



SUBMITTED ELECTRONICALLY

May 2, 2019
Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Fund of Funds Arrangements, Release No. 33-10590; IC-33329; File No. S7-27-18 (Dec. 19, 2018) (the “Proposing Release”).

Dear Ms. Countryman:

The American Investment Council (the “AIC”) is submitting this letter in response to Release No. 33-10590, in which the Securities and Exchange Commission (the “SEC” or the “Commission”) requested comment on proposed new rule 12d1-4 (the “Proposed Rule”) and related rule amendments under the Investment Company Act (the “Act”).¹ The AIC commends the SEC for seeking to create a consistent and streamlined regulatory framework for fund of funds arrangements.

The AIC is an advocacy, communications and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about the private equity and growth capital industry and its contributions to the U.S. and global economy. Established in 2007, and formerly known as the Private Equity Growth Capital Council, the AIC is based in Washington, D.C. The AIC’s members are the world’s leading private equity and growth capital firms, united by their commitment to growing and strengthening the businesses in which they invest. For further information about the AIC and its members, please visit our website at <http://www.investmentcouncil.org>.

Our comments are generally limited to one issue: the Proposing Release does not include private funds within the scope of an “acquiring fund.”² Thus, a private fund would not be permitted to acquire shares of a registered investment company in excess of the limits imposed by Section 12(d)(1) of the Act without obtaining an exemption from the SEC. The Commission’s rationale for excluding private funds appears to be that private funds are not subject to sufficient SEC oversight.

¹ Fund of Funds Arrangements, Rel. No. 33-10590; IC-33329; File No. S7-27-18 (Dec. 19, 2018) available [here](#).

² As used in the Proposing Release and in this letter, a private fund is an issuer that would be an investment company, as defined in Section 3 of the Act, but for Sections 3(c)(1) or 3(c)(7).

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As discussed in detail below, however, we believe that the SEC's concerns are misplaced and fail to recognize the robust regulatory framework that private funds and their managers are subject to under the Investment Advisers Act of 1940 (the "Advisers Act"). The AIC believes that private funds should be permitted to be acquiring funds under the Proposed Rule because (i) such inclusion would be consistent with the goals set forth in the Proposing Release; (ii) the historical basis for such exclusion is based on a more relaxed regulatory landscape in which private funds were subject to less, if any, SEC oversight; (iii) the Proposed Rule's conditions, if applied to private funds, would achieve the Commission's goals of investor protection and may be further refined to address additional concerns; and (iv) private funds are subject to a number of reporting and disclosure requirements which would allow the Commission to monitor compliance. We also respond to the Commission's request for comment concerning its approach to the disclosure of acquired fund fees and expenses.

I. It would be inconsistent with the Commission's goals to exclude private funds from the Proposed Rule's scope.

The Proposed Rule reflects the Commission's belief that "the universe of permissible fund of funds arrangements generally should not turn on the type of the funds in the arrangement." As such, the objectives of the Proposed Rule, as set forth in the Proposing Release, are to (i) create a consistent and efficient rules-based regime for fund of funds arrangements, eliminating unnecessary and potentially confusing distinctions among permissible investments for different types of acquiring funds; (ii) allow greater flexibility for acquiring funds to meet their investment objectives; and (iii) provide consistent treatment for various types of arrangements. We believe that it would be consistent with these goals for a private fund to be treated as an "acquiring fund."

First, the SEC has experience in allowing private funds to invest in money market funds, notwithstanding the limitations imposed by Section 12(d)(1). Specifically, Rule 12d1-1 currently allows private funds to invest in shares of registered money market funds in excess of the limits imposed by Section 12(d)(1). As far as we know, the SEC has not identified any abuses relating to private funds relying on Rule 12d1-1.

Additionally, private funds are no different than other types of institutional investors which are not subject to the investment limitations imposed by Section 12(d)(1).³ We see no reason why private funds should be singled out for special treatment under the Proposed Rule. Like other types of institutional investors, private funds may invest in other funds in order to pursue their investment objectives and strategies. For example, a private fund may desire to invest in one or more exchange-traded funds in order to access a cost-effective and liquid basis to pursue a private fund's hedging strategy or to otherwise obtain exposure to the equity markets. As such, removing obstacles to investing in other funds may facilitate private fund activities and benefit private fund investors.

