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May 2, 2019

By E-Mail

rule-comments@sec.gov

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

Re: File No. S7-27-18 – Fund of Funds Arrangements (Release Nos. 33-10590; IC-33329)

Dear Ms. Countryman:

We welcome the opportunity to comment on the new rule and amendments proposed by the U.S. Securities and Exchange Commission (the “Commission”) with respect to the above-referenced release (the “Proposing Release” and the proposed rules, amendments and rescissions therein collectively referred to as the “Proposed Rule”). Skadden, Arps, Slate, Meagher & Flom LLP’s Investment Management Group has significant experience advising registered and regulated closed-end investment companies (“closed-end funds”)¹ and their sponsors, advisers and underwriters. While our comments are informed by our experience representing closed-end funds, we are submitting these comments on our own behalf, and the views contained herein do not necessarily reflect the views of any of our clients.

We acknowledge the obvious care and thoughtfulness that the Commission put into the preparation of the Proposing Release and appreciate the opportunity to offer comments. As the primary regulator of the fund industry, we believe the Commission is uniquely positioned and most qualified to address investments by funds in other funds.

¹ “Closed-end funds” as used herein includes closed-end funds that have elected to be regulated as business development companies.

Background

The historical restrictions on fund of funds arrangements arose out of Congress' concern that such arrangements could lead to "pyramiding", a practice under which investors in the acquiring fund could control the assets of the acquired fund and use those assets to enrich themselves at the expense of acquired fund shareholders."² As noted in the Proposing Release, such "[c]ontrol could be exercised either directly (such as through the voting power of a controlling interest) or indirectly (such as coercion through the threat of large-scale redemptions)."³ Although the views of Congress and the Commission have evolved with respect to fund of funds arrangements, as evidenced by statutory exemptions, Commission rules, and exemptive orders, these subsequent developments have often been premised on passive investment in acquired funds that allows the acquiring funds to achieve "asset allocation, diversification and other investment objectives"⁴ with "specified conditions that are designed to prevent the abuses that led Congress to enact section 12(d)(1)."⁵ One of the primary goals of these measures has been allowing investors "to gain exposure to a particular market or asset class in an efficient manner"⁶ or "exposure to an asset class or fund that may not otherwise be available to that investor."⁷ However, coupled with the benefit of increased exposure to new types of investments has been the understanding that such access is not a predicate for control or abuse by managers. Indeed, the Proposing Release confirms that the Commission views the Proposed Rule as an effort to "create a more consistent and efficient regulatory framework for fund of funds arrangements"⁸ that "would provide investors with the benefits of fund of funds arrangements, while protecting them from the historical abuses [associated with such arrangements]."⁹ In particular, the Proposing Release expressly acknowledges the harm that could inure to closed-end fund investors at the hands of acquiring funds that commonly seek to enrich themselves and their shareholders at the expense of long-term retail closed-end fund investors.¹⁰

² Proposing Release at 9.

³ *Id.*

⁴ *Id.* at 7.

⁵ *Id.* at 12.

⁶ *Id.* at 7.

⁷ *Id.* at 8.

⁸ *Id.* at 13.

⁹ *Id.*

¹⁰ *See id.* at 37 ("We also believe that requiring acquiring funds to utilize mirror voting or pass-through voting whenever their holdings exceed the statutory limit in section 12(d)(1)(A)(i) is appropriate to protect the acquired fund (and ultimately its investors) from undue influence through shareholder votes. A 3% threshold for the voting condition is particularly important because our proposal would allow funds to acquire shares of closed-end funds under proposed rule 12d1-4. Closed-end funds historically have been the target of proxy contests."). *See also*, 2018 Investment Company Fact Book, at ch.5 (Investment Company Institute 2018),

(cont'd)

In light of the historical evolution of the Commission's position with respect to fund of funds arrangements and consistent with the Commission's stated goal of creating a "comprehensive, streamlined framework [that] would reduce confusion and subject fund of funds arrangements to a tailored set of conditions that would enhance investor protection,"¹¹ we believe that the Proposed Rule should be revised in order to prevent potential abuses and further enhance investor protections, especially in situations involving closed-end funds that are often the targets of activist investors seeking to profit at the expense of closed-end funds' long-term shareholders by employing a discount arbitrage strategy.¹² Accordingly, we respectfully submit the following comments for the Commission's consideration.

