating pillars, and creates challenges for orderly roll-downs consistent with our funds' glide paths.

II. The proposed redemption restrictions would have a substantial negative impact on JPMAM SmartRetirement funds

The proposed rule would prohibit an acquiring fund from redeeming more than three percent of an acquired fund's total outstanding shares in any 30-day period. The Release explains that this limitation is intended to address concerns that an acquiring fund could influence or control an acquired fund using the threat of large-scale redemptions.[12] Implicit in these concerns, although not directly expressed in the Release, is the notion that redemptions exceeding three percent of an acquired fund could harm investors in such a fund.

As explained in more detail below, the proposed limitation would be extremely problematic for our SmartRetirement funds, and would not be in the best interests of their shareholders; it could also harm shareholders of the funds in which SmartRetirement funds invest. While a range of options for complying with the rule may be possible, such as increasing the number of acquired funds,

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[11] *See*, *e.g.*, J.P. Morgan SmartRetirement Funds Prospectus dated Nov. 1, 2018, at p. 81 (*available at* https://am.jpmorgan.com/JPMorgan/TADF/46641u739/SP?site=JPMorgan) (explaining that the funds' investment policy includes selecting "asset classes and underlying funds that the Adviser believes will outperform the Fund's benchmarks"). This language is also used in each vintage's summary prospectus in the discussion of the fund's main investment strategies.

[12] *See* Release at 47.

investing primarily in ETFs, or restructuring our funds, we do not believe any of them would better serve our clients' interests than our current structure. Indeed, given the challenges of managing target date funds under the proposed limitations, we would expect registered funds to lose market share to other structures that would not be subject to the rule, such as managed portfolio offerings with wrap fees for individual investors[13] and collective investment trusts for use on 401(k) platforms.[14]

a. The three percent redemption restriction would be extremely problematic for SmartRetirement Funds, and not in the best interests of shareholders

SmartRetirement funds frequently hold in excess of three percent of acquired JPMAM mutual funds. At the five recent quarter ends through December 31, 2018, 15 (of 20) SmartRetirement funds held in excess of three percent of at least one acquired fund. Of those 15 funds, more than half held in excess of three percent of 10 or more acquired funds. And of those holdings that were greater than three percent, the average holding size was 7.5 percent of an acquired fund.

As discussed above, annual roll-downs according to the SmartRetirement funds' glide paths may result in substantial redemptions from acquired funds. In addition, SmartRetirement fund portfolio managers select, review, and modify holdings of acquired funds to achieve the best outcomes for their investors, which may include redeeming out of certain funds completely when a better opportunity is available. Finally, the SmartRetirement funds' tactical asset allocation strategy may require flexibility to redeem certain investments to take advantage of others. Limiting portfolio managers' ability to execute these strategies in a timely manner substantially disrupts their ability to achieve the best outcomes for investors. Over the past 3 years, the SmartRetirement Funds have redeemed in excess of three percent of an acquired fund's shares within a 30 day period more than 100 times.

In addition to disrupting portfolio managers' ability to efficiently execute the SmartRetirement funds' investment strategy, we believe the three percent limit could pose additional risks to shareholders. Requiring acquiring funds to redeem large positions slowly over time could place SmartRetirement shareholders at a substantial disadvantage to other shareholders in the acquired funds that are not subject to the same restrictions, including direct investors as well as those using managed portfolios. For example, in the event of an idiosyncratic (*e.g.,* personnel or reputational) or

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13 Under this option, an adviser selects a group of funds for the investor or offers a predetermined selection. When used in lieu of a target-date fund, the adviser would rebalance the portfolio to reduce risk as the client ages. Compared to funds of funds, this approach incorporates an added layer of fees, less tax efficiency, and more complexity.

