June 11, 2019

Submitted via email to: rule-comments@sec.gov

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

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

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section of the American Bar Association (the "ABA") with respect to the above-referenced release proposing a new Rule 12d1-4 and related amendments to other rules and requesting comments on the proposal. Part I of the letter was primarily prepared by the Subcommittee on Investment Companies and Investment Advisers of the Committee, while Part II was primarily prepared by the Hedge Funds Subcommittee of the Committee.

The comments set forth in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and should not be construed as representing the policy of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law nor does it necessarily reflect the views of all members of the Committee.

The Committee commends the efforts of the Securities and Exchange Commission (the "Commission") in establishing a streamlined regulatory framework for fund of funds arrangements and appreciates the Commission's endeavor to make such arrangements more flexible for funds. Further, the Committee thanks the Commission for this opportunity to comment on the proposal.

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PART I

I. Introduction

On December 19, 2018, the Commission proposed new Rule 12d1-4 (the "Proposed Rule") and related amendments under the Investment Company Act of 1940, as amended (the "1940 Act"), in order to "streamline" the regulatory framework for fund

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of funds arrangements.[1] The Proposed Rule would permit a fund to acquire shares of another fund in excess of the limits of Section 12(d)(1)(A) of the 1940 Act without relying on Section 12(d)(1)(G) and Rule 12d1-2, Section 12(d)(1)(F) or obtaining exemptive relief from the Commission. Accordingly, the Commission is also proposing to rescind Rule 12d1-2 under the 1940 Act and the various exemptive orders granting relief from Section 12(d)(1). By subjecting fund of funds arrangements to a tailored set of conditions under the Proposed Rule, the Commission seeks to enhance investor protection while still providing funds with flexibility to meet their investment objectives. Finally, the Commission is proposing related amendments to Rule 12d1-1 (to continue to allow funds that rely on Section 12(d)(1)(G) of the 1940 Act to invest in money market funds that are not part of the same group of investment companies following the rescission of Rule 12d1-2) and to Form N-CEN (to require funds that rely on the Proposed Rule to include information regarding their reliance on the Proposed Rule on their Form N-CENs).

While we acknowledge the benefit of a streamlined regulatory framework and applaud the Commission's effort in proposing a comprehensive framework for fund of funds arrangements, we believe the harms the Commission's proposal imposes on funds and investors outweigh the benefits in many respects. We believe the proposal will require significant restructuring of current fund of funds arrangements, resulting in unnecessary costs and burdens to funds and their investors. Accordingly, the Committee has prepared the below comments and recommendations regarding the Commission's proposal to address these concerns.

II. Rescission of Rule 12d1-2 and Section 12(d)(1) Exemptive Relief

a. Rule 12d1-2

The Commission is proposing to rescind Rule 12d1-2 and the exemptive orders granting relief from Sections 12(d)(1)(A), (B), (C) and (G) of the 1940 Act, with the exception of exemptive relief relating to interfund lending arrangements. The Committee believes that the Commission's proposal to rescind Rule 12d1-2 and Section 12(d)(1) exemptive relief is overly broad and would result in the restructuring of current fund of funds arrangements which fund complexes spent considerable resources developing in reliance on Rule 12d1-2 and Section 12(d)(1) exemptive relief.

Rule 12d1-2 was adopted to provide a fund relying on Section 12(d)(1)(G) with greater flexibility to meet its investment objective when the risks that led to the restrictions in Section 12(d)(1) are minimized. It allows open-end registered investment companies or unit investment trusts ("UITs") (collectively, "Open-End Funds") investing in affiliated Open-End Funds in reliance on Section 12(d)(1)(G) ("Affiliated Funds of Funds") also to invest in unaffiliated investment companies (up to the limits in Section 12(d)(1)(A)), securities, and money market funds (when the investment is made in reliance on Rule 12d1-1). Affiliated Funds of Funds' universe of possible investments was further expanded by the Commission's staff in the

[1] *Fund of Funds Arrangements*, SEC Release No. IC-33329, 84 Fed. Reg. 1286 (Feb. 1, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-02-01/pdf/2018-27924.pdf (the "Proposing Release").

Northern Lights No-Action Letter, under which an Affiliated Fund of Funds relying on Rule 12d1-2 can invest in financial instruments, such as derivatives, that otherwise might not be considered securities.[2]

Many Affiliated Funds of Funds invest in affiliated and unaffiliated funds, other securities, and derivatives in reliance on Rule 12d1-2 and the *Northern Lights* No-Action Letter. The Proposed Rule would require such funds instead to rely on either: (1) Section 12(d)(1)(G), in which case they would not be permitted to invest in unaffiliated funds up to the statutory limits, other securities or derivatives; or (2) the Proposed Rule, in which case they would be required to comply with its conditions. In the first case, such a fund would be required to change its investment strategies potentially to the detriment of the fund and its investors. In the second case, compliance with the conditions of the Proposed Rule would result in significant additional costs to the fund and its shareholders and could prohibit certain investments that are permissible in reliance on Rule 12d1-2. For example, an Affiliated Fund of Funds that relies on Rule 12d1-2 can invest in an unaffiliated registered fund of private equity funds up to the statutory limits in Section 12(d)(1)(A). Under the Proposed Rule, however, this structure would not be permitted since the acquired fund would be investing in funds that rely on an exclusion provided for in Section 3(c)(1) or 3(c)(7) of the 1940 Act. Such Affiliated Fund of Funds might be forced to wind down such investments if Rule 12d1-2 is rescinded, which would be contrary to investor expectations, may not be permissible under contractual transfer restrictions and may occur at an inopportune time.

For these reasons, the Committee recommends that the Commission retain Rule 12d1-2 and further recommends that Rule 12d1-2 be expanded to allow Affiliated Funds of Funds also to invest in derivatives and other assets that might not be securities, subject to conditions similar to those in the *Northern Lights* No-Action Letter. The Commission has recognized that allowing an Affiliated Fund of Funds relying on Rule 12d1-2 to invest in other investments, such as derivatives, does not result in the pyramiding of funds or the related potential abuses that the Proposed Rule is designed to address.[3] Such an outcome would allow currently existing Affiliated Fund of Funds to continue pursuing their existing investment strategies without significant additional burdens, particularly costs, and would achieve the Commission's goal of streamlining the regulatory framework applicable to fund of funds arrangements.

b. Section 12(d)(1) Exemptive Relief

The Commission has proposed to rescind all exemptive orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) (except for those orders providing relief from Section 12(d)(1)(A) and (B) with respect to certain interfund lending arrangements). While the Proposed Rule is meant to eliminate the need for funds seeking to establish fund of funds arrangements to apply to the Commission for relief from the limitations of Section 12(d)(1)(A), the Commission acknowledges the hardship that the rescission of current exemptive orders would have on existing fund of funds arrangements.[4]

The Committee believes that the Commission's proposal to rescind Section 12(d)(1) exemptive relief is overly broad. The Committee certainly respects the Commission's goal of uniformity in the regulatory framework for fund of funds arrangements, but believes that uniformity should not be achieved

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[2] *See Northern Lights Fund Trust*, Staff No-Action Letter (Jun. 29, 2015).