³ Like private funds, certain of these institutional investors (such as insurance companies, banks, common trust funds and other pooled investment vehicles) would be investment companies but for Section 3(c) of the Act. As discussed below, we do not believe that Congress's decision in 1996 to treat private funds as investment companies for the limited purposes of Section 12(d)(1) should preclude the SEC from providing private funds with appropriate exemptive relief.

The Commission has previously cited the threat of redemptions as a reason to keep Section 12(d)(1) applicable to private funds (to the extent that a private fund is acquiring shares of a registered investment company).⁴ In practice, however, the AIC believes that the risk of redemptions is limited. For example, a private equity fund is typically organized as a closed-end fund that does not provide investors with an opportunity to redeem their interests in the fund. Thus, the concern that a private equity fund would need to redeem shares in an underlying registered investment company in order to meet its own redemptions simply does not apply. We believe that these concerns are also limited in the case of other types of private funds that may provide for periodic redemptions.

In any event, the Proposed Rule contains a redemption limitation that is designed to reduce the risks imposed by large scale redemptions by registered investment companies. While we believe that there may be other less intrusive means of achieving the objectives of the proposed redemption limitation, the proposed limitation does illustrate that the SEC has the tools for addressing these concerns. The proposed redemption condition, or another condition that achieves the Commission's objective, could be equally applicable to private funds. Thus, concerns over the risk of large-scale redemptions should not be an issue in extending the Proposed Rule to private funds.

II. It would be consistent with Congressional intent to allow private funds to be acquiring funds given the changed regulatory landscape.

As noted in the Proposing Release, in enacting NSMIA, Congress provided the SEC with the authority to exempt fund of funds arrangements if the exemption “is consistent with the public interest and the protection of investors.”⁵ In so doing, Congress urged the SEC to use its exemptive authority under Section 12(d)(1)(J) “in a progressive way as the fund of funds concept continues to evolve over time.” We believe changes in the regulatory landscape would be consistent with such goals such that private funds should be allowed to rely on the Proposed Rule.

In the past, and specifically in the Commission's 2008 rule proposal addressing fund of funds arrangements, private funds appear to have been excluded from the exemptive relief because of concerns relating to the ability of the SEC to oversee their operations and monitor

⁴ See, e.g., Division of Investment Management, Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulations* (May 1992) (noting that private issuers could “exert undue influence over registered funds, disrupting their portfolio management through the threat of redemption.”), available [here](#). Based on this recommendation, in the National Securities Markets Improvement Act of 1996 (“NSMIA”), Congress provided that an issuer relying on Section 3(c)(1) or Section 3(c)(7) would be deemed to be an investment company for purposes of Sections 12(d)(1)(A)(i) and 12(d)(1)(B)(i) of the Act.

⁵ Section 12(d)(1)(J).

their investments.⁶ The AIC believes that these concerns are no longer applicable given statutory and regulatory changes since 2008. In 2008, for example, investment advisers, including private fund managers, with fewer than 15 clients, were exempt from registration under the Advisers Act and were not subject to SEC examinations or reporting and recordkeeping requirements. Thus, at that time, it may have been reasonable for the SEC to conclude that it would not be in a position to monitor private fund compliance with the 2008 Proposal.

Since 2008, however, and specifically since the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), most private fund advisers are either registered investment advisers or exempt reporting advisers, subject to SEC oversight.⁷ This includes being subject to SEC examinations and requirements to keep books and records.⁸ Private funds are also now required to file detailed reports concerning their portfolio investments on Form PF. In addition, as part of the Dodd-Frank Act, Section 204(b) of the Advisers Act provides that the records of a private fund to which a registered investment adviser gives investment advice are deemed to be the records and reports of the investment adviser. Accordingly, since the 2008 Proposal, the SEC has acquired ample tools to monitor a private fund’s investments in registered investment companies. These are the very types of changes that warrant the SEC using its exemptive authority under Section 12(d)(1)(J) to extend the Proposed Rule to private funds.

