SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 270 and 274

[Release Nos. 33–10871; IC–34045; File No. S7–27–18]

RIN 3235–AM29

Fund of Funds Arrangements

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the “Commission”) is adopting a new rule under the Investment Company Act of 1940 (“Investment Company Act” or “Act”) to streamline and enhance the regulatory framework applicable to funds that invest in other funds (“fund of funds” arrangements). In connection with the new rule, the Commission is rescinding rule 12d1–2 under the Act and certain exemptive relief that has been granted from sections 12(d)(1)(A), (B), (C), and (G) of the Act permitting certain fund of funds arrangements. Finally, the Commission is adopting related amendments to rule 12d1–1 under the Act and to Form N–CEN.

DATES: Effective Date: This rule is effective January 19, 2021.

Compliance Dates: The applicable compliance dates are discussed in sections II.D, II.F and III of this final rule.


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I. Introduction

We are adopting new rule 12d1–4 under the Investment Company Act and several related amendments to streamline and enhance the regulatory framework applicable to fund of funds arrangements. This framework reflects the Commission’s decades of experience with fund of funds arrangements and will create a consistent and efficient rules-based regime for the formation, operation, and oversight of fund of funds arrangements. 2 We believe that this framework will provide investors with the benefits of fund of funds arrangements, and will provide funds with investment flexibility to meet their investment objectives efficiently, in a manner consistent with the public interest and the protection of investors. Funds increasingly invest in other funds as a way to achieve asset allocation, diversification, or other investment objectives. According to staff estimates, approximately 40% of all registered funds hold an investment in at least one fund, and total net assets in mutual funds that invest primarily in other mutual funds have grown from $469 billion in 2008 to $2.54 trillion in 2019. 3 Retail investors similarly use fund of funds arrangements as a convenient way to allocate and diversify their investments through a single, professionally managed portfolio. For example, a fund of funds may provide an investor with the same benefits as separate direct investments in several underlying funds, without the increased monitoring and recordkeeping that could accompany investments in each underlying fund. 4

In December 2018, we proposed rule 12d1–4, which would permit a fund to acquire shares of another fund in excess of the limits of section 12(d)(1) without obtaining an exemptive order from the Commission, subject to certain conditions. 5 Because the proposed rule would provide a comprehensive exemption for funds of funds to operate, the Commission also proposed to rescind rule 12d1–2 under the Act and individual exemptive orders permitting certain fund of funds arrangements. In connection with the proposed rescission of rule 12d1–2, we proposed amendments to rule 12d1–1 under the

2 See infra Table 2. Of those funds investing in other funds, 48% invest at least 5% of their assets in other funds, and 26% hold more than 90% of their assets in other funds. See infra section VI. For more data on fund of funds arrangements, see infra Table 4.

3 During this period the number of mutual funds utilizing this arrangement grew from 836 to 1,469.


5 Target-date funds are a common type of fund of funds arrangement and are designed to make it easier for investors to hold a diversified portfolio of assets that is rebalanced over time without the need for investors to rebalance their own portfolio. See Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Investment Company Act Release No. 29301 (June 16, 2010) [75 FR 35920 (June 23, 2010)] (proposing disclosure requirements for target date retirement funds’ marketing materials).

6 See Fund of Funds Arrangements, Investment Company Act Release No. 10590 (Dec. 19, 2018) [84 FR 1286 (Feb 1, 2019)] (“2018 FOF Proposing Release”). For purposes of this release and rule 12d1–4, we generally use the term “funds” to refer to registered investment companies and business development companies (“BDCs”) unless the context otherwise requires. A BDC is a closed-end fund that: (i) is organized under the laws of, and has its principal place of business in, any state or state; (ii) is operated for the purpose of investing in securities described in section 55(a)(1)–(3) of the Act and makes available “significant managerial assistance” to the issuers of those securities, subject to certain conditions; and (iii) has elected under section 55(a)(1) of the Act to be subject to the provisions addressing activities of BDCs under the Act. See 15 U.S.C. 80a–2(a)(48). Section 6(f) of the Act exempts BDCs that have made the election under section 54 of the Act from registration provisions of the Act.

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Act to allow funds that rely on section 12(d)(1)(G) of the Act to invest in money market funds that are not part of the same group of investment companies. Finally, the Commission proposed certain disclosure amendments to Form N-CEN to provide the Commission additional census-type information regarding fund of funds arrangements.

We received more than 100 comment letters on the proposal. Many commenters supported the Commission’s goal of simplifying the regulatory framework for fund of funds arrangements. However, some commenters recommended modifications to the proposed rule. For example, several commenters suggested changing the scope of arrangements permitted by the rule or expanding the scope of certain exemptions. Many commenters also recommended alternatives to the proposed rule’s conditions. Conditionally unaffiliated fund of funds arrangements were proposed, for example, several commenters suggested changing the scope of arrangements permitted by the rule or expanding the scope of certain exemptions. Many commenters also recommended alternatives to the proposed rule’s conditions.

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The combination of statutory exemptions, Commission rules, and exemptive orders has created a regulatory regime where substantially similar fund of funds arrangements are subject to different conditions. For example, an acquiring fund could rely on section 12(d)(1)(G) and rule 12d1–2 when investing in an acquired fund within the same group of investment companies. Alternatively, the acquiring fund could rely on relief provided by an exemptive order, which would allow it to invest in substantially the same investments, but could require the fund to comply with different conditions. Over time, industry participants have experimented with new fund of funds structures, relying on combinations of statutory exemptions and Commission exemptive orders, and considering staff no-action letters, to create novel fund of funds arrangements. For example, some commenters described funds that have combined various forms of section 12(d)(1) relief to create fund structures that include three or more layers of funds.27

B. Rule 12d1–4 Overview

In order to create a more consistent and efficient regulatory framework for fund of funds arrangements, rule 12d1–4 will permit a registered investment company or business development company (“BDC”) (collectively, “acquiring funds”) to acquire the shares of funds controlled by an investment company or BDC (collectively, “acquired funds”) in excess of the limits in section 12(d)(1), subject to the following conditions:

• Control. Rule 12d1–4 will prohibit an acquiring fund and its “advisory group” from controlling an acquired fund, except in certain limited circumstances.

• Voting. Rule 12d1–4 will require an acquiring fund and its advisory group to use mirror voting if it holds more than 25% of an acquired open-end fund or UIT due to a decrease in the outstanding securities of the acquired fund and if it holds more than 10% of a closed-end fund, with the ability to use pass-through voting when acquiring funds are the only shareholders of an acquired fund.28

• Required Findings. Rule 12d1–4 will require investment advisers to acquiring and acquired funds that are management companies to make certain findings regarding the fund of funds arrangement, after considering specific factors. The final rule also will require certain findings with respect to UITs and separate accounts funding variable insurance contracts, taking into account the unique structural characteristics of such entities.

• Fund of Funds Investment Agreement. Rule 12d1–4 will require funds that do not have the same investment adviser to enter into an agreement prior to the purchase of acquired fund shares in excess of section 12(d)(1)’s limits (a “fund of funds investment agreement”).

• Complex Structures. Rule 12d1–4 will impose a general three-tier prohibition with certain enumerated exceptions. However, in addition to these exceptions, the rule will allow an acquired fund to invest up to 10% of its total assets in other funds (including private funds), without regard to the purpose of the investment or types of underlying funds.

As proposed, we are rescinding rule 12d1–2 under the Act, and amending rule 12d1–1 to allow funds that rely on section 12(d)(1)(G) to invest in money market funds that are not part of the same group of investment companies in reliance on that rule.29 In addition, certain staff no-action letters relating to section 12(d)(1) will be withdrawn.30 The resulting regulatory framework will reduce confusion and subject similar fund of funds arrangements to tailored conditions that will enhance investor protection, while continuing to provide funds with investment flexibility to meet their investment objectives. In addition, the rule will allow the Commission, as well as funds and
advisers seeking exemptions, to focus exemptive order review resources on novel products or arrangements.

II. Discussion

A. Scope

1. Registered Funds and BDCs

As proposed, rule 12d1–4 will permit registered investment companies and BDCs to acquire the securities of other registered investment companies or BDCs in excess of the limits in section 12(d)(1). As a result, open-end funds (including ETFs), UITs (including ETFs organized as UITs), and closed-end funds (including BDCs), can operate in accordance with rule 12d1–4, as both acquiring and acquired funds.31 The scope of permissible acquiring and acquired funds under rule 12d1–4 is greater than the scope of funds that was permitted by the Commission’s exemptive orders. For example, the rule will allow open-end funds, UITs, and ETFs to invest in unlisted closed-end funds and listed BDCs beyond the limits in section 12(d)(1).32 The rule similarly will increase permissible investments for closed-end funds beyond ETFs to allow them to invest in open-end funds, UITs, other closed-end funds, and BDCs, in excess of the section 12(d)(1) limits. BDCs, which currently may invest in ETFs in excess of the section 12(d)(1) limits, also will be permitted to invest in open-end funds, UITs, other BDCs, other closed-end funds and ETMFs. Finally, the rule will allow ETMFs to invest in open-end funds, UITs, BDCs and other closed-end funds. Rule 12d1–4, therefore, will create a consistent framework for all registered funds and BDCs and eliminate unnecessary and potentially confusing distinctions among permissible investments for different types of acquiring funds.

Several commenters supported including all open-end funds, UITs, BDCs and other closed-end funds within the scope of permissible fund of funds arrangements under the rule.33 The commenters noted that proposed rule 12d1–4 would provide funds covered by the rule with flexibility to meet their investment objectives and level the playing field among registered funds and BDCs operating in accordance with the rule. However, one commenter raised concerns with arrangements that the Commission has not previously permitted in exemptive orders.34 This commenter stated that the Commission lacks experience with funds of funds arrangements that include unlisted closed-end funds and BDCs and suggested that permitting these funds to rely on the rule as acquired funds would increase retail investor exposure to higher cost investments. The commenter also questioned whether one rule should apply to all types of fund of funds arrangements, noting that several of the statutory requirements of section 12(d)(1) apply differently to open-end funds and closed-end funds, and the Commission’s historical exemptive relief also treated these types of funds differently. The commenter additionally questioned whether the Commission has appropriately analyzed the risks of fund of funds arrangements involving ETMFs or “non-transparent” ETFs.

After considering these comments, we continue to believe that the universe of permissible fund of funds arrangements generally should not turn on the type of acquiring or acquired fund. Instead, the rule should address differences in fund structures with tailored conditions that protect investors in all types of covered investment companies against the abuses historically associated with funds of funds. We believe the conditions of rule 12d1–4 provide appropriate flexibility for innovative fund of funds structures while creating a consistent and streamlined regulatory framework that protects investors in all types of funds. For example, for a management company to rely on the rule, the investment advisers to both the acquiring and acquired fund must make certain determinations before entering into the fund of funds arrangement.35

Similarly, the rule will also require principal underwriters or depositors of UITs and insurance companies offering certain separate accounts to make findings tailored to their characteristics.36 The rule also imposes a requirement that certain acquiring funds and acquired funds enter into a fund of funds investment agreement, and imposes voting requirements on acquiring funds’ holdings of acquired funds above certain ownership thresholds that differ depending on the type of acquired fund, as described more fully below.37

With respect to BDCs, we believe that the rule’s conditions and existing statutory provisions will protect investors from concerns related to undue influence, fees that are excessive due to being duplicative, or complex structures. For example, as we noted in the proposal, an acquiring fund board already has a responsibility to see that the fund is not overcharged for advisory services regardless of any findings we require.38 Additionally, the rule will require fund of funds arrangements involving BDCs to satisfy the other conditions of rule 12d1–4, including the requirement to make certain findings as described in section II.C.2.b. below. One element of these findings is a determination that the fees and expenses associated with an investment in an acquired fund, including an investment in an acquired BDC, do not duplicate the fees and expenses of the acquiring fund. Further, a BDC operating in accordance with the rule as an acquiring fund is subject to other existing limitations on its ability to invest in acquired funds.39

31 See infra section I.C.2.b.ii. For example, UITs do not have a board of directors and do not engage in active management of a portfolio. The rule therefore will require different determinations for UITs.

32 See infra sections I.C.1 and 2.

33 Specifically, section 15(c) of the Act requires the acquiring fund’s board of directors to evaluate any information reasonably necessary to evaluate the terms of the acquiring fund’s advisory contracts (which information would include fees, or the elimination of fees, for services provided by an acquired fund’s adviser). Section 36(b) of the Act imposes on fund advisers a fiduciary duty with respect to their receipt of compensation. We believe that to the extent advisory services are being performed by another person, such as the adviser to an acquired fund, this fiduciary duty would require an acquiring fund’s adviser to charge a fee that bears a reasonable relationship to the services that the acquiring fund’s adviser is providing, and not to any services performed by an adviser to an acquired fund. See 2018 FOF Proposing Release supra footnote 6, at 63–64.

34 See infra section II.C.2.b.i.


36 See CPA Comment Letter.

37 See infra section I.C.2.b.i.

38 See infra section I.C.2.b.ii. In some instances, commenters have raised concerns with arrangements that do not include the proposed or current holder of the acquired fund. For example, one commenter questioned whether the Commission has properly analyzed the risks of fund of funds arrangements involving BDCs to satisfy the other conditions of rule 12d1–4, including the requirement to make certain findings as described in section II.C.2.b. below. One element of these findings is a determination that the fees and expenses associated with an investment in an acquired fund, including an investment in an acquired BDC, do not duplicate the fees and expenses of the acquiring fund. Further, a BDC operating in accordance with the rule as an acquiring fund is subject to other existing limitations on its ability to invest in acquired funds.
Similarly, we do not believe that including ETMFs or non-transparent ETFs within the scope of the rule will present unique investor protection concerns that we have not already extensively considered and addressed with respect to traditional registered open-end funds and fully transparent ETFs. Along with fully transparent ETFs, ETMFs and non-transparent ETFs generally are subject to the protections of the Act applicable to all registered open-end funds, including governance and other requirements. Accordingly, we believe that the conditions of rule 12d1–4, when combined with the protections imposed by the Act on all investment companies, appropriately address concerns of duplicative fees, undue influence, and complex structures with respect to these products.

Finally, one commenter suggested that the concerns underlying section 12(d)(1) of the Act largely do not apply to ETFs as acquired funds in a fund of funds structure.40 This commenter stated that passive investments in ETFs do not implicate Congress’ concerns regarding duplicative fees and undue influence, particularly when an investor holds an ETF to gain exposure to a particular market or asset class in an efficient manner, to allocate and diversify investments, or efficiently hedge a portion of a portfolio or balance sheet. The commenter stated that ETFs have not been subject to influence from activist investors despite ETF shares trading in the secondary market, perhaps because ETF shares have not historically traded at a significant discount to net asset value. Accordingly, the commenter urged the Commission to exempt the sale of ETFs as acquired funds from the limitations in section 12(d)(1)(B) of the Act.

After considering comments, we continue to believe that investments in ETFs should be subject to the limitations set forth in section 12(d)(1), and that any investments in excess of the 12(d)(1) limits should be subject to protective conditions. As a threshold matter, ETFs issue redeemable securities and are generally classified as open-end funds under the Act.41 As we discussed in our 2008 ETF Proposing Release, we believe that investments in ETFs, similar to investments in traditional open-end funds, raise the same concerns of pyramiding and the threat of large-scale redemptions as other types of open-end funds.42 For example, an acquiring fund might seek to use its ownership interest in an ETF to exercise a controlling influence over the ETF’s management or policies, or to enter into a transaction with an affiliate of the acquiring fund. These concerns are most pronounced when a fund invests in an ETF in a primary market transaction through an authorized participant.43 ETFs, like other open-end funds, also operate pursuant to the prohibition in section 12(d)(1)(B), which provides that it is unlawful knowingly to sell or otherwise dispose of any securities of which the ETF is an issuer to any other investment company in excess of the limits in subsection (i) and (ii). Therefore, ETFs that receive inquiries and other communications from persons identifying themselves as potential purchasers of the ETF’s shares as or through an authorized participant may want to implement policies and procedures to determine whether those persons intend to purchase ETF shares for investment companies.44 Further, principal underwriters and broker-dealers that transact in an ETF’s shares (including an ETF’s authorized participants), are subject to the requirements of section 12(d)(1)(B) of the Act. Accordingly, the final rule will treat ETFs consistently with other open-end funds and will permit investments in ETFs as acquired funds subject to the rule’s conditions designed to protect acquired funds and their shareholders.

2. Private Funds and Unregistered Investment Companies

As proposed, the final rule will not permit private funds and unregistered investment companies, such as foreign funds, to rely on the rule as acquiring funds.45 As a result, private funds and unregistered investment companies may acquire no more than 3% of a U.S. registered fund under the Act.46

Several commenters suggested that the Commission broaden the scope of rule 12d1–4 to permit investments by private funds or unregistered investment companies in acquired funds beyond the limits in section 12(d)(1).47 Some of these commenters highlighted the potential for private and unregistered investment companies to invest in non-transparent investment companies stated that such funds do not operate in a materially different manner from registered funds and therefore the concerns underlying section 12(d)(1) are not pronounced for private and unregistered investment companies nor are different conditions warranted.48

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40 Comment Letter of WisdomTree Asset Management, Inc. (Dec. 12, 2019) (“WisdomTree Comment Letter”).

41 While most ETFs are classified as open-end funds, some ETFs are structured as UITs. Regardless of structure, we continue the redemption of ETF shares in creation unit-sized aggregations by authorized participants insulates ETFs from the abuses that section 12(d)(1) was designed to prevent.

42 See 2008 ETF Proposing Release, supra footnote 18, at 69.

43 See generally 2019 ETF adopting Release, supra footnote 25, at section 1B (explaining that an authorized participant that has a contractual arrangement with the ETF (or its distributor) to purchase and redeem ETF shares directly from the ETF in blocks called “creation units” as a principal for its own account or as agent for others, including institutional investors (such as funds)).

44 For example, an ETF that explains its obligations pursuant to section 12(d)(1)(B) to potential purchasers who reach out directly to the ETF, and documents that exchange with the potential purchaser would satisfy its obligation not to knowingly sell or otherwise dispose of any of its securities in excess of 12(d)(1)(B) limits. Further, if an ETF intends to rely on rule 12d1–4 to exceed the section 12(d)(1) limits, such ETF would be required to comply with the conditions of the rule, including entering into a fund of funds investment agreement with the acquiring investment company.

45 We use the term “foreign fund” to refer to an “investment company” as defined in section 3(a)(1)(A) of the Act that is organized outside the United States and that does not offer or sell its securities in the United States in connection with a public offering. See section 7(d) of the Act (prohibiting a foreign fund from using the U.S. mails or any means or instrumentality of interstate commerce to offer or sell its securities in connection with a public offering unless the Commission issues an order permitting the foreign fund to register under the Act). A foreign fund may conduct a private U.S. offering in the United States without violating section 7(d) of the Act if the foreign fund conducts its activities with respect to U.S. investors in compliance with either section 3(c)(1) or 3(c)(7) of the Act (or some other available exemption or exclusion). See 2018 FOF Proposing Release, supra footnote 4, at section 3(c)(7)(D).


47 See supra footnote 6, at 18–20.

48 Sections 3(c)(1) and 3(c)(7) of the Act subject private funds to the 3% limitation on investments in registered funds, 15 U.S.C. 80a–3(c)(1) and 3(c)(7)(D).

49 See supra footnote 4, at 18–20.

While commenters generally suggested subjecting private funds and unregistered investment companies to the same conditions as other acquiring funds, some commenters recommended additional conditions that could apply to private funds and unregistered investment companies under the rule. For example, commenters suggested that the rule could include recordkeeping and reporting requirements tailored to private funds and unregistered investment companies or limit the availability of the rule to private funds and unregistered investment companies or limit the availability of the rule to private funds and unregistered investment companies if the adviser is registered with the Commission. Some commenters suggested that the final rule allow private funds and unregistered investment companies to invest in only certain types of funds, such as ETFs, subject to appropriate conditions.

Other commenters recommended that the rule exclude unregistered investment companies as acquiring funds because the Commission has not yet extended exemptive relief allowing such entities to acquire other investment companies in excess of the section 12(d)(1) limits. These commenters stated that the Commission does not have experience with this type of fund of funds arrangement, and recommended that the Commission first provide relief to unregistered investment companies through the exemptive application process. These commenters suggested that this process would allow the Commission to weigh the facts and circumstances of each particular applicant, and the type of underlying fund in the proposed fund of funds arrangement. Two commenters recommended that the rule exclude private funds as acquiring funds because of concerns of undue influence over closed-end funds. After considering comments, we continue to believe that the rule should not include private funds and unregistered investment companies as acquiring funds. We acknowledge that permitting private funds and unregistered investment companies to rely on the rule as acquiring funds would provide these funds greater investment flexibility, and would increase the scale of U.S. registered funds that were acquired by private funds and unregistered investment companies. However, we do not have sufficient experience tailoring conditions for private funds and unregistered investment companies' investments in registered funds to address in a rule of general applicability the concerns such funds present as acquiring funds, as described below. To date, few applicants have requested relief to permit private funds or unregistered investment companies to invest in registered funds beyond the limits in section 12(d)(1) of the Act. We believe it would be more appropriate to consider designing protective conditions through the exemptive application process because including private funds and unregistered investment companies as acquiring funds raises different concerns. Private funds and unregistered investment companies are not registered with the Commission, and their investments in registered funds would not be subject to the reporting requirements under the Act. In particular, private funds and unregistered investment companies are not subject to periodic reporting on Form N–PORT or the new reporting requirements that we are adopting on Form N–CEN regarding compliance with rule 12d1–4.

Additionally, while several commenters noted that many advisers to private funds are required to disclose investment information about their investment companies on Form PF, Form PF does not require advisers to disclose the position-level information that would allow us to monitor compliance with rule 12d1–4 and its impact on the fund industry. In addition, smaller private fund advisers are not required to file Form PF. Accordingly, under the existing regulatory framework, the Commission does not receive routine reporting on the amount and duration of private fund or unregistered investment companies in registered funds. As noted in the 2018 FOF Proposing Release, even if private funds and unregistered investment companies provided basic reporting on investments in underlying funds, that reporting alone may not provide an adequate basis to protect against undue influence and monitor compliance with the rule's conditions.

Private funds and unregistered investment companies are not subject to many of the governance and compliance requirements of the Act that are designed to protect investors and reduce conflicts of interest that are inherent in a fund structure. Such requirements are integral to the oversight and monitoring provisions of rule 12d1–4 for registered funds. For example, private funds and unregistered investment companies are not subject to the board governance requirements of sections 10 and 16 of the Act and the chief compliance officer requirements of rule 38a–1. We are

Comment Letter of Gracie Asset Management (May 2, 2019) ("Gracie Comment Letter"); AIC Comment Letter; IAA Comment Letter; Comment Letter of Ropes & Gray LLP (May 2, 2019) ("Ropes Comment Letter"). One commenter stated that fee layering and complex structure concerns are not as significant in the private fund context as they are in the registered fund context because private fund investors must meet sophistication standards and typically perform due diligence on a private fund’s structure and fees. Comment Letter of Massachusetts Mutual Life Insurance Company (May 2, 2019).

Some commenters stated that certain private funds have sought to control closed-end funds that trade at a discount to their NAV and suggested tailored control and voting conditions if private funds could rely on the rule to invest in closed-end funds and BDCs. See AIC Comment Letter; SIFMA AMG Comment Letter. See also infra section II.C.1.a.i.

Invesco Comment Letter; MFA Comment Letter; ICI Comment Letter; Gracie Comment Letter; AIC Comment Letter; BlackRock Comment Letter; Clifford Chance Comment Letter; NYC Bar Comment Letter; IAA Comment Letter; ABA Comment Letter.

See, e.g., BlackRock Comment Letter; Parallax Comment Letter; MFA Comment Letter (stating that the Commission has already allowed private funds to invest in money market funds beyond the limits of section 12(d)(1) of the Investment Company Act in rule 12d1–1, and that secondary market transactions were less liquid in nature, which may raise certain abuses that section 12(d)(1) was designed to prevent).


The exemptive application process provides an opportunity to consider tailored conditions and limitations for a specific applicant that seeks relief to permit private funds or unregistered investment companies to invest in registered funds beyond the limits in section 12(d)(1) of the Act. If granted, the Commission and its staff could monitor fund of funds arrangements that operate pursuant to such exemptive relief, determine whether the conditions and limitations of the relief operate as intended, and consider whether further rulemaking may be appropriate.

Form N–PORT requires certain registered funds to report information about their monthly portfolio holdings to the Commission in a structured data format. See Investment Company Reporting Modernization, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] ("Reporting Modernization Adopting Release"). Rule 31a–1 under the Act sets forth certain other recordkeeping requirements for registered investment companies. See AIC Comment Letter (stating that the Commission could consider amending Form PF to require an adviser to report if any of the private funds they advise relied on the rule during the reporting period); Clifford Chance Comment Letter; NYC Bar Comment Letter; IAA Comment Letter; ABA Comment Letter; Invesco Comment Letter; Parallax Comment Letter; Gracie Comment Letter. See also 17 CFR 275.204b–1 (requiring certain investment advisers to private funds to file Form PF to report information about the private funds they manage).

2018 FOF Proposing Release, supra footnote 6, at 20.

To protect shareholders and address conflicts of interest that can arise from the management of investment companies, the Act requires that a

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adopting rule 12d1–4 against the background of these existing requirements and the protections they provide for shareholders in a fund of funds arrangement. Without incorporating additional governance and compliance obligations for private funds and unregistered investment companies as acquiring funds, we do not believe rule 12d1–4 would have sufficiently protective conditions to address the undue influence concerns that Congress raised with respect to fund of funds arrangements. We believe designing such protective conditions through the exemptive application process would allow the Commission to weigh the policy considerations described above in the context of the facts and circumstances of the specific fund of funds arrangement described in the application. The exemptive application process would allow the Commission to consider appropriate investor protection provisions, including governance and reporting requirements, applicable to any such arrangement. The exemptive application process also would provide the Commission with an opportunity to analyze the operation and effects of these fund of funds arrangements before determining whether and how to address such arrangements in a rule of general applicability. We encourage interested parties to share their views on such arrangements by contacting staff in the Division of Investment Management.

In addition to the challenges applicable to unregistered funds generally, foreign fund investments in registered funds present additional concerns. Specifically, the Commission understands that some foreign laws and regulations may limit or prevent disclosure of information to the Commission. These types of restrictions may include privacy laws and so-called “blocking statutes” (including secrecy laws) that prevent the disclosure of information relating to third parties and/or disclosure to the U.S. government. Additionally, abusive practices by unregistered investment companies that were associated with such investments were a concern underlying Congress’s amendments to section 12(d)(1) in 1970. For example, a Commission report stated that acquiring investment companies could seek to redeem large holdings in acquired funds due to the instability of certain foreign economies, political upheaval, or currency reform. The Commission also noted that an unregistered investment company could seek to exert undue influence through the shareholder voting process. For these reasons, we also do not believe it is appropriate at this time to include foreign funds in the scope of acquiring funds under rule 12d1–4.