14 Due in large part to fee sensitivity, 401(k) plans have been increasingly adopting CITs over mutual funds, particularly in target date strategies. Between 2015 and 2017, CITs' share of total target date assets grew from 32 percent to 37 percent. *See* The Cerulli Report – US Defined Contribution Distribution 2018 at 83. JPMAM has observed a similar shift, with many clients moving from our mutual funds to CITs. We expect that, if adopted as proposed, the Fund of Funds rule could accelerate that shift.

asset class (*e.g.,* market disruption) event, other shareholders could exit at will, leaving the SmartRetirement funds with an increasing share of the depleted acquired fund even as they try to exit, and prolonging the time necessary for the acquiring fund to redeem its position. Requiring a drawn-out exit from an acquired fund could also create the risk of front-running, as the market could easily observe a fund of funds redeeming three percent every thirty days and ascertain that it is liquidating its position.

Finally, as noted in comment letters by the ICI and AMG, the proposed three percent redemption restriction could have implications for a fund's liquidity profile under recently adopted Rule 22e-4 and related filings.[15] Specifically, holdings that exceed three percent of an acquired fund would presumably need to be classified as illiquid, altering the liquidity profile of the acquiring fund as reported to the SEC on Form N-PORT. A fund of funds that holds a large percentage of its assets in such holdings could also potentially exceed the fifteen percent limit on illiquid assets under that rule.[16] We believe it is counterintuitive that a security widely touted as having daily redeemability at its current net asset value should be classified as illiquid, barring highly unusual circumstances (*e.g.*, a temporary market disruption in the underlying asset class).[17]

For all of these reasons, we disagree with the SEC's assertion that the proposed redemption limit would not have a large effect on funds.[18]

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[15] *See supra* note 7.

[16] Our preliminary experience with Rule 22e-4 classifications suggests that this would be most likely to occur during roll downs. Under Rule 22e-4, a fund must classify each holding according to a liquidity assessment of the amount of the holding the fund would reasonably anticipate trading (RATS). RATS assessments take into account factors such as historical fund flow patterns and market conditions. RATS for SmartRetirement funds are currently below ten percent, meaning that a SmartRetirement fund can classify an underlying fund based on the ability to sell less than ten percent of its holding in that fund. In the ordinary course, this is likely to result in most underlying funds being classified as highly liquid; however, during roll downs or other times that a SmartRetirement fund makes a large allocation shift equal to three percent of an underlying fund, the remainder of the position in that acquired fund would be considered illiquid for 30 days. A fund that was de-risking by reducing holdings in several underlying equity funds could find that all of its remaining holdings in those acquired equity funds were temporarily required to be classified as illiquid.

[17] *See, e.g.,* Open-End Fund Liquidity Risk Management Programs; swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Proposed Rule, Release Nos. 33-9922, IC-31835 (Sept. 22, 2015) ("Daily redeemability is a defining feature of open-end management investment companies ('open-end funds' or 'funds) such as mutual funds.").

[18] *See* Release at n. 125 and accompanying text. We would note that the SEC's analysis underlying this belief, as described in n. 125, is flawed for several reasons, including 1) the assumption that changes in quarterly holdings occur evenly across the three months in each quarter (our own experience suggests that this assumption is invalid), and 2) the analysis took place during a period of stable and rising markets, during which tactical maneuvering was less critical and large outflows less likely. Additionally, while the scope of the analysis is not clear, it appears to capture all redemptions of underlying funds, not just those by funds of funds, which are likely to have larger holdings and therefore larger redemptions. In other words, the broad scope is likely to have diluted the results; funds of funds would be unduly impacted by the restriction. As noted above, the SmartRetirement funds alone have exceeded these limits over 100 times in the last 3 years.

b. Modifying portfolio management techniques to comply with the three percent redemption restriction is not in the best interest of shareholders

As part of our analysis of the proposed rule, we considered ways to avoid or minimize the impact of the three percent redemption restriction, including investing in a larger number of funds so we that hold smaller proportions of each acquired fund, or relying more on ETFs (which are not subject to the redemption restrictions if transacted on the secondary market[19]). We do not believe either of these options are in the best interests of shareholders.