[3] Proposing Release, at 1308.

[4] *See* Proposing Release, at 1310.

at the expense of current fund of funds arrangements. The Commission's proposal to eliminate a fund's ability to rely on currently existing Section 12(d)(1) exemptive relief would result in significant disruption to current fund of funds structures, resulting in undue costs and burdens. The Committee thus seriously questions the Commission's statement that "the operations of most existing fund of funds arrangements would not be significantly negatively affected by the need to comply with the requirements of Proposed Rule 12d1-4, as opposed to their [current exemptive] orders."[5] Given that the exemptive relief funds currently receive from Section 12(d)(1) is extensive and well-established, the Committee believes that the Commission should not rescind certain exemptive relief, as discussed below. Funds of funds currently relying on Section 12(d)(1) exemptive relief devoted considerable effort and resources to developing their current products. Effectively replacing this framework with a new one would add significant and undue costs and burdens. Further, while similar fund of funds arrangements may be subject to different conditions, the conditions imposed by current exemptive relief under Section 12(d)(1), or the varied nature of such conditions, does not detract from the investor protections the Commission seeks. For all of these reasons, the Committee disagrees with the Commission's proposal to rescind all Section 12(d)(1) exemptive relief (except for relief related to certain interfund lending arrangements) and recommends grandfathering such exemptive relief as a less burdensome alternative. Grandfathering exemptive relief would allow currently existing funds of funds to avoid having to abandon or restructure current fund of funds arrangements on which they spent considerable effort, time and resources.

In grandfathering exemptive relief from Section 12(d)(1), and in reviewing which exemptive orders to rescind,[6] if any, the Committee believes that the Commission should take into consideration the approach taken with respect to the adoption of Rules 18f-3 and 12d1-1. Similar to the current regulatory framework for funds seeking to establish fund of funds arrangements, the prohibitions in Section 18(f)(1) and Section 18(i) of the 1940 Act required open-end investment companies seeking to issue multiple classes of shares to apply for exemptive relief before the Commission adopted Rule 18f-3, which eliminated the need for such orders. Despite the varying conditions imposed by the then-established exemptive orders, the Commission recognized the time and money spent on developing new products in reliance on the hundreds of exemptive orders it issued and allowed issuers relying on such exemptive relief to continue to do so following the adoption of Rule 18f-3.[7] Similarly, in adopting Rule 12d1-1, the Commission did not rescind previously issued cash sweep exemptive orders.[8] For reasons similar to those advanced by the Commission in these prior rulemakings, the Committee believes that fund complexes that have spent considerable time and resources developing fund of funds arrangements in reliance on Section 12(d)(1) exemptive relief should be allowed to continue to operate in reliance on that relief.

Further, the Committee is concerned that the review of no-action and interpretive letters relating to Section 12(d)(1) by the Division of Investment Management (the "Division") will result in an overbroad

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[5] *See* Proposing Release, at 1311.

[6] *See* Proposing Release, at 1312.

[7] *See Exemption for Open-End Management Investment Companies Issuing Multiple classes of Shares*, at 2, SEC Release No. 33-7143 (Feb. 6, 1995), available at https://www.sec.gov/rules/final/finend.txt.

[8] *Fund of Funds Investments*, SEC Release No. IC-27399, 74 Fed. Reg. 36640 (June 20, 2006), available at https://www.sec.gov/rules/final/2006/33-8713fr.pdf.

elimination of letters withdrawn as moot, superseded, or otherwise inconsistent with the Proposed Rule.[9] While the Committee recognizes that the withdrawal of such letters may result in uniformity of the regulatory framework for fund of funds arrangements going forward, the Committee requests that the Commission consider the complexity and value of the no-action and interpretive relief in evaluating which letters, if any, to rescind.

III. Conditions

a. Undue Influence: Voting and Control

i. Voting

The Proposed Rule provides that if an acquiring fund and its advisory group hold more than 3% of an acquired fund's outstanding voting securities in the aggregate, each holder must either vote its acquired fund shares in the same proportion as the vote of all other shareholders ("mirror voting") or seek voting instructions from its shareholders ("pass-through voting"). With this condition, the Commission seeks to limit the acquiring fund and its advisory group's power to influence shareholder votes of the acquired fund. The Commission requested comment on whether the voting threshold should vary depending on the type of acquired fund. Due to the different ways in which an acquiring fund could seek to influence the outcome of shareholder votes of open-end and closed-end acquired funds, the Committee believes that the Proposed Rule's voting conditions should differ based on the type of acquired fund.

For acquired funds that are Open-End Funds, we believe that the Proposed Rule should have a higher threshold consistent with the parallel condition under current exemptive relief. Specifically, under current exemptive orders permitting investments in Open-End Funds in excess of the Section 12(d)(1)(A) limits, an acquiring fund must mirror vote its shares only if the acquiring fund and its advisory group holds more than 25% of the acquired fund's shares. Acquiring funds that invest in Open-End Funds have operated under this condition for years without concern. Experience under current exemptive relief supports the inclusion of voting conditions that require mirror voting or pass-through voting for investments in Open-End Funds only if the acquiring fund and its advisory group (or the acquiring fund and its sub-advisory group) hold more than 25% of the acquired fund's shares, consistent with the condition in existing exemptive orders.

The Proposed Rule potentially poses serious concerns for acquired funds that are closed-end registered investment companies ("Closed-End Funds") or business development companies ("BDCs") in light of the trend for certain activist investors to seek to acquire sizable positions in these funds. As noted in the Proposing Release, 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. In light of this potential, the Committee believes that the voting conditions that apply to investments in Closed-End Funds and BDCs should be modified to protect the interests of long-term investors in Closed-End Funds and BDCs. Under the Proposed Rule, an activist investor could form a closely-held 1940 Act-regulated fund to make investments in Closed-End Funds and BDCs. When such an acquiring fund passes a vote through to its investors in accordance with the voting conditions of the

[9] *See id.*, at 1311-1312.

Proposed Rule, these investors would be likely to vote in a manner that is consistent with the activist's interests. 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 securities, contrary to its investment objective and strategies, or cause the acquired fund to engage in tender offers that could unduly shrink the fund's assets and reduce economies of scale for long-term investors.

To protect the interests of an acquired fund's long-term investors, we urge 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 to gain its 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 Committee believes that mirror voting should be required for investments in a Closed-End Fund or BDC 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). The concept of mirror voting as a mechanism to prevent potentially coercive behavior by an acquiring fund is even more crucial if the Commission allows, as the Committee urges below, private funds to invest in Closed-End Funds or BDCs in excess of the 3% limit in Section 12(d)(1) in reliance on the Proposed Rule. Mirror voting would balance the interests of private fund managers to gain investment exposure to Closed-End Funds and BDCs, and the interests of Closed-End Funds and BDCs in preventing activists from using the Proposed Rule to abuse long-term Closed-End Fund and BDC investors.