B. Exemptions From the Act’s Prohibition on Certain Affiliated Transactions

As proposed, rule 12d1–4 will provide an exemption from section 17(a) of the Act. In addition, the final rule will provide a limited exemption from that section for in-kind transactions for certain affiliated persons of ETFs. Section 17(a) of the Act generally prohibits an affiliated person of a fund, or any affiliated person of such person, from selling any security or other property to, or purchasing any security or other property from, the fund. It is designed to prevent affiliated persons from managing the fund’s assets for their own benefit, rather than for the benefit of the fund’s shareholders. Absent an exemption, section 17(a) would prohibit a fund that holds 5% or more of the acquired fund’s securities from making any additional investments in the acquired fund, limiting the

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63 The Commission has stated that a foreign fund that uses U.S. jurisdictional means in the offering of the securities it issues and that relies on section 3(c)(1) or 3(c)(7) of the Investment Company Act would be a private fund. See 2018 FOF Proposing Release, supra footnote 6, at n.52 (citing Dechert LLP, Staff No-Action Letter (Aug. 24, 2009)) (noting that under certain circumstances, a foreign fund may make a private U.S. offer in reliance on the exclusion from the definition of “investment company” in sections 3(c)(1) or 3(c)(7) of the Act, and such a foreign fund is subject to section 12(d)(1) to the same extent as a U.S. 3(c)(1) or 3(c)(7) fund).

64 See Commission and Designing Compliance Programs for Investment Companies and Investment Advisers, Investment Company Act Release No. 26329 (Dec. 17, 2003) (‘‘Compliance Rule Adopting Release’’). Under rule 38a–1, a fund would adopt policies and procedures reasonably designed to prevent a violation of the federal securities laws by the fund and designate one individual responsible for administering the fund’s policies and procedures as a chief compliance officer. See Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26329 (Dec. 17, 2003) (‘‘Compliance Rule Adopting Release’’). Under rule 38a–1, a fund would adopt policies and procedures reasonably designed to prevent a violation of rule 12d1–4.

65 One commenter pointed to rule 12d1–4 as a model for private fund investments in registered funds. Prior to the adoption of that rule, the Commission considered specific proposals for exemptive relief for certain private funds to invest in affiliated money market funds. See, e.g., Scudder Global Fund, Inc., et al., Investment Company Act Release Nos. 24276 (Feb. 3, 2000) [65 FR 6420 (Feb. 9, 2000)], 24073 (Feb. 29, 2000) (order) and related application; Pioneer America Income Trust, et al., Investment Company Act Release Nos. 25607 (Jun. 7, 2002) [97 FR 40757 (Jun. 13, 2002)] (notice of order) and 25608 (Jun. 7, 2002) [97 FR 40757 (Jun. 13, 2002)] (notice of order) and related application. However, the Commission has not yet granted relief for private funds to invest in registered funds in excess of the limits of section 12(d)(1) of the Act.
unlikely the prospect of overreaching by an affiliated fund. For example, the rule prohibits the acquiring fund and its advisory group from controlling the acquired fund, which is designed to prevent a fund of funds arrangement that involves overreaching.

An acquired fund that is an open-end fund or UIT also is protected from overreaching due to the Act’s requirement that all purchasers receive the same price. This ensures that the affiliated person pays the same consideration for fund shares as non-affiliated persons, consistent with the standards set out in section 17(b). We believe that this would be true in the context of closed-end funds because the acquired fund’s repurchase of its shares would provide little opportunity for the acquiring fund to overreach since all holders would receive the same price.

As a result, we believe that this exemption is necessary and appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. We also believe that the exemption from section 17(a) is necessary in light of the goals of rule 12d1–4, subject to the conditions set forth in the rule. Existing orders have provided exemptive relief from the affiliated transaction provisions in section 17(a) under similar conditions for many years.

Commenters generally supported the proposed exemptions from section 17(a), agreeing with our view that the utility of the proposed rule would be limited if it did not exempt fund of funds arrangements from the affiliated transaction prohibitions in that section. These commenters requested, however, that the Commission clarify the availability of the exemption from section 17(a) when an acquired ETF transacts on an in-kind basis with an affiliated acquiring fund. The commenters noted that the 2018 FOF Proposing Release suggests, consistent with fund of funds exemptive orders, that the rule would provide relief for the delivery or deposit of basket assets on an in-kind basis by an affiliated fund (that is, by exchanging certain assets from the ETF’s portfolio, rather than in cash), but the proposed rule text referred only to relief to permit the purchase and sale of fund shares between the acquiring fund and acquired fund.

After considering comments, we are adopting a modified exemption from section 17(a) to clarify the rule provides relief from section 17(a) for in-kind transactions when an acquiring fund is purchasing and redeeming shares of an acquired ETF under certain circumstances. As adopted, the rule will provide exemptions from section 17(a) with regard to the deposit and receipt of baskets by an acquiring fund that is an affiliated person of an ETF (or who is an affiliated person of such a person) solely by reason of holding with the power to vote 5% or more of the ETF’s shares or holding with the power to vote 5% or more of any investment company that is an affiliated person of the ETF. Consistent with exemptive orders regarding ETF applicants, the exemption will not be available where the ETF is in turn an affiliated person of the acquiring fund, or an affiliated person of such person, for a reason other than such power to vote.

We are adopting the rule with this exemption because we agree with commenters that this rule text clarification is appropriate to permit ETFs to engage in in-kind purchase or redemption transactions with certain affiliated acquiring funds on the same basis that they would be permitted to engage in a cash purchase or redemption transactions with such affiliated acquiring funds under the rule.

70 Rule 12d1–4(a)(3). “Basket” for purposes of rule 12d1–4 will have the same meaning as in rule 6c–11(a)(1). See rule 12d1–4(d).


72 An ETF would be prohibited under section 17(a)(2) from purchasing securities and other property (i.e., securities and other property in the ETF’s basket assets) from the affiliated acquiring fund in exchange for ETF shares. An acquiring fund would be prohibited under section 17(a)(1) from selling any securities and other property (i.e., securities and other property in the ETF’s basket assets) to an affiliated ETF in exchange for the ETF’s shares. The orders we have granted permitting investments in ETFs provide relief from section 17(a) to permit these transactions. See Barclays Global Fund Advisors, et al., Investment Company Act Release Nos. 24394 [Apr. 17, 2000] [65 FR 21215 (Apr. 20, 2000)] (notice) and 24451 [May 12, 2000] (order) and related application. In addition, rule 6c–11 under the Investment Company Act and our ETF exemptive orders provide separate affiliated transaction relief for the acquisition or sale of ETF basket assets as part of the creation or redemption of ETF creation units, but that relief would not be sufficient to allow an ETF’s in-kind transaction with another fund. See 17(c) Continued
Purchases and redemptions of ETF creation units are typically effected in kind, and section 17(a) would prohibit these in-kind purchases and redemptions by a fund affiliated with the ETF. We believe that such an exemption is appropriate because all purchases and redemptions of creation units with such an affiliated fund are at an ETF’s next-calculated NAV, and an ETF would value the securities deposited or delivered upon redemption in the same manner, using the same standards, as the ETF values those securities rather than the ETF’s NAV. We do not believe that these transactions will rise to the policy concerns that section 17(a) is designed to prevent.

Further, similar to other fund of funds arrangements, without an exemption from section 17(a), the rule would be limited in its utility. In this case, section 17(a) would prohibit the delivery or deposit of basket assets on an in-kind basis by certain affiliated funds (that is, by exchanging certain assets from the ETF’s portfolio rather than in cash). As a result, we also believe that the exemption from section 17(a) regarding this limited exception for ETF in-kind baskets is necessary in light of the goals of rule 12d1–4, subject to the conditions set forth in the rule.

Some commenters also suggested the Commission clarify, or provide exemptive relief from, section 17(a) for other affiliated transactions that are within the statutory limits of section 12(d)(1) or fund of funds arrangements that rely on a statutory exemption. A few commenters stated that it would frustrate Congressional intent if the Commission does not extend section 17(a) exemptive relief to these types of fund of funds arrangements.

Section 12 and section 17 address different concerns under the Act. Section 12 addresses concerns regarding “pyramiding,” where 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 by virtue of their stake in the acquired fund. Section 17(a) addresses self-dealing and other types of overreach of a fund by its affiliates. Although an arrangement may not raise pyramiding concerns, it may still give rise to self-dealing concerns. As a result, we do not believe it would frustrate congressional intent, as asserted by commenters, for some fund of funds arrangements that are within the limits of, or exempt from, section 12(d)(1) to be subject to the prohibitions of section 17(a).

However, we recognize that certain fund of funds arrangements are nearly impossible to utilize absent relief from section 17(a). In the past, we have considered relief to be implied in these circumstances. We believe that it is appropriate to imply relief under sections 12(d)(1)(E) and 12(d)(1)(G) because, without this relief, these statutory provisions would be inoperable. Transactions permitted by sections 12(d)(1)(E) and 12(d)(1)(G) are typically affiliated transactions prohibited by section 17(a). An interpretation that there is an implied exemption from section 17(a) for fund of funds arrangements that involve affiliated persons but do not exceed the limits of sections 12(d)(1)(A), (B), or (C), or that meet the statutory exemption in section (F) of the Act. The section 17(a) exemptions provided in this rule are limited in scope to those necessary for a fund of funds structure to operate under the rule and are consistent with the exemptive relief that we have provided under our exemptive orders. The types of arrangements that are otherwise permissible under section 12(d)(1) could include arrangements where funds are affiliated persons for reasons other than holding 5% or more of the acquired fund’s securities. For example, under section 12(d)(1)(A) of the Act, an acquiring fund that acquires only 3% of the total outstanding voting stock of an acquired fund generally would not be an affiliated person by virtue of its holdings. Expanding section 17(a) relief to all transactions that are permitted by section 12(d)(1), without the transaction being subject to protections addressing the relevant concerns underlying section 17(a), raises issues that would require a careful consideration of whether additional conditions are necessary to sufficiently address any risks posed by these transactions.

Also, unlike transactions permitted by sections 12(d)(1)(E) and 12(d)(1)(G), transactions under these other provisions are possible without an implied exemption from section 17(a). We have historically considered whether an exemption from section 17(a) is appropriate (and subject to appropriately protective conditions) separately. Thus, while we are not providing the requested interpretation, affiliated arrangements within the statutory limits of section 12(d)(1) or that rely on section 12(d)(1)(F) may continue to apply separately for an exemptive order pursuant to section 17(b). In addition, funds that comply with the conditions in rule 12d1–4 may rely upon the rule’s exemption from section 17(a) even if they are not relying upon it for an exemption from section 12(d)(1).

Two commenters requested that we provide an exemption from section 17(d) and rule 17d–1 for affiliated arrangements that rely upon rule 12d1–4, or otherwise comply with section 12(d). We decline to do so. Section 17(d) of the Act makes it unlawful for first- and second-tier affiliates of a fund, the fund’s principal underwriters, and

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Footnotes:

81 Rule 6c–11(b)(3).
82 See supra footnote 25 at section II.B.3.
83 See supra footnote 73 and footnote 25, at nn.130–134 and accompanying text.
84 See supra footnote 6, at n.70.
85 See, e.g., Section 12(d)(1)(E)(iii) (limiting the exception to situations where the acquiring fund only owns the acquired fund) and section 12(d)(1)(G)(ii) (limiting the exception to situations where the two funds are part of the same group of investment companies). For fund of funds arrangements relying on section 12(d)(1)(E), Commission staff has taken the position that application of section 17(a) of the Act to a registered feeder fund’s cash redemption from a registered master fund would not be consistent with the basic relationship that section 12(d)(1)(E) is intended to permit. See Signature Financial Group, Inc., SEC Staff No-Action Letter (Dec. 26, 1999) (“Signature Financial No-Action Letter”). Section 12(d)(1)(G) of the Act codified certain exemptive orders that the Commission had issued permitting funds to purchase other funds in the same group of funds beyond the limits in section 12(d)(1). The Commission issued those orders generally to funds of funds where the acquiring and acquired funds were related because they shared a common investment adviser or the advisers were affiliated persons within the meaning of section 2(a)(3)(C) of the Act. Those orders provided relief from section 17(a) of the Act. See T. Rowe Price Spectrum Fund, Inc., Investment Company Act Release Nos. 21371 (Sept. 22, 1995) [60 FR 50654 (Sep. 22, 1995)] (notice) and 21425 (Oct. 16, 1995) [order] (“T. Rowe Price Spectrum Fund, Investment Company Act Release Nos. 21372 (Sept. 22, 1995) [60 FR 50654 (Sep. 22, 1995)] (notice) and 21426 (Oct. 16, 1995) [order]; see also MassMutual Institutional Funds, SEC Staff No-Action Letter (Oct. 19, 1998).
86 See, e.g., 2018 POF Proposing Release, supra footnote 6, at n.70.
88 An acquiring fund’s percentage of outstanding shares of the acquired fund would decrease from without further acquisition, such as when there is a decrease in the outstanding securities of the acquired fund, resulting in the acquiring fund exceeding the 5% threshold.
89 For example, some arrangements investing in both affiliated and unaffiliated underlying funds in amounts not exceeding the limits in section 12(d)(1)(F) have received an exemption from section 17(a) for investments in affiliated funds. See, e.g., Hennion & Walsh, Inc., et al., Investment Company Act Release Nos. 26207 (Oct. 14, 2003) [68 FR 59954 (Oct. 20, 2003)] (notice) and 26251 (Nov. 10, 2003) (order).
90 See SIFMA AMG Comment Letter; PIMCO Comment Letter. Section 17(d) of the Act makes it unlawful for first- and second-tier affiliates of a fund, the fund’s principal underwriters, and
rule 17d–1 applications, and the fact that we do not normally provide such relief as part of our fund of funds exemptive orders, we believe it is appropriate to address requests for relief from section 17(d) and rule 17d–1 separately from rule 12d1–4. Fund of funds arrangements within the statutory limitations of section 12(d)(1) may apply separately for relief through an application for an order under rule 17d–1 under the Act.

C. Conditions

Consistent with the public interest and the protection of investors, rule 12d1–4 includes conditions designed to prevent the abuses that historically were associated with fund of funds arrangements and that led Congress to enact section 12(d)(1). These conditions are based on the conditions in prior fund of funds exemptive orders and commenters’ suggestions. The rule establishes a framework that will subject fund of funds arrangements to a tailored set of conditions that address differences in fund structures. The following table sets forth a general overview of the differences among the conditions under our current exemptive relief, proposed rule 12d1–4, and the final rule:

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<td>Undue Influence</td>
<td>Voting conditions (including the point at which the voting condition is triggered) differ based on the type of acquired fund. Once an acquiring fund (and any other funds within the advisory group) holds more than 3% of the acquired closed-end fund’s outstanding voting securities, the acquiring fund must vote shares of the acquired closed-end fund in the manner required by section 12d(d)(1)(E) (i.e., either pass-through or mirror voting), while non-fund entities within the advisory group must use mirror voting. For acquired open-end funds or UITs, an acquiring fund (and its advisory group) must vote their shares using mirror voting only if the acquiring fund and its advisory group become holders of more than 25% of the acquired fund’s outstanding voting securities due to a decrease in the outstanding securities of the acquired fund. Fund boards must make certain findings and adopt procedures to prevent over-reaching and undue influence by the acquiring fund and its affiliates. Requires an agreement between acquiring and acquired funds agreeing to fulfill their responsibilities under the exemptive order (a “participation agreement”).</td>
<td>Voting conditions do not differ based on the type of acquired fund and would require an acquiring fund and its advisory group to use pass-through or mirror voting when they hold more than 3% of the acquired fund’s outstanding voting securities. An acquiring fund’s ability to quickly redeem or tender a large volume of acquired fund shares is restricted (replacing the requirements for participation agreements and board findings/procedures).</td>
<td>Voting conditions (including the point at which the voting condition is triggered) differ based on the type of acquired fund. Voting conditions will require an acquiring fund and its advisory group to use mirror voting when they hold more than: (i) 25% of the outstanding voting securities of an open-end fund or UIT due to a decrease in the outstanding securities of the acquired fund; or (ii) 10% of the outstanding voting securities of a closed-end fund. In circumstances where acquiring funds are the only shareholders of an acquired fund, however, pass-through voting may be used. Requires a fund of funds investment agreement between acquiring and acquired funds unless they have the same investment adviser that includes any material terms necessary for each adviser to make the appropriate finding under the rule, a termination provision, and a requirement that the acquired fund provide fee and expense information to the acquiring fund. Adviser(s) of acquiring and acquired funds that are management companies must make certain findings regarding the fund of funds structure. The principal underwriter or depositor of a UIT must analyze the fund of funds structure and determine that the arrangement does not result in duplicative fees. Allows an acquired fund to invest up to an additional 10% of its assets in other funds.</td>
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<tr>
<td>Complex Structures</td>
<td>Limits the ability of an acquired fund to invest in underlying funds (that is, it limits structures with three or more tiers of funds), subject to certain enumerated exceptions.</td>
<td>Limits the ability of funds relying on certain exemptions to invest in an acquiring fund and limits the ability of an acquired fund to invest in other funds subject to certain enumerated exceptions. Requires an evaluation of the complexity of the fund of funds structure and aggregate fees. Specific considerations vary by acquiring fund structure.</td>
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affiliated persons of the fund’s principal underwriters, acting as principal, to effect any transaction in which the fund or a company controlled by the fund is a joint or a joint and several participant in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant. See 15 U.S.C. 80a–17(d). Rule 17d–1(a) prohibits first- and second-tier affiliates of a fund, the fund’s principal underwriter, and affiliated persons of the fund’s principal underwriter, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such fund or company controlled by a fund is a participant “unless an application regarding such joint enterprise, arrangement or profit-sharing plan has been filed with the Commission and has been granted.”

90 First-tier affiliates are investment companies and their affiliated persons. Second-tier affiliates are affiliated persons of their affiliated persons.

91 In the past, some fund of funds exemptive orders included relief from section 17(d) and rule 17d–1 for certain service arrangements. See, e.g., T. Rowe Spectrum Order, supra footnote 86.

92 Schwab, supra footnote 23; Innovator ETFs, supra footnote 32.

93 For example, the conditions regarding layering of fees vary based on the structure of acquiring fund. See infra section II.C.2.b.i.
The conditions in rule 12d1–4 as adopted are substantially similar to the conditions that have been included in our exemptive orders since 1999. We discuss each of the conditions below.

1. Control and Voting

a. Control

In order to address concerns that a fund could exert undue influence over another fund, as proposed, rule 12d1–4 will prohibit an acquiring fund and its advisory group from controlling, individually or in the aggregate, an acquired fund, except in the circumstances discussed below. This condition generally comports with the conditions of the exemptive relief the Commission has previously issued.

The Act defines control to mean the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. The Act also creates a rebuttable presumption that any person who, directly or indirectly, beneficially owns more than 25% of the voting securities of a company controls the company and that any person who does not own that amount does not control it. A determination of control is not based solely on ownership of voting securities of a company and depends on the facts and circumstances of the particular situation. We have long held that “controlling influence” includes, in addition to voting power, a dominating persuasiveness of one or more persons, the act or process that is effective in checking or directing action or exercising restraint or preventing free action, and the latent existence of power to exert a controlling influence.

We proposed that an acquiring fund and its advisory group could not control (individually or in the aggregate) an acquired fund. Accordingly, any 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 acquiring fund, therefore, generally could make a substantial investment in an acquired fund (i.e., up to 25% of the acquired fund’s shares). If, however, facts and circumstances gave an acquiring fund and its advisory group the power to exercise a controlling influence over the acquired fund’s management or policies (other than as discussed below), the acquiring fund and other funds in its advisory group would not be able to rely on the rule even if the fund and its advisory group owned 25% or less of the acquired fund’s voting securities.

Commenters generally supported using the concept of “control” as defined under the Act to guard against potential coercive behavior by an acquiring fund, and agreed that this condition is consistent with the conditions of existing exemptive relief. One commenter stated that the proposed control provision protects acquired funds from undue influence concerns without disrupting investment strategies or creating difficult compliance requirements. We also received more particularized comments relating to control of closed-end funds, as discussed below.

Reflecting these comments, rule 12d1–4 will prohibit an acquiring fund and its advisory group from acquiring, and therefore exercising, control over an acquired fund as proposed. We believe this condition will limit a fund’s ability to exert undue influence over another fund. As discussed in more detail below, we addressed commenters’ concerns regarding undue influence of acquired closed-end funds by imposing a lower ownership threshold that triggers the rule’s voting conditions for such funds, and by requiring mirror voting when an acquiring fund exceeds the threshold.

i. Advisory Group Definition

The rule will require an acquiring fund to aggregate its investment in an acquired fund with the investment of the acquiring fund’s advisory group to assess control as proposed. This aggregation requirement is consistent with past exemptive orders and is designed to prevent a fund or adviser from circumventing the control condition by investing in an acquired fund through multiple controlled advisory groups.

Layering of Fees

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<td>Caps sales charges and service fees at limits under current FINRA sales rules (rule 2341) even in circumstances where the rule would not otherwise apply.</td>
<td>Requires an evaluation of the complexity of the fund of funds structure and aggregate fees.</td>
<td>Generally the same as proposed, but the investment adviser to an acquiring management company must find that the aggregate fees and expenses are not duplicative.</td>
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<tr>
<td>Generally the same as proposed, but the in-</td>
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Commenters recommended that the Commission alter its definition of “advisory group” or revisit the requirement to aggregate affiliated entities for purposes of determining control.106 For example, several commenters suggested that we adopt a narrower definition of “advisory group,” stating that an acquiring fund’s investment adviser or depositor may not direct the investments of the affiliates that fall within the proposed definition of “advisory group,” and in fact could be unaware of investments by such affiliates.107 One of these commenters stated that this definition of advisory group could be particularly problematic for large financial services organizations that have many affiliates under common control, but that operate independently.108 Some commenters recommended that the aggregation requirement exclude affiliates that are not subject to actual control by the investment adviser or exclude certain control affiliates where there are information barriers or other limits.109

One commenter stated that section 12(d)(1)(A) of the Act does not require an investment adviser to aggregate holdings across its private funds for purposes of determining control and suggested that rule 12d1–4 follow a similar approach.110 This commenter suggested that the Commission instead prevent an acquiring fund from seeking to exert control over an acquired fund by including a general provision in the rule prohibiting an entity from doing anything indirectly which, if done directly, would violate the rule.

On the other hand, some commenters suggested that the Commission should adopt a broader definition of advisory group than proposed.111 Specifically, these commenters recommended that the Commission expand the aggregation requirement to include all accounts managed by the acquiring fund’s adviser, subadviser or their respective affiliates.

Upon considering the comments received, we continue to believe requiring an acquiring fund to aggregate its holdings with its advisory group will help prevent a fund or adviser from circumventing the control condition. Because the control condition effectively allows an acquiring fund and its advisory group to obtain a significant ownership stake in an acquired fund by investing through multiple related entities, we believe it is appropriate to subject all of the affiliates in an advisory group to this condition. Our exemptive orders include a similar condition, and funds relying on those orders likely already have established policies and procedures to monitor compliance with the aggregation requirement embedded in the definition of the term “advisory group.”

We acknowledge that the definition of “advisory group” may capture many affiliates of an acquiring fund and its investment adviser in a complex financial services firm, and will result in monitoring and compliance burdens that are greater than if the definition only looked to the holdings of an acquiring fund and its adviser. To the extent that a particular advisory group has not already established policies and procedures pursuant to an exemptive order, we also acknowledge that the advisory group may need to restructure information barriers to permit entities within the advisory group to share the necessary information to comply with the rule. However, other provisions of the Act and our rules also extend to affiliated persons of an investment adviser.113 These provisions apply to affiliated persons, regardless of the complexity that may arise because of the way in which a financial services firm has determined to structure itself. Funds (and their advisers) have experience developing compliance policies and procedures in those circumstances.114 We believe that requiring the entities that fall within this definition to aggregate their holdings in an acquired fund for purposes of the control condition will more effectively address the risk of undue influence over an acquired fund.

The breadth of entities that are included within an advisory group will reduce the risk that an acquiring fund and its advisory group will exert undue influence over an acquired fund by accumulating a controlling ownership position across the advisory group’s accounts. We believe that the condition’s definition of advisory group strikes an appropriate balance between the flexibility for efficient market activity and protection of acquired funds and their shareholders.

Additionally, we continue to believe that the advisory group definition should not encompass funds managed by unaffiliated sub-advisers. Absent common control, there is little risk that an advisory group and sub-advisory group would coordinate to exert undue influence on an acquired fund.115 Consistent with past exemptive orders, therefore, rule 12d1–4 will not require an acquiring fund to aggregate the ownership of an acquiring fund advisory group with an acquiring fund sub-advisory group. Instead, each of these groups will consider its ownership percentage separately and will be subject to the voting provisions as discussed below.116

ii. Closed-End Funds

Rule 12d1–4 will include voting requirements specific to acquired closed-end funds in response to concerns raised by commenters with respect to undue influence over closed-end funds.117 The proposed rule included voting requirements, as described in section II.C.1.b below, and would have required that an acquiring entity:

106 See, e.g., ICI Comment Letter; BlackRock Comment Letter. Another commenter generally supported a requirement that funds advised by the same adviser cannot in the aggregate hold in excess of 3% of the outstanding voting securities of a given acquired fund. Comment Letter of General American Investors Company, Inc. (May 2, 2019).

107 ICI Comment Letter; ABA Comment Letter; Voya Comment Letter.

108 ICI Comment Letter (noting that many affiliates may have firewall restrictions that prevent the affiliates from coordinating their investments).

109 See, e.g., ABA Comment Letter; SIFMA AMG Comment Letter; Dechert Comment Letter. One commenter further suggested that the Commission clarify that a feeder fund that invests in an acquired fund in reliance on Section 12(d)(1)(E) should not be included in the advisory group’s ownership calculation, noting that a feeder fund is already required to use pass-through or mirror voting pursuant to 12(d)(1)(E)(iii)(aa). Comment Letter of Capital Research and Management Company (May 2, 2019) (“Capital Group Comment Letter”).

110 MFA Comment Letter.

111 Advent Comment Letter; Comment Letter of Skadden, Arps, Slate, Meagher & Flom LLP (May 2, 2019) (“Skadden Comment Letter”).

112 See, e.g., Symmetry Panoramic Trust and Symmetry Partners, LLC, Investment Company Act Release Nos. 33317 (Dec. 6, 2018) [83 FR 63918 (Dec. 12, 2018)] (notice) and 33354 (Feb. 1, 2019) (order) and related application.