III. Private funds would be able to comply with the Proposing Release’s tailored conditions just as well as other registered investment companies.

As noted above with respect to the Proposed Rule’s limitation on redemptions by acquiring funds, the Proposed Rule’s conditions addressing other issues associated with fund of funds arrangements would be equally applicable to private funds and protective of acquired funds.

First, the Proposed Rule’s limitations on control and voting could be made applicable to private funds. As a general matter, this would address the Commission’s investor protection objectives. The AIC believes, however, that these voting conditions should be modified to protect the interests of long-term investors in closed-end registered investment companies (“Closed-End Funds”) and business development companies (“BDCs”). These types of funds are often targets for activist investors who may seek to require acquired funds to take short-term actions that may not be consistent with the best interests of the acquired funds’ long-term investors. For example, activist acquiring fund investors may require a Closed-End Fund or BDC to “open-end,” thus limiting the ability of the acquired fund to invest in less liquid

⁶ Exchange-Traded Funds, SEC Rel. No. 33-8901; IC-28193, File No. S7-07-08 (May 11, 2008), available [here](#) (the “2008 Proposal”).

⁷ Pub. L. No. 111-203, 124 Stat. 1376 (2010). Specifically, Section 403 of the Dodd-Frank Act repealed the 15-client exemption under the Advisers Act.

⁸ See, e.g., Securities and Exchange Commission, Information for Newly-Registered Investment Advisers (Nov. 23, 2010), available [here](#).

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securities, contrary to its investment objectives. Pass-through voting in such instances would likely result in such votes being cast to reflect the interests of the activist acquiring fund investors as opposed to the interests of those acquired fund investors with longer-term investment horizons.

To protect the interests of an acquired BDC's longer-term investors, the AIC recommends that the Proposed Rule be revised to require mirror voting if the acquired fund is a BDC or Closed-End Fund. Under these circumstances, an acquiring fund could invest in a Closed-End Fund or BDC in order to gain the desired investment exposures without using its voting power in the acquired fund to pursue steps that could adversely affect the acquired fund's long-term investors. The AIC believes that mirror voting would be required in all instances where an acquiring fund relies on the Proposed Rule (*i.e.*, once the acquiring fund acquires more than 3% of an acquired fund's shares). In addition, the AIC supports an exception to the voting condition for certain acquiring funds that are managed by the investment adviser or sub-adviser of the Closed-End Fund or BDC. In circumstances where the acquiring private fund is managed by an affiliated investment adviser, it is unlikely that the investors in the acquiring fund would use their vote to pursue steps that are inconsistent with the long-term interests of investors in the acquired fund.

Alternatively, the Proposed Rule could provide a mechanism to allow Closed-End Funds or BDCs to screen prospective acquiring funds in order to limit the ability of activist funds to invest in excess of the limitations imposed by Section 12(d)(1). One means would be to require an acquiring fund to seek the affirmative consent of the applicable Closed-End Fund or BDC prior to acquiring its shares in reliance on the Proposed Rule. A Closed-End Fund or BDC could then screen prospective acquiring funds to prevent activists from investing in reliance of the Proposed Rule.

Second, the risk of duplicative fees is no greater for private funds and may in fact be less of a concern. Private fund managers are required to provide full and fair disclosures of the fees and expenses associated with investing in a private fund.⁹ More often than not, the information and disclosures provided to private fund investors go beyond what is required by the Commission to be reported in the Form ADV. The Commission has previously noted that these disclosures may be sufficiently protective of historical abuses to eliminate Section 12(d)(1)'s limitations.¹⁰ As discussed further below, however, the AIC believes that the Proposed Rule provides the Commission an opportunity to address the deficiencies of the disclosure requirements governing acquired fund fees and expenses ("AFFE").