Alternatively, the decision to implement protections such as mirror voting could be left to the acquired fund upon its determination that an acquiring fund holding over 3% has attempted to influence or control the management or policies of the acquired fund. Under this approach, the current governing structures of Closed-End Funds and BDCs would remain intact unless acts or communications by an acquiring fund trigger the need for additional protections, such as mirror voting or imposing the redemption limits discussed in more detail below. If this approach is adopted, an acquiring fund could continue to own up to 25% of an acquired fund as long as the acquiring fund did not attempt to influence or control the acquired fund. This approach would permit Closed-End Funds and BDCs to prevent activists from using the Proposed Rule to the detriment of long-term Closed-End Fund and BDC investors. This approach would also promote the interests of acquired funds generally because it would not disrupt the current governing structures of such funds where there is no present or imminent threat of influence or control by an acquiring fund.

An additional way to protect acquired funds from being influenced or controlled by acquiring funds would be to provide a mechanism that allows an acquired fund to screen acquiring funds. For example, if an acquiring fund were required to seek the affirmative consent of the acquired fund prior to investing in the acquired fund's shares in reliance on the Proposed Rule, then a prospective acquired fund would have leverage to negotiate limits on the acquiring fund's investment to prevent the acquiring fund from exerting undue influence on the acquired fund, similar to the leverage held by prospective acquired funds today when negotiating and entering into the participation agreements that are required under current Section 12(d)(1) exemptive orders.

The Committee supports an exception to the voting condition for certain affiliated funds that is set out in subsection (b)(1)(iii) of the Proposed Rule. As the Commission acknowledges, in circumstances where the acquiring fund is managed by an affiliated investment adviser, it is unlikely that the investors in the acquiring fund would exert undue influence and use their vote to pursue initiatives that are inconsistent with the long-term interests of investors in the acquired fund.

ii. Control

The Proposed Rule provides that an acquiring fund and its advisory group must not control (individually or in the aggregate) an acquired fund. Under the 1940 Act, control is presumed when a person (or a group) beneficially owns, directly or through one or more controlled companies, more than 25% of another person's voting securities. The Proposed Rule defines two types of "advisory groups": (1) an acquiring fund's investment adviser or depositor (*i.e.*, sponsor), and any person controlling, controlled by, or under common control with such investment adviser or depositor; or (2) an acquiring fund's investment sub-adviser and any person controlling, controlled by, or under common control with such investment sub-adviser. The Commission requested comment on whether it should exclude control affiliates of an acquiring fund's investment adviser or depositor (or sub-adviser) from the definition of "advisory group" and only include control affiliates of the acquiring fund. We agree with this suggestion and urge the Commission to exclude control affiliates of an acquiring fund's investment adviser, investment sub-adviser and/or depositor from the definition of an acquired fund's "advisory group" and instead only include control affiliates of the acquiring fund. For certain large asset managers, the breadth of entities that could potentially be included in an acquiring fund's "advisory group" under the Proposed Rule is so vast that it would be unduly burdensome to impose this restriction on these organizations.

b. **Undue Influence: Redemption Limit**

Under the Proposed Rule, once an acquiring fund holds in excess of 3% of an acquired fund's total outstanding shares (*i.e.*, the statutory limit imposed by Section 12(d)(1)(A)(i)), it would not be permitted to redeem more than 3% of the acquired fund's total outstanding shares in any 30-day period.

In the Proposing Release, the Commission did not identify instances in which acquiring funds holding more than 3% of an acquired fund's outstanding shares engaged in the types of abuses at which Section 12(d)(1)(A) is directed. Instead, the Commission indicated that the redemption limit is designed to provide a prophylactic check against the influence that an acquiring fund can have on an acquired fund through the threat of large-scale redemptions.[10] The Commission itself, however, suggested in the proposing release for Rule 12d1-2 that such a check was unnecessary in a fund of funds context.[11]

Prior to the adoption of Rule 12d1-2 in 2006, Affiliated Fund of Funds were, absent exemptive relief, limited to investing in certain affiliated funds, government securities and short-term paper.[12] Affiliated Funds of Funds were not limited to investing only up to a particular percentage of their assets with respect to their investments in affiliated acquired funds. Since then, however, Affiliated Funds of

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[10] Proposing Release, at 1298.

[11] *Fund of Funds Investments*, Proposed Rule, Investment Company Act Release No. 26198 (Oct. 1, 2003) at 58228 - 58229 ("Since 1940 we have provided limited relief for funds to acquire shares of other funds when the proposed arrangements did not present the risk of abuses that [S]ection 12(d)(1) was designed to prevent...These [proposed] rules would codify and expand upon a number of exemptive orders we have issued that permit funds to invest in other funds.") (the "Fund of Funds Investments Proposing Release").

[12] 15 U.S.C. § 80a-12(d)(1)(G)(i)(II).

Funds have been able to rely on Rule 12d1-2 to also invest in unaffiliated funds (subject to the limits in Section 12(d)(1)(A) or (F)), stocks, bonds and other securities[13] and in unaffiliated money market funds in reliance on Rule 12d1-1. In proposing Rule 12d1-2, the Commission noted that Congress encouraged it to "provide exemptions from [the Section 12(d)(1)] limitations 'in a progressive way,' taking into account factors that related to the protection of investors."[14] At the time, the Commission indicated that there did not appear to be any additional concerns or risks in allowing an Affiliated Fund of Funds to invest in unaffiliated funds subject to the limits of Section 12(d)(1)(A) or (F) or directly in other types of investments.[15] Fast forward to the present day, the proposed redemption limit (unlike the control and voting conditions) applies to Affiliated Funds of Funds even though the Proposing Release itself, in discussing the control and voting conditions in the context of Affiliated Funds of Funds, notes that "[w]e believe that these arrangements do not raise the same concerns regarding undue influence as other types of fund of funds arrangements because of the subadviser's duties as a fiduciary to both the acquiring fund and acquired fund."[16]

Rule 12d1-2 was designed to provide an acquiring fund relying on Section 12(d)(1)(G) with greater flexibility to meet its investment objective by complementing an acquiring fund's investments in affiliated funds. Rescission of Rule 12d1-2, as proposed, would eliminate the flexibility that Congress intended funds of funds relying on Section 12(d)(1)(G) to have. In light of the historical record that these funds of funds arrangements do not raise the concerns of undue influence that underlie Section 12(d)(1), we question the need for the proposed redemption limit – particularly in the context of Affiliated Funds of Funds.[17] The imposition of such a redemption limit would represent a very significant change from current practice,[18] where Affiliated Funds of Funds may own and freely redeem significant amounts of affiliated underlying funds even when they invest in other securities and unaffiliated underlying funds, pursuant to Rule 12d1-2.