113 See, e.g., section 7(a) of the Act (prohibiting first- and second-tier affiliates of a fund from borrowing money or other property, or selling or buying securities or other property to or from the fund, or any company that the fund controls). See also supra footnote 68 and accompanying text.

114 See 17 CFR 270.38a–1 (rule 38a–1 under the Act) (requiring registered investment companies to adopt, implement and periodically review written policies and procedures reasonably designed to prevent violations of the federal securities laws). See also Compliance Rule Adopting Release, supra footnote 59 (noting that funds or their advisers should have policies and procedures in place to identify affiliated persons and to prevent unlawful transactions with them).

115 However, if the sub-adviser or any person controlling, controlled by, or under common control with such investment sub-adviser acts as an acquired fund’s investment adviser or depositor, then the sub-advisory group and advisory group will be required to aggregate their ownership for purposes of determining control pursuant to rule 12d1–4(b)(1)(ii).

116 See rule 12d1–4(b)(1)(ii).

117 These voting conditions will also apply to voting of shares of acquired BDCs. See rule 12d1–4(b)(1)(ii).
In the 2018 FOF Proposing Release, we requested comment on whether the rule’s control and voting requirements should vary depending on the type of acquired fund, including whether there should be a lower or higher threshold for closed-end funds, and whether the threshold should differ for listed and unlisted closed-end funds. As adopted, the rule does not impose a lower investment limit on investments in a closed-end fund by an acquiring fund and its advisory group, nor does the rule impose a mirror-voting requirement at a lower ownership threshold than the voting requirements applicable to open-end funds and UITs. Specifically, the rule will require mirror voting if an acquiring fund and its advisory group hold more than 10% of the voting securities of a closed-end fund. This voting requirement is designed to protect an acquired closed-end fund from undue influence through the shareholder vote mechanism. In addition, the rule will require an acquiring fund to enter into a fund of funds investment agreement with an acquired fund prior to exceeding the investment limits set forth in section 12(d)(1). Together, these provisions are designed to protect acquired closed-end funds from undue influence by acquiring funds and their advisory groups.

Several commenters recommended alternatives to the proposed control condition for fund of funds arrangements with acquired closed-end funds. For example, commenters recommended that, instead of relying on the concept of “control” for acquired closed-end funds, rule 12d1–4 should limit the aggregate ownership by an acquiring fund and its advisory group to 10% of an acquired closed-end fund’s voting securities in order to protect these funds from undue influence. One commenter stated that an acquiring fund that holds approximately 15% of an acquired closed-end fund could dictate certain actions of the acquired closed-end fund. The commenter also recommended expanding the definition of advisory group and requiring an acquiring fund and the expanded advisory group to reduce its holdings in an acquired fund to less than 25% within a defined period of time in order to discourage activist investors from increasing their holdings in target funds just prior to effectiveness of the rule. Two commenters encouraged the Commission to allow acquired funds and their boards, at their option, to set their own limit for an acquiring fund’s investments. These commenters suggested that an agreement between an acquiring and acquired fund (similar to a participation agreement under current fund of funds exemptive relief) could allow the acquired fund and its board to evaluate effects of the acquiring fund’s investment, including any risks of undue influence, and set an appropriate limit. Similarly, commenters suggested that the rule should provide acquired funds with the ability to grant consent to potential investments by acquiring funds, effectively permitting acquired funds to screen their investors and refuse investments by acquiring funds based on undue influence concerns.

Other commenters suggested the Commission adopt a passive investor certification and reporting regime similar to that under Section 13 of the Securities Exchange Act of 1934 and Schedules 13D and 13G to protect acquired closed-end funds against undue influence. Under such a regime, an acquiring fund would certify to the Commission, or would only be able to operate in accordance with rule 12d1–4, if it holds the acquired fund’s securities in the ordinary course of business and not for the purpose of or in connection with significantly changing or influencing the management or policies of the acquired fund. Commenters representing closed-end funds or their investors also recommended that, if rule 12d1–4 were to permit private funds to acquire closed-end funds, it should incorporate additional protections specific to closed-end funds.

As an additional protective condition, discussed below in section II.C.2, the rule will require an acquiring fund and an acquired closed-end fund that do not share an investment adviser to enter into a fund of funds investment agreement prior to the acquiring fund exceeding the investment limits of section 12(d)(1)(A). This agreement will

124 Advent Comment Letter; Comment Letter of TPG Specialty Lending, Inc. (May 2, 2019) (“TPG Comment Letter.”).
125 See also FIMCO Comment Letter (recommending that, if private funds and foreign funds are permitted to rely on the rule, such funds must act within the limits of section 12(d)(1)(C) as if they were registered funds); Skadden Comment Letter; ICI Comment Letter. Section 12(d)(1)(C) prohibits funds (together with companies or funds they control and funds that have the same adviser) from acquiring more than 10% of the outstanding voting stock of a closed-end fund. 15 U.S.C. 80a–12(d)(1)(C).
126 Dimensional Comment Letter, Advent Comment Letter.
127 Dimensional Comment Letter (noting that a higher discretionary investment limit might be beneficial for a newly formed or smaller fund that seeks large investments by acquiring funds in order to achieve economies of scale); Advent Comment Letter (explaining that an acquired fund might use a participation agreement to permit an acquiring fund to purchase more than 10% of its voting securities, and the participation agreement can require passive relief).
128 See, e.g., Comment Letter of Neuvosec, LLC (May 2, 2019) (“Neuvosec Comment Letter”); SIFMA AMG Comment Letter; FIMCO Comment Letter; Skadden Comment Letter; Voya Comment Letter; Guggenheim Comment Letter; Advent Comment Letter.
129 See rule 12d1–4(b)(1). This voting requirement applies at a 10% ownership threshold, while the Act creates a rebuttable presumption that any person who directly or indirectly beneficially owns more than 25% of the voting securities of a company controls the company.
130 See, e.g., Part C of Form N-POR (requiring monthly disclosure of certain registered management investment companies’ portfolio holdings, including disclosure of investments in other investment companies).
enable an acquired closed-end fund to screen potential acquiring fund investors and set conditions on investments in the acquired fund, if desired. The agreement also will allow an acquired closed-end fund to terminate the agreement with an acquiring fund without penalty, which would then prohibit the acquiring fund from making additional purchases of the acquired fund beyond the section 12(d)(1)(A) limits.

Rule 12d1–4 also includes voting requirements specific to closed-end funds that preserve voting discretion for investment advisers below a specified threshold of ownership, while seeking to avoid amplifying the voting power of any particular investor.131 These voting requirements are described in the section below. Finally, because private funds will not be permitted to rely on the rule as acquiring funds, we are not adopting any specific conditions associated with private fund investments in closed-end funds under rule 12d1–4.

In addition to comments on closed-end fund issues under the rule, several commenters raised general concerns about private fund investments in closed-end funds that are outside the scope of rule 12d1–4.132 These commenters stated that there have been instances in which an investment adviser to several private funds (each with less than 3% of the outstanding voting shares of a closed-end fund) acquired a significant aggregate interest in an acquired closed-end fund and sought to unduly influence the fund to the detriment of long-term shareholders through proxy contests or other means.133 The commenters recommended various ways to address these private fund investments in closed-end funds under section 12(d)(1).

For example, these commenters recommended that the Commission: (i) Recommend legislation to deem any private fund an “investment company” for purposes of section 12(d)(1)(C) of the Act;134 (ii) extend the 3% limit of section 12(d)(1)(A)(i) to any separate accounts for which an advisory group has sole or shared voting or disposition authority;135 (iii) deem ownership of more than 3% of a registered fund by a private fund advisory group to be a violation of section 12(d)(1)(A)(i) pursuant to section 48(a) of the Act;136 or (iv) treat affiliated private funds that “are not materially different in investment operations or investment policies” as a single fund for purposes of section 12(d)(I).137 On the other hand, some commenters opposed restrictions on private fund investments in closed-end funds under section 12(d)(1).138 These commenters stated that private funds invest in closed-end funds in accordance with the relevant provisions of the Act. In addition, one commenter stated that Congress did not impose more restrictive limits on the ability of private funds to acquire equity stakes in regulated funds when it amended the Act to subject private funds to the restrictions of sections 12(d)(1)(A)(i) and 12(d)(1)(B)(i).139

After considering comments, we believe commenters’ additional recommendations with respect to investments in closed-end funds that are within the statutory limitations of section 12(d)(1) are beyond the scope of this rulemaking.140


The final rule will require an acquiring fund and its advisory group to vote their shares of an acquired fund: (i) Using mirror voting if the acquiring fund and its advisory group (in the aggregate) hold more than 25% of the outstanding voting securities of an acquired open-end fund or UIT due to a decrease in the outstanding securities of the acquired fund;141 and (ii) using mirror voting if the acquiring fund and its advisory group (in the aggregate) hold more than 10% of the outstanding voting securities of an acquired closed-end fund or BDC.142 Similar to our exemptive orders, the final rule’s voting conditions will differ based on the type of acquired fund.

Proposed rule 12d1–4 would have required an acquiring fund and its advisory group to vote their securities in the manner prescribed by section 12(d)(1)(E)(iii)(aa) of the Act if the acquiring fund and its advisory group (in the aggregate) hold more than 3% of the outstanding voting securities of an acquired fund.143 The proposed rule would have applied a uniform condition across all types of acquired funds to simplify and streamline the requirement. Commenters generally supported the proposed voting conditions, stating that they protect acquired funds without disrupting current investment strategies or creating new or difficult compliance requirements.144 As discussed in more detail below, however, some commenters suggested modifications to the ownership threshold that would trigger the voting condition or the required manner of voting, based on the type of acquired fund.145

We believe that the voting conditions of the final rule, which we modified to respond to the concerns expressed in these comments, will help to facilitate compliance monitoring and are better

131 See infra section II.C.1.b.
132 See, e.g., Comment Letter of Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (May 2, 2019) (“Chamber of Commerce Comment Letter”) recommending that the Commission review existing rules to address “regulatory loopholes” related to fund of funds structures and ownership thresholds; Comment Letter of Anthony S. Colavita (Apr. 30, 2019); Comment Letter of Anthonie van Eiks (Apr. 30, 2019); Comment Letter of Kinchen C. Bizzell (May 2, 2019); Comment Letter of Salvatore Scheck (May 2, 2019); Comment Letter of Peter Baldino (May 2, 2019); Comment Letter of Clarence A. Davis (May 6, 2019) (“Bulldog Comment Letter”); TPG Comment Letter. See also Saba Comment Letter, citing NSMIA at sections 209(a)(1) and 209(a)(4)(D) (codified at Sections 3(c)(1) and Section 3(c)(7) of the Investment Company Act).
133 See supra footnotes 133–137 and accompanying text.
134 ICI Comment Letter; Comment Letter of Calamos Investments LLC (May 2, 2019) (“Calamos Comment Letter”); Nuveen Comment Letter; Dechert Comment Letter; Voya Comment Letter; Cuggenheim Comment Letter. See also Gabelli Comment Letter (recommending that the Commission seek legislative changes to create a private right of action to enforce rules relating to ad visor investment in closed-end funds).
135 Gabelli Comment Letter.
136 Advent Trustees Comment Letter; Gabelli Comment Letter; Advent Comment Letter; Skadden Comment Letter.
137 Skadden Comment Letter.
139 Saba Comment Letter, citing NSMIA at sections 209(a)(1) and 209(a)(4)(D) (codified at Sections 3(c)(1) and Section 3(c)(7) of the Investment Company Act).
140 See supra footnotes 133–137 and accompanying text.
141 In circumstances where acquiring funds are the only shareholders of an acquired fund, however, pass-through voting may be used.
142 Mirror voting requires the fund to vote the shares held by it (fund, under rule 12d1–4, an acquiring fund’s advisory group) in the same proportion as the vote of all other holders of the acquired fund. In mirror voting, the tabulation agent for the shareholder meeting will first tabulate the votes for a proposal and then apply the resulting ratio (for/against/abstain) to the shares instructing that they are to be mirror voted.
143 Proposed rule 12d1–4(b)(1)(ii). Section 12(d)(1)(E)(iii)(aa) of the Act requires an acquiring fund to either: (i) Seek voting instructions from its security holders and vote such proxies in accordance with their instructions ("pass-through voting"); or (ii) use mirror voting.
144 Invesco Comment Letter; CFA Comment Letter (specifically supporting the application of the voting condition to an acquiring fund and its advisory group).
145 See Invesco Comment Letter; CFA Comment Letter, WisdomTree Comment Letter; IPA Comment Letter; Advent Comment Letter; Skadden Comment Letter; FS Comment Letter; ABA Comment Letter.
Several commenters recommended that the rule adopt the voting triggers set forth in exemptive orders. These commenters stated that current exemptive orders only impose voting requirements when a fund and its advisory group hold, in aggregate, more than 25% of the outstanding voting securities of an acquired open-end fund or UIT. They also noted that open-end funds and UITs may not be particularly susceptible to influence by shareholder votes because they do not hold routine shareholder meetings. Accordingly, these commenters stated that there was little practical or policy justification to impose voting requirements at a 3% ownership threshold on shares of acquired open-end funds and UITs.145 In contrast, these commenters stated that there was little practical or policy justification to impose voting requirements at a 3% ownership threshold on shares of acquired open-end funds and UITs.145

After considering the comments received, we believe that it is appropriate that the final rule include voting requirements for investments in open-end funds and UITs that are consistent with the voting requirements imposed by prior exemptive orders in this area. We are persuaded that the 25% ownership threshold is appropriate for open-end funds and UITs given that these funds hold shareholder meetings infrequently, and because commenters did not raise concerns about undue influence of these funds through shareholder voting. The rule’s voting conditions therefore will apply to the same scope of entities in an acquiring fund’s advisory group as the voting conditions in our existing fund of funds exemptive orders. A 25% ownership threshold will also minimize the administrative burden associated with the voting requirement for these funds. Accordingly, the final rule

will require mirror voting if an acquiring fund and its advisory group hold more than 25% of the voting securities of an open-end fund or UIT. We expect an acquiring fund would only exceed 25% of the securities of an open-end fund or UIT due to a decrease in the outstanding voting securities of the acquired fund because the rule prohibits an acquiring fund from controlling an acquired fund and because of the rebuttable presumption regarding control under the Act.155

However, the rule will impose a 10% ownership threshold on acquired closed-end funds. We believe a 10% ownership threshold (an increase from the proposed 3% threshold) will permit an acquiring fund and its advisory group to gain substantial exposure to such funds with full voting discretion, but will reduce undue influence concerns associated with shareholder votes, which are greater for acquired closed-end funds than for other types of acquired funds given the more frequent shareholder meetings.156 We are concerned that a higher threshold for acquiring fund investments in closed-end funds, such as 15% or 25%, could give an acquiring fund’s advisory group the ability to dictate certain fund actions and unduly influence the acquired closed-end fund.

ii. Mirror Voting
The final rule will require mirror voting if an acquiring fund and its advisory group hold more than (i) 25% of the outstanding voting securities of an open-end fund or UIT due to a decrease in the outstanding voting securities of the acquired fund or (ii) engage in mirror voting when appropriate or required. See, e.g., Invesco Comment Letter; SIFMA AMG Comment Letter. To the extent that an advisory group utilizes information barriers and determines to rely on this rule, the advisory group may need to update its policies and procedures to allow entities across the advisory group to monitor compliance with the aggregate ownership thresholds set forth in rule 12d1-4. See, e.g., Dechert Comment Letter.

The Act creates a rebuttable presumption that any person who directly or indirectly beneficially owns more than 25% of the voting securities of a company controls the company. The presumption of control continues until the Commission makes a final determination to the contrary by order either on its own motion or on application by an interested person. See 15 U.S.C. 80a-2(a)(9).

155 See, e.g., Nuveen Comment Letter (stating that a 10% threshold is a reasonable ownership threshold to limit undue influence concerns while allowing acquiring funds to hold larger positions in closed-end funds without forfeiting the right to exercise their independent judgment regarding shareholder proposals); MFA Comment Letter (stating that a 10% ownership threshold would probably appropriately balance the need to prevent influence of shareholder votes with allowing acquiring funds that do not have the ability to influence acquired funds to participate in shareholder votes).
10% of the outstanding voting securities of an acquired BDC or other closed-end fund. As described above, the proposed rule would have required acquiring funds to use either pass-through or mirror voting if the acquiring fund and its advisory group exceeded a set ownership threshold, regardless of the type of acquired fund. In the 2018 FOF Proposing Release, we requested comment on whether we should adopt the voting requirements of the proposed rule, or whether the final rule should codify the voting provisions set forth in existing exemptive orders.

Several commenters suggested modifications to the proposed voting requirement. For example, one commenter generally opposed pass-through voting for closed-end fund voting securities because an activist acquiring fund and its advisory group would likely vote according to the recommendations of its activist investment manager. This commenter suggested that the rule permit pass-through voting of investments in an acquired closed-end fund only if required by the terms of an adviser’s investment advisory contract. Another commenter recommended that the rule require an acquiring fund to mirror vote its shares of an acquired open-end fund if it controls the acquired fund. The commenter explained that, at a beneficial ownership of more than 25% of the voting securities of an acquired open-end fund, there is a greater risk that an acquiring fund can exert undue influence on the acquired fund and thus the burden of mirror voting on acquired fund shares is a reasonable trade-off. Some commenters stated that the rule’s proposed voting requirements could conflict with an acquiring fund adviser’s fiduciary duty to vote underlying fund shares in the best interest of the acquiring fund. These commenters stated that large advisory firms may serve many clients with different investment strategies and shareholder voting interests, and a voting requirement that applies across an advisory group could cause an affiliate of an acquiring fund to be in violation of its fiduciary duties under Sections 404(a)(1)(A) and (B) of the Employee Retirement Income Security Act of 1974 if forced to adhere to the rule’s voting requirements. Further, commenters stated that a mirror-voting requirement may require an adviser to vote fund holdings in a manner that is contrary to its proxy voting policies.

Some commenters expressed concern regarding the effect of the required voting procedures for acquired closed-end funds. These commenters stated that requiring acquiring funds to use mirror voting if they hold more than 3% of an acquired closed-end fund may increase the relative voting power of private funds or separate account structures that would not rely on rule 12d1–4, and therefore would not be subject to the voting requirements of the rule. These commenters noted that mirror voting by an acquiring fund and its advisory group at a low ownership threshold could effectively amplify the voting position of these types of investors.

After considering comments, we believe it is appropriate to require acquiring funds and their advisory group to engage in mirror voting. However, in circumstances where rule 12d1–4 or section 12(d)(1) requires all of the security holders of an acquired fund to engage in mirror voting, and it would not be possible for every shareholder to engage in mirror voting, such acquiring funds must use pass-through voting. For example, if an acquired fund is offered solely to acquiring funds that rely on rule 12d1–4, there may be no other investors to vote the acquired fund shares; therefore, under these circumstances, the acquiring fund’s shares must be “passed-through” to the acquiring fund’s shareholder for voting purposes. We believe requiring an acquiring fund and its advisory group to use mirror voting in most cases, with an ownership threshold set at 25% for open-end funds and UITs and at 10% for closed-end funds, will help address the commenters’ concerns regarding undue influence over acquired funds through shareholder voting.

We further believe that requiring an acquiring fund and its advisory group to use mirror voting in most cases, without generally providing the option for pass-through voting, will simplify operational and compliance burdens for acquiring funds and their advisory groups. For example, this approach will facilitate compliance monitoring for fund groups that have multiple types of acquiring funds. As under our existing exemptive orders, we believe an adviser would need to consider these voting requirements as a component of its fiduciary duty when determining whether and how much an acquiring fund should invest in an acquired fund under the rule.

iii. Exceptions to the Control and Voting Conditions

We are adopting, as proposed, exceptions to the control and voting conditions when: (i) An acquiring fund is within the same group of investment companies as an acquired fund; or (ii) the acquiring fund’s investment sub-adviser or any person controlling, or under common control with such investment sub-adviser acts as the acquired fund’s investment adviser or depositor. The exceptions are designed to include arrangements that are permissible under section 12(d)(1)(G) and our exemptive orders within the regulatory framework of rule 12d1–4. We define the term “group of investment companies” as any two or more registered investment companies or business development companies that hold themselves out to investors as related companies for investment and investor services.

Commenters supported these exceptions. Commenters agreed with the Commission that, in circumstances where an affiliated investment manager manages the acquiring fund, 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 fund.

157 2018 FOF Proposing Release, supra footnote 6 at 45–46.
158 Advent Comment Letter.
159 Voya Comment Letter.
160 ICI Comment Letter (stating that there may be shareholder proposals, such as merger approvals or changes to fundamental investment strategy, for which an adviser believes that neither mirror voting nor pass-through voting is in the acquiring fund’s or shareholders’ best interest); Voya Comment Letter. The voting conditions are similar to those included in our existing exemptive orders.
161 Schwab Comment Letter.
162 SIMA AMG Comment Letter (noting that activist investors have accumulated ownership of closed-end funds through separate investments by private funds and separately managed accounts); Nuveen Comment Letter.
163 One commenter recommended that the rule prescribe a mirror voting procedure whereby the acquiring fund must provide legal proxy to the proxy agent for the shareholder vote and request that the acquiring fund’s shares be voted in the same proportion as the vote of all other shareholders. Bulldog Comment Letter. We do not believe it is necessary to include such a prescription in this rule because we understand that proxy agents are able to tabulate and process shareholder votes that are subject to a mirror-voting requirement and such agents would not require a legal proxy to be set forth in the rule text.
164 Rule 12d1–4(b)(1)(ii). The exception to the control and voting conditions for sub-advisory arrangements will cover arrangements that may not qualify for the exclusion otherwise available to funds within the same group of investment companies if the acquiring fund and acquired fund do not hold themselves out as related funds for purposes of investment and investor services. See 2018 FOF Proposing Release, supra footnote 6, at n.166 and accompanying text.
165 See 2018 FOF Proposing Release, supra footnote 6, at section II.C.1.b.
166 Rule 12d1–4(d).
167 See, e.g., Invesco Comment Letter; ABA Comment Letter.
acquired fund.\textsuperscript{168} Based on our experience overseeing fund of funds arrangements, we believe these exceptions from the control and voting conditions are appropriately tailored to except only those fund of funds arrangements that do not raise the concerns of undue influence that underlie section 12(d)(1).

The definition of “group of investment companies” is similar to the definition used in many of our exemptive orders permitting investments in listed closed-end funds and listed BDCs. We intended to clarify that BDCs and other closed-end funds are within the scope of this exception. The determination of whether advisers are control affiliates, however, depends on the relevant facts and circumstances.\textsuperscript{169}

We believe that whether a group of funds sharing a common adviser or having advisers that are all control affiliates could satisfy the “holding out” prong of the definition would depend on the totality of communications with investors by or on behalf of the funds. For example, the acquiring fund’s prospectus could identify the acquired funds in which the acquiring fund expects to invest, and disclose the control relationship among the advisers to the acquiring and acquired funds. In our view, it is not necessary for acquired funds to include comparable disclosure in their prospectuses or for acquired funds and acquiring funds to market themselves as related companies for all purposes and to all potential investors.\textsuperscript{170} Rather, the requirement in this definition that the funds must hold themselves out to “investors” as related companies for purposes of investment and investor services refers only to potential investors in the acquiring fund because the relevant inquiry is how these funds are holding themselves out to their potential investors. Disclosure in the acquiring fund’s prospectus of the identity of the acquired funds in which the acquiring fund expects to invest, and of the control relationship among the advisers to the acquired and acquiring funds, therefore, is one way to satisfy the “holding out” requirement of the definition. As we stated in the 2018 FOF Proposing Release, we believe that it would be false or misleading for a group of investment companies to hold themselves out as related companies as that term is used in rule 12d1–4 unless they are related investment companies. As proposed, the rule will subject fund of funds arrangements within these exclusions to a more limited set of conditions than other fund of funds arrangements. In circumstances where the acquiring and acquired fund share the same adviser, the adviser would owe a fiduciary duty to both funds, serving to protect the best interests of each fund.\textsuperscript{171} In addition, 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 acquiring 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.\textsuperscript{172} We believe that the rule’s other conditions, such as the fund of funds investment agreement and adviser findings described below, would mitigate the risks of undue influence when the arrangement involves funds that have advisers that are control affiliates.

2. Redemption Limits, Fund Findings, and Fund of Funds Investment Agreements

In lieu of the proposed limitation on redemptions by an acquiring fund, we are adopting a requirement, expanded from the proposal, for an investment adviser to a management company operating in accordance with the rule to evaluate and make certain findings regarding the arrangement.\textsuperscript{173} The rule will also require tailored findings regarding acquiring UITs and a certification regarding separate accounts funding variable insurance contracts (these findings and certifications, collectively with the management company evaluations and findings, “Fund Findings”). In addition, unless they have the same adviser, the acquiring fund and acquired fund will be required to enter into a fund of funds investment agreement effective for the duration of the funds’ reliance on the rule, which must include certain specific terms. These provisions are, as discussed below, designed to address concerns over the exercise of undue influence through excessive redemptions that the proposed redemption limit provision was designed to address, while also addressing the duplicative fee and complex structure concerns that underlie section 12(d)(1)(A). a. Proposed Redemption Limit and Disclosure Requirements

The proposed rule would have prohibited an acquiring fund that acquires more than 3% of an acquired fund’s outstanding shares (i.e., the statutory limit) from redeeming or submitting for redemption, or tendering for repurchase, more than 3% of an acquired fund’s total outstanding shares in any 30-day period (the “redemption limit”).\textsuperscript{174} The proposed redemption limit was designed to address concerns that an acquiring fund could threaten large-scale redemptions as a means of exercising undue influence over an acquired fund and would have limited an acquiring fund’s ability to quickly redeem or tender a large volume of acquired fund shares.\textsuperscript{175} The Commission proposed the redemption limit believing it would (along with the proposed control and voting conditions) address the same concerns regarding undue influence and overreaching that the conditions currently found in the exemptive orders sought to address, without requiring procedures and related board findings covering particular instances where undue influence and overreaching could exist. The Commission stated that replacing these conditions with the proposed redemption, control, and voting conditions could lower compliance

\textsuperscript{168} Comments suggested excluding funds within the same group of investment companies from other conditions of the proposed rule, including the proposed redemption limit. While we are not adopting the proposed redemption limit, we have tailored the rule’s conditions to account for the different undue influence concerns of funds within the same group of investment companies as compared to funds that are not part of the same group of investment companies.

\textsuperscript{169} We believe, for example, that funds that are advised by the same investment adviser, or by advisers that are control affiliates of each other, would be “related” companies for purposes of the rule. The definition of “affiliated person” includes any person directly or indirectly controlling, controlled by, or under common control with, such other person. See section 2(a)(3)(C) of the Act. See also Investment Company Mergers, Investment Company Act Release No. 25259 (Nov. 8, 2001) [66 FR 57602 (Nov. 15, 2001)] (proposing rule amendments to permit mergers and other business combinations between certain affiliated investment companies), id. at 11.