⁹ *See, e.g.*, Form ADV, Part 2, Item 5 (Fees and Compensation). We also note that registered investment advisers are subject to the anti-fraud provisions of the Advisers Act, including Section 206 and Rule 206(4)-8 thereunder, providing an additional layer of investor protection.

¹⁰ *Supra* note 4 (citing conflict of interest provisions under the Act and advisers' fiduciary duties to clients as "important investor protections" that could be sufficiently protective if Section 12(d)(1)'s limitations were eliminated.).

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Third, the risk of overly complex structures is no greater for private funds than for other registered investment companies. In practice, investor confusion in fund of funds arrangements may be less likely to occur in the private fund context given the sophistication of investors. Finally, private fund managers are subject to Rule 206(4)-7 under the Advisers Act – the Compliance Rule. Thus, a private fund manager that relied on the Proposed Rule would be required to establish the necessary policies and procedures for achieving compliance with the Proposed Rule including maintaining appropriate records documenting compliance.¹¹

IV. The AIC does not believe that additional reporting and/or recordkeeping requirements are necessary for private funds to take advantage of the Proposing Release.

While private funds themselves are not registered with the Commission and do not file reports under Form N-CEN or N-PORT, as noted above, private fund sponsors are generally registered with the SEC as registered investment advisers and are subject to reporting requirements that the Commission may use to assess reliance with the Proposed Rule. The AIC believes that the current framework of registration and reporting provides an adequate framework for private funds to rely on the Proposed Rule and for the SEC to track compliance. Further, the AIC does not believe any additional reporting forms would be necessary, as both Form ADV and Form PF provide the Commission with information that may be used “in their regulatory programs, including examinations, investigations, and investor protection efforts relating to private fund advisers.”¹² For example, a registered investment adviser may disclose its expectation that a fund it manages will rely on the Proposed Rule in its Form ADV.¹³ The SEC could also rely on current forms of reporting for private fund managers to provide information with respect to their actual investments in reliance on the Proposed Rule. In particular, Item 26.A in Section 2a of Form PF requires large private fund advisers to report a fund’s investments in registered investment companies. Similarly, we note that Item 5.K of Part 1 of Form ADV requires advisers to disclose registered investment company and business development company investments by separate managed accounts. We would be happy to work with the SEC and its staff to explore additional private fund reporting that might address any additional concerns. Finally, as noted previously, private funds are experienced in establishing

¹¹ Section 204 and rule 204-2 of the Advisers Act (generally requiring investment advisers to maintain and preserve books and records and make them available to the SEC for inspection).

¹² Commodity Futures Trading Commission and Securities and Exchange Commission, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3308; File No. S7-05-11 (October 31, 2011), *available* [here](#). *See also* Securities and Exchange Commission, Form ADV and Investment Advisers Act Rules, Release No. IA-4509; File No. S7-09-15 (August 25, 2016) (noting that the “information collected on Form ADV serves a vital role in [the SEC’s] regulatory program and [the SEC’s] ability to protect investors.”), *available* [here](#).

¹³ Specifically, Item 8 of Part 2 requires that advisers describe their investment strategies and the material risks involved.

the necessary policies and procedures (which may include recordkeeping) for tracking compliance with the Proposed Rule's conditions.¹⁴

V. The SEC should modify the rules governing the disclosure of acquired fees and expenses.

The Proposing Release requested comment on the current regime for disclosing AFFE. The AFFE disclosure regime requires a registered acquiring fund to include in its fee and expense tables and expense ratios the fees and expenses of the acquired funds in which it invests.¹⁵ In the case of an exchange-traded BDC, however, this requirement can distort and overstate the expenses of the acquiring fund. For example, when an acquiring fund purchases another fund (*e.g.*, a mutual fund) at the acquired fund's net asset value, the AFFE rules provide the means to reflect and disclose the aggregate fees and expenses that will be paid by acquiring fund investors. Listed BDCs, however, trade and are purchased at market price, which theoretically accounts for future operating expenses. By requiring an acquiring fund that invests in a listed BDC to include the BDC's expenses in the acquiring fund's expense ratio, the acquiring fund may be double-counting expenses, making an investment in the acquiring fund (and indirectly, in the BDC) less attractive.¹⁶