The rationale behind the redemption limit also may not have fully taken into account the alternative means that currently exist to address the threat of undue influence and large scale redemptions with respect to acquired funds. Congress, in enacting Section 12(d)(1)(F)(ii), created an alternative methodology for resolving this problem by allowing acquired funds to set a permissible level at which to limit redemptions[19]

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[13] The Commission has provided exemptive relief, and the staff has provided no-action relief, to permit an Affiliated Fund of Funds relying on Section 12(d)(1)(G) and Rule 12d1-2 also to invest in assets in instruments that may not be securities. *See* Proposing Release at 1309 n. 209; 1311 n. 228; *see also Northern Lights Fund Trust.*

[14] Fund of Funds Investments Proposing Release (citing H.R. Rep. No. 622, 104th Cong., 2d Sess., at 44-45 (1996)).

[15] *See* Proposing Release, at 1309.

[16] Proposing Release, at 1297. The Commission went further, stating 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 interest of each fund. In addition, in cases where the arrangement involves funds that are advised by advisers that are control affiliates, we do not believe that the acquiring fund adviser generally would seek to benefit the acquired 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)." *Id.*

[17] Unlike the restrictions that apply to control and voting, the redemption limitations apply even when (1) the acquiring fund is within the same group of funds as an acquired fund, and (2) the acquiring fund's subadviser (or any person controlling the subadviser) acts as the acquired fund's adviser.

[18] We understand that other comment letters have addressed reliance by the industry on Rule 12d1-2 since its adoption.

[19] Proposing Release, at 1300.

– allowing the underlying funds to self-resolve this problem as needed by imposing voluntary limitations at the underlying fund level, as opposed to being subject to an inflexible mandatory limitation. There are, however, other alternatives as well. For example, the adviser and its portfolio managers of Affiliated Funds of Funds in certain contexts have the ability to coordinate investing activities to address redemptions at the level of both the acquiring and acquired funds. Acquired mutual funds, in both an affiliated or unaffiliated fund of funds context, may have the ability to redeem in-kind (*see, e.g.*, *Signature Financial Group*, SEC Staff No-Action Letter (Dec. 22, 1999)), subject to board-adopted procedures to avoid disruption from large-scale redemptions. Similarly, most exchange-traded funds ("ETFs") have the ability to redeem in-kind and avoid similar disruption. As the Commission acknowledged in adopting Rule 22e-4 under the 1940 Act (the "Liquidity Rule"), "In-Kind ETFs"[20] do not face the same types of redemption risks as some other types of funds because of their in-kind creation and redemption mechanisms.[21] Each of these existing alternatives adequately addresses the threat of undue influence and large scale redemptions and can be applied to all fund of funds arrangements. Additionally, requiring an acquiring fund to obtain the affirmative consent of a prospective acquired fund prior to investing in reliance on the Proposed Rule would provide the prospective acquired fund with leverage to negotiate limits that would restrict the acquiring fund from exerting undue influence on the acquired fund, or would allow the acquired fund to prevent the acquiring fund from investing in its shares in reliance on the Proposed Rule.

The Commission also notes that the Proposed Rule "would level the playing field among [acquiring funds]." The Committee submits that the proposed redemption limit instead effectively puts acquiring funds, as shareholders in the acquired funds, at a disadvantage relative to other shareholders of the acquired fund (*e.g.*, institutional and retail investors) who would not be subject to such limitations. For example, if a broker-dealer with a large scale allocation to an acquired fund redeemed all of its shares of the acquired fund, it may decrease the assets under management of the acquired fund such that the acquiring fund now holds greater than 3% of the acquired fund's assets, in turn forcing the acquiring fund to be subject to the redemption limit. Ultimately, this results in harm to not only shareholders of the acquiring fund, but also to the shareholders of the acquired fund, as it decreases the acquired fund's assets under management by way of the domino effect that is triggered by the redemption limit.

The Proposed Rule creates an uneven playing field for the acquired funds by making some types of acquired funds more accessible than others. Under the Proposed Rule, investments in acquired funds that are ETFs, listed Closed-End Funds and BDCs – which the acquiring fund could dispose of through a sale on an exchange, rather than by redemption from such acquired fund – are not subject to the 3% limit on redemptions. Use by the industry of this carve-out from the 3% limit would favor those acquired funds that can be sold in secondary market transactions, to the detriment of mutual funds. It may also leave the acquiring fund with a narrower universe of potential acquired funds.

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[20] The Liquidity Rule defines an "In-Kind ETF" as an ETF that meets redemptions through in-kind transfers of securities, positions, and assets other than a *de minimis* amount of cash and that publishes its portfolio holdings daily. 17 CFR § 270.22e-4(a)(9).

[21] Some of the risks that the Commission relied on in the Proposed Release to justify the Proposed Rule's control and voting provisions are less of a concern for In-Kind ETFs, which suggests that In-Kind ETFs should not be subject to the stringent redemption provisions under the Proposed Rule.

A further discussion of the unintended consequences of the proposed redemption limits with respect to portfolio management techniques, existing fund of funds arrangements and the Liquidity Rule is provided below:

i. Impact of Redemption Limits on Existing Fund of Funds Portfolio Management Techniques.

The 3% limit on redemptions from an acquired fund could restrict an acquiring fund's ability to respond to large shareholder redemptions and to gain investment exposures to certain asset classes, and could constrain an acquiring fund from reallocating its assets or optimally rebalancing its portfolio among various underlying acquired funds or other investments. In addition, the limitation could make it difficult for an acquiring fund with a significant investment in an acquired fund to replace that acquired fund in a reasonable time period following a decision to make such an investment change, which could be problematic where the acquiring fund's adviser perceives the need to act quickly. In that regard, the Proposing Release notes that, assuming an acquiring fund holds up to 25% of the outstanding shares of an acquired fund and is subject to the Proposed Rule's 3% limit on redemptions, it could take an acquiring fund ten months to fully unwind its investment in an acquired fund.[22] An acquiring fund could seek to address this challenge under the Proposed Rule by holding a larger percentage of its assets in cash and/or limiting its investments in acquired funds to 3% or less of the acquired fund's total outstanding shares. Either of these options, however, could have an adverse effect on the acquiring fund's performance, hamper the development of certain investment strategies and make investments in smaller, niche acquired funds or newly launched acquired funds less attractive investments. Consider the latter example where an acquiring fund shifts from investing in a small number of acquired funds to investing less than 3% of its assets in dozens of acquired funds to comply with the Proposed Rule – this could create suboptimal allocation and increased expenses for the acquiring fund. Other acquiring funds, such as a target date fund, whose portfolio is constructed based on an asset allocation mix that becomes more conservative as the target date approaches may not, as a result of the Proposed Rule, be able to change asset allocations in accordance with their intended glide path.

ii. Impact of Redemption Limits on Existing Fund of Funds Arrangements that Cannot Rely on Section 12(d)(1)(G).