\textsuperscript{170} If the acquired funds’ marketing materials and/or prospectuses include any statements that are inconsistent with the representations made in the prospectuses for the acquiring funds regarding how the acquired fund and acquiring fund are related companies because of the affiliation of their investment advisers, such statements could call into question whether the funds are holding themselves out as related companies and potentially render the control exception unavailable to the fund of funds arrangement.

\textsuperscript{171} See 2018 FOF Proposing Release, supra footnote 6, at 41 and associated footnotes.

\textsuperscript{172} Id.

\textsuperscript{173} See infra footnotes 259 through 276 and accompanying text.
costs and burdens and enhance investor protection for acquired funds. Many commenters opposed the proposed redemption limit.176 These commenters raised a number of concerns, including: (1) Operational or administrative challenges; (2) the redemption limit’s potential effects on the acquiring fund’s investment objectives and its ability to respond timely to changing economic or market conditions; (3) the impact on competition and innovation; (4) whether funds in the same group of investment companies should be subject to the requirements; (5) concerns relating to liquidity; and (6) the cost of the proposed limits.177 These commenters offered a number of alternatives in lieu of the proposed redemption limit.178 We also received a number of comments on a proposed disclosure requirement relating to the redemption limit.179

Operational and administrative challenges. Commenters stated that the proposed redemption limit would present a number of operational or administrative challenges, including disrupting existing fund of funds arrangements.180 Many commenters provided evidence that the proposed redemption limit would have a large effect on funds.181 For example, one commenter provided survey results showing that, in the past three years, 228 fund of funds arrangements conducted 1,399 redemption transactions in excess of 3%.182 One commenter stated that, in the case of large-scale redemptions, an acquiring fund may have difficulty meeting redemption requests from its own shareholders in light of this limit, in part because making in-kind distributions to its shareholders would be difficult on such a large scale.183 Other commenters questioned whether this requirement was consistent with the requirements of the Act, including section 22(e) which generally prohibits registered investment companies from suspending the right of redemption of redeemable securities.184 Some commenters discussed the challenges associated with tracking the outstanding voting securities of numerous third-party funds for investment threshold and redemption limit percentages over rolling 30-day periods, noting that this information is not readily available to the investing public.185 Another commenter stated that it may be challenging to build compliance system enhancements that can account for multiple redemptions within any rolling 30-day period and apply those calculations to outstanding share balances that change daily.186 Some commenters stated that these challenges would cause portfolio management teams to reduce exposures to acquired funds as their holding approach the redemption limit as a means to mitigate these challenges.187 Other commenters stated that the proposed redemption limit could prevent an acquiring fund from timely participating in certain transactions, such as liquidations or mergers of the acquiring fund, even where the acquiring fund’s board and/or its shareholders have approved such transactions.188

Potential impacts on investment strategies. Several commenters expressed the view that the proposed redemption limit could impose acquirers with competing investment strategies, or its ability to follow their investment strategy.189 Commenters stated that portfolio managers routinely change allocations among underlying funds in response to economic or market conditions, or in keeping with the stated investment strategy of the fund of funds, and that redemption limits could prevent portfolio managers from making such changes in a timely fashion.190 For example, some commenters noted that the proposed redemption limit would prevent or limit portfolio managers’ ability to make investment changes when they identify an underlying fund as underperforming or no longer meeting the needs of the investment strategy of the fund of funds.191 One commenter stated that the proposed redemption limit could force acquiring funds and their shareholders to hold onto underlying funds that underperform, have higher costs than alternatives that become available, or no longer achieve the fund’s strategy.192 Another commenter suggested that to comply with the proposed redemption limit, some funds may alter an acquiring fund’s investment strategy to invest in different affiliated or unaffiliated acquired funds to avoid owning more than 3% of any acquired fund, which could frustrate the investment expectations of shareholders, and may increase the costs and complexity of the fund.193 Other commenters noted that this restriction would force acquiring fund portfolio managers to liquidate other positions to meet redemption requests.194 Another raised concerns as to whether the limit would impair rebalancing and restructuring transactions that may involve redemptions beyond the 3% limit.195

Impact on competition and innovation. Several commenters stated that requiring acquiring funds to redeem large positions slowly over time could place acquiring fund shareholders at a substantial competitive disadvantage to investors that are not subject to the same restrictions.196 One of these commenters also stated that the redemption limit

176 See, e.g., ICI Comment Letter; Morningstar Comment Letter. Some commenters did support specific elements of the proposed limit. See, e.g., MFA Comment Letter (supporting the approach that the limit not apply to sales of fund shares in secondary market transactions).

177 See, e.g., ICI Comment Letter; Fidelity Comment Letter; Comment Letter of John Hancock Investments (May 2, 2019) (“John Hancock Comment Letter”).


179 See, e.g., SIFMA AMG Comment Letter; Fidelity Comment Letter; PGIM Comment Letter.

180 See, e.g., ICI Comment Letter; Guggenheim Comment Letter; Capital Group Comment Letter; SIFMA AMG Comment Letter; Fidelity Comment Letter; Dechert Comment Letter; Ropes Comment Letter; Comment Letter of the Independent Directors Council (May 1, 2019) (“IDC Comment Letter”).

181 See, e.g., Comment Letter of JP Morgan Asset Management (May 2, 2019) (“JP Morgan Comment Letter”);

182 See 2018 FOF Proposing Release, supra note 6, at n.125 and accompanying text.

183 See Fidelity Comment Letter. See also ABA Comment Letter; Ropes Comment Letter.

184 See TRP Comment Letter; Fidelity Comment Letter; SCFA Comment Letter; NYC Bar Comment Letter (questioning whether the Commission was, in effect, redefining “redeemable security” under the Act).

185 See, e.g., Fidelity Comment Letter; Ropes Comment Letter.

186 See TRP Comment Letter.

187 See Dechert Comment Letter; JP Morgan Comment Letter.

188 See Allianz Comment Letter; John Hancock Comment Letter.

189 See, e.g., SIFMA AMG Comment Letter (providing survey results suggesting the proposed rule would have “a significant impact on the fund of funds business”); CFA Comment Letter (stating that the proposed redemption limit would inappropriately lock fund of funds investors into funds that no longer serve their best interests for unreasonable amounts of time).


191 See Nationwide Comment Letter; Vanguard Comment Letter; Dimensional Comment Letter.

192 See CFA Comment Letter. See also Voya Comment Letter.

193 See Allianz Comment Letter.

194 See TRP Comment Letter; Dechert Comment Letter; Ropes Comment Letter.

195 See Vanguard Comment Letter.

196 See, e.g., JP Morgan Comment Letter; SIFMA AMG Comment Letter (arguing that retail investors may be unfairly disadvantaged because their exposure to acquired funds through a fund of funds would be subject to the proposed redemption limit, while other investors who directly invested in an acquired fund would not be so limited and therefore would be able to access liquidity with priority over acquiring fund investors); Fidelity Comment Letter.
would encourage consolidation, raise barriers to entry for new fund managers, and limit investment options for investors. Many commenters stated that the limitation would have an adverse impact upon smaller funds, in part because the 3% limit would be easier to cross with such funds. Others asserted that it would adversely impact target-date funds. Other commenters focused on the proposed redemption limit’s impact on fund innovation. For example, one commenter stated that the redemption limit could inhibit the formation of new investment products, such as funds intended to serve as underlying funds for other funds in the same group of investment companies, because a sufficient number of investors would not hold the new product to avoid triggering the 3% limit. Similarly, a commenter raised concerns that the proposed redemption limit could discourage acquiring funds from exposure to non-traditional asset classes, which often have more volatile in- and out-flows and smaller asset bases, resulting in a less desirable mix of assets made available to investors. This commenter stated that if the proposed redemption limit discourages an acquiring fund from investing in an acquired fund, this could reduce overall economies of scale and operational efficiencies of the acquired fund or even challenge its viability.

Some commenters predicted that the proposed redemption limit would have a chilling effect on acquiring funds using mutual funds in their allocations and would effectively codify the limits set forth in sections 12(d)(1)(A) and (B) of the Act as the maximum investment in unrelated acquired funds. Other commenters indicated that acquiring funds would restructure to avoid the proposed redemption limitation, including investing in a larger number of funds in order to hold smaller proportions of each acquired fund, or relying more on ETFs.

**Same group of investment companies.** Several commenters argued the need for applying the proposed redemption limit to acquiring funds investing in acquired funds in the same group of investment companies, stating that it would be unnecessary and inappropriate to do so. Some of these commenters highlighted that the proposed rule included exceptions from the voting and control provisions for funds in the same group of investment companies and stated that a similar exception should be included from the redemption limit. One commenter argued that the proposed redemption limit could pose particular challenges for contracted arrangements involving funds within the same group, such as when an acquired fund is exclusively available to acquiring funds managed by the same adviser. As a result, these commenters asserted there would be no colorable risk that the acquiring fund would threaten redemptions to exert undue influence. Another commenter stated that, for affiliated fund of funds arrangements, the common investment adviser’s fiduciary duties to both the acquiring and acquired funds would adequately address duplicative and excessive fee concerns.

**Liquidity.** Commenters also identified a number of concerns regarding the proposed redemption limit’s impact upon the liquidity of the acquiring fund’s portfolio. A number of commenters thought that this aspect of the proposal would increase the difficulty of complying with rule 22e-4 by potentially impacting the liquidity categorization of an acquired fund’s shares. Some commenters stated that the proposed restriction would impose liquidity constraints on funds, which could become more pronounced if a particular acquired fund is under redemption pressures. Other commenters discussed the impact of the proposed restriction on fund liquidations. Cost. Commenters also raised concerns over increased costs and expenses because of the proposed limit. Several commenters stated that the proposed redemption limit would increase compliance costs because of the burden of monitoring the 3% threshold. One commenter thought portfolio management costs would increase if an adviser could not effect a particular strategy through a fund due to the redemption limit. Some commenters suggested that acquiring funds with a limited number of acquired funds might restructure to a “sleeved” approach—i.e., funds historically organized as funds of funds, rather than investing in acquired funds, would instead hire various sub-advisers to manage directly specified assets of the fund, thus increasing costs. Some commenters also noted that the proposed limit would result in significant transaction costs as the acquiring funds restructure their investment strategies and portfolios.

**Alternatives.** Some commenters suggested alternatives to the proposed redemption limit. For example, some commenters suggested that the proposed redemption limit exclude fund of funds arrangements that involve funds in the same group of investment companies or are otherwise affiliated, stating that there is minimal risk of undue influence by an acquiring fund over an acquired fund within the same group of investment companies.

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197 See Dechert Comment Letter.
198 See, e.g., PIMCO Comment Letter; IDC Comment Letter; Voya Comment Letter; Chamber of Commerce Comment Letter.
200 See Comment Letter of Russell Investment Management, LLC (May 3, 2019) (“Russell Comment Letter”). See also Comment Letter of Mutual Fund Directors Form (May 2, 2019) (“MFDF Comment Letter”) (stating that the proposed limit may limit the desire of acquiring funds to buy large stakes in acquired funds, thus disincentivizing innovation).
201 See Voya Comment Letter.
202 See Capital Group Comment Letter.
204 See, e.g., Allianz Comment Letter; Fidelity Fixed Income Trustees Comment Letter.
205 See, e.g., PIMCO Comment Letter; Wells Fargo Comment Letter; Chapman Comment Letter.
206 See Fidelity Fixed Income Trustees Comment Letter (arguing that there is no colorable risk of using the threat of redemptions to bully third-party investors in, or advisers to, such affiliated underlying funds).
207 See SIFMA AMG Comment Letter.
208 See, e.g., MFDF Comment Letter; Wells Fargo Comment Letter; Capital Group Comment Letter (suggesting alternatives on how to consider acquired fund shares under the proposed redemption limit for rule 22e-4 purposes); Dechert Comment Letter.
209 See, e.g., ABA Comment Letter; Fidelity Comment Letter (noting that the acquiring fund could be required to remain invested in an acquired fund facing a crisis such as fraud or bankruptcy whereas other investors were not likely to redeem).
210 See Invesco Comment Letter; Chapman Comment Letter; Schwab Comment Letter.
211 See, e.g., TRP Comment Letter; NYC Bar Comment Letter; Ropes Comment Letter. See 2018 FOF Proposing Release, supra footnote 6, at section II.C.2.
212 See Guggenheim Comment Letter. See also Fidelity Comment Letter (discussing the potential for managed account programs to move to direct fund investments, rather than fund of funds).
213 See Allianz Comment Letter; Fidelity Comment Letter (stating such an approach could increase costs related to screening, due diligence, and ongoing monitoring and oversight, and would increase the oversight responsibilities and workload of the funds’ boards of directors, estimating that the number of sub-advisers over seen by the funds’ boards would approximately triple).
214 See Wells Fargo Comment Letter; Fidelity Comment Letter.
215 See, e.g., Vanguard Comment Letter; Fidelity Rutland Comment Letter; Dimensional Comment Letter.
216 See, e.g., Invesco Comment Letter; Allianz Comment Letter; Thrivent Comment Letter. As discussed in more detail below, we are not
suggested an exception for fund liquidations,\textsuperscript{217} and another suggested an exception for redemptions that merely facilitate redemption requests from the acquiring fund’s shareholders.\textsuperscript{218} Other commenters questioned the need to replace the conditions in the existing exemptive orders.\textsuperscript{219} Some suggested that the rule permit funds to rely either on existing exemptive relief or the rule, or that the Commission codify existing relief in a rule, so that funds with existing relief would not have to comply with the proposed redemption limit.\textsuperscript{220}

Some commenters suggested making the redemption requirement permissive,\textsuperscript{221} letting the funds determine the size of permissible redemptions,\textsuperscript{222} increasing the percentage of shares that could be redeemed,\textsuperscript{223} or providing a shorter time period to align the applicable time period with rule 22e–4.\textsuperscript{224} Others questioned the need for redemption limits at all to protect acquiring funds’ investment in unaffiliated acquired funds, particularly given the existence of other protections in rule 12d1–4 and elsewhere (such as other regulations or existing fiduciary obligations).\textsuperscript{225} Some commenters suggested that we exempt in-kind redemptions from the requirement.\textsuperscript{226}

Other commenters stated that participation agreements, either consistent with existing Commission orders or altered in various ways, could be an alternative to the proposed redemption limit because they would provide opportunities for acquired funds to protect their interests, while preserving the benefits of fund of funds structures for shareholders.\textsuperscript{227} As support for this framework, one commenter suggested that the acquiring fund’s investment adviser certify to the acquired fund’s investment adviser that it will not invest in the acquired fund as a means to exert undue influence over the acquired fund or to influence any services or transactions and notify the acquired fund if its investment exceeds the proposed redemption limit.\textsuperscript{228} This commenter also suggested that the rule require periodic reporting to each of the acquiring and acquired funds’ board of directors.

Another commenter suggested that the final rule require participation agreements that are approved by each of the acquiring and acquired funds’ board of directors,\textsuperscript{229} although others stated that the board should not be required to be involved in approving fund of funds arrangements.\textsuperscript{230} This commenter suggested requiring the board review at least annually, of all transactions between the acquired fund and affiliates of the acquiring funds to determine whether the acquiring funds have influenced the transactions.\textsuperscript{231} The commenter also suggested that the rule allow acquired funds and their boards, at their option, to set their own limit for an acquiring fund’s investment. Another commenter stated that participation agreements operate efficiently and effectively to prevent undue influence and are an effective alternative to the proposed redemption limit.\textsuperscript{232} Other commenters stated that one of the key elements of a participation agreement is the ability for the acquired fund to refuse to enter into the participation agreement, which prevents the acquiring fund from investment in the acquired fund beyond the limits set forth in section 12(d)(1)(A).\textsuperscript{233}

Another commenter stated that the proposed limit was unnecessary because funds frequently negotiate large-scale redemptions to minimize any impacts that would result in undue influence.\textsuperscript{234} One commenter stated that funds can manage the threat of undue influence from large-scale redemptions by delaying payment for up to seven days where immediate payment would harm the fund.\textsuperscript{235} Others suggested that the Commission require pre-notification of large trades as an alternative to the limit.\textsuperscript{236}

Commenters suggested a number of other alternatives to the proposed redemption limit. One commenter suggested that we limit the overall percentage of acquired fund shares that an acquiring fund could own to 20%.\textsuperscript{237} Another recommended a policies and procedures-based system to ensure that the acquiring fund’s adviser acts in the acquiring fund’s best interest.\textsuperscript{238} Others suggested that, if the Commission retains the proposed redemption limit, we also retain rule 12d1–2.\textsuperscript{239} One suggested that the Commission replace the real-time tracking that would have been required to satisfy the proposed redemption limit with an allowance to rely upon the shares listed in the acquired fund’s most recently published financial statements.\textsuperscript{240}

Disclosure. In connection with the proposed redemption limit, we also proposed that a fund relying on rule 12d1–4 would be required to disclose in

\textsuperscript{217} See NYC Bar Comment Letter (suggesting a redemption management agreement); ICI Comment Letter (suggesting a simplified participation agreement); Federated Comment Letter; PIMCO Comment Letter; John Hancock Comment Letter (further suggesting that the adviser, rather than the fund, be responsible for monitoring and oversight, subject to board reporting).

\textsuperscript{218} See, e.g., Invesco Comment Letter; Comment Letter of MFS Investment Management (May 2, 2019) (“MFS Comment Letter”); BlackRock Comment Letter.

\textsuperscript{219} See Schwab Comment Letter; see also John Hancock Comment Letter (suggesting to exempt situations where the acquiring fund goes over 3% as a result of the decrease in the outstanding securities of the acquired fund from the proposed limit).

\textsuperscript{220} See NYC Bar Comment Letter.

\textsuperscript{221} See BlackRock Comment Letter.

\textsuperscript{222} See, e.g., PIMCO Comment Letter; BlackRock Comment Letter.

\textsuperscript{223} See Comment Letter of Thrivent Financial for Lutherans (May 1, 2019) (“Thrivent Comment Letter”); Ropes Comment Letter (stating that the ability of an acquired fund to satisfy redemption requests in-kind mitigates undue influence concerns).

\textsuperscript{224} See ICI Comment Letter; Voya Comment Letter; Invesco Comment Letter.

\textsuperscript{225} See Dimensional Comment Letter.
its registration statement that it is (or at times may be) an acquiring fund for purposes of the proposed rule. This disclosure requirement was intended to put other funds seeking to rely on rule 12d1–4 on notice that a fund they seek to acquire is itself an acquiring fund, and therefore to allow a fund to limit its acquisition of the acquiring fund’s securities accordingly.

Commenters generally opposed the disclosure requirement, predicting that funds would prophylactically disclose that they may rely upon the rule, and that acquired funds would not be able to monitor continuously the disclosure of potential acquired funds. Further, commenters suggested that such an approach could reduce the number of funds willing to become acquired funds and create fewer investment opportunities for funds of funds. As an alternative, a commenter recommended that acquiring funds disclose a principal investment strategy of investing in other funds, or allow funds to rely on a representation in a participation agreement. One commenter suggested that the Commission provide alternative disclosures for BDCs and other closed-end funds.

b. Fund Findings and Fund of Funds Investment Agreement

After considering the comments received, we have determined not to adopt the proposed redemption limit or require funds to disclose whether they are (or at times may be) an acquiring fund for purposes of the rule. Instead, we are adopting a combination of conditions that we believe will protect investors in fund of funds arrangements from the concerns the proposed redemption limit sought to address and will provide the notice that the proposed disclosure requirements would have provided. Specifically, the rule will require: (i) An acquired management company’s adviser to make certain findings focused on addressing undue influence concerns, including through redemptions, by considering specific enumerated factors; (ii) an acquiring fund’s adviser, principal underwriter, or depositor to conduct an evaluation of the complexity of the fund of funds structure and its aggregate fees and expenses and make a finding that the fees and expenses are not duplicative; and (iii) both the acquired fund’s adviser and the acquiring fund’s adviser to enter into a fund of funds investment agreement to memorialize the terms of the arrangement (including terms that serve as a basis for the required findings) when the acquiring and acquired fund do not share an investment adviser. The rule’s requirements vary based on the structural characteristics of the funds involved in the arrangement, but seek the same goal of avoiding the historical abuses that section 12(d)(1) was intended to prevent.

The Commission proposed the redemption limit believing that it would be more effective and less burdensome than conditions set forth in our orders. Commenters provided additional context and information regarding the impact of the proposed limit, suggesting that the proposed redemption limit would have a larger impact on fund of funds arrangements and would be more burdensome than the Commission contemplated in the proposal. We believe that our adopted approach expanding the proposed finding requirement will address undue influence concerns more effectively and with less disruption to current market practices than the proposed redemption limit (or the conditions in our existing exemptive orders) and will more effectively put funds on notice that a fund they seek to acquire is itself an acquiring fund.

i. Evaluations and Findings for Management Companies

Under the final rule, a fund’s investment adviser will be required to make certain evaluations and findings that are tailored to the specific concerns that underlie section 12(d)(1). For management companies that are acquired funds, rule 12d1–4 will require the acquired fund’s investment adviser to find that any undue influence concerns associated with the acquiring fund’s investment in the acquired fund are reasonably addressed, after considering certain specific factors. These factors are (1) the scale of contemplated investments by the acquiring fund and any maximum investment limits; (2) the anticipated timing of redemption requests by the acquiring fund; (3) whether, and under what circumstances, the acquiring fund will provide advance notification of investment and redemptions; and (4) the circumstances under which the acquired fund may elect to satisfy redemption requests in kind rather than in cash and the terms of any redemptions in kind. These factors are designed to focus the analysis of an acquired fund’s adviser on potential ways to reduce the threat of undue influence, including through redemptions, when an acquiring fund invests in the acquired fund beyond the section 12(d)(1) limits under the rule. Because concerns regarding undue influence are more salient for acquired funds, only the adviser to an acquired fund will be required to make this determination.

In cases where the acquiring fund is a management company, rule 12d1–4 will require the management company’s adviser to evaluate the complexity of the structure associated with the acquiring

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243 See generally SIFMA AMG Comment Letter; Fidelity Rutland Comment Letter; Skadden Comment Letter. However, a few commenters did suggest enhanced disclosure, including an expansion of this disclosure requirement, in lieu of other proposed requirements. See Comment Letter of Massachusetts Mutual Life Insurance Company (May 2, 2019) (“MassMutual Comment Letter”) (with regard to private funds); Bepos Comment Letter; Nationwide Comment Letter (with regard to the proposed redemption limit).

244 Fidelity Comment Letter.

245 Fidelity Comment Letter. One commenter also suggested that investor confusion concerns could be mitigated by an acquired fund’s adviser, including with an assurance regarding its disclosure in its report to the acquired fund’s board. TRP Comment Letter. See infra Comment Section I.C.2.c (discussing the board reporting requirements).

246 See BlackRock Comment Letter.

247 We are, as proposed, amending N–CEN to require reporting when an acquired fund has holdings in other funds. See infra Section III.

248 The final rule refers to “fees and expenses” in a number of places where the proposed rule only referred to “fees.” Compare rule 12d1–4(b)(2)(ii)(A) with proposed rule 12d1–4(b)(2)(ii)(A). In the 2018 FOF Proposing Release, when we discussed fees, we mentioned a number of “fees” that may more appropriately be characterized as “expenses.” See 2018 FOF Proposing Release, supra footnote 6, at 61 (discussing fees for recordkeeping, sub-transfer agency services, sub-accounting services, or other administrative services). In order to avoid confusion, we have revised the relevant provisions to refer to both fees and expenses, not just fees.

249 The Fund Findings requirement will apply regardless of the form and structure of the other fund acquired by or acquiring the fund in question. Thus, an adviser to an acquiring fund that is a management company would still need to make its finding with respect to the acquiring fund even if the acquired fund is, for example, a UIT (which will not need its own Fund Finding under the rule).

250 The conditions in our orders generally require fund boards to make certain findings and, for investments in unaffiliated funds, adopt procedures to prevent overreaching and undue influence by the acquiring fund and its affiliates once the investment in an unaffiliated acquired fund exceeds the section 12(d)(1) limit. See 2018 FOF Proposing Release, supra footnote 6, at n.117 and accompanying text.

251 For example, the fund of funds investment agreement discussed below will allow the acquired fund to screen potential acquiring fund investments, thereby addressing the notice concern enumerated in the proposal. See 2018 FOF Proposing Release, supra footnote 6, at 79.

252 The term “management companies” includes BDCs. See generally 15 U.S.C. 80a–4 (defining “management company” as an investment company other than a face amount certificate company or UIT) and 15 U.S.C. 80a–58 (defining “management companies”).

253 See supra footnotes 17 and 18 and accompanying text.

evaluation of the complexity of the structure and aggregate fees and expenses associated with the acquiring fund’s investment in the acquired fund, determine that the investment is in the best interest of the acquiring fund. As adopted, the rule will instead require that the acquiring fund’s adviser, after a similar evaluation, determine that the acquiring fund’s fees and expenses do not duplicate the fees and expenses of the acquired fund. In the 2018 FOF Proposing Release, we had sought comment on whether we should require a best interest determination and whether we should require the determination be made on a basis of the reasonableness of fees. We have made this change in part based upon comments that we received in response to this request that the concept of “best interest” in this context was unclear or overly broad, and that we should instead require advisers to make their determinations based upon specific elements including whether the fees are duplicative. While some commenters approved, and even recommended that we expand the use, of the best interest standard, we believe that focusing an adviser’s analysis under this provision upon an evaluation of the complexity of the fund of funds structure and a determination regarding whether fees and expenses are duplicative will be more effective in mitigating overly complex structures and duplicative fees and expenses.

Second, the proposed finding requirement for management companies would have applied only to acquiring funds, not to acquired funds. As adopted, the rule will additionally require a finding by advisers to acquired funds with a specific set of factors tailored to the concerns of an acquired fund. The principal goal of the proposed redemption limit was to protect acquired funds from the threat of undue influence due to large-scale redemptions. A number of commenters suggested that there were more appropriate ways to protect acquired funds from this concern. Among these were suggestions that the adviser to an acquired fund make an evaluation similar to that of an acquiring fund. We agree that this analysis, coupled with the fund of funds investment agreement as discussed below, is better suited to protect against this risk in that it avoids unduly impeding portfolio management or liquidity risk management while utilizing the acquired fund’s adviser to assess the risks of undue influence presented by the investment, taking into account the enumerated factors.