As explained above, fund selection is one of the critical features of the SmartRetirement investment process. We regularly evaluate approximately 150 of JPMAM's global strategies to select between 10 and 25 funds that we believe will provide the appropriate strategic asset allocation while outperforming their benchmarks and delivering risk-adjusted alpha. Expanding the universe of acquired funds simply in order to hold less than three percent of each could substantially diminish our ability to deliver excess return through fund selection.[20]

Similarly, we do not believe shifting SmartRetirement assets from actively managed mutual funds into ETFs to avoid the redemption restriction is a good option. SmartRetirement funds are already permitted to invest a portion of their assets in ETFs. However, many of the active strategies that SmartRetirement invests in are not available as ETFs; thus, shifting to ETFs specifically to avoid the three percent redemption restriction would also run counter to the funds' strategy of picking the best investments. In addition, managing large amounts of assets using ETFs adds additional complexities, including managing the costs and challenges associated with transacting in the secondary markets. Finally, some of the notable benefits of investing in ETFs, such as tax and transaction cost efficiencies, are muted when primary market, in-kind transactions are prohibited.[21]

c. Restructuring the funds to remain outside the scope of the proposed rule is not in the best interest of shareholders

We also considered two possibilities to remain outside the scope of the proposed rule. First, we evaluated limiting our investments to funds within the same group of investment companies,

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[19] *See* Release at note 124 and accompanying text.

[20] Expanding the universe of funds SmartRetirement invests in order to reduce the need to hold in excess of three percent of any underlying fund may also run counter to JPMAM's long-term business strategy of focusing our resources where we believe we have an advantage, which has included closing funds that are underperforming or out of favor. *See, e.g.,* Nicole Piper, "JPM cuts funds, fees and roles in growth push," *Citywire*, February 26, 2019, *available at* https://citywireusa.com/professional-buyer/news/jpm-cuts-funds-fees-and-roles-in-growth-push/a1204722.

[21] With respect to ETFs and principal transactions directly between an acquiring fund and an acquired affiliated ETF, we support exemptions from Section 17 of the Investment Company Act of 1940 that would permit an acquiring fund to purchase and sell ETF shares in creation units in-kind through an authorized participant (*see* Release at note 71 and accompanying text, noting that such exemptions were proposed as part of the Commission's 2008 ETF rule proposal).

government securities, and short-term paper, a structure protected by Section 12(d)(1)(G) of the Investment Company Act of 1940. This option is not practicable, however, because, as described above, the SmartRetirement funds use tactical allocations to take advantage of short to intermediate term opportunities using direct investments and derivatives.[22] Giving up this flexibility would present a substantial and undesirable impediment to the execution of our investment strategy.

For example, the portfolio management team may implement a temporary strategy of enhancing equity exposure by buying index futures, which are inexpensive, highly liquid, and incur low transaction costs.[23] Obtaining this temporary exposure using only mutual funds would require selling holdings in another asset class and adding to one or more equity funds, and then reversing the allocation when the tactical opportunity has run its course. This approach would be inefficient in terms of both time to execute and overall cost, and could also subject shareholders in the acquired funds to mutualized transaction costs and associated impacts – the very impacts the proposed rule seeks to minimize.

Another way to remain outside the scope of the proposed rule would be to convert SmartRetirement funds into funds comprised of a series of separate accounts, rather than underlying funds; each of the separate accounts or "sleeves" would invest in individual securities in a particular asset class, and would likely be managed by the JPMAM asset class specialists that also manage the mutual funds. In fact, JPMAM analyzed this option in detail several years ago as part of a strategic review of its funds of funds, and opted not to execute upon it, for several reasons.

First, a fund of sleeves structure would incorporate substantial operational complexity: instead of the target date funds investing in a subset of the same group of 25 funds, each would require its own sleeve of a model portfolio. If each of our 20 funds invested in 18 sleeves (the median number of funds currently acquired), this would result in 450 individual sleeves. We estimated that this approach would require several full time portfolio managers and related support and control staff to manage this structure. From an investor perspective, such a structure could also be far more complex to understand, particularly as the strategy executed its glide path and began shifting asset allocations.[24]

Moving to sleeves would also reduce portfolio management efficiencies (*i.e.,* tax and transaction cost). Under the fund of funds structure, new inflows into one SmartRetirement fund (*e.g.,* contributions through 401(k) plans) that flow through to acquired funds can offset redemptions in the acquired funds caused by rebalancing or other redemptions from another SmartRetirement fund;

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[22] *See* J.P. Morgan SmartRetirement Funds Prospectus, *supra* note 11, at 80.