Affiliated Funds of Funds would not be restricted by the 3% limit on redemptions under the Proposed Rule if they were to rely solely on Section 12(d)(1)(G). However, acquiring funds that seek to invest in acquired funds that are not in the same family of funds would not be able to rely on Section 12(d)(1)(G) to avoid the constraint of the Proposed Rule's 3% limit on redemptions. These funds would have limited options—operate subject to the 3% redemption limit, restructure to an Affiliated Fund of Funds arrangement (which could potentially adversely affect acquired funds in unaffiliated fund of funds arrangements) for a limited group of fund of funds, convert to a collective investment trust or other vehicle that is not subject to the limits in Section 12(d)(1), or, more likely, liquidate. In addition, under the Proposed Rule, these unaffiliated funds of funds might face certain challenges in seeking to comply with the 3% limit

[22] *See* Proposing Release, at 1320 n. 260.

on redemptions, as they would not necessarily have real-time daily knowledge of the size of any unaffiliated acquired fund.[23]

iii. Impact of Redemption Limits As a Result of Liquidity Risk Management Programs.

The Proposed Rule's redemption limits would have important implications for a registered open-end acquiring fund's liquidity risk management program adopted under Rule 22e-4 of the 1940 Act (the "Liquidity Rule").[24] Under the Liquidity Rule, Open-End Funds must treat securities that cannot be sold or disposed of in seven calendar days or less as "illiquid."[25] As the Proposed Rule would restrict the redemption of holdings above 3% of the acquired fund's shares within a 30-day period, those holdings would be rendered illiquid. Any such holdings must, in the aggregate, comprise 15% or less of the fund of funds' net assets under the Liquidity Rule. This limitation may make it difficult to manage a fund of funds that cannot rely on Section 12(d)(1)(G), *i.e.,* one in which the adviser, as a fiduciary, believes that an investment in an unaffiliated fund is warranted.[26] It also practically may limit the fund of funds' investment options. We further note that an open-end acquired fund is itself subject to the liquidity risk management provisions of the Liquidity Rule, and thus, there is a question as to the additional utility of a 3% limit on redemptions from such acquired fund. In that regard, the Liquidity Rule was adopted, in part, to "reduce the risk that a fund will be unable to meet its redemption obligations[.]"[27]

If a redemption limit is included in the final rule, we urge the Commission to specify that an investment made in reliance on the final rule is not "illiquid" for purposes of the Liquidity Rule and the final rule's redemption limit should only be considered for purposes of the Liquidity Rule's classification requirement.

Given the lack of actual harm in the marketplace under the existing fund of funds framework and the significant impact the redemption limits would have on existing fund of funds arrangements, including rendering certain of such arrangements nonviable, we urge the Commission to reconsider including the redemption limits as a condition.

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[23] "[T]he acquiring fund would need to track its redemptions of acquired fund shares." Proposing Release, at 1300.

[24] "An acquiring fund that holds more than 3% of an acquired fund's total outstanding shares should take this [redemption] limitation into account when classifying this portfolio investment as part of its liquidity risk management program under [the Liquidity Rule]." Proposing Release, at 1299-1300 n. 128.

[25] The Liquidity Rule defines an "illiquid investment" as "any investment that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment . . . ." 17 CFR § 270.22e-4(a)(8).

[26] As noted above, acquiring funds also may face some practical challenges monitoring compliance with this requirement with respect to unaffiliated acquired funds, as the acquiring fund may not know how many acquired fund shares are outstanding on a given day.

[27] *Investment Company Liquidity Risk Management Programs*, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)] at 82143.

c. Complex Structures

In attempting to address a Congressional concern underlying Section 12(d)(1) that multi-tier structures *(i.e.*, fund of funds structures involving three or more tiers) may lead to excessive fees and investor confusion, the Proposed Rule "would include conditions designed to prevent the creation of complex structures that could cause investor confusion or result in duplicative and excessive fees."[28] While we support certain aspects of the Proposed Rule in this regard and believe they will be helpful in furthering these goals, we believe, as discussed below, that certain elements of the proposal relating to multi-tier structures should be reconsidered as we believe they will not result in any meaningful benefits to shareholders, may adversely affect fund performance and increase costs to shareholders, and do not directly address Congressional and Commission concerns regarding funds of funds structures.

i. Certain Current Multi-Tier Structures Should Be Preserved

We believe that multi-tier structures have the potential to benefit shareholders in a wider array of circumstances than recognized by the Commission in the Proposing Release, and that certain multi-tier structures undertaken under the current regulatory framework should continue to be permitted under the proposal. The Proposed Rule would prohibit a fund that is relying on Section 12(d)(1)(G) or the Proposed Rule from acquiring outstanding voting securities in excess of the limits in Section 12(d)(1)(A) of any fund that discloses its status as an acquiring fund.[29] In addition, the Proposed Rule would generally prohibit acquired funds from investing in other investment companies or private funds in excess of the limits in Section 12(d)(1)(A).[30] The Proposed Rule would permit an acquired fund to invest in a fund in excess of the limits in Section 12(d)(1)(A) in certain limited circumstances, including, among others, if the acquired fund invests in a fund for short-term cash management purposes pursuant to Rule 12d1-1 or exemptive relief.[31]

Notwithstanding the proposed exceptions to the limitations on multi-tier structures, the Committee believes that rescission of various orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) and related no-action and interpretive letters, as contemplated by the proposal, would be disruptive to current multi-tier structures that are operating effectively and are beneficial to shareholders, and that requiring those structures to be restructured would be costly to shareholders and could result in inefficient implementation of portfolio management strategies. For example, without the ability to rely on existing relief, the conditions in the Proposed Rule relating to multi-tier structures would require advisers, with the oversight of fund boards, to restructure certain current existing multi-tier structures that benefit from being able to

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[28] Proposing Release, at 1306.

[29] Proposed Rule 12d1-4(b)(4)(ii). Proposed Rule 12d1-4(b)(4)(i) requires a fund to disclose in its registration statement that it is (or may be) an acquiring fund.

[30] Proposed Rule 12d1-4(b)(4)(iii).

[31] *See* Proposed Rule 12d1-4(b)(4)(iii)(A) (the acquired fund's investment is in reliance on Section 12(d)(1)(E)), Proposed Rule 12d1-4(b)(4)(iii)(B) (the acquired fund invests for short-term cash management purposes pursuant to Rule 12d1-1 or exemptive relief), Proposed Rule 12d1-4(b)(4)(iii)(C) (the acquired fund invests in a subsidiary that is wholly-owned and controlled by the acquired fund), Proposed Rule 12d1-4(b)(4)(iii)(D) (the acquired fund receives securities as a dividend or as a result of a company's plan of reorganization) and Proposed Rule 12d1-4(b)(4)(iii)(E) (the acquired fund acquires the securities to engage in interfund borrowing and lending transactions pursuant to exemptive relief).

invest in a "central" fund. Under the Proposed Rule, multi-tier structures that use "central" funds (which "centralize" the portfolio management of floating rate or other instruments) would need to be restructured, as discussed further below (unless other exemptive relief was granted by the Commission or no-action or interpretive relief was issued by its staff). In addition to higher shareholder costs and inefficient portfolio management strategies, such restructurings may result in transaction costs and unforeseen tax consequences. Certain other multi-tier structures such as "funds of sleeves," in which a fund has multiple sub-advisers, may also be forced to restructure, which could bring about administrative challenges, causing some investment managers to instead choose to devote more resources to hedge funds, bank collective investment funds or other unregistered accounts.