Third, the proposed rule would have required that the acquiring fund’s adviser report its finding and the basis thereof to the acquiring fund’s board of directors. Because the initial finding itself would have to be made prior to investing in an acquired fund in reliance on the rule, commenters were confused as to whether the investment could be made before this initial report to the board was made. One commenter suggested we clarify that the adviser would not report until the next regularly scheduled board meeting. We agree with this commenter, and are clarifying in the final rule that, while the adviser must complete the applicable Fund Findings (and fund of funds investment agreement) prior to initial investment, the adviser must report no later than the next regularly scheduled board meeting.

Fourth, the proposed rule would have required the acquiring fund’s adviser to make a finding both prior to the initial investment and with such frequency as the acquiring fund’s board deems to be necessary.

255 See supra footnote 38. See also Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248 (Jan. 5, 2019) [84 FR 33669 (July 12, 2019)] (“Fiduciary Duty Interpretation”) (“The duty of care includes, among other things: (i) The duty to provide that is in the best interest of the client, (ii) the duty to seek best execution of a client’s transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship”).
256 See infra Section II.C.4.c.
259 Proposed rule 12d1–4(b)(3)(i).
260 Consistent with this change, the final rule will require both this evaluation and the finding regarding fees and expenses, as well as the basis for these two items, be reported to the board. Rule 12d1–4(b)(2)(i)(C).
262 2018 FOF Proposing Release, supra footnote 6, at Section II.C.3.
263 See ICI Comment Letter; CFA Comment Letter; NYC Bar Comment Letter.
264 See NYC Bar Comment Letter; ICI Comment Letter. See also Fiduciary Fixed Income Trustees Comment Letter (noting that, in their experience, the adviser rarely found that fund only charges fees if the fees are not duplicative). But see Dechert Comment Letter (recommending that the finding requirement not include any factors).
265 See SIFMA AMG Comment Letter.
266 See Rule 12d1–4(b)(2)(i)(B).
reasonable and appropriate thereafter, but in any case no less frequently than annually. We requested comment on whether we should prescribe the frequency of these determinations, and some commenters suggested that we not mandate a specific frequency.\footnote{274 See ABA Comment Letter; Dechert Comment Letter. See also NYC Bar Comment Letter (opining that the OCC’s rule under rule 38a-1 obviates the need for advisers to report to fund directors on all proposed investments).} However, some commenters suggested the Commission adopt the same or more frequent assessment and reporting frequency that we proposed in recommending their own alternatives to the proposed redemption limit,\footnote{275 See ICI Comment Letter; John Hancock Comment Letter.} and one recommended that we retain ongoing reporting but on a discretionary basis.\footnote{276 See NYC Bar Comment Letter. See also ABA Comment Letter (stating that fund boards should be able to select their desired reporting frequency and that the rule should not mandate a minimum frequency).} We agree that mandating ongoing assessments and reporting is unnecessary, particularly in light of other reporting and oversight mechanisms, such as rule 38a-1 under the Investment Company Act, which requires a fund’s chief compliance officer to provide an annual written report to the board. As a result, the final rule will require an adviser to report the applicable Fund Findings to the board once; subsequent reporting regarding these Fund Findings will be conducted at least annually under the fund’s compliance program. In addition, we do not believe it is necessary to prescribe additional requirements given the board’s oversight role over fund operations.\footnote{277 See Compliance Rule Adopting Release, supra footnote 59 (“A fund’s board plays an important role in overseeing fund activities to ensure that they are being conducted for the benefit of the fund and its shareholders”).} Some commenters suggested that we require no specific best interest determination.\footnote{278 See, e.g., ABA Comment Letter; NYC Bar Comment Letter.} One commenter stated that these determinations are implicit in the investment management duties of an investment adviser.\footnote{279 See ABA Comment Letter.} Another commenter stated that the Commission should provide guidance, in lieu of a best interest determination, that sets forth factors that an investment adviser should consider before investing in an acquired fund.\footnote{280 See ABA Comment Letter.} Commenters disagreed, however, on whether the proposed best interest determination would be too flexible or not flexible enough. For example, one commenter agreed with the proposed requirements for investment advisers, but stated that the proposed requirements would not prevent fund of funds arrangements from charging duplicative fees.\footnote{281 See NYC Bar Comment Letter.} This commenter suggested that the proposed best interest finding and the evaluation standards are too flexible, and that the Commission should interpret “best interest” to mean “the best of the reasonably available options.” The commenter also suggested that the Commission explicitly require advisers to waive duplicative fees. Conversely, another commenter agreed with the proposed best interest requirement, but stated that the proposed factors on which the finding would be based on were not flexible enough.\footnote{282 See CFA Comment Letter; PGIM Comment Letter (arguing that the rule should not require fee waivers because a fund board of directors is already required to evaluate the terms of advisory agreements, which encompass the finding requirements of the proposed rule).} This commenter suggested that we permit the investment adviser to consider any factors that it deems relevant in its best interest finding, including subjective factors relating to investment merits.\footnote{283 See Dechert Comment Letter.} One commenter recommended expanding the proposed best interest determination to take into account fees, complexity, investment characteristics, fund size, underlying asset liquidity, asset volatility, legal structure and other characteristics.\footnote{284 See id. (“[P]ortfolio managers should be given deference and afforded flexibility with respect to their consideration of factors that they deem most relevant to the proposed best interest finding, including subjective factors relating to investment merits.”).} Another commenter suggested that instead of the proposed best interest finding, the final rule should require the acquiring fund’s investment adviser to find that the investment in the acquired fund is “appropriate in light of the complexity and aggregate fees.”\footnote{285 See SIFMA AMG Comment Letter.} This commenter stated that this suggestion would more closely align the requisite finding (on complexity and aggregate fees instead of the proposed best interest finding) because the information on which advisers rely in making these evaluations relates to complexity and fees.

In the 2018 FOF Proposing Release, we noted that many of the conditions relating to fee limitations required in our exemptive orders, such as fee waivers and board findings regarding fees, were redundant in light of a fund adviser’s and board’s fiduciary duties and statutory obligations. As a result, we did not propose to require them as part of the finding requirement.\footnote{286 See 2018 FOF Proposing Release, supra footnote 6, at n.146 and accompanying text.} A number of commenters agreed with this approach,\footnote{287 See ICI Comment Letter; Voya Comment Letter; PGIM Comment Letter; ABA Comment Letter.} but one commenter would have required fee waivers.\footnote{288 See CFA Comment Letter.} This commenter argued that fiduciary duties are often not enough to ensure that investors are not subject to duplicative fees.\footnote{289 See also ICI Comment Letter of Anonymous, (Dec. 28, 2018) (suggesting that, if an underlying fund pays a fee, those payments should be made into the assets of the acquiring fund, and that fund of funds arrangements should not be used to avoid fee limitations).} We are requiring specific evaluations and findings to help address this concern.\footnote{290 See also infra notes 297 to 299 and accompanying text.}

After considering comments, and in conjunction with our determination to eliminate the proposed redemption limit, we are adopting a modified requirement for management companies regarding Fund Findings that is designed to address the complexity and fees associated with the fund of funds arrangement, as well as undue influence concerns, such as from the threat of large-scale redemption. However, we are also providing advisers with flexibility to tailor their analysis to these specific concerns.

This requirement will apply to all management companies, including when both funds involved are in the same group of investment companies. While we believe it is appropriate to provide an exception from the voting and control conditions under the rule for funds in the same group of investment companies, such an exception is not appropriate for the finding condition. For example, two management companies in the same group of investment companies could

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\footnote{274 See ABA Comment Letter; Dechert Comment Letter. See also NYC Bar Comment Letter (opining that the OCC’s rule under rule 38a-1 obviates the need for advisers to report to fund directors on all proposed investments).}

\footnote{275 See ICI Comment Letter; John Hancock Comment Letter.}

\footnote{276 See NYC Bar Comment Letter. See also ABA Comment Letter (stating that fund boards should be able to select their desired reporting frequency and that the rule should not mandate a minimum frequency).}

\footnote{277 See Compliance Rule Adopting Release, supra footnote 59 (“A fund’s board plays an important role in overseeing fund activities to ensure that they are being conducted for the benefit of the fund and its shareholders”).}

\footnote{278 See, e.g., SIFMA AMG Comment Letter (stating the “adviser to an acquiring fund, rather than the acquiring fund’s board, should be the party primarily responsible for entering into and monitoring fund of funds arrangements”); Invesco Comment Letter.}

\footnote{279 See, e.g., PGIM Comment Letter; ABA Comment Letter; NYC Bar Comment Letter.}

\footnote{280 See, e.g., ABA Comment Letter; NYC Bar Comment Letter.}

\footnote{281 See ABA Comment Letter.}

\footnote{282 See NYC Bar Comment Letter.}

\footnote{283 See CFA Comment Letter; but see PGIM Comment Letter (arguing that the rule should not require fee waivers because a fund board of directors is already required to evaluate the terms of advisory agreements, which encompass the finding requirements of the proposed rule).}

\footnote{284 See Dechert Comment Letter.}

\footnote{285 See id. (“[P]ortfolio managers should be given deference and afforded flexibility with respect to their consideration of factors that they deem most relevant to the proposed best interest finding, including subjective factors relating to investment merits.”).}

\footnote{286 See SIFMA AMG Comment Letter.}
have two different advisers and two different boards satisfying their fiduciary duties to their respective shareholders. Requiring these advisers to evaluate the fund of funds arrangement separately and make the appropriate findings tracks their separate—albeit parallel—fiduciary duties. Further, this requirement also applies if both the acquiring and acquired funds have the same adviser. This approach is similar to the proposed redemption limit, which would have applied to both unaffiliated and affiliated fund of funds arrangements.

We also believe that it is appropriate to require each fund’s investment adviser to make the applicable Fund Findings because whether to invest in an acquired fund to achieve a fund’s investment objective, or accept any investment from an acquiring fund, is generally a question of portfolio management. That said, given the conflicts of interest at issue, we believe that the rule as adopted should provide a framework for advisers to conduct their analysis. Also, as discussed below, the fund’s board of directors will be required to review these arrangements as part of its oversight responsibilities.

Acquired Fund Findings. We are requiring that advisers to acquired management companies make a finding that any undue influence concerns associated with the acquiring fund’s investment in the acquired fund are reasonably addressed. As part of this finding, the acquired fund’s investment adviser is required to review a specific list of non-exhaustive factors. We believe these factors will help ensure that acquired fund advisers make appropriate determinations when assessing whether a fund of funds arrangement has terms that reasonably address undue influence by the acquiring fund, including through the threat of large-scale redemptions. Additionally, because this finding requirement (along with the fund of funds investment agreement) is replacing the protections that the proposed redemption limit would have provided, requiring consideration of specific factors is designed to enable the acquired fund to effectively negotiate appropriate terms regarding the acquiring fund’s use of redemptions and other ways that the acquiring fund could exert undue influence over the acquired fund.

The rule does not dictate the particular terms or how acquired fund advisers must evaluate or weigh these factors because we believe that the investment adviser is in the best position to make these decisions. We believe that the adviser’s familiarity with a fund’s investment strategies and operations will inform its ability to identify and discern the most pertinent factors and concerns related to a fund of funds arrangement. This flexibility will allow an acquired fund to establish a fund of funds arrangement that appropriately protects its own interests and those of its investors.

We believe that collectively this list of factors will assist acquired fund advisers in determining whether undue influence has been reasonably addressed. We devised these factors based upon the issues we raised in the 2018 FOF Proposing Release and as informed by comments received with regard to the redemption limit. This list of factors is not an exhaustive list, and acquired fund advisers should consider anything else relevant under the circumstances when making their findings.

One commenter objected to a finding that involves an analysis of specific factors, stating that we should afford portfolio managers deference and flexibility when making an investment decision. This commenter suggested that the fiduciary duties of the adviser and board are sufficient to protect against the undue influence concerns behind section 12(d)(1). Another commenter made a similar suggestion, stating that the guidance provided regarding the proposed finding requirement would add complexity, cost, and additional time to the investment process without adding significant value beyond the adviser exercising its fiduciary duty alone. While we agree that an adviser acting according to its fiduciary duty helps to protect against these concerns, the factors we are adopting should help the acquired fund adviser to exercise that duty by focusing upon those issues we believe are most important for an acquired fund in assessing this risk.

We believe each of the following factors is appropriate for an investment adviser to a management company to consider before making its finding:

- **Scale of investment.** The final rule will require the acquired fund’s investment adviser to consider the scale of contemplated investments by the acquiring fund and any maximum investment limits. For example, the investment adviser may determine that certain levels of investment by an acquiring fund in excess of the section 12(d)(1) limits would be appropriate for the acquired fund’s operations. Conversely, the adviser could determine that investments above a certain level would raise undue influence concerns because of the adverse effect a large-scale redemption from one large investor (e.g., 10% of the acquired fund’s outstanding voting shares) could have on the fund and its investors. Assuming the funds have different advisers, the acquired fund could set the limit in the fund of funds investment agreement, or for funds with the same adviser, as part of the written record of its Fund Findings. To the extent an acquiring fund exceeded the acquired fund’s specified threshold, the acquired fund could terminate the fund of funds agreement as an additional means of prohibiting additional investments. Alternatively, an acquired fund’s adviser may determine that such a limitation on its investment is not necessary to address reasonably undue influence by the acquiring fund through the threat of large-scale redemptions.

- **Anticipated timing of redemption requests.** The final rule will require the acquired fund’s investment adviser to consider the anticipated timing of redemption requests by the acquiring fund. The acquired fund’s adviser could, for example, determine that the
undue influence concerns regarding an acquiring fund’s investment would be reasonably addressed only if the acquiring fund commits to submitting redemption requests over multiple days. Depending on the particular investment strategy and liquidity of the acquired fund, such an adviser might consider the impact of immediate, large redemption requests and determine that the undue influence concerns would be reasonably addressed only if such requests are made over multiple days. For example, the adviser may request or require that the acquiring fund provide advance notice of a large redemption before entering into a fund of funds investment agreement. However, any agreement related to this factor would still have to comply with section 22(e) of the Act.

• **Advance notification of investments or redemptions.** The final rule will require the acquiring fund’s investment adviser to consider whether and under what circumstances the acquiring fund will provide advance notification of investments and redemptions. For example, the acquiring fund’s investment adviser would need to consider whether the acquiring fund’s investment adviser to only charge fees for advisory services that are performed by another person, such as the acquirers of the acquired fund versus direct investment in the acquired fund’s shareholders and to prevent excessive layering of fund costs.

In evaluating the complexity of a fund of funds structure, an acquiring fund’s investment adviser should consider the complexity of the acquiring fund’s investment in an acquired fund versus direct investment in assets similar to the acquired fund’s holdings. The adviser should consider whether the resulting structure would make it difficult for shareholders to appreciate the fund’s exposures and risks or circumvent the acquiring fund’s investment restrictions and limitations. The adviser also should consider whether an acquired fund invests in other funds, which may create additional complexities.

In evaluating the fees associated with the fund’s investment in acquired funds, an adviser should consider the fees of both the acquiring and acquired funds within the fund of funds arrangement with an eye towards duplication. Specifically, an adviser should consider whether the acquiring fund’s advisory fees are for services that are in addition to, rather than duplicative of, the adviser’s own services to the acquiring fund. The adviser also should consider the other fees and expenses, such as sales charges, recordkeeping fees, sub-transfer agency services, and fees for other administrative services.

We believe the flexibility provided by the rule will allow an acquiring fund to establish a fund of funds investment agreement that appropriately protects its own interests and those of its investors. However, as with acquired fund advisers, in negotiating a fund of funds investment agreement, an acquiring fund adviser should address all matters to the extent necessary to allow the fund to comply with legal and regulatory requirements under the Federal securities laws.

An acquiring fund board already has a responsibility to see that the fund is not being overcharged for advisory services regardless of any findings we require. Section 15(c) of the Act requires the board of directors of the acquiring fund to evaluate any information reasonably necessary to evaluate the terms of the acquiring fund’s advisory contracts (which information would include fees, or the elimination of fees, for services provided by an acquired fund’s adviser). Section 36(b) of the Act also imposes on fund advisers a fiduciary duty with respect to their receipt of compensation. We believe that to the extent advisory services are being performed by another person, such as the adviser to an acquired fund, this fiduciary duty would require an acquiring fund’s adviser to only charge fees or expenses for the services that the acquiring fund’s adviser is providing, and not for any services performed by an adviser to an acquired fund. In addition, when an adviser to an acquiring fund (or an affiliate of an adviser) receives compensation from, or related to, an acquired fund in connection with an investment by the acquiring fund, the adviser has a conflict of interest. The adviser has a fiduciary duty to the acquiring fund under the Advisers Act and must act in the best interest of its clients, including eliminating or making full and fair disclosure of this conflict. Nevertheless, we believe that it is appropriate for the rule to require that the acquiring fund’s adviser find that the aggregate fees and expenses are not duplicative, given the inherent conflict.

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303 Investors in mutual funds can redeem their shares on each business day and, by law, must receive approximately their pro rata share of the fund’s net assets (or its cash value) within seven calendar days after receipt of the redemption request. See section 22(e) of the Act (providing, in part, that no registered investment company shall suspend the right of redemption, or postpone the date of payment upon redemption of any redeemable security in accordance with its terms for more than seven days after tender of the security absent unusual circumstances).


305 Many funds reserve the right to redeem their shares in-kind instead of with cash. See, e.g., rule 18F–1; rule 22e–4(b)(4); Election by Open-End Investment Companies to Make Only Cash Redemptions, Investment Company Act Release No. 6561 (June 14, 1971) [36 FR 11919 (June 23, 1971)] (stating that the definition of “redeemable security” in section 2(a)(32) of the Investment Company Act “has traditionally been interpreted as giving the issuer the option of redeeming its securities in cash or in kind”).

306 See 2006 FOF Adopting Release, supra footnote 19, at n.52 and accompanying text.


308 See 2006 FOF Adopting Release, supra footnote 19, at n.52.

309 See Fiduciary Duty Interpretation, supra footnote 255.
of interest the adviser faces in this circumstance. This finding, which is reported to the board of directors, gives the fund’s board information specific to the fund of funds arrangement to review when exercising its oversight responsibilities over the adviser.

**Investment Adviser Reporting and Board Oversight.** The final rule will require the adviser to a management company to report its evaluation, finding, and the basis for its evaluation or finding to the fund’s board of directors no later than the next regularly scheduled board meeting. As discussed above, the final rule differs from the proposed rule in that we will not additionally require the fund’s board of directors to set the frequency of determination as reasonable and appropriate after the initial investment, but in any case no less frequently than annually.

Some commenters suggested that the Commission eliminate or modify the requirement that the investment adviser of the acquiring fund report the proposed best interest determination to the acquiring fund’s board of directors. One commenter characterized this requirement as unduly burdensome, as another mandatory report that may be complex and data heavy. Rather than reporting the finding to the board of directors before investing in an acquired fund, a commenter recommended that the final rule require such reporting and the basis for the adviser’s determination to the board of directors at the next regularly scheduled meeting. On the other hand, one commentator stated that the board of directors appropriately serves an oversight role, supporting the proposal’s investment adviser reporting requirements. The commenter recommended that the frequency of reporting should be set forth in a fund’s policies and procedures adopted and approved by the board under subsection 38a-1 under the Act.

We continue to believe that the board of directors provides an additional layer of protection for acquiring and acquired funds that are management companies and their respective investors against the abuses historically associated with fund of funds arrangements. We are therefore adopting conditions that will require the investment adviser to each of the acquiring and acquired funds to report its evaluation, finding, and the basis for its evaluation or finding. We are adopting this change to the proposed rule to conform to the final rule’s regulatory framework, which now applies to acquiring and acquired fund advisers. As proposed, the final rule will not require a management company’s adviser to make the applicable Fund Findings in connection with every investment in an acquired fund.

### ii. UIT Findings

Rule 12d1-4 will include an alternative finding condition when the acquiring fund is a UIT. Specifically, on or before the date of initial deposit of portfolio securities into a registered UIT, the UIT’s principal underwriter or depositor must find that the fees of the UIT do not duplicate the fees and expenses of the acquired funds that the UIT holds or will hold at the date of deposit. The final rule will require the principal underwriter or depositor to base its finding on an evaluation of the complexity of the structure and the aggregate fees and expenses associated with the UIT’s investment in acquired funds. This finding requirement is essentially the same as proposed.

We received limited comments addressing this aspect of the proposal, but the comments received provided support or did not recommend any UIT-specific changes to the proposal. For example, one commenter supported the rule requiring the principal underwriter or depositor of a UIT to make a finding regarding aggregate UIT and acquired fund fees.

The condition for acquiring UITs under rule 12d1-4 differs from the condition applicable to acquiring management companies in many respects, and we believe that this is appropriate for several reasons. First, by statute, a UIT is unmanaged and its portfolio fixed. Unlike a management company, a UIT does not have a board of directors, officers, or an investment adviser to render advice during the life of the trust. Second, acquiring UITs typically raise different fee and expense concerns than management companies. A UIT, for example, does not bear investment advisory fees, and the payments UITs make are limited by section 26 of the Act.

Due to the unmanaged nature of UITs and the fixed nature of their portfolios, we continue to believe it would be inconsistent with their structure to require a re-evaluation of their acquired fund finding over time or other reporting requirements. The requirement only applies, therefore, at the time of the UIT’s creation. Nevertheless, this determination generally should consider the planned structure of the UIT’s holdings. In particular, if the UIT tracks an index, the determination should consider the index design and whether the index design is likely to lead to the UIT holding acquired funds with duplicative fees or overly complex structures. We believe that the UIT-specific finding requirement that its fees and expenses do not duplicate the fees and expenses of the acquired funds that the UIT holds or will hold at the date of deposit, is an appropriately calibrated means to protect investors, given a UIT’s unmanaged structure.

Unlike acquired management companies, we are not extending this finding requirement to acquired funds that are UITs. We do not believe it is necessary to require these UITs to make similar findings given their structure. A UIT that is an acquired fund does not have similar section 12(d)(1) undue influence concerns as a management company because the UIT is unmanaged. This is distinguishable from UITs that are acquiring funds where we are only requiring UITs to consider the complexity of the structure and the aggregate fees and expenses associated with the UIT’s investment, redeemable securities, each of which represents an undivided interest in a unit of specified securities).

322 Section 26(a)(2)(C) of the Act requires that the trust indenture for a UIT prohibit payments to the depositor or to any affiliated person thereof, except payments for performing bookkeeping and other administrative services of a character normally performed by the trustee or custodian itself. 80 U.S.C. 80a-26(a)(2)(C). UIT ETFs have exemptive relief that allow the ETF to pay certain enumerated expenses that would be prohibited under section 26(a)(2)(C). See Exchange-Traded Funds, Investment Company Act Release No. 33140 (July 31, 2018) [80 FR 37332 (July 31, 2018)] (“2018 ETF Proposing Release”) at n.52 and accompanying text.

323 However, if the acquiring fund is a management company, it would need to make its own finding consistent with the rule. See supra footnote 248.
which is only relevant when the UIT is acquiring other funds.

This condition will apply only at the time of initial deposit for UITs that are formed after the rule’s effective date as proposed. We do not believe it is necessary to exclude UITs that are already in existence from relying on rule 12d-1 as acquiring funds. UITs that serve as separate account vehicles funding variable annuity and variable life insurance contracts will be subject to additional fee conditions, as discussed below. The majority of UITs fall into this category.329 In addition, we believe that existing UIT ETFs are unlikely to rely on rule 12d-1 as acquiring funds because they replicate the components of broad-based securities indexes that do not currently include funds.330 Even if funds were to become significant components of these indexes in the future, we believe that acquiring funds that invest in broad-based securities indexes are unlikely to raise complex structure concerns because the funds replicate the relevant index.331 If an index were to include funds, the UIT ETF would simply acquire those funds as part of replicating the broader index. Such an arrangement also is unlikely to raise duplicative fee concerns because existing UIT ETFs do not bear advisory fees, sales loads, or other types of service fees at the UIT ETF level. Finally, UITs that do not serve as variable insurance contract separate account vehicles or that are not ETFs typically have a limited term, sometimes of approximately 12–18 months.332 Given this short term, the number of UITs that have not made the finding required by rule 12d-1 would decrease quickly over time. Absent this provision, it is unlikely that pre-existing UITs could rely upon the rule given the statutory requirement that UITs be organized under a trust indenture, contract of custodianship or agency, or similar instrument.

iii. Separate Accounts Funding Variable Insurance Contract Certification

With respect to a separate account funding variable insurance contracts that invests in an acquiring fund, the final rule will require an acquiring fund to obtain a certification from the insurance company issuing the separate account that it has determined that the fees and expenses borne by the separate account, acquiring fund, and acquired fund, in the aggregate, are consistent with the standard set forth in section 26(f)(2)(A) of the Act.333 The standard set forth in section 26(f)(2)(A) of the Act provides that the fees must be reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company. This requirement generally is the same as proposed.334 Comments received regarding the insurance company certification generally raised concerns with this requirement.335 One commenter stated that the certification requirement is inappropriate because the separate account is a separate and distinct legal entity from the fund of funds arrangement.336 For example, this commenter stated that typical fees associated with separate accounts, such as mortality and expense risk fees or account fees and expenses, are the responsibility of, and paid by, the insurance contract owners. Some commenters also stated that the acquiring fund’s investment adviser may have limited ability to obtain or compel this type of certification from an unrelated insurance company to comply with the rule.337 Some commenters stated that section 26 of the Act already requires that the separate account and sponsoring insurance company fees and charges deducted under a variable insurance contract, in the aggregate, be reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company.338 Commenters argued that, in making this determination, the insurance company sponsoring the separate account is entitled to rely on the obligations already imposed on the investment adviser and board of trustees of any fund in which the separate account invests, to ensure that the fees borne by any funds that are available through variable insurance contracts are appropriate.339 Other commenters argued that the requirement was superfluous in light of existing requirements for review and approval of acquiring and acquired fund advisory agreements under section 15(c) of the Act and a fund adviser’s fiduciary duty under section 36(b) of the Act with respect to the receipt of compensation for services, or of payments of a material nature, from an acquiring or acquired fund.340

We believe the final rule should include a condition that addresses the concerns underlying the limits in section 12(d)(1), particularly duplicative fee concerns, in this three-tier arrangement.341 We disagree with commenters that the finding is unnecessary or duplicative of section 15(c) or section 36(b) because we believe it is appropriate to address concerns with duplicative fees at each tier of the arrangement. In addition, section 15(c) and 36(b) generally will not apply in each tier of such an arrangement since the funds involved in this arrangement typically include UITs, which do not have boards of directors or investment advisers.342 In addition, this certification requirement will ensure an analysis of the aggregate fee and expense structure of all the funds involved.

The final rule’s conditions for separate accounts funding variable insurance contracts are based on the current fund of funds exemptive orders.343 Our exemptive orders include a condition similar to the certification requirement.344 Under the orders, the

329 According to UIT annual Form N-CEN filings, as of April 2020, insurance UITs made up 674 of the total 716 registered UITs.