Overview

As noted, shares of closed-end funds often trade at a discount to their net asset value and this discount has increasingly led activist investors to target such funds in search of short-term profits for themselves, often to the detriment of a closed-end fund's retail long-term shareholders, most of whom also invested at a discount to enjoy an enhanced return over time compared to investing at net asset value. Indeed "[s]ome of the most prominent players [in the closed-end fund space], such as Saba, Bulldog Investors, Karpus and CLIM [City of London Investment Management], have made no bones about the fact that their play is buying up shares of closed-end funds they believe to be underperforming, forcing changes, and raking in the profits."¹³ The "changes" these investors seek are typically some kind of "liquidity" event at or near net asset value, such as an open-ending, liquidation or substantial tender offer, or even a commitment to make fixed distributions irrespective of earned income, which can shrink the fund over time. The activist may use a variety of tactics to achieve this aim, such as proxy contests, shareholder proposals, seeking to replace directors or seeking to terminate the closed-

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available at www.icifactbook.org ("Also, 38 percent of households owning closed-end funds were retired from their lifetime occupations, compared with 23 percent of households owning mutual funds."). While closed-end fund investors are also described as "affluent" relative to national medians, closed-end fund investors are decidedly retail in nature, with median household income of \$100,000 and median household financial assets of \$250,000. *See id.*

¹¹ Proposing Release at 13.

¹² Closed-end funds are typically listed on a national securities exchange and frequently trade at a price that represents a discount to the fund's net asset value. Certain investors seek to take advantage of this market dynamic by purchasing closed-end fund shares trading at a discount and then using their position in the fund to seek to force some kind of "liquidity" event at or near net asset value – be it an open-ending, a liquidation or a large scale tender offer – and profit from the difference between the price at which the closed-end fund shares are purchased and the price at which the "liquidity" event occurs. *See, e.g.,* Proposing Release at 37 & n.95; Rose F. DiMartino, *Protecting Closed-End Fund Investors: A Call to Amend 1940 Act Section 12(d)(1)(A)*, *The Investment Lawyer*, Jan. 2019, at 23-24 ("Protecting CEF Investors").

¹³ Scott Van Voorhis, "Activist Investors Press For Changes in Closed-End Funds." *The Street* (December 29, 2018), available at <https://www.thestreet.com/investing/activist-investors-press-for-changes-in-closed-end-funds-14821722>.

end fund's advisory contract. The common thread, however, is that a "liquidity" event often settles the matter and results in the withdrawal of whatever coercive proposals or activities have been put forward. The activist and its shareholders then profit from the difference between the discounted price at which the closed-end fund shares are purchased and the price at which the "liquidity" event occurs. This perhaps is good for the short-term interests of the activist and its investors, but these types of coerced actions can impose substantial harm on the fund and its long-term shareholders. Portfolio securities may have to be sold at fire sale prices to raise cash to fund the liquidity event and the fund will likely need to delever at the same time.¹⁴ This can leave the fund with a smaller, less liquid and harder to value portfolio. It can also substantially increase the fund's expense ratio, further harming long-term shareholders and endangering the viability of a fund structure that is clearly beneficial to market stability and long-term investors. Moreover, in our experience advising closed-end funds, any discount narrowing benefit from a self-tender offer at or near net asset value is typically short-lived and the closed-end fund's discount often returns to historical levels. As a policy matter, the Commission should be seeking to foster the expansion rather than the reduction of closed-end funds.¹⁵

Many of these activist closed-end fund investors currently implement their activist discount arbitrage strategies through private funds excluded from the definition of "investment company" under sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 ("1940 Act"). The use of these funds without the involvement of a registered investment company would be outside of the scope of the Proposed Rule. However, several prominent closed-end fund activists utilize registered investment companies as well.¹⁶ We also believe it is imperative in the course of adopting a new rule to level the playing field so that activist investors are not incentivized to use exclusively private funds in a manner that evades the statutory limitations of section 12(d)(1).¹⁷ In conjunction with any adoption of the Proposed Rule, the Commission or its staff should clarify that affiliated private funds which are not materially different in investment operations or investment policies should be treated as a single fund for purposes of section 12(d)(1)'s limitations. This has for many years been the staff's policy under section 3(c)(1) of the 1940 Act¹⁸ and should be utilized under section 12(d)(1) to prevent evasion of statutory purpose. We describe this view in greater detail in our comments below.