We understand the Commission's concerns with respect to multi-tier structures, which include duplicative and excessive fees, undue influence exerted by an acquiring fund over an acquired fund, and investor confusion,[32] and we agree with the Commission that these concerns are not implicated by certain multi-tier structures, such as those exceptions currently proposed, noted above. While the proposal permits limited enumerated multiple-tier arrangements, however, we believe that there are other currently permitted multi-tier structures that also do not implicate the Commission's concerns and therefore should not be prohibited under the final rule.

We are most concerned that a fund's investment in a central fund, even for short-term cash management purposes, would not be covered by the above exceptions even though it is a cost-effective practice that benefits shareholders. In addition to the exemptive relief under Section 12(d)(1) received by many fund complexes,[33] the *Franklin Templeton* No-Action Letter and *Thrivent* No-Action Letter currently provide no-action relief for underlying funds to invest in central funds.[34] While the proposal clearly calls for the rescission of all orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) (except for those orders providing relief from Section 12(d)(1)(A) and (B) with respect to certain interfund lending arrangements), the proposal notes that the Division is reviewing staff no-action and interpretative letters relating to Section 12(d)(1) to establish whether any of those letters should be withdrawn as well.[35]

We believe that multi-tier arrangements involving central funds do not raise concerns of undue influence or duplicative fees, since central funds generally charge no management or distribution fees and are available only to affiliated funds, most commonly for short-term cash management purposes. Under the *Franklin Templeton* No-Action Letter, a fund of funds relying on Section 12(d)(1)(G) may invest in an underlying fund that invests in shares of a central fund, with up to 5% of the underlying fund's assets invested in the central fund and up to 10% of the underlying fund's assets invested in the central fund and other funds, notwithstanding the Section 12(d)(1)(G) condition requiring each underlying fund to adopt a

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[32] *See Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, H.Rep. No. 2337, 89th Cong., 2d Sess. 312-324 (1966). *See also* Proposing Release, at 1306.

[33] *See, e.g.*, Highland Capital Management, L.P., *et al.*, Investment Company Act Release Nos. 29890 (Dec. 19, 2011) [76 FR 80424 (Dec. 23, 2011)] (notice) and 29918 (Jan. 17, 2012) (order) and related application. Brinker Capital Destinations Trust, *et al.*, Investment Company Act Release Nos. 32478 (Feb. 14, 2017) [82 FR 11277 (Feb. 21, 2017)] (notice) and 32534 (Mar. 16, 2017) (order) and related application.

[34] *Franklin Templeton Investments*, Staff No-Action Letter (April 3, 2015); *Thrivent Financial for Lutherans and Thrivent Asset Management LLC*, Staff No-Action Letter (Sep. 27, 2016).

[35] Proposing Release, at 1311-1312.

policy that prohibits it from investing in other funds in reliance on Section 12(d)(1)(F) or (G). The *Thrivent* No-Action Letter expands this relief to allow an underlying fund to invest up to 25% of its assets for short-term cash management purposes in a fixed-income fund that has a dollar-weighted average portfolio maturity of up to 3 years.

The Committee strongly believes that the *Franklin Templeton* and *Thrivent* No-Action Letters should not be withdrawn, and it would favor the codification of this relief. The Proposed Rule currently permits an acquired fund's investment "for short-term cash management purposes pursuant to [Rule 12d1-1] or exemptive relief from the Commission."[36] Unless otherwise permitted by exemptive relief, this exception would only apply to investments in money market funds. However, we believe that it is also important for acquired funds to continue to be able to invest in short-term bond funds for short-term cash management purposes (as is permitted under certain current exemptive relief and the *Thrivent* No-Action Letter). If cash management central funds need to become money market funds under the proposal or if portfolio managers are required to find other cash management strategies, the flexibility of the portfolio managers of such funds would be significantly limited, which may ultimately increase costs and reduce the returns to shareholders of the investing funds. In addition, it is unclear whether the Commission would be willing to grant exemptive relief that would permit funds to invest generally in all types of central funds, such as short-term bond central funds, and, if so, how the conditions of the exemptive relief would differ. For all of these reasons, we recommend that the Commission make it clear that funds in multi-tier arrangements will have the ability to invest in central funds whether in reliance on Section 12(d)(1)(G) or the Proposed Rule. In addition, since we do not believe that investment in central funds implicates the Commission's concerns, we hope that the Commission will further consider expanding the relief to use *Thrivent's* 25% limit for all underlying fund investments in central funds or to eliminate the limit altogether (as in Rule 12d1-1).

In addition to our views stated above regarding the use of central funds, we believe that Rule 12d1-4 when adopted should provide an exception for acquired funds to equitize cash by investing in other funds, such as certain ETFs. Consistent with the rationale supporting the use of central funds, upon which the Commission's staff has agreed in the past, the ability of a fund to equitize cash and, in the case of certain Closed-End Funds, such as interval funds and tender offer funds, to potentially increase the fund's liquidity by investing in ETFs, is a valuable and efficient portfolio management tool and benefits shareholders. Any potential confusion to shareholders could be addressed by clear disclosure regarding an acquired fund's cash management and liquidity strategies.

Finally, we note that the Commission emphasized the fiduciary duty imposed on advisers by Section 36(b) of the 1940 Act with respect to the Proposed Rule's provision requiring an acquiring fund's adviser to determine that it is in the best interest of the acquiring fund to invest in an acquired fund. As an adviser of a fund using a multi-tier structure is also subject to this fiduciary duty, we believe that advisers should be able to determine that certain multi-tier structures (particularly those permissible under current relief, such as the use of a central fund) are in the best interest of the acquiring fund.

[36] Proposed Rule 12d1-4(b)(4)(iii)(B).

ii. Best Interest Determination as to Complex Structures and Layering of Fees

Regarding complex structures and duplication of fees, the Proposed Rule would address various types of acquiring funds differently.