330 There are five existing UIT ETFs that had total assets of approximately $436.6 billion as of December 31, 2019, representing 85.7% of UIT assets. All existing UIT ETFs seek to track the performance of a broad-based securities index by investing in the component securities of the index in the same approximate portions as the index.

331 The exemptive relief that has been granted to UIT ETFs provides that the trustee will make adjustments to the ETF’s portfolio only pursuant to the specifications set forth in the trust formation documents in order to track changes in the ETF’s underlying index. The trustee does not have discretion to make these portfolio adjustments. See 2018 ETF Proposing Release, supra footnote 81, at nn. 46–47 and accompanying text.

332 This estimate is based on staff sampling of equity UIT prospectuses.
insurance company must certify to the acquiring fund that the aggregate of all fees and charges associated with each variable insurance contract that invests in the acquiring fund are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company.

Under the rule, an insurance company sponsoring a separate account must certify that the fees and expenses borne by the separate account, acquiring fund, and acquired fund in the aggregate are reasonable and consistent with the standard set forth in section 26 of the Act. Because the final rule will require most funds to enter into a fund of funds investment agreement, we considered whether to codify the approach of the exemptions and require that the fund of funds investment agreement include a representation regarding the insurance company’s certification. 345 Rule 12d1–4 will not require that the fund of funds investment agreement include this representation, although the agreement may do so. This is consistent with our general approach not to codify in our rule all the particularized terms that an agreement must include to reflect the fund of funds arrangement.

iv. Fund of Funds Investment Agreements

The final rule will require funds to enter into a fund of funds investment agreement before the acquiring fund acquires securities of the acquired fund in excess of the limits of section 12(d)(1) in reliance on rule 12d1–4 unless both funds have the same adviser. 346 This requirement works in tandem with the requirement to make certain Fund Findings by providing a method to hold the parties to the arrangement to the terms that led each fund’s investment adviser to agree to the arrangement in the first place. In negotiating the fund of funds investment agreement, funds can set the terms of the agreement to support the Fund Findings. For example, an acquired fund could require the acquiring fund to agree to submit redemptions over a certain amount for a given period as a condition to the fund of funds investment agreement. This agreement both sets the expectations of the parties at the outset of the arrangement and provides a method of enforceability should one party not live up to these expectations. Thus, the fund of funds investment agreement is designed to address historical abuse concerns under section 12(d)(1), including an acquiring fund threatening large-scale redemptions as a means of exercising undue influence over an acquired fund. 347 Further, the requirement to enter into such agreement puts the acquired fund on notice that an acquiring fund is investing in it in reliance on the rule. In the 2018 Proposing Release, we requested comment on alternatives to the proposed redemption limit, specifically asking whether we should permit acquired funds to set their own redemption limit (and, if so, what parameters we should establish) or whether we should require participation agreements. 348 As discussed above, a number of commenters recommended a negotiated agreement similar to the participation agreements required in our exemptive orders as an alternative to the proposed redemption limit. 349 We agree with these commenters that a negotiated agreement, combined with the findings requirements discussed above, would be a more effective control against the threat of the use of large redemptions to exercise undue influence than the proposed redemption limit.

The fund of funds investment agreement differs in certain ways from the requirement in our exemptive orders that, prior to investing in another fund, acquiring and acquired funds enter into a participation agreement. Participation agreements under our orders require both funds in a fund of funds arrangement (and their investment advisers) to fulfill their responsibilities under the order. 350 Participation agreements also require that the acquiring fund notify the acquired fund prior to investing in excess of the limits of section 12(d)(1)(A) and provide the acquired fund a list of the names of each of its affiliates to help the acquired fund ensure compliance with the affiliated transaction provisions of the Act. 351 Because all funds operating in accordance with rule 12d1–4 will be required to comply with the rule’s conditions, the rule will not require that a fund of funds investment agreement include these types of contractual provisions. 352 In contrast to a participation agreement, the fund of funds investment agreement will be required to memorialize the terms of the arrangement that serve as a basis for the required finding. The agreement will empower funds relying on the rule to negotiate and tailor appropriate terms to protect their interests in a fund of funds arrangement. For example, the fund of funds investment agreement will provide a mechanism for an acquired fund to limit an acquiring fund’s investments in reliance on the rule and arm itself with other tools it desires to protect against potential undue influence from an acquiring fund.

Rule 12d1–4 also will require funds operating in accordance with it to enter into a fund of funds investment agreement that includes three specific provisions. While some commenters suggested that we did not need to outline specific provisions in these agreements, 353 we believe that certain minimum requirements are necessary to ensure that the fund of funds agreement is effective at curtailing undue influence. These requirements are based on the Fund Findings, as well as elements of our exemptive orders and

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345 See 2018 FOFO Proposing Release, supra footnote 6, at 57–58. We also requested comment on: (i) Whether participation agreements require the parties to a fund of funds arrangement to provide information necessary for compliance with other provisions of the Act; and (ii) whether we should codify the conditions of existing exemptive orders including the procedural requirements. See id.

346 See supra footnote 6. We also requested comment on: (i) Whether participation agreements require the parties to a fund of funds arrangement to provide information necessary for compliance with other provisions of the Act; and (ii) whether we should codify the conditions of existing exemptive orders including the procedural requirements. See id.

347 The Commission proposed the certification requirement, in part, because the proposal did not contemplate participation agreements. See 2018 FOFO Proposing Release, supra footnote 6, at section II.C.3.c.

348 See 2018 FOFO Proposing Release, supra footnote 6, at 57–58.

349 We believe that, due to the flexibility that the final rule provides in this regard, no special exceptions for certain funds or situations, such as interval funds or acquired fund liquidations, are necessary, as discussed above. See ICI Comment Letter (stating that because of the flexibility of the final rule, no special exceptions for exemptive orders are necessary). But see Capital Group Comment Letter (stating that because of the flexibility of the final rule, no special exceptions for exemptive orders are necessary). But see Capital Group Comment Letter (stating that because of the flexibility of the final rule, no special exceptions for exemptive orders are necessary).

350 Fund of funds exemptive orders require a participation agreement to state, without limitation, that the funds’ boards and their investment advisers understand the terms and conditions of the order and agree to fulfill their responsibilities under the order. See, e.g., ETF Managers Trust, et al., Investment Company Act Release Nos. 33799 (Feb. 19, 2020) [85 FR 10794 (Feb. 25, 2020)] (notice) and 33823 (Mar. 24, 2020) (order) and related application (“ETF Management Letter”).

351 While not required by exemptive orders, some funds include other provisions in participation agreements to govern the fund of funds arrangement, such as provisions related to mirror voting, waiver of compensation, and notification upon exceeding certain thresholds. We are not requiring that these conditions be included in the written agreement.

352 See ICI Comment Letter.

353 See ICI Comment Letter (stating that because a fund of funds arrangement would need to comply with the generally applicable provisions of the rule, its participation agreement would not require notification). But see Capital Group Comment Letter (suggesting that the Commission should include practical conditions in a participation agreement-type regime).
commenters’ recommendations in response to our requests for comment.\textsuperscript{354}  
First, the fund of funds investment agreement must include any material terms necessary for the adviser, underwriter, or depositor to make the Fund Finding where the funds involved include management companies or UITs.\textsuperscript{355} This ensures that the adviser or other party making the Fund Finding will have memorialized the terms of the investment that underpin the Fund Finding, thereby making these terms fixed and clearly agreed if a dispute arises in the future. Given the importance of the Fund Findings to rule 12d1–4’s protections, we believe that it is critical for the agreement to identify such terms to minimize ambiguity.  
Second, each fund of funds investment agreement must include a termination provision whereby either party can terminate the agreement with advance written notice within a period no longer than 60 days.\textsuperscript{356} This provision allows an acquired fund the ability to terminate an acquiring fund’s acquisition of additional fund shares and provides the acquired fund with the negotiating leverage to address undue influence concerns. Termination of the agreement does not, unless otherwise agreed to by the parties, require that the acquiring fund reduce its position in the acquired fund, but will prevent the acquiring fund from purchasing additional shares of the acquired fund beyond the limits of section 12(d)(1).\textsuperscript{357}  
Lastly, the agreement must include a provision requiring an acquired fund to provide the acquiring fund with fee and expense information to the extent reasonably requested.\textsuperscript{358} We believe that this requirement is appropriate to assist the acquiring fund’s adviser with assessing the impact of fees and expenses associated with an investment in an acquired fund. For example, an acquired fund that invests in other funds would more readily have fee and expense information associated with the underlying investment than the acquiring fund. Which may inform the acquiring fund’s consideration of fees and expenses associated with an investment in the acquired fund. We believe that fund of funds investment agreements are material contracts not made in the ordinary course of business. As a result, they must be filed as an exhibit to each fund’s registration statement.\textsuperscript{359}  
In sum, we believe that this requirement provides important additional protections beyond those provided by the Fund Findings requirement. First, it ensures both parties agree to the significant terms of the investment, including those terms on which the adviser or other party making the Fund Finding has based its analysis. Second, it ensures that an acquiring fund has the information it needs to assess the impact of the relevant fees and expenses. Lastly, these agreements permit funds to terminate the investment if they so choose, thereby ending the funds’ ability to rely upon the rule for additional investments in the acquired fund.  
The rule will not require acquired funds and acquiring funds that are advised by the same adviser to enter into a fund of funds investment agreement. We believe that there are comparatively fewer benefits to formalizing a fund of funds arrangement with an executed agreement if the funds have the same adviser, assuming that the funds’ adviser has made the applicable Fund Finding. Given the importance of the fund of funds investment agreement to the structure of the rule, we think it important to require it of every fund unless the same adviser is the primary adviser to both funds. That is, the exception will not be available when an investment adviser acts as an adviser to one fund and a sub-adviser to the other fund in a fund of funds arrangement relying on the rule or as sub-adviser to both funds. We believe that this distinction is appropriate because a sub-adviser may not have the same access to information or be negotiating from the same position as other advisers. Thus, in situations where an adviser is the primary adviser to the acquired fund and serves as the sub-adviser to the acquiring fund, a fund of funds investment agreement would be required. Similarly, funds that do not have an adviser, such as internally managed funds or UITs, always would need to enter into a fund of funds investment agreement. Funds that do have the same adviser must still memorialize the arrangements that led the relevant adviser to make the Fund Finding for each fund under the rule.\textsuperscript{360}  
In the 2018 Proposing Release, we noted that an adviser to both an acquiring and acquired fund would owe a fiduciary duty to each of these funds.\textsuperscript{361} As noted above, some commenters suggested that this was a reason to exclude affiliated funds of funds from the proposed redemption limit.\textsuperscript{362} However, another commenter questioned whether advisers to more than one fund can effectively exercise their fiduciary duty to each fund independently of the other fund.\textsuperscript{363}  
Advisers must act in accordance with their fiduciary duties to each respective fund, which should address the conflicts of interests advisers face when acting as an adviser to both the acquiring and acquired funds. Because of this, and the requirement to make the Fund Findings, we believe that it is unnecessary to apply the fund of funds investment agreement requirement to funds having the same adviser. In cases where an adviser believes that it cannot satisfy its fiduciary duty to both funds in a fund of funds arrangement relying on the rule, the adviser should not enter into the arrangement.  
We also are not exempting all funds within the same group of investment companies from the fund of funds investment agreement requirement, as suggested by a number of commenters in relation to the more-restrictive proposed redemption limit.\textsuperscript{364} While some funds within the same group may
have effective communication and controls such that a fund of funds investment agreement may seem duplicative, not all do. As we noted above, two funds in the same group of investment companies could have two different advisers and two different boards satisfying their fiduciary duties to their respective funds and shareholders. In some cases, the investment advisers to funds in the same group of investment companies are not even affiliated persons.365 Further, these funds are likely subject to different compliance policies and procedures and, as a result, we believe that a fund of funds investment agreement is an effective mechanism to memorialize the arrangement in these circumstances.

In summary, we believe that the requirement to enter into a fund of funds investment agreement, coupled with the expanded Fund Findings, are collectively a more effective approach than the proposed redemption limit to address undue influence concerns from redemption procedures and, as a result, we believe that a fund of funds investment agreement is an effective mechanism to memorialize the arrangement in these circumstances.

3. Complex Structures

A concern underlying section 12(d)(1) is that complex multi-tier fund structures could lead to excessive fees and investor confusion. To address this concern rule 12d1–4 will include conditions designed generally to restrict fund of funds arrangements to two-tiers, largely as proposed. Additionally, as proposed, rule 12d1–4 includes exceptions to the two-tier limitation that are limited in scope and designed to capture circumstances that do not raise the concerns underlying section 12(d)(1) of the Act. In response to concerns raised by commenters, however, we are adding an additional exception that will permit an acquired fund to invest up to 10% of its total assets in other funds without restriction on the purpose of the investment or types of underlying funds, or the size of the investment in a particular underlying fund (the “10% Bucket”). The final rule’s conditions seek to permit innovation and efficient portfolio management while limiting the potential for confusing structures and duplicative fees.

a. General Prohibition on Three-Tier Structures

Rule 12d1–4 includes conditions designed to restrict fund of funds arrangements to two tiers (other than in limited circumstances), generally as proposed. Commenters were mixed with respect to the proposed rule’s general prohibition on three-tier structures. Some commenters agreed with the Commission that multi-tier structures have the potential to confuse investors and generate duplicative fees.366 One commenter, for example, supported a broad restriction that limits fund of funds arrangements to two levels.367 Some commenters generally supported a prohibition on three-tier structures, but also advocated for broad-based exceptions for certain acquired fund investments in underlying funds that had been permitted under historical exemptive relief and included in the proposed rule.368 Other commenters stated that multi-tier structures may be beneficial and recommended that the Commission allow such structures by relying on other aspects of the rule to enhance investor protection.369 Some commenters recommended that the rule permit certain specific multi-tier structures, stating that such structures are beneficial to fund shareholders and do not raise the concerns section 12(d)(1) was designed to prevent.370

366 See, e.g., CFA Comment Letter; Invesco Comment Letter; Voya Comment Letter. 367 CFA Comment Letter. 368 See, e.g., Invesco Comment Letter (recommending exceptions for securities lending programs and cash sweep arrangements), Voya Comment Letter (recommending exceptions for master-feeder arrangements, short-term cash management, interfund borrowing and lending, and investments in wholly owned subsidiaries). 369 Morningstar Comment Letter (advising against a general prohibition on three-tier structures in favor of fee and expense disclosure in prospectuses and annual reports); TRP Comment Letter (stating that the proposed rule’s requirements that an adviser evaluate the complexity of the structure and engage in a best interest finding are sufficient without a broader prohibition on three-tier structures). 370 See, e.g., ICI Comment Letter (recommending that the rule include an expanded list of permitted multi-tier fund of fund arrangements that could be beneficial to shareholders); Fidelity Rutland Comment Letter (recommending that the rule permit three-tier structures where the underlying fund is an ETF or where all three funds in the structure are in the same group of investment companies); Comment Letter of Davis Polk & Wardwell LLP (May 2, 2019) (“DPW Comment Letter”) (recommending that the rule permit three-tier structures where the underlying fund is a limited life grantor trust). 371 TRP Comment Letter (recommending a principles-based approach to general rule that would generally permit multi-tier structures subject to other conditions of the rule). 372 See, e.g., PIMCO Comment Letter; Nuveen Comment Letter; SIFMA AMG Comment Letter. 373 ICI Comment Letter. See also IPA Comment Letter (recommending that the rule exempt BDC investments in private funds from the general prohibition on three-tier structures); Guggenheim Comment Letter (recommending an exception for structured finance vehicles if the rule generally prohibits acquired funds from investing in private funds); TRP Comment Letter; SIFMA AMG Comment Letter. 374 See, e.g., Morningstar Comment Letter; TRP Comment Letter (suggesting enhancing the proposed report to the board to include a statement that the adviser believes the fund of funds structure and disclosure documents sufficiently mitigate the risk of the three-tier structure being overly confusing to investors). But see CFA Comment Letter (expressing skepticism about the benefit of enhanced disclosures to retail investors) citing Study Regarding Financial Literacy Among Investors As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Staff of the U.S. Securities and Exchange Commission (August 2012).

Similarly, one commenter wrote that the proposed three-tier condition was too rigid and would constrain legitimate three-tier arrangements.371 Further, some commenters noted that the proposed condition would require restructuring of certain fund of funds arrangements, resulting in additional costs for investors and limiting the variety of investment strategies available in the marketplace.372 Some commenters also recommended that the three tier limitations should not apply to acquired fund investments in private funds, since section 12(d)(1) does not restrict a fund from investing in private funds.373

As an alternative to the three-tier condition, some commenters suggested that the Commission require the acquiring fund adviser to engage in a best interest determination and enhanced board reporting on the use of complex structures.374 Other commenters recommended that the Commission require enhanced investor disclosure rather than restricting fund structures.375 Although we acknowledge that three-tier structures may provide efficient and cost-effective exposure to certain market segments in certain circumstances, we continue to believe that multi-tier structures can obfuscate the fund’s investments, fees, and related risks.376 For example, if an acquiring fund invests in an acquired fund that in turn invests in other funds, an acquiring
fund shareholder could find it difficult to determine the nature and value of the holdings ultimately underlying his or her investment. Accordingly, we continue to believe that it is appropriate to limit the ability of funds to structure multi-tier arrangements in reliance on rule 12d1–4. We also believe that enhanced disclosure, without additional limitations on multi-tier structures, would be insufficient to address potential investor confusion associated with complex structures. As discussed below, we have made certain modifications to the final rule, however, that are designed to provide additional flexibility for acquired funds to gain exposure to underlying funds in order to minimize disruption, the existing fund structures and preserve some flexibility for efficient multi-tier arrangements. We believe that the final rule’s three-tier limitation appropriately provides such flexibility and provides protections against complex structures and excessive fees.

b. Limitations on Other Funds’ Acquisitions of Acquiring Funds

Rule 12d1–4 includes a condition designed to prevent an acquiring fund from also being an acquired fund under the rule or under section 12(d)(1)(G) of the Act. Specifically, the rule prohibits a fund that is relying on section 12(d)(1)(G) of the Act (15 U.S.C. 80a–12(d)(1)(G)) or rule 12d1–4 from acquiring, in excess of the limits in section 12(d)(1)(G), the outstanding voting securities of an acquiring fund (a “second-tier fund”), unless the second-tier fund makes investments permitted by rule 12d1–4(b)(3)(ii) as discussed below. As a result, this condition will limit a fund’s ability to create multi-tier arrangements, subject to certain limited exceptions. This condition is generally more comprehensive and, therefore, limiting, than the conditions in our orders, and addresses certain multi-tier arrangements that have emerged. For example, this type of three-tier structure would permit a target date fund (itself an acquiring fund) to simply act as a conduit through which an insurance product separate account invests.

This provision, however, will not prevent a fund from investing all of its assets in an acquiring fund in reliance on section 12(d)(1)(E). We do not believe three-tier structures involving a master-feeder arrangement present the risk that section 12(d)(1) was designed to address. In addition, this condition will not prevent other funds from acquiring the voting securities of an acquiring fund in amounts of 3% or less, which effectively creates a type of three-tier structure that does not raise the concerns that section 12(d)(1) was designed to prevent.

Rule 12d1–4’s limitation on investments in acquiring funds is generally consistent with the proposed complex structures provision. However, the final rule will not apply the condition only to investments in an acquiring fund that discloses in its registration statement that it may be an acquiring fund for purposes of rule 12d1–4, as proposed. Because rule 12d1–4 will require most funds to enter into a fund of funds investment agreement, and an adviser that manages both acquiring and acquired funds should have information regarding an acquired fund’s investments, the final rule will prohibit a fund from investing in an acquiring fund without tying this limitation to registration statement disclosures.

While several commenters addressed the proposed limit on multi-tier structures generally, no commenters addressed whether the rule should prohibit a fund from investing in an acquiring fund. We continue to believe that concerns of undue influence, complex structures, and excessive fees apply both to three-tier structures where registered funds invest in acquiring funds and three-tier structures where an acquired fund invests a substantial portion of its assets in other registered funds. Accordingly, we continue to believe that it is appropriate to limit funds’ ability to invest in acquiring funds, subject to the exception for funds relying on section 12(d)(1)(E). We believe this condition will help limit the construction of complex multi-tier structures, while preserving some flexibility for efficient multi-tier arrangements. In addition, rule 12d1–4 does not prohibit other funds from acquiring the voting securities of an acquiring fund in amounts allowed by the Act (i.e., 3% or less). We do not believe that multiple registered funds holding 3% or less of the acquiring fund implicate the historical abuses, such as undue influence, that section 12(d)(1) is intended to prevent.

c. Limitations on Acquired Funds’ Acquisition of Other Funds and Private Funds; Exceptions to Three-Tier Limitation

As proposed, rule 12d1–4 will include a condition designed to limit fund of funds arrangements where the acquired fund is itself an acquiring fund. The rule generally will prohibit arrangements where an acquired fund invests in other investment companies or private funds in excess of the limits in section 12(d)(1)(A). Specifically, the rule states that no acquired fund may purchase or otherwise acquire the securities of an investment company or private fund if immediately after such purchase or acquisition, the securities of investment companies and private funds owned by the acquired fund have an aggregate value in excess of 10% of the value of the total assets of the acquired fund, subject to certain enumerated exceptions. We continue to believe that the general limitation on acquired fund investments in other investment companies or private funds is an appropriate means to protect against the creation of overly complex structures. While investments by acquired funds in other investment assets or in private funds may provide efficient exposure to a specific asset class or offer other portfolio management advantages, such investments can be confusing to investors and can result in additional undue influence.

382 A fund could acquire the securities of an investment company, because such a controlled company is also subject to section 12(d)(1)(F) of the Act. Specifically, the rule prohibits such a fund from acquiring the securities of an investment company, because such a controlled company is also subject to section 12(d)(1)(F) of the Act.

383 Proposed rule 12d1–4(b)(4)(ii) (prohibiting a fund relying on the rule or section 12d1–4(b)(3)(ii) of the Act from acquiring the securities of a fund that diagnoses in its most recent registration statement that it may be an acquiring fund in reliance on proposed rule 12d1–4).

384 We believe funds investing in reliance on section 12(d)(1)(G) likely would have, or be able to obtain, sufficient information to know which other funds within the same group of investment companies are acquiring funds under rule 12d1–4. See 2018 FOF Proposing Release, supra footnote 6, at 79. We do not believe that funds within the same group of investment companies will face challenges in obtaining this information because of the potential for information barriers. See supra section II.C.1.a.i.

385 See 2018 FOF Proposing Release, supra footnote 6, at 78–79.

386 Rule 12d1–4(b)(3)(ii). This prohibition applies to investments in a company that is controlled by an investment company, because such a controlled company is also subject to section 12(d)(1) when it acquires the securities of other investment companies. See section 12(d)(1)(A).

387 See 2018 FOF Proposing Release, supra footnote 6, at 81.
fees and expenses.\textsuperscript{388} We believe that this potential reduction of investment flexibility for acquired funds is appropriate to prevent potential increases in duplicative fees and expenses, and to avoid the investor confusion, that might occur if the final rule did not impose such limits on multi-tier structures.\textsuperscript{389} As explained above with respect to complex structures generally, we believe a structural three-tier prohibition will help to limit the potential for complex structures that could be difficult for investors to understand even with comprehensive disclosures.\textsuperscript{390}

Largely as proposed, the rule will allow arrangements where an acquired fund invests in other funds in certain enumerated circumstances. These exceptions are limited in scope and are designed to capture circumstances where an acquired fund may invest in another fund to efficiently manage uninvested cash, to address specific regulatory or tax limitations, or to facilitate certain transactions. Specifically, these categories include securities of another investment company that is: (i) Acquired in reliance on section 12(d)(1)(E) of the Act (i.e., master-feeder arrangements); (ii) acquired pursuant to rule 12d1–1; (iii) a subsidiary wholly-owned and controlled by the acquired fund; (iv) received as a dividend or as a result of a plan of reorganization of a company; or (v) acquired pursuant to exemptive relief from the Commission to engage in interfund borrowing and lending transactions.\textsuperscript{391} These categories have been permitted under existing exemptive orders and addressed in no-action letters, and do not raise the concerns that section 12(d)(1) was designed to address, as discussed further below.

We made several modifications to the enumerated exceptions of the proposed rule to address many of the concerns identified by commenters. Additionally, in a change from the proposal, rule 12d1–4 will include a separate exception that will permit an acquired fund to invest up to 10% of its assets in other investment companies or private funds. As discussed below, we do not believe that permitting these arrangements will raise concerns identified by Congress when enacting section 12(d)(1).\textsuperscript{392}

i. Master-Feeder Investments

The proposed exception for master-feeder arrangements in reliance on section 12(d)(1)(E) of the Act did not receive substantial public comment and we are adopting as proposed.\textsuperscript{393} Under section 12(d)(1)(E) of the Act, the acquired feeder fund in this example is, in effect, a conduit through which the acquiring fund can access the master fund. We do not believe that permitting these arrangements would create an overly complex structure that could confuse investors, nor do we believe that these arrangements involve concerns regarding undue influence or layering of fees.\textsuperscript{394} For example, an acquired feeder fund’s investment in its master fund would be entirely transparent because the feeder fund would disclose the master fund’s portfolio holdings in its shareholder reports.

ii. Rule 12d1–1 Investments

The final rule will permit an acquired fund to invest more than 10% of its total assets in investment companies and private funds if such investments are made pursuant to rule 12d1–1. The proposed rule included an exception for short-term cash management purposes pursuant to rule 12d1–1 or exemptive relief from the Commission.\textsuperscript{395} Several commenters requested clarification or expansion of this proposed exception.\textsuperscript{396} For instance, two commenters recommended that the Commission remove the phrase “short-term cash management purposes” from the exception because rule 12d1–1 does not include the phrase.\textsuperscript{397} These commenters suggested there could be a variety of reasons other than short-term cash management that an acquired fund would invest in reliance on rule 12d1–1 that do not raise any additional fund of funds concerns.\textsuperscript{398} Another commenter requested that the Commission clarify the applicable exemptive relief referenced in the exception, since the Commission also proposed to rescind relevant exemptive relief.\textsuperscript{399}

Some commenters recommended that the final rule eliminate the reference to rule 12d1–1 and instead expand the types of investments that would be permitted for short-term cash management purposes to include short-term bond funds.\textsuperscript{400} Another commenter recommended that the Commission expand the relief to permit acquired funds to equitize cash by investing in other funds, such as certain ETFs.\textsuperscript{401} One commenter recommended that the Commission also consider exceptions for securities lending and cash sweep arrangements among affiliates.\textsuperscript{402}

In response to concerns raised by commenters, we have modified this exception to permit an acquired fund to...