¹⁴ Most closed-end funds use some type of leverage. *See, e.g.*, 2018 Investment Company Fact Book, at ch.5 (Investment Company Institute 2018), *available at* www.icifactbook.org ("At year-end 2017, at least 341 funds, accounting for 64 percent of closed-end funds, were using structural leverage, types of portfolio leverage (tender option bonds or reverse repurchase agreements), or both as part of their investment strategy.").

¹⁵ Closed-end funds buffer market stress during periods of dislocations because they are not required to liquidate portfolio positions to satisfy redemptions. As a result, they are able to remain more fully invested.

¹⁶ Examples include Special Opportunities Fund, Inc. (File No. 811-07528), advised by Bulldog Investors, LLC; and Matisse Discounted Closed-End Fund Strategy (a series of Starboard Investment Trust, File No. 811-22298), advised by Deschutes Portfolio Strategies, LLC, dba Matisse Capital.

¹⁷ Sections 3(c)(1) and 3(c)(7) of the 1940 Act subject private funds relying on these exclusions from the definition of "investment company" to the 3% limitation on ownership of registered and regulated investment companies in section 12(d)(1)(A)(i).

¹⁸ *See, e.g.*, Cornish & Carey Commercial, Inc., SEC Staff No-Action Letter (Jun. 21, 1996).

We wish to emphasize that, fundamentally, the policy rationale for the Proposed Rule is grounded in the principle that acquiring funds should be passive investors and that an acquiring fund's ability to influence an acquired fund through voting power should be limited if the acquiring fund is investing in excess of the limitations contained in section 12(d)(1) of the 1940 Act.¹⁹ As the Proposing Release itself recognizes, this is a critical protection for closed-end funds.²⁰ This principle ensures that the reason for including section 12(d)(1) in the 1940 Act in the first place – to prevent investors in an acquiring fund from controlling the assets of the acquired fund and using those assets to enrich themselves at the expense of acquired fund shareholders – is respected when acquiring funds are permitted to invest in excess of statutory limits.²¹ If the Proposed Rule is not revised, we believe that activist closed-end fund investors will be able to use the Proposed Rule to achieve the very end that section 12(d)(1) and presumably the Proposed Rule seek to avoid – an acquiring fund using its position in a closed-end fund's voting securities to enrich its investors at the expense of the closed-end fund's other investors.

We believe that certain revisions to the Proposed Rule are necessary in order to ensure that closed-end funds and their shareholders are protected from potential abuses of the rule by closed-end fund activists. Accordingly, we respectfully submit that the Proposed Rule should be revised as follows: (i) an acquiring fund should not be permitted to rely on the Proposed Rule unless it is truly a "passive investor;" (ii) an acquiring fund should be required to use mirror voting; (iii) the definition of "advisory group" should be expanded to include all advisory clients, including separately managed accounts; and (iv) funds that do not maintain an active registration statement should be permitted to claim "acquiring fund" status in annual or semi-annual reports to shareholders.

1. The Commission or its staff should address the abuse of section 12(d)(1)(A)(i) by certain private fund managers in conjunction with any adoption of the Proposed Rule.

Activist closed-end fund investors currently typically use private funds to implement their activist discount arbitrage strategies and frequently take advantage of the fact that section 12(d)(1)(A)(i)'s 3% limitation on ownership of registered fund voting securities by a private fund does not expressly require multiple similar private funds having the same or affiliated investment advisers to aggregate their positions.²² Often, multiple private funds, directed by the

¹⁹ See Proposing Release at 35-37.

²⁰ See *id.* at 37 ("We also believe that requiring acquiring funds to utilize mirror voting or pass-through voting whenever their holdings exceed the statutory limit in section 12(d)(1)(A)(i) is appropriate to protect the acquired fund (and ultimately its investors) from undue influence through shareholder votes. A 3% threshold for the voting condition is particularly important because our proposal would allow funds to acquire shares of closed-end funds under proposed rule 12d1-4. Closed-end funds historically have been the target of proxy contests.").

²¹ See *id.* at 9.