Management companies. Proposed Rule 12d1-4(b)(3)(i) requires the investment adviser of an acquiring fund that is a management company to determine that such fund's investment in an acquired fund is in the best interest of the acquiring fund, based upon the investment adviser's evaluation of (i) the complexity of the fund of funds structure, and (ii) the aggregate fees associated with the acquiring fund's investment in an acquired fund, before causing the fund to invest in an acquired fund in reliance on the Proposed Rule.[37] The adviser must present this best interest determination, as well as its underlying rationale, to the board of the acquiring fund in advance of the fund's investment in an acquired fund in reliance on the Proposed Rule. Thereafter, the adviser must make the same determination, based on an evaluation of the same factors, "with such frequency as the acquiring fund's board of directors deems reasonable and appropriate, but in any case, no less frequently than annually."[38]

The Proposing Release requests comment on whether the best interest determination in sub-paragraph (i) should be required in the first instance and, if so, whether the Proposed Rule should dictate the frequency with which the adviser should make this determination.[39] The Committee strongly agrees with the Commission's observation that "whether to invest in an acquired fund to achieve a fund's investment objective, rather than other types of assets, is a question of portfolio management"[40] and with the Commission's decision to not require acquiring fund boards to make specific findings provided for in some of the Commission's currently outstanding exemptive orders relating to Section 12(d)(1), such as a determination that advisory fees payable by an acquiring fund are based on services provided by its adviser "that are in addition to, rather than duplicative of, the services provided by an adviser to an acquired fund." The Committee likewise agrees with the statements in the Proposing Release that a fund board's role, in this area as in most others, is to provide oversight.[41] The Committee suggests, however, that the requirements of periodic "best interest" determinations and related mandatory board reporting are not necessary and urges that they be reconsidered by the Commission.

First, an acquiring fund's investment adviser provides continuous investment management services to the fund. The Commission has noted on many occasions that an investment adviser has a fiduciary duty to its advisory clients.[42] As the Commission notes, an investment adviser's decisions regarding an acquiring fund obtaining desired exposure through investment in an acquired fund versus through another means is a matter of ordinary course portfolio management, and there would seem to be

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[37] Proposing Release, at 1302.

[38] *Id.*

[39] *Id.*, at 1305.

[40] *Id.*, at 1302.

[41] *See infra*, note 3.

[42] *See, e.g.*, Proposing Release, at 1297 (citing the U.S. Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1964)); Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003), n.68.

no need for the specific determinations contemplated by the Proposed Rule, or for fund boards to be asked to prescribe how frequently they should be made. Such determinations are implicit in the investment management duties of a fund adviser and the Committee questions whether the Commission should, in a rule, provide that they would only be made from time to time. The Committee, on the other hand, agrees that it is entirely consistent with the Commission's role to provide guidance to fund advisers on the types of factors it believes investment advisers should consider in evaluating fund of funds arrangements, and urges that the adopting release for a final rule include guidance of the type included in the Proposing Release.

Second, the Committee is concerned that the board reporting requirement in sub-paragraph (i) may unduly burden fund boards with yet another mandatory report, as well as a further requirement for them to specify frequency, in an environment where the Commission and its staff have rightly been focused on freeing fund boards to exercise their oversight responsibilities in the way they believe is most consistent with effective oversight in each board's particular circumstances. The Committee suggests that the Proposed Rule be revised so as to not require fund boards to receive and review a new class of potentially complex and "data heavy" reports that they may not feel are necessary or helpful to them in exercising their oversight role. The Commission recognizes in the Proposing Release that an adviser's decision to obtain exposure for a fund through investment in another fund is a portfolio management decision,[43] and fund boards ordinarily do not involve themselves in portfolio management decisions as this would conflict with their oversight role and potentially involve them in the adviser's routine investment judgments (which include analysis of the fee and expense structure of acquired funds, and whether such investments are in keeping with the best interests of acquiring fund shareholders). Fund boards would review any materials provided by the adviser and, if the Commission mandates relatively frequent reporting, fund boards could expend significant time and effort considering such reports, which may actually inhibit them from exercising their intended oversight role. This requirement therefore risks overburdening fund boards with a new category of unnecessary compliance-type report and distracting them from their core responsibilities. Relatedly, the reporting requirement could present boards with new logistical difficulties. Given the challenges inherent in scheduling fund board meetings, which are often held quarterly, this requirement could result in unnecessary delays in an acquiring fund's investments in other funds.

As noted above, the Commission acknowledges in the Proposing Release that the intended role of fund boards is one of oversight rather than day-to-day supervision.[44] The Committee urges the Commission to view the board's role in overseeing an acquiring fund's compliance with any final rule in the context of its oversight of compliance generally. In adopting Rule 38a-1 under the 1940 Act, which requires funds to adopt compliance programs and to appoint a chief compliance officer ("CCO") to manage such programs, the Commission stated that "providing fund boards with direct access to a single person with overall compliance responsibility for the fund" would "enhance the efficiency of funds' ... operations by

[43] Proposing Release, at 1302.

[44] *See, e.g.*, Proposing Release at 1302 (stating that the "acquiring fund's board of directors would be required to review these arrangements, and any conflicts they may present, as part of its *oversight* responsibilities", and that the rationale of the adviser reporting requirement is to "enable effective board oversight" over fund activities) (italics added).

centralizing responsibility for the compliance function" under the CCO.[45] The Commission envisioned that boards would exercise oversight of the compliance program without "becom[ing] involved in the day-to-day administration of the program."[46] The Division has reiterated and affirmed this commitment to retaining the oversight role of fund boards. In a 2018 no-action letter, the Division declined to recommend enforcement action against fund directors who sought to rely on CCO reports concluding that transactions effected in reliance on certain exemptive rules were compliant with board procedures adopted pursuant to the relevant exemptive rule, rather than the board itself making such determinations.[47] The Committee envisions that prior to the effective date of a final fund of funds rule, many if not most acquiring fund CCOs would develop and implement compliance policies and procedures reasonably designed to ensure compliance with the rule and that no special board reporting would be required unless a fund board determines that such reporting would be helpful to it in exercising its oversight responsibilities.

The Committee urges the Commission to reconsider the role of fund boards as reflected in the Proposed Rule and to adopt a final rule that does not mandate new compliance burdens on fund boards that are inconsistent with their oversight role. However, to the extent the Commission determines to retain the proposed best interest determination and board reporting requirement, the Committee urges that the Commission not require that fund boards review the adviser's initial determination to invest in acquired funds prior to such investments being made. Proposed Rule 12d1-4(b)(3)(i) states that an acquiring fund's adviser must make a best interest determination "before investing in an acquired fund in reliance on [the Proposed Rule], and with such frequency as the acquiring fund's board of directors deems reasonable and appropriate thereafter", and must "report its finding and the basis for the finding to the acquiring fund's board of directors." However, it is unclear whether such a determination must be made and presented in advance of the first investment in a given acquired fund, or in advance of all investments in such fund. The Proposing Release suggests that advisers could effectively pre-approve investments in acquired funds fitting within certain routine parameters, without needing to report to the board on all such investments, noting that an adviser "could consider establishing parameters for routine investments in acquired funds, and review individual transactions that are outside of those parameters."[48] The Committee requests clarification on the minimum board reporting requirements to which advisers to acquiring funds will be subject, and urges that, given these are portfolio management decisions and compliance with the new rule will be overseen by a fund's CCO, after-the-fact board reporting be satisfactory so as not to deprive acquiring funds of the ability to take advantage of investment opportunities on a timely basis.