The AIC also believes that one of the unforeseen consequences of requiring acquiring funds to include the expenses of BDCs in their AFFE disclosures was the reduction of investment demand in BDCs. Generally, mutual funds and many other institutional investors benchmark their investment performance to an index because, for example, (*i*) they have a policy requiring that they replicate the index (as in the case of an index fund) or (*ii*) they may have a preference for investing in shares included within the index (even if they do not seek to replicate the index). As such, if a security is removed from that index, these mutual funds and institutional investors are likely to dispose of that security as well. In 2014, certain index providers removed BDCs from their indices based on what we understand were concerns relating to the AFFE disclosure requirements.¹⁷ This action resulted in many institutional investors in

¹⁴ *Supra* note 8.

¹⁵ See Item 3 of Form N-1A.

¹⁶ See NASDAQ, NASDAQ Governance Clearinghouse, *Business Development Companies Seek to Improve Retail Investor Access to Private Markets* (Sept. 24, 2018), available [here](#) (“Adding the total expenses of the BDC into the expense ratio of a regulated fund effectively double counts the impact in a registered fund’s expense ratio. A BDC’s trading price already reflects its operating expense structure, which reduces the total return of the acquiring funds’ investment in the BDC. Reflecting these expenses again under the AFFE rule results in double counting a BDC’s expenses. The existing application of the AFFE rule disclosure to a BDC investment is therefore misleading and inaccurate.”).

¹⁷ S&P Global, Press, *S&P U.S. Indices Methodology Update* (Feb. 24, 2014), available [here](#). See, also, Fitch Ratings, Fitch Wire, *Removal of BDCs from Indices May Reduce Equity Access* (“We believe expenses are the key issue [in the S&P announcement that it is removing BDCs from its indices], since the inclusion of BDCs can inflate the expense ratio of a fund investing in BDC shares. BDC’s

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BDCs selling their own shares. It has been reported that, from September 2012 to December 2014, 46% of institutional investors sold 75% or more of their position in BDCs and mutual funds.¹⁸

Future demand for listed BDCs is likely to continue to be suppressed if the AFFE disclosure requirements are not modified. The ability of BDCs to access the capital markets is of particular importance for BDCs and the American economy, particularly in light of the basic purpose of the BDC provisions of the Investment Company Act: “to help make capital more readily available to small, developing, and financially troubled businesses.”¹⁹

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The AIC appreciates the opportunity to comment on the Proposed Rule and the AFFE question and would be pleased to answer any questions you might have regarding our comments.

Respectfully submitted,



Jason Mulvihill
Chief Operating Officer & General Counsel
American Investment Council

expenses are treated differently than the expenses of other companies held in the indices, because they... fall under the Investment Company Act of 1940. Their management fees and other costs become “acquired fund fees” for a fund owning BDC shares.”), *available [here](#)*; Seeking Alpha, Portfolio Strategy, *Quantifying BDCs’ Removal From the Russell Indices* (Jun. 19, 2014) (noting that “Russell and S&P’s reason for excluding BDCs stems from the SEC’s [AFFE] requirement which forces funds which own BDCs such as Russell ETFs to report a BDC’s expenses as if they were their own.”), *available [here](#)*.

¹⁸ S&P Global. Data based on publicly available information. Analysis excludes banks from “institutional investors” and includes BDCs with a market capitalization of \$300 million or greater as of Dec. 31, 2017 that were publicly traded on Sept. 30, 2012.

¹⁹ SEC, Press Release, *SEC Broadens Opportunities for Small Business Financing* (May 15, 2008), *available [here](#)*; SEC, Press Release, *SEC Adopts New Rules for Business Development Companies and Reproposes New Category of Eligible Portfolio Company* (Oct. 26, 2006), *available [here](#)*; Small Business Investment Incentive Act of 1980, H.R. 7554, 96th Cong. (1980), amending the 1940 Act.