²² See generally Protecting CEF Investors.

same investment adviser, and having substantially the same investment objectives and investment policies, will each invest in the acquired closed-end fund up to this 3% limit, with the net effect of the activist private fund adviser being able to direct the vote on much more than just the 3% voting stake that any one private fund can acquire. This blatant end-run around section 12(d)(1)(A)(i) runs afoul of section 48(a) of the 1940 Act, which prohibits that which cannot be done directly from being done indirectly, in the same way as did the use of similar funds to evade the 100 investor limitation of section 3(c)(1) of the 1940 Act. The Commission or its staff needs to address this section 12(d)(1) abuse in the same way as abuse of section 3(c)(1) was addressed.²³ This action should be taken in conjunction with any adoption of the Proposed Rule in order to put all participants on the same playing field.

2. An acquiring fund and its advisory group should not be permitted to use the Proposed Rule if, individually or in the aggregate, or in conjunction with any other person, they seek to influence the management or policies of the acquired fund.

As proposed, one condition to reliance on the Proposed Rule is that the acquiring fund and its advisory group will not control (individually or in the aggregate) an acquired fund.²⁴

The Proposing Release states that “an acquiring fund and its advisory group’s beneficial ownership of up to 25% of the voting securities of an acquired fund would be presumed not to constitute control over the acquired fund” (the “25% Presumption”).²⁵ A fund relying on the Proposed Rule, therefore, generally could make a substantial investment in an acquired fund (*i.e.*, up to 25% of the acquired fund’s shares).²⁶ While the 25% Presumption establishes a convenient benchmark, we believe that passivity, rather than the mere absence of definitive control, should be the condition for obtaining the benefits of an exemption. In that regard, we believe that the current regulatory regime with respect to Schedule 13D and 13G filings provides a more appropriate framework within which to assess whether an acquiring fund and its advisory group intend to make the kind of passive investment in the acquired fund that the Commission’s historical relief from the statutory requirements of section 12(d)(1) contemplates as a means of preventing the abuses against which section 12(d)(1) guards.²⁷

The Commission’s rules adopted under the Williams Act provide a well-established framework for determining whether an investment in an issuer’s securities is held in the ordinary course of business for passive investment purposes. In fact, the Commission even repeatedly

²³ See, e.g., Cornish & Carey Commercial, Inc., SEC Staff No-Action Letter (Jun. 21, 1996).

²⁴ Proposed Rule 12d1-4(b)(1)(i).

²⁵ Proposing Release at 32.

²⁶ *Id.*

²⁷ *Id.* at 7-12.

refers to Schedule 13G filers as “passive investors.”²⁸ These are the *only* types of investments that should be permitted in acquired funds in excess of the section 12(d)(1) limitations in the 1940 Act. Item 10 on Schedule 13G requires a “passive investor” to certify that it holds the subject securities in the ordinary course of business and that the securities were not acquired and are not held for the purpose of or with the effect of changing or influencing the management or policies of the issuer (the “13G Certification”).²⁹ We believe that the standard embodied in the 13G Certification should be incorporated into Rule 12d1-4 as a condition to reliance on the exemptive rule, or at a minimum that the 13G Certification should be required to be made in some form, whether to the issuer at the time of investment or to the Commission in periodic reporting. Obtaining open-ending or liquidation of a fund or a substantial self-tender offer is certainly evidence of the type of influence that constitutes control under the 1940 Act. Funds should not be subject to such a result at the hands of managers relying on an exemptive rule.

Permitting investors that cannot make the 13G Certification to rely on an exemptive rule premised on protecting acquired funds from undue influence is inconsistent with the objectives of section 12(d)(1) and the Commission’s historical rationale for granting relief therefrom. The “non-control” condition to the Proposed Rule, as proposed, only would disqualify an acquiring fund from relying on the Proposed Rule if it in fact controlled the acquired fund. Activist closed-end fund investors, frankly, will abuse this condition. Such an investor could very well acquire up to 25% of a closed-end fund’s voting securities and agitate quite effectively for a self-enriching “liquidity” event at or near net asset value that will harm long-term shareholders in the closed-end fund, all the while filing Schedule 13Ds and taking the position that, while it is seeking to influence the control / management or policies of the acquired closed-end fund, it certainly does not in fact exercise a controlling influence over the acquired fund’s management or policies. We believe this dynamic has the potential to cause activist closed-end fund investors to consolidate their operations into a single registered fund and obtain even larger positions in acquired closed-end funds than they currently routinely acquire,³⁰ which would result in greater

²⁸ See Amendments to Beneficial Reporting Requirements, Exchange Act Rel. No. 39538 (Jan. 12, 1998); Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Rel. No. 37403 (Jul. 3, 1996).