\textsuperscript{388} See Guggenheim Comment Letter. Although one commenter suggested that the rule should not limit an acquired fund’s ability to invest in private funds because section 12(d)(1)(E) of the Act does not limit a fund’s ability to invest in private funds. (See ICI Comment Letter), the risks in investor confusion and fee layering apply both with respect to an acquired fund’s investments in other investment companies and with respect to an acquired fund’s investments in private funds in a multi-tier structure. Accordingly, we believe it is appropriate that the complex structures limitations of rule 12d1–4 apply to an acquired fund’s investments in private funds. This approach also is consistent with the complex structures limitations in our exemptive orders.

\textsuperscript{389} We believe it would be more appropriate for the Commission to consider multi-tier structures that do not fall within the confines of rule 12d1–4 through the exemptive application process. This will allow the Commission to weigh the policy considerations of such structures in the context of the facts and circumstances of the specific fund of funds arrangements described in the application. While the expenses of a third-tier fund may represent only a small proportion of the expenses of a top-tier acquiring fund because a third-tier fund would represent only a small proportion of the top-tier acquiring fund’s investment portfolio, the exemption application process would permit the Commission to consider whether additional fee- or expense-related conditions would be appropriate in connection with a specific multi-tier arrangement or in connection with a specific investment strategy undertaken through a multi-tier structure.

\textsuperscript{390} For example, without a general three-tier prohibition, an acquired fund could shift a substantial portion of its assets among underlying funds with different investment exposures and risks, and disclosure at the acquiring fund level may still leave acquiring fund investors unaware of substantial changes to their investment exposure and risks at the acquiring fund and underlying fund levels. See CFA Comment Letter (expressing skepticism about the benefit of enhanced disclosures to retail investors); but see Morningstar Comment Letter (supporting an enhanced disclosure requirement) and TRP Comment Letter (suggesting that the adviser report to the fund’s board that a fund of funds disclosure documents sufficiently mitigate the risk of investor confusion).

\textsuperscript{391} Rule 12d1–4(b)(3)(ii).

\textsuperscript{392} See also 2018 FOF Proposing Release, supra footnote 6, pp 80–83 and associated footnotes (describing the enumerated circumstances under which our exemptive orders permitted three tier fund of funds structures and the rationale in support of such structures).

\textsuperscript{393} NYU Bar Comment Letter (supporting the exceptions for master-feeder arrangements and investments in wholly-owned and controlled subsidiaries).

\textsuperscript{394} See 2018 FOF Proposing Release, supra footnote 6, at p. 78.
invest in investment companies and private funds in excess of the section 12(d)(1) limits if such investments are made pursuant to rule 12d1–1. We requested comment as to whether the rule should include additional limits on acquired funds’ use of subsidiaries, and requested suggestions on the contours of any such limitations. Commenters did not address this aspect of the proposal, and rule 12d1–4 will include an exception to the general three-tier limitation for investments through such wholly-owned and controlled subsidiaries. Because the wholly-owned subsidiary’s financial statements are consolidated with the financial statements of the acquired fund, we do not believe that this arrangement would be so complex that investors could not understand the nature of such exposure.

iv. Investments Received as a Dividend

The proposed rule included exceptions for arrangements where an acquired fund receives fund shares as a dividend or as a result of a plan of reorganization. Acquired funds do not acquire such investments to create a multi-tier fund structure. Rather, a fund acquires these investments from a business restructuring unrelated to a fund’s status as an acquired fund under the rule. The proposed rule also included an exception for acquired fund investments entered into pursuant to exemptive relief from the Commission to engage in interfund borrowing and lending. This exception would facilitate certain interfund transactions, subject to conditions specifically designed to address the concerns that investors could not understand the nature of such exposure.

b. Ten Percent Bucket

In addition to the enumerated exceptions to the limitations on acquired fund investments, the rule will permit an acquired fund to invest up to 10% of its total assets in other funds, regardless of the size of the investment in any one fund, in order to provide funds with additional flexibility, and thereby permit certain structures that could benefit investors through greater efficiency. For purposes of calculating the 10% Bucket, investments by an acquired fund pursuant to the general exceptions in the section above would not be included. While the proposed rule did not include the 10% Bucket for acquired fund investments in other funds, we requested comment on whether the proposed rule’s limitations were appropriately calibrated to mitigate complex structure concerns, and whether we should adopt different investment limits. We also requested comment on whether the rule should permit acquired funds relying on section 12(d)(1)(G) to invest in a third-tier fund in order to centralize the portfolio management of floating rate or other instruments.

Under rule 12d1–4, an acquired fund might utilize the 10% Bucket for cash management purposes outside of investments made in reliance on rule 12d1–1, to equitize cash, or for any other portfolio management purposes. The 10% Bucket provides flexibility for fund of funds arrangements to evolve, while limiting the complex arrangements that section 12(d)(1) was designed to prevent. If an acquired fund wishes to acquire other underlying funds in excess of the 10% Bucket, the acquired fund may seek exemptive relief. In such circumstances, the Commission would have the opportunity to consider the proposed

Note: The document contains references to sections and rules, which are not transcribed in this natural text representation.
structure in the context of rule 12d1–4 and weigh the benefits of the proposed structure against the concerns underlying section 12(d)(1).

As discussed above, section 12(d)(1)(A)(iii) of the Act limits an acquiring fund’s total investment in other funds to no more than 10% of the acquiring fund’s assets. The 10% Bucket effectively applies this 10% limit to acquired funds’ investments in underlying funds.416 The rule as adopted, however, would not impose the 3% and the 5% limits of section 12(d)(1)(A)(i) and (ii), respectively, on investments by an acquired fund in third-tier funds. Accordingly, the rule will not prohibit an acquired fund from holding more than 3% of the outstanding voting securities of any single third-tier fund and will not prohibit an acquired fund from investing more than 5% of its assets in any single third-tier fund. Rather, the 10% Bucket will allow an acquired fund some flexibility to invest up to 10% of its assets in other funds in order to meet its investment objectives while minimizing shareholder confusion by limiting the extent of those acquired fund investments. This limit is intended to prohibit multiple layers of funds, which raise greater concerns of duplication of fees and expenses as well as investor confusion, and reflects a view that funds that invest in another fund beyond the 3% and the 5% limits of section 12(d)(1)(A)(i) and (ii), but not the 10% limit of section 12(d)(1)(A)(iii), are not primarily designed to invest in other funds and do not implicate the concerns that led to the adoption of the 10% limit in 1970.417 In such a

structure, by which an acquired fund relies on the 10% Bucket to invest in an underlying fund in excess of the section 12(d)(1) limits, the acquired fund and underlying funds must comply with the conditions of rule 12d1–4 as acquiring and acquired funds, respectively, or operate pursuant to another exemption.418

We proposed a similar provision in 2008 as part of a proposal to allow funds to invest in ETFs beyond the section 12(d)(1) statutory limits.419 In order to prevent the formation of overly complex structures, the proposed 2008 rule would have prohibited an acquired ETF from investing more than 10% of its assets in other funds and private funds. One commenter on proposed rule 12d1–4 recommended that rule 12d1–4 include a 10% bucket to provide additional flexibility for acquired fund investments in other funds, and noted that the Commission’s 2008 rule proposal included such a provision.420

As discussed in the 2018 FOF Proposing Release, the staff has previously stated that it would not recommend enforcement action if an acquired fund in a fund of funds arrangement invested up to 10% of its assets in other funds, including “central funds,” which are affiliated funds commonly created by an adviser for the purpose of efficiently managing exposure to a specific asset class.421

However, the staff stated its position in light of several considerations, including that: (a) An acquired fund would not exceed the 5% limit in section 12(d)(1)(A)(ii) with respect to an investment in shares of a single central fund or the 10% limit in section 12(d)(1)(A)(iii) with respect to investments in underlying investment companies generally; (b) management fees and other fees that were subject to limits; (c) acquisitions by the central fund in other investment companies or private funds that were subject to limits; (d) a requirement that shares of the central fund be sold solely to the funds within the same group of investment companies; and (e) the board of directors of each of the funds would consider the reasons for the proposed investments in the central fund and the benefits expected to be realized from such investments.422 In a subsequent letter, the staff stated that it would not recommend enforcement action if an acquired fund invested, solely for short-term cash management purposes, up to 25% of its assets in a central fund that is a fixed-income fund that could have a dollar-weighted average portfolio maturity of up to 3 years.423

Several commenters advocated that the final rule permit acquired funds to invest in central funds.424 Commenters noted that central funds are frequently used for cash management purposes, but Commission take any enforcement action under sections 12(d)(1)(A) and (B) and (other sections of the Act) if an acquiring fund relying on section 12(d)(1)(G) purchases or otherwise acquires shares of an underlying fund that, in turn, purchases or otherwise acquires shares of the central fund. For example, in the Franklin Templeton No-Action Letter also included a representation that an acquired fund’s adviser would waive fees on assets invested in underlying central funds.425

416 Like the limits under section 12(d)(1) of the Act, the 10% Bucket is an acquisition test. Accordingly, if an acquired fund holds more than 10% of its assets in other underlying funds due to market movements it could not invest any additional assets in underlying funds, but the 10% Bucket would not require the acquired fund to dispose of its existing investments in underlying funds to under 10% of its assets. Further, if an existing acquired fund holds more than 10% of its total assets in other funds pursuant to an existing exceptive order, the acquired fund would not be required to dispose of those holdings after the rescission of its exceptive order and the effective date of the rule. However, the acquired fund could invest additional assets in underlying funds only in accordance with the terms of the rule.417 See Reporting Materialized Adopting Release, supra footnote 56, at 81936. See also PPI Report supra footnote 64, at page 322 (describing concerns about the organization and operation of registered investment companies whose primary purpose is the acquisition of shares of other registered investment companies). The House and Senate Reports that accompanied the 1970 amendment to the Act describe concerns about “fundholding companies” whose portfolios consist entirely or largely of the securities of other investment companies. See H.R. Rep. No. 1382, 91st Cong., 2d Sess. 28 (1970) (“1970 Amendments House Report”); S. Rep. No. 184, 91st Cong., 1st Sess. 29 (1969) (“1970 Amendments Senate Report”). By imposing the 10% limit in section 12(d)(1)(A)(iii) as part of the 1970 amendments to the Act, Congress distinguished between investment companies that invest less than 10% of their assets in other investment companies, on the one hand, and fund holding companies whose primary purpose is the acquisition of shares of other registered investment companies, on the other.418 For example, if an acquired fund invests 10% of its total assets in a third-tier underlying fund, and the investment by the acquired fund accounts for 20% of the voting stock of a underlying fund, the acquired fund and the underlying fund would be required to comply with the conditions of rule 12d1–4 as an acquiring fund and acquired fund, respectively.419 2008 ETF Proposing Release, supra footnote 18, at n.225 and accompanying text (requiring an acquired ETF to have a disclosed policy that prohibits it from investing more than 10% of its assets in other investment companies in reliance on section 12(d)(1)(F) and 12(d)(1)(G) of the Act).420ICI Comment Letter (“Allowing for this exception generally would permit the structures contemplated by the recent adoption of the 2008 Commission proposal, and permit acquired funds to have additional limited ability to invest in other funds whose investments would not exceed the basic 10 percent limit included in Section 12(d)(1)(A)(iii) to protect against overly complex structures.”).421 2018 FOF Proposing Release, supra footnote 6, at 86. See Franklin Templeton Investments, Staff No-Action Letter (pub. avail. April 3, 2015) (“Franklin Templeton No-Action Letter”). In the Franklin Templeton No-Action Letter, the staff stated it would not recommend that the
could also be used to gain exposure to any asset class or sector.\textsuperscript{422} Several commentators recommended that the rule permit acquired funds to invest in private funds, structured finance vehicles, and other entities that rely on sections 3(c)(1) or 3(c)(7) of the Act that are not traditionally considered pooled investment vehicles.\textsuperscript{426} Other commentators requested an exception for acquired fund investments in ETFs.\textsuperscript{427} While the final rule does not incorporate prior staff positions regarding acquired fund investments in central funds, the rule provides substantial flexibility for fund groups to continue to utilize central funds within the 10% Bucket. The 10% Bucket allows acquired funds to gain exposure to any asset class or sector through investments in affiliated or unaffiliated underlying investment companies and private funds without imposing many of the limitations that were associated with prior staff positions in this area.

As we discussed in the 2018 FOF Proposing Release, some existing multi-tier structures may be required to modify their investments to ensure compliance with rule 12d1–4.\textsuperscript{428} For example, as of June 2018, we identified 231 three-tier structures for which both the first- and second-tier funds invested in other funds beyond the limits in section 12(d)(1).\textsuperscript{429} Such multi-tier arrangements may need to restructure their holdings over time to continue to maintain the same investment, to the extent that the acquired funds in such structures invest more than 10% of their assets in underlying funds, exclusive of investments in underlying funds made pursuant to the enumerated exceptions described above.\textsuperscript{430}

We agree with commentators that additional flexibility to enter into multi-tier arrangements could lead to efficiencies and cost savings for fund investors. However, unlimited ability to enter into multi-tier arrangements could lead to complex structures in which an acquiring fund shareholder finds it difficult to determine the nature and value of the holdings ultimately underlying his or her investment. We do not believe that a 25% limit would be appropriate for investments in underlying funds in pursuit of any investment purpose because such a limit is based on considerations related to investments in central funds for short-term cash management purposes. In addition, such a limit would be far in excess of the 10% limit that Congress enacted in 1970 in response to its concerns about “fund holding” companies.\textsuperscript{431} Accordingly, rule 12d1–4 provides flexibility for acquired funds to invest in private funds, structured finance vehicles, central funds, ETFs, and other investment funds up to a 10% limit, consistent with the 10% limit set forth in section 12(d)(1). We believe that this 10% Bucket, when combined with the enumerated exceptions discussed above, will provide flexibility for beneficial multi-tier arrangements while limiting the harms that Congress sought to prevent.

4. Recordkeeping

The final rule will require the acquiring and acquired funds that participate in fund of funds arrangements in accordance with the rule to maintain and preserve certain written records for a period of not less than five years, the first two years in an easily accessible place. These records include: (i) A copy of each fund of funds investment agreement that is in effect, was in effect in the past five years, and any amendments thereto; (ii) a written record of the relevant Fund Finding made under the rule and the basis therefor within the past five years; and (iii) the certification from each insurance company required by the rule.\textsuperscript{432} These requirements are largely as proposed, with the addition of fund of funds investment agreement records as these agreements were not part of the proposal. Also, to match the expansion of the Fund Findings requirement, both acquiring and acquired funds will need to keep records of the applicable evaluations and findings under the final rule. We also are not adopting the proposed requirement to keep the reports provided to the board of directors regarding management company findings, as we believe that this would be duplicative with the requirements of rule 31a–1, particularly the requirements to keep minute books of directors’ meetings and advisory material received from the investment adviser.\textsuperscript{433} We did not receive comments on the recordkeeping provisions of the proposed rule.\textsuperscript{434} Funds and UITs currently have compliance program-related recordkeeping procedures in place that incorporate this type of retention period, and consistency with that period minimizes compliance burdens to funds related to the preservation of the records.\textsuperscript{435} Although the retention period would differ from the required period for UIT findings under rule 22e–4 and the general recordkeeping requirements in rule 31a–2, we believe it is appropriate to have consistent recordkeeping requirements under rule 12d1–4.\textsuperscript{436} We believe that these recordkeeping requirements allow for external examinations of compliance with this condition without placing an undue burden on the funds. Moreover, because the fund of funds investment agreement sets forth the relevant material terms of the fund of funds arrangement specific to particular acquiring funds and acquired funds, we believe it is appropriate to include it as part of a fund’s recordkeeping requirements.

D. Rescission of Rule 12d1–2 and Amendment to Rule 12d1–1

1. Rescission of Rule 12d1–2

We are rescinding rule 12d1–2, as proposed, to create a more consistent and efficient regulatory framework for the regulation of fund of funds arrangements. As discussed above, section 12d1(1)(c) allows a registered open-end fund or UIT to acquire an unlimited amount of shares of other open-end funds and UITs that are in the same “group of investment companies.” A fund relying on this exemption is subject to certain conditions, including

\textsuperscript{422} See, e.g., Capital Group (2) Comment Letter (describing central fund investments in investment-grade corporate bonds, mortgage-backed securities and high yield securities).

\textsuperscript{426} ICI Comment Letter; Guggenheim Comment Letter; Dechert Comment Letter; Comment Letter of Small Business Investor Alliance, et al. (Feb. 28, 2019) (“SBIA Comment Letter”); FS Comment Letter; IPA Comment Letter; PIMCO Comment Letter; SIFMA AMG Comment Letter.

\textsuperscript{427} Ropes Comment Letter; Chapman Comment Letter; ICI Comment Letter.

\textsuperscript{428} 2018 FOF Proposing Release, supra footnote 6, at 150.

\textsuperscript{429} Id.

\textsuperscript{430} As noted above, because the 10% Bucket is an acquisition test, if an acquired fund holds more than 10% of its assets in other underlying funds pursuant to an existing exemptive order, the acquired fund would not be required to dispose of those holdings after the rescission of its exemptive order and the effective date of the rule. However, the acquired fund could invest additional assets in underlying funds only in accordance with the terms of the rule.


\textsuperscript{432} Rule 12d1–4(c).

\textsuperscript{433} Rule 31a–1(b)(4) and (11).

\textsuperscript{434} We received comments on the substantive elements underlying the proposed recordkeeping requirements. See supra section I.C.2.b (discussing proposed findings and determinations requirements and related comments).

\textsuperscript{435} The retention period is consistent with the period provided in rule 38a–1(d).

\textsuperscript{436} See rule 22e–4(c) (requiring a UIT to maintain, for the life of the UIT and for five years thereafter, a record of the determination that the portion of the illiquid investments that the UIT holds or will hold at the date of deposit that are assets is consistent with the redeemable nature of the securities it issues). See also Investment Company Liquidation Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)]; 2018 FOF Proposing Release, supra footnote 6, at 60.
a condition limiting the types of securities an acquiring fund can hold, in addition to the shares of funds in the same group of investment companies, to government securities and short-term paper.\footnote{437} Congress designed this limit to restrict the use of this exemption to a “bona fide” fund of funds, while providing the fund with a source of liquidity to redeem shares.\footnote{438}

In 2006, the Commission exercised its exemptive authority to adopt rule 12d1–2.\footnote{439} Rule 12d1–2 codified, and in some cases expanded, three types of relief that the Commission provided for fund of funds arrangements that did not conform to the section 12(d)(1)(G) limits. Specifically, rule 12d1–2 permitted a fund relying on section 12(d)(1)(G) to: (i) Acquire the securities of other funds that are not part of the same group of investment companies, subject to the limits in section 12(d)(1)(A) or 12(d)(1)(F); \footnote{440} (ii) invest directly in stocks, bonds, and other securities; \footnote{441} and (iii) acquire the securities of money market funds in reliance on rule 12d1–1.\footnote{442} Rule 12d1–2 was designed to provide a fund relying on section 12(d)(1)(G) with greater flexibility to meet its investment objective when the risks that lead to the restriction in section 12(d)(1)(G) are minimized.\footnote{443} The Commission stated that the investments permitted under rule 12d1–2 did not raise additional concerns under section 12(d)(1)(G) because: (i) They were not investments in funds; or (ii) they represented fund investments that are limited in scope \footnote{444} (i.e., cash sweep arrangements under rule 12d1–1) or amount \footnote{445} (i.e., up to the limit in section 12(d)(1)(A) or 12(d)(1)(F)).

We have also granted exemptions that permit funds to invest in funds within the same group of investment companies as an alternative to the requirements of section 12(d)(1)(G) and rule 12d1–2.\footnote{446} Funds relying on these orders could invest in the same group of related investment companies and unaffiliated funds without regard to the limitations in sections 12(d)(1)(A) or 12(d)(1)(F). In addition, funds relying on our exemptive orders could invest to a greater extent in funds that were not part of the same group of investment companies and in other investments. Funds relying on exemptive relief also could invest in closed-end funds to a greater extent than funds relying on section 12(d)(1)(G) combined with rule 12d1–2 and could invest in other financial instruments that may not be securities within the meaning of section 2(a)(36) of the Act, such as derivatives.\footnote{447}

Our exemptive orders include conditions that differ from the conditions in section 12(d)(1)(G) and the conditions within those orders also differ depending on whether the investment involves an acquired fund that is in the same group of investment companies.\footnote{448} The orders generally subject investments in funds that are not part of the same group of investment companies to a broader set of conditions designed to protect investors from the harms Congress sought to address by enacting section 12(d)(1).\footnote{449} Under this existing framework, substantially similar fund of funds arrangements are subject to different limitations and conditions.\footnote{450} This has resulted in an inconsistent and inefficient regulatory framework where the relief on which a fund of funds arrangement is relying is not always clear to other funds, investors, or regulators.

Commenters generally opposed the proposed rescission of rule 12d1–2.\footnote{451} Some commenters stated that rescinding rule 12d1–2 would disrupt investment strategies, opportunities, and operations, and lead to an increase in funds’ compliance or investing costs.\footnote{452} Commenters also suggested, as discussed in more detail below, that the rescission of rule 12d1–2, along with the rescission of exemptive orders and withdrawal of staff letters, would impact funds’ ability to utilize certain fund structures, such as three-tier central fund arrangements.\footnote{453} Several commenters suggested a number of changes to proposed rule 12d1–4 in response to the Commission’s proposed rescission of rule 12d1–2.\footnote{454} For example, these commenters recommended eliminating or substantially restructuring the proposed redemption limit, exempting funds within the same group of investment companies from the proposed redemption limit, or permitting continued reliance on rule 12d1–2 for funds in the same group of investment companies.\footnote{455} In particular, two of these commenters raised specific concerns about the proposed redemption limit’s impact on fund of funds arrangements if the Commission rescinds rule 12d1–2.

Some commenters recommended that the Commission retain rule 12d1–2 and codify existing exemptive orders permitting funds relying on rule 12d1–2 to enter into derivatives and financial

\footnote{437} See 15 U.S.C. 80b–12(d)(1)(C)(i)(II). The acquired fund also must have a policy against investing in shares of other funds in reliance on section 12(d)(1)(F) or 12(d)(1)(G) to prevent multi-tier structures, and overall distribution expenses are limited to prevent excessive sales loads.


\footnote{439} See 2006 FOF Adopting Release, supra footnote 19.

\footnote{440} See rule 12d1–2(a)(1).

\footnote{441} See rule 12d1–2(a)(2). Rule 12d1–2 limits investments to “securities.” The Commission has issued a series of exemptive orders that allow a fund relying on section 12(d)(1)(G) to invest in financial instruments that may not be “securities.” These orders provide that the funds will comply with rule 12d1–2, but for the ability to invest in a portion of their assets in these other investments. See, e.g., Van Eck Associates Corp., et al., Investment Company Act Release Nos. 31547 (Apr. 6, 2013) [78 FR 19380 (Apr. 10, 2013)] (notice) and 31596 (May 6, 2015) (order) and related application.

\footnote{442} 17 CFR 270.12d1–2(a)(3).

\footnote{443} 2006 FOF Adopting Release, supra footnote 19.

\footnote{444} Id.

\footnote{445} See supra footnote 446 and accompanying text (regarding conditions applicable to unaffiliated acquired funds).

\footnote{446} See supra footnote 26.

\footnote{447} See, e.g., Alliance Comment Letter; Invesco Comment Letter; Thrivent Comment Letter; PIMCO Comment Letter; Fidelity Rutland Comment Letter; Schwab Comment Letter; NYC Bar Comment Letter; PGIM Comment Letter, BlackRock Comment Letter; ABA Comment Letter; SIFMA AMG Comment Letter; Capital Group Comment Letter.

\footnote{448} See, e.g., Allegianz Comment Letter; Thrivent Comment Letter; PIMCO Comment Letter; ABA Comment Letter; SIFMA AMG Comment Letter; Capital Group Comment Letter.

\footnote{449} See generally PIMCO Comment Letter.

\footnote{450} See, e.g., Allegianz Comment Letter; Thrivent Comment Letter; ABA Comment Letter; BlackRock Comment Letter; PIMCO Comment Letter; Fidelity Rutland Comment Letter; PGIM Comment Letter; SIFMA AMG Comment Letter.

\footnote{451} See, e.g., NYC Bar Comment Letter; PIMCO Comment Letter; SIFMA AMG Comment Letter.
We continue to believe that it is necessary to rescind rule 12d1–2 in order to harmonize the overall regulatory structure and create a consistent and efficient regulatory framework for the regulation of fund of funds investments. The rescission of rule 12d1–2 will eliminate some of the flexibility of funds relying on section 12(d)(1)(G) to: (i) Acquire the securities of other funds that are not part of the same group of investment companies, subject to the limits in section 12(d)(1)(A) or 12(d)(1)(F); and (ii) invest directly in stocks, bonds, and other securities.458 Accordingly, funds that wish to invest in funds within the same group of investment companies beyond the limits in section 12(d)(1)(A), as well as other securities and the securities of the other funds, will no longer be able to rely on section 12(d)(1)(G) and rule 12d1–2.459 Instead, acquiring funds will have flexibility to invest in different types of funds and other asset classes under rule 12d1–4 under a single set of conditions that are tailored to address the concerns that underlie section 12(d)(1)(A).

We believe that this approach will enhance investor protection by subjecting more funds of funds arrangements to the conditions in rule 12d1–4. As we discussed in the 2018 FOF Proposing Release, the purpose of this rule is to streamline and enhance the regulatory framework applicable to fund of funds arrangements. We have exercised our statutory authority to exempt fund of funds arrangements, we have created a regulatory regime where substantially similar fund of funds arrangements are subject to different conditions. The rule reflects decades of experience with fund of funds arrangements, and will subject funds that operate in accordance with it to a tailored set of conditions that we believe will help protect investors from the harms Congress sought to address by enacting section 12(d)(1) of the Act. The requirements of the rule are designed to provide investors with the benefits of fund of funds arrangements while protecting them from the historical abuses that section 12(d)(1) is designed to prevent.460 We therefore believe that it is crucial that fund of funds arrangements follow the protections of rule 12d1–4 and are rescinding rule 12d1–2. We also are not exempting or providing other relief for existing investments for these funds for similar reasons.

We believe that the tailored conditions in rule 12d1–4 are appropriate to protect investors and create a harmonized fund of funds regulatory regime. We further believe that for fund of funds arrangements currently relying on rule 12d1–2, reliance on rule 12d1–4 will be less disruptive to their arrangements than suggested by commenters because the final rule does not include a redemption limit and permits an acquired fund to invest up to 10% of its total assets in other funds.461 Additionally, rule 12d1–4 includes tailored conditions for fund of funds arrangements in the same group of investment companies by exempting them from the rule’s control and voting conditions.

