MEMO# 31741

May 6, 2019

ICI Comment Letter on SEC's Proposed Fund of Funds Rule

[31741]

May 6, 2019 TO: ICI Members
Investment Company Directors
Closed-End Investment Company Committee
ETF (Exchange-Traded Funds) Committee
ETF Advisory Committee
ICI Securities Regulation Advisory Group
SEC Rules Committee SUBJECTS: Closed-End Funds
Exchange-Traded Funds (ETFs)
Variable Insurance Products RE: ICI Comment Letter on SEC's Proposed Fund of Funds Rule

As you know, in December, the Securities and Exchange Commission proposed a new rule and related amendments under the Investment Company Act of 1940 designed to streamline the regulatory framework for funds that invest in other funds ("fund of funds" arrangements). The SEC also is proposing to rescind Rule 12d1-2 under the Investment Company Act and most exemptive orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Act. Finally, the SEC is proposing related amendments to Rule 12d1-1 under the Act and Form N-CEN.

Although we commend the SEC for its efforts to streamline the regulation of funds of funds, the SEC's proposed approach will disrupt a significant number of such arrangements and deprive investors of investment opportunities that have served investors both efficiently and successfully for many years. As a result, we believe that some aspects of the proposed rule must be modified.

ICI's comment letter is attached and briefly summarized below.

Summary of Comments and Recommendations

In summary, we support the Commission's goal to streamline the regulation of funds of funds and our comments and recommendations, reflecting that shared goal, include the following:

- *Redemption Restriction*. The proposed restriction on the ability of acquiring funds to redeem shares of acquired funds should be removed from the rule. This restriction is not consistent with the manner in which Congress and the SEC successfully have regulated funds of funds for more than 20 years and would significantly disrupt existing fund of funds arrangements without any justification. Among other issues, the proposed redemption restriction would harm investors in funds of funds by imposing arbitrary liquidity constraints on investments that otherwise offer daily redemptions to all other types of investors and by treating them differently than if they were direct investors in the underlying funds. It also seems to ignore the responsibilities and obligations of funds and advisers under Investment Company Act Rule 22e-4, the liquidity risk management rule. We suggest adopting a regulatory approach similar to the approach that Congress and the SEC have previously taken and that has been serving investors very effectively for decades.

- *Other Conditions*. We generally support other proposed conditions to the rule. We believe, however, that some of the requirements relating to the voting of shares of underlying management investment companies should be revised to align with the tested and familiar approach in the current exemptive orders. We also believe that the finding that an acquiring fund adviser would be required to make regarding the complexity and aggregate fees of a fund of funds arrangement should be more specific, and that an acquiring fund should not be required to obtain a certification regarding separate account fees from an insurance company. Finally, we believe that the restrictions on multi-tier arrangements should include additional exceptions, including an exception that would specifically permit funds of funds to use short-term bond funds for cash management purposes consistent with current practice.
- *Scope of Proposed Rule*. With respect to the scope of the relief, we support, as proposed, expanding the relief to include all types of registered investment companies and BDCs as either acquiring funds or acquired funds. We also believe that the SEC should consider further expanding the scope of the relief to permit private funds and foreign funds to rely on the rule to invest in registered funds or BDCs.
- *Changes to Existing Regulatory Regime*. With respect to the proposal to rescind all orders granting relief from Sections 12(d)(1)(A), (B), (C), and (G) of the Investment Company Act, with the exception of interfund lending orders, we believe that the SEC should clarify that the types of orders that would be rescinded are only those relating to fund of funds arrangements addressed by the proposed rule. Similarly, the SEC indicates that the Division of Investment Management is considering withdrawing all staff interpretive and no-action relief that would be moot, superseded, or otherwise inconsistent with the rule. Given that such guidance and no-action relief are extensive and have been provided over many decades, we believe that the SEC and/or the Division of Investment Management should retain certain letters as discussed in the letter or incorporate the staff interpretive and no-action relief into the rule. We believe such an approach is fully consistent with the Commission's goal of streamlining fund of funds regulation.
- *Acquired Fund Fees and Expenses and Investing Related Expense Disclosure.* We recommend that the SEC permit funds to exclude BDCs from the definition of "acquired fund" for purposes of the prospectus fee table presentation. This would allow funds to treat BDCs in the same manner as investments in operating companies for expense presentation purposes. We also recommend that the SEC require funds to disclose investing related expenses in the fund's Statement of Additional Information (SAI) and financial statements rather than in the prospectus fee table.
- *Legislative Changes to Address Private Fund Investments in Closed-End Funds*. In conjunction with the rulemaking, we urge the SEC to work with Congress to introduce legislation that prohibits private funds from exceeding the Section 12(d)(1) restrictions when investing in closed-end funds. Contrary to the statutory intent of the section, some private funds are able to exert undue influence over closed-end fund operations

to the detriment of long-term shareholders. Amendments to Section 12(d)(1) would limit private fund acquisitions in a manner consistent with the intended goals of the statute.

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Attachment