²⁹ The 13G Certification is as follows: “By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect, other than activities solely in connection with a nomination under § 240.14a-11.” “Control” is defined in section 2(a)(9) of the 1940 Act and in Rule 12b-2 under the Exchange Act by reference to exercising a controlling influence over, or direction or causing the direction of, the “management or policies” of a company. The Commission appears to use these formulations interchangeably. See, e.g., Special Opportunities Fund, Inc., Notice of Application, 1940 Act Rel. No. 30647 (Aug. 8, 2013) (“SPE Notice”) (explaining that the conditions of section 12(d)(1)(F) “address[] the concern underlying the restrictions in Section 12(d)(1)(A)—that the fund of funds’ investment adviser or another affiliate not exercise undue influence over the management or policies of an underlying fund . . .”).

³⁰ See, e.g., Protecting CEF Investors, at 24 (“For example, six entities advised by Saba Capital Management, L.P. owned in the aggregate 14.44 percent of Clough Global Equity Fund at the time it entered into a settlement agreement with that fund.”) (citing Schedule 13D filing).

undue influence being exerted on acquired closed-end funds all to the detriment of long-term closed-end fund shareholders and in frustration of the Proposed Rule's expressed objectives.

The Proposed Rule, as written, would give activist closed-end fund investors an unambiguous legal and practical (to the extent current strategies are limited by the necessity of many different private funds)³¹ path to increase the size of the voting stakes used to abuse and harm long-term closed-end fund investors with their short-sighted and self-interested profit play.³² Accordingly, we respectfully submit that the Proposed Rule should be revised to prohibit an acquiring fund and its advisory group, individually or in the aggregate, or in conjunction with any other person, from seeking to influence the management or policies of the acquired fund, irrespective of any factual conclusions about exercising actual control.

3. Acquiring funds should be required to use mirror voting.

Under the Proposed Rule, an acquiring fund and its advisory group would be required to use pass through or mirror voting when the acquiring fund and its advisory group, in the aggregate, hold more than 3% of an acquired fund's outstanding voting securities.³³ In pass through voting, the acquiring fund must "seek instructions from its security holders with regard to the voting of all proxies with respect to [the acquired fund] and ... vote such proxies only in accordance with such instructions," and in mirror voting, the acquiring fund must "vote the [acquired fund] shares held by it in the same proportion as the vote of all other holders of such security."³⁴ The Commission has explained that section 12(d)(1)(E)(iii) is an "attempt to minimize the influence that an acquiring fund's adviser, among others, may exercise over an underlying fund through voting."³⁵ With respect to pass through voting, the Commission's position has been that the "seek instructions" requirement necessitates the pass through of an

³¹ See section 1, above.

³² The Commission has repeatedly recognized the different and unique considerations that apply to other investment companies investing in closed-end funds. *See, e.g.*, Goldman Sachs Trust, et al., 1940 Act Rel. Nos. 33137 (Jun. 27, 2018) (notice) & 33166 (Jul. 24, 2018) (order) (application for a common fund of funds order sets forth as Condition 1 various additional protections related to investments in closed-end funds). Similarly, section 12(d)(1)(C) recognizes the unique abuses that could be wrought on closed-end funds in that registered funds (though, inexplicably, not private funds) with the same investment adviser must aggregate their positions in closed-end funds – unlike under section 12(d)(1)(A)(i) – and limit that aggregate position to 10% of a closed-end fund's voting stock. In this regard, we believe that another avenue the Commission might consider is limiting an acquiring fund's and its advisory group's aggregate ownership in an acquired fund to 10% of the acquired fund's voting stock in the absence of a participation agreement with the acquired fund akin to what the Commission's fund of funds exemptive orders now typically require.

³³ Proposed Rule 12d1-4(b)(1)(ii). The Proposed Rule references voting in accordance with section 12(d)(1)(E)(iii)(aa) of the 1940 Act, which contains voting options commonly referred to as "pass through" and "mirror" voting.

³⁴ 1940 Act § 12(d)(1)(E)(iii)(aa).