In response to the Commission's request for comment on the required frequency of reporting, the Committee believes that fund boards should be able to select their desired reporting frequency and that Rule 12d1-4 as adopted should not mandate any minimum frequency. The Commission's confirming this principle would be consistent with the Commission's statement in the Proposing Release that the board "is in the best position to understand when such a review would be appropriate and the frequency thereof."[49]

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[45] *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IA-2204, 64 Fed. Reg. 247 (Dec. 24, 2003), available at https://www.sec.gov/rules/final/ia-2204.pdf, at text accompanying note 42.

[46] *Id.*

[47] *See Independent Directors Council*, SEC No-Action Letter (Oct. 12, 2018).

[48] Proposing Release, at 1302.

[49] *Id.*

If the Commission believes that some minimum reporting threshold is needed, the Committee supports that it be no more frequent than annually. Of course, a fund board would be free to request more frequent reports, or additional reports, from the fund's adviser at any time.

UITs. We support the Proposed Rule's requirements for a UIT regarding aggregate UIT and acquired fund fees, and the associated responsibilities of a principal underwriter/depositor.

Separate account funding variable insurance contracts. The Committee does not support the proposal to require a "certification" from the insurance company or any other such evaluation on the company's part. An insurance contract's fees and expenses relate to contract costs at the separate account level, and not to an underlying fund that supports the separate account. Section 26(f)(2)(A) of the 1940 Act relates to the fees and expenses at the contract level. Moreover, the Section's enumerated factors are directed to the insurance contract's terms rather than the terms of the underlying funding vehicle.

Any acquiring fund – including one that supports a variable insurance contract – should be evaluated based on the merits of its own investments, risks, and fees and expenses, including any underlying fund fees and expenses. An insurance company should not be required to make a determination relating to its funding vehicle. The insurance contract and the funding vehicle are separate and distinct regarding their costs and the services provided. In addition, requiring an insurance company to evaluate its often numerous combination of funding vehicles is an unnecessary administrative burden.

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PART II

The Commission has requested comments on whether private funds should be permitted to rely on the Proposed Rule. The Committee believes strongly that private funds should be covered by the terms and conditions of Rule 12d1-4 as adopted by the Commission.

Expanding the scope of the Proposed Rule to cover private funds would, as suggested by the Commission, "broaden the funding opportunities for acquired funds."[50] The Division's most recent statistics indicate there are approximately 3,000 advisers to private funds[51]. Private funds invest in funds of funds and ETF's for a range of investment purposes including to efficiently gain access to different sectors and markets and for hedging and risk management.

In seeking comment on the exclusion of private funds from the Proposed Rule, the Commission identifies three potential regulatory distinctions between registered investment companies and private funds. First, that not all advisers to private funds are required to register with the Commission. Second, that private funds and their advisers are not subject to the same reporting requirements as registered funds. And third, that private funds and their advisers are not subject to the same recordkeeping requirements as registered funds.

[50] 84 F.R. at 1331.

[51] Private Fund Statistics, SEC Division of Investment Management (May 2019).

Registered Advisers. The Commission asks whether limiting the availability of Proposed Rule 12d1-4 to those advisers registered with the Commission would be a useful approach. The Committee believes that such an approach would be useful and appropriate. We note that doing so would facilitate the Commission's oversight with respect to fund of funds arrangements under the Proposed Rule. Most advisers to private funds are required to regularly report to the Commission with respect to their investment portfolios in Form PF, and also are subject to regular examination by the Commission's Office of Compliance Inspections and Examinations.

Reporting. The Commission notes that, unlike registered funds, private funds are not subject to reporting on Forms N-CEN and N-PORT. The Committee acknowledges this distinction but submits that advisers to private funds that are registered under the Advisers Act report significant information to the Commission with respect to private funds and their investments in other funds that would provide the Commission a basis with which to ensure that the goals of Rule 12d1-4 are met.

Form ADV.

- Section 7.B.(1) of Form ADV under the Advisers Act requires registered advisers to report whether each private fund is a "fund of funds", defined as a fund that invests 10% or more of its total assets in other pooled investment vehicles, including other private funds or registered investment companies.[52]

- Section 7.B.(1) also requires registered advisers to report whether each private fund has invested in the assets of any registered investment company, regardless of ownership level, during its last fiscal year.[53]

- Form ADV also provides a substantial amount of information regarding the registered investment adviser, its policies and procedures and its key personnel. Notably, for each private fund advised by a registered adviser, information must be provided regarding the fund's assets, investment strategies, directors, investor composition, prime brokers, custodians and auditors.

Form PF

- Registered investment advisers with hedge fund regulatory assets under management exceeding $1.5 billion provide on a quarterly basis the exposures for each hedge fund that they advise, broken out on a monthly basis and classified by asset class and geographic location, as well as fund-level risk metrics and borrowings.[54]

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[52] Form ADV, Part 1A, Schedule D, Section 7.B.(1), Question 8 at https://www.sec.gov/about/forms/formadv-part1a.pdf.

[53] Form ADV, Part 1A, Schedule D, Section 7.B.(1), Question 9 at https://www.sec.gov/about/forms/formadv-part1a.pdf.

[54] Form PF, Questions 29-47 at https://www.sec.gov/about/forms/formpf.pdf.

- Form PF requires advisers to private funds to provide monthly information with respect to their investments in registered investment companies.

- In addition, the acquired funds into which private funds would invest would be required to file N-PORT so that the Commission would receive transparency into the acquired fund's portfolio.

The Committee recognizes that the reporting requirements set out above are not identical to those of N-CEN and N-PORT. If the Commission believes that uniform reporting with respect to fund of funds arrangements is paramount, then rather than excluding private funds, the Commission could consider conditioning reliance on Rule 12d1-4 as adopted with additional reporting. For example, Form ADV could be amended as suggested by the Commission in the Release[55] to include a question regarding whether a private fund relies on Rule 12d1-4, which would allow the Commission to track which private funds avail themselves of the rule.

Form 13F

Another existing reporting requirement that would provide the Commission with information about private funds' holdings of shares of some registered investment companies is Form 13F under the Securities Exchange Act of 1934. Registered investment advisers with $100 million or more of investments in the relevant securities are required to make quarterly filings with the Commission on Form 13F. Such reporting includes holdings in ETFs and closed-end investment companies.[56]

Recordkeeping. Registered investment advisers to private funds are subject, in addition to the reporting requirements described above, to comprehensive recordkeeping requirements relating to the investments and operations of private funds. Rule 204(2) under the Advisers Act specifies the books and records to be maintained by registered advisers, which include records of all securities transactions. The specific recordkeeping required by the Proposed Rule would be equally applicable to private funds as well as registered investment companies, if the Proposed Rule is expanded to cover private funds.

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[55] 84 Fed. Reg. 1291.

[56] Division of Investment Management: Frequently Asked Questions About Form 13F, Question 7 (Mar. 15, 2017) at: https://www.sec.gov/divisions/investment/13ffaq.htm.

The Committee appreciates the opportunity to comment on the Proposed Rule, and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters and to respond to any questions.

Very truly yours,

Robert E. Buckholz
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