[23] Like many other mutual funds, SmartRetirement funds also use derivatives to equitize cash.

[24] A fund of sleeves would hold thousands of individual securities, rather than 10 to 25 funds, making portfolio holdings disclosures far more complicated.

if each fund were comprised of individual sleeves, these efficiencies would be eliminated. For example, imagine that the glide path indicates that SmartRetirement 2040 fund should reduce its equity exposure, necessitating a $20M redemption from a U.S. equity fund. At the same time, weekly inflows into the 2045, 2050, 2055 and 2060 funds would result in an aggregate $10M allocation to the same fund. Under the fund of funds structure, the U.S. equity fund would experience a net redemption of $10M. However, if each fund had separate sleeves, the 2040 fund would trigger $20M in sales of the US equity fund, while each of the 2045, 2050, 2055 and 2060 funds would collectively purchase $10M of equities; the shareholders in the funds would bear these transaction costs and, for the 2040 fund, any capital gains associated with the sales.

Finally, we estimated the conversion would require technology improvements, as well as shareholder and board approval, which together would result in a material one-time expenditure, in addition to the ongoing costs of new staff described above. At the time, we did not believe this structure offered sufficient benefits to warrant the cost, which would ultimately be borne by shareholders.[25]

d. The proposed rule could negatively impact shareholders in acquired funds

While the options considered above focus on the potential impacts to SmartRetirement investors, it should be noted that the current structure also provides benefit to investors in the funds in which SmartRetirement funds invest. Most notably, the inclusion of SmartRetirement assets in acquired JPMAM funds provides scale, which dilutes transaction costs and offers efficiencies in portfolio management, and can result in lower overall fees.[26] Most of the options we have considered to address the three percent redemption restriction would cause the SmartRetirement funds to substantially reduce allocations to acquired funds, diminishing the benefits of scale and imposing substantial one-time transaction costs associated with the redemptions.

Moreover, JPMAM has practices in place to protect the acquired funds and their shareholders from potential harm that could be caused by large redemptions from SmartRetirement and other large investors.

III. JPMAM has practices in place to address potential harm to both the acquiring and acquired funds from large redemptions

JPMAM has a number of practices in place to address potential harm that could be caused by large redemptions. These effects can accrue to both the acquiring fund (or other investor) and acquired funds – careful execution of redemptions benefits all shareholders. While this letter focuses on

[25] As part of this initiative, we also considered opening mutual funds for the exclusive use of JPMAM funds of funds. While the cost of this approach was lower than a conversion to funds of sleeves, we determined that the costs outweighed the benefits.

[26] For example, for certain JPMAM funds, administration fees decline on a percentage basis as a fund's AUM increases.

activity by the SmartRetirement funds, it is important to note that the acquired JPMAM funds request and typically receive similar treatment from all large investors, including those that are not themselves funds (*e.g.,* institutional investors), whether affiliated or not. In our experience large investors, including financial intermediaries, managed portfolios, and institutional investors, are amenable to procedures designed to facilitate careful redemptions, as they understand it is typically in their interest as well as the interests of remaining shareholders including, frequently, their other clients.

First, as a matter of course, SmartRetirement funds (and other JPMAM-managed funds of funds) generally provide advance notice of impending transactions (purchases or redemptions[27]) to the acquired funds' portfolio management and administration teams. Strategic allocation changes are generally known well in advance (30 days or more); tactical changes that could result in large trades are generally communicated as soon as known; and monthly rebalancing (to maintain intended exposures) are generally communicated several days in advance.