³⁵ In the Matter of Special Opportunities Fund, Inc., 1940 Act Rel. No. 31213 (Aug. 15, 2014) ("SPE Order").

acquired fund's proxy material to the acquiring fund's investors, and the acquiring fund obtaining instructions from its investors with respect to voting.³⁶

We believe that pass through voting is inconsistent with the passivity principles underlying relief from the 3% limitation and provides insufficient protection to acquired funds and their shareholders, especially when the acquiring fund is an activist closed-end fund investor. Presumably, investors in the activist's acquiring fund want exposure to the activist's abusive discount arbitrage strategy and will accommodate the adviser's desire to unduly influence the acquired closed-end fund to the detriment of that fund's long-term shareholders. The Commission has even seen and considered an example of this very dynamic.³⁷ Pass through voting may be workable in the contexts envisioned by the statutory language – dedicated feeder funds and funds *not* holding more than 3% of any one underlying fund. It is not workable or consistent with the statutory purpose where acquiring funds and their advisers can own and control more than 3%. Thus, allowing the pass through of a larger-than-3% voting stake to an activist's investors would give rise to the very harms the Proposed Rule is trying to avoid: “investors in the acquiring fund [controlling] the assets of the acquired fund and [using] those assets to enrich themselves at the expense of acquired fund shareholders.”³⁸

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

³⁶ See Investment Company Amendments Act of 1970 Relating to Exemptions for Certain Companies, Pyramiding of Investment Companies, Regulation of Fund Holding Companies and Rescission of Rule 11b-1, 1940 Act Rel. No. 6440 (Apr. 6, 1971) (“1971 Release”); *accord* SPE Notice; SPE Order.

³⁷ In 2011 a well-known activist registered closed-end fund – Special Opportunities Fund, Inc. (“SPE”) – requested declaratory relief from the Commission that would have accommodated a pass through voting procedure inconsistent with section 12(d)(1)(E)(iii)(aa). See SPE Notice (the voting procedure consisted of the shareholders of SPE having approved a proposal to “instruct the Adviser to vote proxies received by the Fund from any [underlying fund] on any proposal (including the election of directors) in a manner which the Adviser reasonably determines is likely to favorably impact the discount of such [underlying fund’s] market price as compared to its net asset value”; the Commission stated that this voting procedure did “not appear to be consistent with the purposes and policies behind section 12(d)(1)(F) of the [1940] Act [which incorporates the requirements of section 12(d)(1)(E)(iii)], or with the guidance the Commission articulated in the 1971 Release.”). While the Commission ultimately denied this request, it did so after a shareholder of SPE filed a hearing request supporting SPE’s position. See SPE Order. This, together with the favorable vote of SPE shareholders described in the SPE Notice, is an obvious demonstration of how an activist’s investors are aligned with its strategy of seeking short-term profits at the expense of the acquired closed-end fund’s long-term investors.

³⁸ Proposing Release at 9 (*emphasis added*).

Therefore, we respectfully submit that paragraph (b)(1)(ii) of the Proposed Rule should be revised to require that an acquiring fund and its advisory group use *only* mirror voting as a condition of reliance on the rule.

4. The definition of “advisory group” should be expanded to include any account managed by the acquiring fund’s investment adviser, sub-adviser or any of their respective control affiliates.

The Proposed Rule uses the concept of an “advisory group” for purposes of aggregating beneficial ownership.³⁹ As defined in the Proposed Rule, the advisory group includes either the adviser or the sub-adviser and any person or persons controlling, controlled by or under common control with such entity.⁴⁰ This definition leaves significant loopholes, especially in the case of an advisory group with a significant separately managed account business.⁴¹ Separately managed accounts clients generally are not viewed as being “controlled” by the adviser either because they are not “companies,” or because they are entities over which an adviser lacks the necessary elements of control.⁴²

