

MEMO# 20707

December 19, 2006

SEC Staff Guidance on Definition of "Acquired Funds" in Fund of Funds Disclosure Rules

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20707] December 19, 2006 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 63-06 SEC RULES MEMBERS No. 110-06 SMALL FUNDS MEMBERS No. 87-06 UNIT INVESTMENT TRUST MEMBERS No. 29-06 VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 14-06 RE: SEC STAFF GUIDANCE ON DEFINITION OF "ACQUIRED FUNDS" IN FUND OF FUNDS DISCLOSURE RULES In June, the Securities and Exchange Commission adopted new fund of funds rules that, among other things, mandate new disclosure of the fees and expenses of "Acquired Funds."¹ At a recent meeting of the Institute's SEC Rules Committee, SEC staff clarified that the term "Acquired Funds" for this purpose was intended to cover mutual funds, hedge funds, private equity funds, and other pooled investment vehicles, but not other securities, such as structured finance products and collateralized debt obligations. The new fund of funds rules require that any registered fund investing in shares of another fund include in its prospectus fee table an additional line item titled "Acquired Fund Fees and Expenses." The instructions to the registration statement disclosure forms define "Acquired Fund" as any company in which a fund has invested during the relevant period that "(A) is an investment company or (B) would be an investment company under section 3(a) of the Investment Company Act ... but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Investment Company Act."² At the recent SEC Rules Committee meeting, SEC staff addressed the question of whether certain types of securities that rely on the exceptions in Sections 3(c)(1) and 3(c)(7), such as certain structured finance products and collateralized debt obligations, were covered by the definition of 1 See Memorandum No. 20135, dated June 28, 2006. 2 See Form N-1A, Item 3, Instruction 3(f)(i); Form N-2, Item 3, Instruction 10.a.; Form N-3, Item 3, Instruction 19(d); Form N-4, Item 3, Instruction 17(a); and Form N-6, Item 3, Instruction 4(b). This new disclosure obligation applies to registration statements filed on or after January 2, 2007. 2 "Acquired Fund." The staff affirmed that the definition of Acquired Fund was not intended to capture these types of securities, but rather was intended to cover mutual funds, hedge funds, private equity funds, and other securities traditionally thought of as pooled investment vehicles. The staff stated that it did not expect the SEC or the staff to take action (e.g., through disclosure comments, inspection deficiency letters, or enforcement referrals) based on a fund's failure to include in its "Acquired Fund Fees and Expenses" the fees and expenses of structured finance products, collateralized debt obligations, and other securities not traditionally thought of as pooled investment vehicles. The disclosure issue is one of several definitional questions arising

under the new fund of funds rules. The staff has invited industry suggestions for a workable distinction between pooled investment vehicles and other securities in the disclosure requirement, as well as a definition of “securities” in the context of Rule 12d1-2 that would accurately reflect investments in derivative instruments that prior exemptive relief has allowed. The staff has also agreed to consider technical questions from the industry, and may address them in a Q&A format. The Institute will continue to work with the staff to clarify and resolve these issues. If you have suggestions or other issues to discuss under the fund of funds rule, please contact me (202-371-5430 or rcg@ici.org) or Mara Shreck (202-326-5923 or mshreck@ici.org). Robert C. Grohowski Senior Counsel Securities Regulation – Investment Companies

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.