In addition to these courtesy notifications, more formal procedures exist for large trades in JPMAM funds. All trades over pre-defined dollar thresholds, which are set individually for each fund, are immediately escalated to the portfolio management, fund administration, and independent risk teams. Further, all flows exceeding five percent of a fund are analyzed by a cross-functional working group generally comprised of portfolio management, funds administration, independent risk, compliance and operation. This working group reviews the size of the flow, the fund(s) involved and other relevant information. Based on the facts and circumstances (including, for example, liquidity and market conditions for the underlying securities), and in accordance with defined scenarios in the JPMAM "Liquidity Playbook" the group will determine the most appropriate method to handle the flow. For example, an investor may be asked to spread out large trades (purchases or redemptions) over several days or weeks to minimize the impact to the acquired fund, or, where possible, to accept a redemption in kind.[28]

Finally, JPMAM's internal liquidity risk management framework incorporates consideration of investor concentration. The framework regularly measures the percentage of each fund held by the largest investors, including funds of funds, relative to the liquidity of the portfolio, to ensure the funds can meet redemptions even if a large investor leaves the fund. Portfolio managers are also permitted to refuse additional subscriptions if they are concerned about investor concentration. This framework is intended to protect investors with respect to concentration risk from all types of

[27] While the Commission is understandably focused on redemptions, which unlike purchases cannot be refused, large purchases can also negatively impact the underlying fund, especially if the inflow cannot be invested quickly and creates a cash drag on the portfolio.

[28] We also request advance notification from unaffiliated investors that have large holdings in our funds (*e.g.,* investment advisers or brokerage platforms); although we cannot require such notice, our investors typically agree to provide it.

investors, affiliated or not, including individuals, platforms, and managed portfolios – not just funds of funds.[29]

IV. The three percent redemption restriction is unnecessary, particularly for affiliated funds of funds; possible alternatives

The Release explains that the three percent redemption restriction is intended to address concerns that an acquiring fund could influence or control an acquired fund using the threat of large-scale redemptions.[30] We believe that the redemption restriction is unnecessary, because the procedures described above adequately protect JPMAM funds from the risk of outsized redemptions, or influence gained through the threat of such redemptions, by large investors, funds or otherwise, and whether affiliated or not. We do not believe the Commission has adequately articulated sufficient concerns to warrant the negative impacts of the proposed redemption restrictions.

This is especially true with respect to funds investing in other funds within the same group of investment companies. The Release observes that, "[i]n circumstances where the acquiring fund and acquired fund share the same adviser, the adviser would owe a fiduciary duty to both funds, serving to protect the best interests of each fund."[31] It goes on to state that, in arrangements where funds are "advised by advisers that are control affiliates, we do not believe that the acquiring fund adviser generally would seek to benefit the acquiring fund at the expense of the acquired fund (nor do we believe that the acquiring fund would seek to influence the acquired fund through its ownership interest in the acquired fund)."[32]

We agree with these assessments, as did Congress when it enacted Section 12(d)(1)(G) of the Investment Company Act of 1940 in 1996, and as the Commission did in 2006 when it adopted Rule 12d1-2, allowing funds permitted under Section 12(d)(1)(G) to also invest in securities and a limited amount of unaffiliated funds.[33] Indeed, it is not at all clear from the Release why the Commission is

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[29] As discussed in more detail in the ICI's comment letter, the SEC's recently adopted liquidity risk management rule (Rule 22e-4) is similarly designed to address funds' ability to meet reasonably anticipated outflows while minimizing harm to existing shareholders. *See* Letter from Paul Schott Stevens, *supra* note 7.

[30] *See supra* note 12.

[31] Release at 41 (describing rationale for excepting affiliated funds of funds from the control and voting provisions); *see also* Release at 54 (requesting comment on whether certain types affiliated funds of funds should be exempt from the redemption restrictions for the same reasons).

[32] Release at 39. The release explains that "the definition of 'affiliated person' includes any person directly or indirectly controlling, controlled by, or under common control with, such other person," (Release at n.101), but notes that the determination of whether advisers are control affiliates depends on facts and circumstances.