Nonetheless, the use of separately managed accounts, in conjunction with acquiring funds relying on the Proposed Rule, can result in the same abuses section 12(d)(1) was designed to guard against and which the Proposed Rule seeks to prevent. Just like with a controlled entity, such as a private fund, an adviser is often delegated voting discretion and dispositive power over separately managed account assets. And with that authority, the adviser can exert undue influence on an acquired fund in the same manner. It is not hard to imagine scenarios in which an activist adviser may seek to end-run the requirements of the Proposed Rule using separately managed accounts. For example, the acquiring fund and the “advisory group” – which would generally include the adviser’s private funds since it or an affiliate would likely be the general partner of those funds and thus “control” them – may own 24% of an acquired closed-end fund; but perhaps the adviser also manages separate accounts that collectively own an additional 27% of the acquired closed-end fund. Now the adviser controls the vote on 51% of the acquired closed-end fund, clearly can dictate to the acquired fund what to do, and has arguably complied with the Proposed Rule since the separate account ownership arguably would not be aggregated with the acquiring fund and affiliated private fund ownership. This is very much a real possibility for smaller closed-end funds without large market capitalizations – perhaps the most vulnerable group as it relates to fund of fund arrangements. This cannot be the result the Commission

³⁹ Proposed Rule 12d1-4(b).

⁴⁰ Proposed Rule 12d1-4(d).

⁴¹ We generally use the term “separately managed account” clients to refer to the types of clients identified in Item 5.K of Form ADV Part 1. For example, Karpus Investment Management, another well-known closed-end fund activist, has over \$3 billion in separately managed account assets according to its Form ADV filed on September 27, 2018.

⁴² See 1940 Act §§ 2(a)(8)-(9).

intends. We believe that higher standards should apply to any entity or “advisory group” that would seek to benefit from the exemption offered by the Proposed Rule.

We therefore respectfully submit that the definition of “advisory group” in paragraph (d) of the Proposed Rule should be revised to include any account managed by the acquiring fund’s investment adviser, sub-adviser or any of their respective control affiliates.

5. Funds that do not maintain an active registration statement should be permitted to claim “acquiring fund” status in annual or semi-annual reports to shareholders.

The Proposed Rule would allow a fund to claim “acquiring fund” status by disclosing its intent to rely on the Proposed Rule in its registration statement.⁴³ The stated purpose of this disclosure requirement is to effectuate the Proposed Rule’s limits on complex multi-tier structures⁴⁴ by putting “other funds seeking to rely on Rule 12d1-4 on notice that a fund they seek to acquire is itself an acquiring fund. This disclosure would allow a fund to limit its acquisition of the acquiring fund’s securities accordingly.”⁴⁵ While this would work well for open-end funds and for closed-end funds that maintain an active registration statement, many closed-end funds do not maintain an active registration statement and would be precluded from claiming “acquiring fund” status unless they were to file a new registration statement at considerable cost and expense.⁴⁶ We therefore respectfully submit that (i) paragraph (b)(4)(i) of the Proposed Rule should be revised to permit disclosure of possible acquiring fund status in a fund’s annual or semi-annual shareholder reports, (ii) paragraph (b)(4)(ii) of the Proposed Rule should be revised to include a conforming reference to a fund’s annual or semi-annual report, and (iii) paragraph (b)(4)(iii) of the Proposed Rule should be revised to include a clarifying statement that the prohibitions contained therein do not apply to a fund that has claimed acquiring fund status in its registration statement or shareholder reports. We believe these clarifications would be uncontroversial.

⁴³ Proposed Rule 12d1-4(b)(4)(i).

⁴⁴ Proposed Rule 12d1-4(b)(4)(ii). *See* Proposing Release at 78.

⁴⁵ Proposing Release at 79.

⁴⁶ *See* 1940 Act Rule 8b-16(b) (excusing closed-end funds from annually updating their 1940 Act registration statements, provided certain information is included in the fund’s annual shareholder reports).

Vanessa Countryman

May 2, 2019

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Conclusion

We support the Commission's efforts to provide a consistent and efficient regulatory framework for fund of funds arrangements, but we believe that the Proposed Rule can and should be revised in order to protect closed-end funds and their shareholders from potential abuses by activists whose short-term profit focus harms long-term retail closed-end fund investors. We appreciate the opportunity to submit, and the Commission's consideration of, our comments. Should the Commission have any questions regarding these comments, please feel free to contact Richard Prins (██████████), Michael Hoffman (██████████), Kevin Hardy (██████████) or Kenneth Burdon (██████████).

Very truly yours,

A handwritten signature in black ink that reads "Skadden, Arps, Slate, Meagher & Flom LLP". The signature is written in a cursive, flowing style.

Skadden, Arps, Slate, Meagher & Flom LLP

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