[33] The adopting release for Rule 12d1-2 cited exemptive orders and commenters to support the idea that "these investments would allow an acquiring fund greater flexibility in meeting investment objectives that may not be met as well by investments in other funds in the same fund group, while not presenting any additional concerns that section 12(d)(1)(G) was intended to address." We note that the same holds true today; it would be an unfortunate and irrational

proposing to impose redemption restrictions on funds within the same group of investment companies, which presents a challenge for commenters trying to offer constructive solutions. We urge the Commission to more clearly articulate its concerns with these structures so that alternatives can be considered.

One possible interpretation of the language in the Release suggests that while the Commission is confident that funds are protected where the acquired and acquiring fund share the same adviser, it is less convinced with respect to certain control affiliates. Specifically, "we do not believe that the acquiring fund adviser *generally* would seek to benefit the acquiring fund at the expense of the acquired fund" (emphasis added) could be read to suggest lack of certainty in these cases.

As a preliminary matter, we wholly agree that where funds share a common adviser, the interests of both funds are protected. At a minimum, these arrangements should be excepted from the redemption restriction.[34] As to control affiliates, for purposes of exemption from the control and voting provisions, the proposed rule imposes the further condition that they hold themselves out as related companies.[35] If there are specific instances in which the Commission believes that the protections provided by this condition are insufficient to adequately protect the interests of an acquired fund with respect to redemptions, the Commission could articulate additional conditions for related acquiring funds to qualify for an exemption from the redemption restriction.

For example, where the acquiring and acquired funds are control affiliates and share a common board, it seems clear that the board would provide oversight of both advisers and protect the interests of both funds, similar to when funds share an adviser. A shared Chief Compliance Officer or other common officers could accomplish a similar goal, as could shared policies and procedures relating to investments in related funds, which could set out conditions relating to the investment (*e.g.*, required advance notice of redemptions, where practicable). The SEC could consider these or criteria that would provide assurances of protecting the interests of acquired funds, and exempt control affiliates from the redemption restrictions where such protections are in place.

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outcome if funds that primarily invest in other funds within the same group of investment companies stopped investing in other instruments in order to stay outside the scope of the proposed rule. *See supra* Sec. II.c.

[34] Currently, JPMAM's funds of funds predominantly fall into this category, although a small number may invest in unaffiliated funds in excess of the three percent limit; JPMAM funds are also acquired by unaffiliated funds. *See supra* note 6 and accompanying text. Additionally, while not our preferred option, we would observe that at a minimum, funds investing in mutual funds created for the exclusive use of funds of funds managed by the same adviser should be exempted from the redemption restriction, as there would be no direct investors in the acquired funds that could be harmed by actions of the acquiring funds. *See supra* note 25.

[35] Proposed rule 12d1-4(d). More specifically, the proposed rule would define "group of investment companies," for purposes of the exemption, to include those that "hold themselves out as related companies for investment and investor services."

Finally, should the Commission be uncomfortable exempting affiliated funds of funds (however it defines them) entirely, it could require such funds to maintain policies and procedures specifically designed to address the concerns underlying the proposed redemption restriction, consistent with Rule 38a-1 (*i.e.,* reviewed at least annually and addressed in an annual report to the board) as a condition to exemption from the redemption restriction. We believe such procedures are already implicitly required given the adviser's fiduciary duty to both acquiring and acquired funds, and therefore such a requirement is unnecessary and could add to the substantial burdens already placed on the board and chief compliance officer; however, the Commission may determine that expressly requiring policies and procedures to address the potential risks to acquired funds from undue influence would result in a more considered approach to procedures designed to limit such risks. Such policies might include pre-trade notifications for trades in excess of a specific size and, if appropriate, limitations on the overall share of an acquired fund that an acquiring fund may purchase.

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JPMAM appreciates the opportunity to comment on the Commission's proposed rule. We would be pleased to provide any further information or respond to any questions that the Commission or the staff may have.

Very truly yours,

/s/ Anne Lester

Anne Lester

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