As proposed, in order to limit the hardship that the rescission of rule 12d1–2 could have on existing fund of funds arrangements, we are adopting a one-year period after the effective date before rule 12d1–2 is rescinded. We did not receive comment on this aspect of the proposed rescission of rule 12d1–2. We believe that one year is adequate time for funds relying on current rule 12d1–2 to bring their future operations into conformity with section 12(d)(1)(G) or rule 12d1–4. We also decline to exempt existing funds relying on rule 12d1–2 past this one-year period, as suggested by some commenters,462 because it would add unnecessary complexity to the regulatory framework and potentially create an uneven playing field for funds based on differing rule conditions, as discussed above.

2. Amendment to Rule 12d1–1

We are adopting an amendment to rule 12d1–1 under the Act, as proposed, to allow funds relying on section 12(d)(1)(G) to also rely upon the rule. This provides these funds with continued flexibility to invest in money market funds outside of the same group of investment companies despite the rescission of rule 12d1–2.463 Comments received on this aspect of the proposal supported it.464

We continue to believe that such investments in money market funds do not raise the concerns that underlie section 12(d)(1).465 We also believe that retaining this flexibility will help funds in smaller complexes that do not have a money market fund as part of their fund complex invest in an unaffiliated money market fund, subject to the conditions of rule 12d1–1.466 This limited flexibility may be less costly than complying with section 12(d)(1)(G)’s limited conditions.467 We are therefore amending rule 12d1–1 as proposed, to provide an exemption from section 12(d)(1)(G) for an investment company to acquire the securities of a money market fund.

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455 See, e.g., PIMCO Comment Letter; Fidelity Rutland Comment Letter; PGIM Comment Letter; Blackrock Comment Letter; ABA Comment Letter; SIFMA AMG Comment Letter.
456 See, e.g., Allianz Comment Letter; Thrivent Comment Letter.
457 See, e.g., PIMCO Comment Letter; ABA Comment Letter; NYC Bar Comment Letter; SIFMA AMG Comment Letter.
458 Rule 12d1–2(a)(1) and (a)(2). In connection with our proposed amendment to rule 12d1–1 discussed below, the rescission of section 12(d)(1)(G) could continue to invest in money market funds that are not part of the same group of investment companies even with the proposed rescission of rule 12d1–2(a)(3).
459 Funds also may continue to rely on section 12(d)(1)(F) to make smaller investments in a number of funds and section 12(d)(1)(E) to invest all of their assets in a master-feeder arrangement. See supra footnote 29 and accompanying text.
462 See supra footnote 456 and accompanying text.
463 Rule 12d1–1(a) provides an exemption from section 12(d)(1)(G) for an investment company to acquire the securities of a money market fund. Rule 12d1–2, which we propose to rescind, provided the same relief.
464 See, e.g., BlackRock Comment Letter.
465 See 2006 FOF Adopting Release, supra footnote 19, at n.23 and accompanying text.
466 See id., at section II.A.1(a).
467 See, e.g., section 12(d)(1)(G)(ii)(bb) (limiting combined sales charges and service fees to limits under current FINRA sales rule); section 12(d)(1)(G)(iv) (requiring the acquired fund to have a policy that prohibits it from acquiring securities of registered open-end investment companies or registered UITs in reliance on section 12(d)(1)(G) or (F)).
E. Disclosures Relating to Fund of Funds Arrangements

1. Amendments to Form N–CEN

Form N–CEN is a structured form that requires registered funds to provide census-type information to the Commission on an annual basis. Form N–CEN provides both the Commission and the public with a current and updated census-type information on a wide-range of compliance, risk assessment, and policy related matters. We proposed to add a requirement to Form N–CEN that would require reporting if a management company relied on rule 12d1–4 or the statutory exception in section 12(d)(1)(G) during the reporting period. While Form N–CEN already requires a management company to report if it is a fund of funds, we proposed to collect this information in order to better assess reliance on rule 12d1–4 or the statutory exception in section 12(d)(1)(G) by management companies and to assist us with our accounting, auditing and oversight functions. We also proposed to require UITs to report if they relied on proposed rule 12d1–4 or the statutory exception in section 12(d)(1)(G) during the reporting period. In proposing this requirement, we noted that the UIT section of Form N–CEN does not currently require a UIT to identify if it is a fund of funds.

Commenters that addressed the proposed amendments to Form N–CEN supported them, and we are adopting these amendments to the form as proposed. We believe the amendments we are adopting to the form will help us better assess reliance on rule 12d1–4, or the statutory exception in section 12(d)(1)(G). In turn, this will allow the staff to evaluate whether additional disclosure is needed. These amendments to Form N–CEN will also assist with our accounting, auditing and oversight functions, including compliance with the Paperwork Reduction Act.

2. Acquiring Fund Fees and Expenses

An acquiring fund is currently required to disclose the fees and expenses it incurs indirectly from investing in shares of one or more acquired funds. For example, an open-end fund investing in another fund is required to include in its prospectus fee table an additional line item titled “Acquired Fund Fees and Expenses.”

Since we adopted the AFFE disclosure requirement, some have expressed concerns about the impact of this disclosure on certain acquired funds, including BDCs. The 2018 FOF Proposing Release requested comment on fees and expenses, including with respect to AFFE disclosure.

Some commenters similarly expressed concern about current AFFE disclosure requirements. For example, several commenters suggested that fee table disclosure should focus on a fund’s operating expenses and should not incorporate AFFE. Some commenters suggested eliminating the inclusion of certain investment-related expenses in fee tables in the prospectus for all types of funds, or moving AFFE disclosure to the risk factors or narrative description of a prospectus. Several commenters also expressed particular concern about treating BDCs as acquired fund investments and recommended excluding BDC investments from AFFE.

On the other hand, some commenters expressed general support for the current AFFE disclosure requirements in the prospectus fee table. Two commenters credited AFFE disclosure for providing investors with the necessary information to understand the potential layering of fees in fund of funds arrangements and to compare similar funds and expenses.

We are not addressing AFFE disclosure requirements as part of this rulemaking. Instead, we are considering modifications to AFFE disclosure as part of a broader review of how funds disclose fees in their prospectuses.

In this regard, in the Investor Experience Proposal, the Commission requested comment on a proposal to replace the current requirement that AFFE be included in the prospectus fee table of open-end funds regardless of the scope of investments in acquired funds with a more tailored requirement based on the percentage of assets invested in acquired funds. This amendment, which the Commission proposed in conjunction with other changes to funds’ prospectus fee disclosure requirements, would permit open-end funds that invest 10% or less of their total assets in acquired funds to omit AFFE from the fund’s bottom line expenses in the fee table and instead disclose the amount of the fund’s AFFE in a footnote to the fee table. Open-end funds that invest more than 10% of their total assets in acquired funds would continue to present AFFE as a line item expense ratio and has disproportionately harmed BDCs because this disclosure requirement has led to funds no longer investing in BDCs and several index providers dropping BDCs from their indexes; Chapman Comment Letter; Nuveen Comment Letter; FS Comment Letter; Chamber of Commerce Comment Letter; Comment Letter of Alternative Credit Council (May 2, 2019) (stating that AFFE disclosure overstates the costs of a fund investing in a BDC because it essentially requires double-counting of a BDC’s operating expenses and that because AFFE disclosure has effectively resulted in funds no longer investing in BDCs, it has restricted the market for BDCs, limited institutional ownership of BDCs, and reduced investor choice); ICI Comment Letter; John Hancock Comment Letter.

2. Comments on AFFE Disclosure

In the 2016 FOF Proposing Release, we proposed to include the above disclosures in the prospectus fee table. Many commenters supported this proposal, including the Securities Industry and Financial Markets Association (SIFMA) and the U.S. Chamber of Commerce. However, some commenters expressed concerns about the impact of this disclosure on certain acquired funds, including BDCs. For example, commenters noted that AFFE disclosure may make it more difficult for funds to invest in BDCs because it can lead to double-counting of a BDC’s operating expenses and that because AFFE disclosure has effectively resulted in funds no longer investing in BDCs, it has restricted the market for BDCs, limited institutional ownership of BDCs, and reduced investor choice.

We are not addressing AFFE disclosure requirements as part of this rulemaking. Instead, we are considering modifications to AFFE disclosure as part of a broader review of how funds disclose fees in their prospectuses.
in the prospectus fee table, as they do today. The Commission also requested comment on whether to amend AFFE disclosure requirements similarly for other types of registered investment companies.

F. Compliance Dates

The Commission is providing for a transition period for the amendments to Form N–CEN. Specifically, we are adopting compliance dates for our amendment to Form N–CEN of January 19, 2022, one year following the amendment’s effective date. All reports on this form filed on or after the compliance date must comply with the amendments. Based on the staff’s experience, we believe that this will provide adequate time for affected funds to compile and review the information that must be disclosed.

III. Rescission of Exemptive Relief; Withdrawal of Staff Letters

Pursuant to our authority under the Act to amend or rescind our orders when necessary or appropriate to the exercise of the powers conferred elsewhere in the Act, we are rescinding, as proposed, the exemptive relief permitting fund of funds arrangements that fall within the scope of rule 12d1–4.483 As discussed in more detail below, exemptive relief granted to fund of funds arrangements outside the scope of the rule is not being rescinded.

We proposed to rescind all orders granting relief from sections 12(d)(1)(A), (B), (C), and (G) of the Act with one limited exception. We did not propose to rescind the exemptive orders providing relief from section 12(d)(1)(A) and (B) granted to allow certain interfund lending arrangements.484 Interfund lending arrangements allow certain funds within the same complex to lend money to and borrow money from each other for temporary purposes and subject to certain conditions. While such arrangements require exemptive relief from sections 12(d)(1)(A) and (B), among other provisions, we stated that they were not intended as the pyramiding of funds or the related potential abuses that the proposed rule was designed to address, and thus they were not included within the scope of the proposed rule.

We also proposed to rescind the exemptive relief from sections 12(d)(1)(A) and (B) that has been included in our ETF and ETMF orders.485 We believed that rescinding this fund of funds relief in the ETF and ETMF orders, as well as more generally, would establish a transparent regulatory framework for these arrangements. As discussed in the 2018 FOF Proposing Release, we expected that the need to comply with the requirements of proposed rule 12d1–4, as opposed to their orders, would not significantly negatively affect the operations of most existing fund of funds arrangements.486 Commenters had mixed reactions to our proposal to rescind existing fund of funds exemptive relief. Several commenters supported the proposed rescission of exemptive orders in connection with the adoption of rule 12d1–4, citing the benefits of a standardized rule.487 Many other commenters stated that our proposal would eliminate a fund’s ability to rely on existing fund of funds relief and could increase costs and burdens, including potential restructuring of existing arrangements. Other commenters suggested the Commission take a tailored approach in order to limit disruption to existing fund of funds arrangements.488 For example, one commenter requested we rescind only the exemptive orders described in the 2018 FOF Proposing Release.489 Many commenters requested additional specificity as to which exemptive orders would be withdrawn, and whether the Commission intended to withdraw relief from provisions of the Act other than section 12(d)(1) in such exemptive orders.491

As discussed in more detail below, several commenters requested that the Commission expand the rule to incorporate individualized relief set forth in certain exemptive orders.492 Alternatively, some commenters suggested that the Commission preserve existing orders, and allow current recipients of exemptive relief to follow the conditions of their relief rather than relying on the rule.493 One commenter suggested that the Commission give the holders of exemptive orders at least a one-year period to transition operations or obtain new exemptive relief.494 As proposed, and as discussed in more detail below, we are rescinding the fund of funds exemptive orders that fall within the scope of rule 12d1–4. Specifically, we are rescinding exemptive relief that permits investments in funds beyond the limits in 12(d)(1)(A), (B), or (C) of the Act, other than in circumstances that we believe are outside the scope of rule 12d1–4 as discussed below. We are also rescinding exemptive relief under section 12(d)(1)(G) that permits an affiliated fund of funds to invest in assets that are beyond the scope of that statutory provision. We continue to believe that rescinding these orders will help to create a consistent framework for fund of funds arrangements, subject to conditions that appropriately address the concerns underlying section 12(d)(1), including the prevention of overly complex structures for funds of funds. In order to limit the hardship that revocation of these orders could have on existing fund of funds arrangements, however, we are adopting a one-year period after the effective date before rescission to give acquiring and acquired funds relying on these exemptive orders time to conform their operations with the requirements of the rule and rule amendments.

Funds of funds exemptive relief that falls outside the scope of rule 12d1–4, as well as the relevant portions of fund of funds exemptive orders that grant relief for provisions in the Act outside of the scope of the rulemaking, will remain in place. For example, we have issued several exemptive orders that

Dechert Comment Letter; Chamber of Commerce Comment Letter.

492 Nationwide Comment Letter; Allianz Comment Letter; Voya Comment Letter; Fidelity Comment; NYC Bar Comment Letter; PGIM Comment Letter; PIMCO Comment Letter; Federated 2 Comment Letter.

493 See, e.g., Allianz Comment Letter; PGIM Comment Letter; Fidelity Fixed Income Trustees Comment Letter; Fidelity Rutland Comment Letter; John Hancock Comment Letter.

494 NYC Bar Comment Letter.

485 See section 38(a) of the Investment Company Act (15 U.S.C. 80a–38(a)).

486 See 2018 FOF Proposing Release, supra footnote 6, at 95.
provide relief from sections 17(a) and 17(d) of the Act and rule 17d–1 under the Act that allow a registered fund to invest in private funds.\textsuperscript{495} We are not rescinding the relief from section 17(a) and under section 17(d) and rule 17d–1 granted in these orders. Similarly, we are not rescinding the portions of certain funds of funds exemptive orders that grant relief from section 17(d) of the Act and rule 17d–1 under the Act to enter into fee sharing agreements to avoid duplicative fees.\textsuperscript{496} In addition, to the extent we rescind 12(d)(1) relief, we are also rescinding any related 17(a) relief for the acquisition and redemption of fund shares by another fund. We are not, however, rescinding 17(a) relief permitting sales or redemptions of fund shares in-kind or portfolio transactions between two funds.

The major topical areas of fund of funds exemptive relief that are within the scope of rule 12d1–4 are as follows: \textit{Standard Fund of Funds Relief}. Our exemptive relief relating to standard fund of funds arrangements generally grants exemptions from sections 12(d)(1)(A), (B), and (C) of the Act and sections 17(a)(1) and (2) of the Act to permit acquiring funds to invest in acquired funds in excess of the limits of section 12(d)(1) of the Act.\textsuperscript{497} This relief is rescinded, one year from the effective date of the rule.

\textit{Fund of Funds Relief for ETFs and ETMFs.} As proposed, the exemptive relief from sections 12(d)(1)(A) and (B) that has been included in our ETF and ETMF orders is rescinded, one year from the effective date of the rule. \textit{ETFs Relying on Rule 6c–11.} In 2019, we adopted rule 6c–11 under the Investment Company Act to permit ETFs that satisfy certain conditions to operate without the expense and delay of obtaining an exemptive order from the Commission under the Act.\textsuperscript{498} In connection with that rulemaking, we rescinded those portions of certain ETF exemptive orders that grant relief related to the formation and operation of an ETF, but we did not rescind the relief provided to ETFs from section 12(d)(1) and sections 17(a)(1) and (a)(2) under the Act related to fund of funds arrangements involving ETMFs. The fund of funds exemptive relief for these ETFs is rescinded as well.\textsuperscript{499} \textit{Fund of Funds Relief for Non-Transparent ETFs and ETMFs.} We also have granted exemptive relief permitting certain actively managed ETFs to operate without being subject to the daily portfolio transparency condition included in other actively managed ETF orders ("non-transparent ETFs").\textsuperscript{500} These orders include relief from sections 12(d)(1)(A) and (B) of the Act to permit certain fund of funds arrangements. We have also granted relief from sections 12(d)(1)(A) and (B) permitting ETMFs to be an acquired fund in a fund of funds arrangement.\textsuperscript{501} We believe that non-transparent ETFs and ETMFs raise the same concerns regarding the pyramiding of funds and the related potential abuses that the rule is designed to address. As a result, relief under section 12(d)(1)(A) and (B) for non-transparent ETFs and ETMFs is rescinded as proposed.

\textit{Fund of Funds Direct Investment Relief.} We have granted exemptive relief to permit fund of funds arrangements that rely on section 12(d)(1)(G) of the Act to invest in assets other than funds within the same group of investment companies, government securities, and short-term paper. Certain exemptive relief granted prior to the adoption of rule 12d1–2 in 2006 permitted funds of funds relying on section 12(d)(1)(G) to invest in securities and other financial instruments.\textsuperscript{502} Some exemptive orders granted after the adoption of rule 12d1–2 provide relief from rule 12d1–2(a) to the extent necessary to permit an acquiring fund that relies on section 12(d)(1)(G) of the Act to invest in financial instruments that may not be "securities."\textsuperscript{503} Although some commenters requested we retain the relief for direct investments,\textsuperscript{504} we are rescinding this relief, one year from the effective date of the rule. As discussed above in section II.D, we are rescinding rule 12d1–2 in order to create a more consistent and efficient regulatory framework for the regulation of fund of funds arrangements. We similarly believe that rescinding the direct investment exemptive relief will establish an appropriate, consistent framework for the regulation of these fund of funds arrangements by subjecting them to the conditions of rule 12d1–4 if they continue to invest in assets other than those permitted by section 12(d)(1)(G) of the Act. \textit{Fund of Funds Affiliated Structures.} The Commission granted certain exemptive relief to permit an open-ended fund or UIT to invest in other open-end funds and UITs that are in the "same group of investment companies" in excess of the limits in section 12(d)(1), subject to certain enumerated conditions.\textsuperscript{505} Some exemptive orders

\textsuperscript{495} See, e.g., Aberdeen Asset Management Inc., et al., Investment Company Act Release Nos. 33058 (March 27, 2018) (notice) and 33080 (April 24, 2018) (order).

\textsuperscript{496} See, e.g., Lord Abbett Investment Trust, et al., Investment Company Act Release Nos. 23088 (March 27, 1998) (notice) and 23122 (April 21, 1998) (order) (granting relief for, among other things, a servicing arrangement under which one or more of the applicant funds may pay a portion of the administrative expenses of another applicant fund).

\textsuperscript{497} The standard fund of funds orders grant an exemption from section 12(d)(1)(A) and 12(d)(1)(B). See, e.g., Aberdeen Asset Management Inc., et al., Investment Company Act Release Nos. 28429 (Sept. 30, 2008) (notice) and 28475 (Oct. 28, 2008) (order) (subcategory of these standard fund of funds exemptive orders also grant additional relief under section 12(d)(1)(C) to permit investment in closed-end funds beyond the limits imposed by section 12(d)(1)(C)). See, e.g., Ares Credit and Income Trust and Ares Capital Management III LLC, Investment Company Act Release Nos. 33243 (Sept. 21, 2018) (notice) and 33275 (Oct. 17, 2018) (order). The rescission of standard fund of funds exemptive orders applies to the orders that grant additional relief under section 12(d)(1)(C), as well, since that relief is within the scope of rule 12d1–4.

\textsuperscript{498} 2019 ETF Adopting Release, supra footnote 25, at 8.

\textsuperscript{499} Id. We also stated that ETFs relying on rule 6c–11 that do not have exemptive relief from sections 12(d)(1)(A) and (B) may enter into fund of funds arrangements as set forth in recent ETF exemptive orders, provided that such ETFs satisfy the terms and conditions for fund of funds relief in those orders. The 2019 ETF Adopting Release noted that this position would be available only until the effective date of a rule permitting registered funds to acquire the securities of other registered funds in excess of the limits in section 12(d)(1), including rule 12d1–4 if adopted. See id. at 130–133. In order to give any ETFs relying on this position sufficient time to come into compliance with rule 12d1–4, however, this position will be available for a one-year period following the effective date of rule 12d1–4.

\textsuperscript{500} Because these non-transparent ETFs do not provide daily portfolio transparency, they do not meet the conditions of rule 6c–11. See 2019 ETF Adopting Release, supra footnote 25, at text accompanying n. 192.

\textsuperscript{501} See, e.g., Eaton Vance Order, supra footnote 485.

\textsuperscript{502} See supra footnote 465 noting that master-feeder relief for ETMFs will not be rescinded.

\textsuperscript{503} See, e.g., Nations Fund Trust, Investment Company Act Release Nos. 24781 (Dec. 1, 2000) (notice) and 24804 (Dec. 27, 2000) (order) (permitting a fund to invest in funds in the same group of investment companies in excess of the limits in section 12(d)(1), subject to certain enumerated conditions).

\textsuperscript{504} See, e.g., Context Capital Advisors, LLC, et al., Investment Company Act Release Nos. 31689 (June 24, 2015) and 31720 (July 21, 2015). As discussed in more detail below, certain staff no-action letters in connection with this rulemaking, including the Northern Lights Fund Trust, SEC Staff No-Action Letter (June 26, 2015) ("Northern Lights Letter") will be withdrawn. The Northern Lights Letter permits an affiliated fund of funds arrangement relying on section 12(d)(1)(G) to invest a portion of its assets in other financial instruments (e.g., derivatives that are not securities under the Act), consistent with its investment objectives, policies and restrictions.

\textsuperscript{505} See, e.g., Allianz Comment Letter.

\textsuperscript{506} Some of these orders pre-date the implementation of section 12(d)(1)(G), while other orders also included this relief for certain affiliated fund of funds arrangements. See, e.g., Franklin Templeton Fund Manager, et al., Investment Company Act Release Nos. 21994 (May 20, 1996) (notice) and 22022 (June 17, 1996) (order); Aberdeen Asset Management Inc., et al., Investment Company Act Release Nos. 28429 (Sept. 30, 2008) (notice) and 28475 (Oct. 28, 2008) (order). See also Continued
also permitted funds of funds to invest in an affiliated closed-end fund.\(^{507}\) As with the standard fund of funds relief, we are rescinding the affiliated structure relief. These fund of funds arrangements may rely on section 12(d)(1)(G) or rule 12d1–4 to the extent they intend to purchase other funds in the same group of funds beyond the limits of section 12(d)(1). Additionally, although several commenters requested that the Commission not rescind certain exemptive relief that allows an acquired fund’s investment in short-term bond funds for cash management or collateral management purposes,\(^{508}\) rule 12d1–4 provides appropriate flexibility for funds to invest in these purposes. Specifically, rule 12d1–4 permits an acquiring fund to invest in any acquired fund in excess of the statutory limits pursuant to the conditions of the rule. Further, rule 12d1–4 provides an exception from the rule’s general prohibition against three tiers to permit an acquired fund to invest in an underlying fund pursuant to rule 12d1–1 in excess of the statutory limits, and provides the 10% Bucket, which permits an acquired fund to invest up to 10% of its assets in other investment companies for any investment purposes. Rule 12d1–4 limits the potential for confusing structures and duplicative fees, while providing the flexibility of the 10% Bucket. Accordingly, we believe it is appropriate to rescind this relief, one year from the effective date of the rule. For similar reasons, we believe it is appropriate to rescind the exemptive relief that acquired funds have relied on to invest in “central funds.”\(^{509}\) We believe that the 10% Bucket provided in rule 12d1–4, when combined with the enumerated exceptions discussed above, will provide appropriate flexibility for beneficial multi-tier arrangements while limiting the harms that Congress sought to prevent. Accordingly, the central funds exemptive relief falls within the scope of rule 12d1–4 and is rescinded.


\(^{508}\) See PGIM Comment Letter (referring to its exemptive order permitting acquired funds (and acquiring funds) to invest in a public or private short-term bond fund for cash management purposes).

\(^{509}\) See supra footnote 421 and accompanying text describing central funds. See also PIMCO Comment Letter (referring to PIMCO Funds, et al., Investment Company Act Release Nos. 25220 (Oct. 22, 2001) (notice) and 25272 (Nov. 19, 2001) (order)). See also supra footnote 424 for commenters addressing central fund arrangements, including related to the Thrivent No-Action Letter.

\(^{510}\) As discussed above, some existing multi-tier structures, including “central funds” arrangements that currently rely on existing exemptive relief, may be required to modify their investments to ensure compliance with rule 12d1–4.\(^{511}\) However, unlimited ability to enter into multi-tier arrangements could lead to complex structures in which an acquiring fund shareholder finds it difficult to determine the nature and value of the holdings ultimately underlying his or her investment.

Captive Funds. One commenter requested that the Commission retain exemptive orders for fund of funds arrangements that are captive to an affiliated managed account program.\(^{512}\) This commenter stated these kinds of captive funds of funds are simply conduits that advisers use to deliver a more efficient range of investment strategies and achieve a more consistent allocation of investment strategies across these accounts. We recognize that rescinding such exemptive relief may cause fund of funds arrangements that are captive to an affiliated managed account program to restructure to comply with the conditions of rule 12d1–4.\(^{513}\) However, rule 12d1–4 provides appropriate flexibility and conditions for affiliated fund of funds structures, including structures that are captive to an affiliated managed account program. Accordingly, such exemptive relief is rescinded, one year from the effective date of the rule.

We have also given relief from section 12(d)(1) in certain circumstances that we believe are outside the scope of rule 12d1–4. The major topical areas section 12(d)(1) exemptive relief that we believe are outside the scope of rule 12d1–4 are as follows:

**Interfund Lending.** As proposed, we are not rescinding the exemptive relief from section 12(d)(1)(A) and (B) granted to allow certain interfund lending arrangements. Commenters generally agreed with this approach.\(^{514}\) We continue to believe that these arrangements do not result in the pyramiding of funds or the related potential abuses that rule 12d1–4 is designed to address.

**Affiliated Insurance Fund Relief.** Commenters requested more clarity with respect to certain orders allowing insurance funds to invest in fixed income instruments issued by affiliates. For example, one commenter requested clarification regarding the status of its 2002 exemptive relief, which permits its funds of funds to invest in affiliated and unaffiliated underlying funds, other securities, and a fixed interest contract issued by its affiliate.\(^{515}\) Another commenter similarly requested clarification whether we are rescinding its exemptive relief, a portion of which allows funds to invest in a guaranteed rate investment contract issued by an affiliate.\(^{516}\) The orders cited by these commenters grant exemptions from 12(d)(1)(A) and 12(d)(1)(B), as well as from section 17(a) for the purchase of the guaranteed rate investment contract issued by an affiliate. As described above, we are rescinding only the portion of the exemptive orders granting fund of funds relief that falls within the scope of rule 12d1–4. We agree with commenters that the relief granted under sections 6(c) and 17(b) permitting investment in a fixed income instrument issued by an affiliate is distinct from the fund of funds relief granted in these orders. As noted above, we are not rescinding relief under section 17 when the relief does not implicate fund of funds arrangements. Accordingly, we are not rescinding this portion of the exemptive relief, which is unrelated to the fund of funds exemptive relief.

**Transaction-Specific Relief.** From time to time, we have granted exemptive relief to funds under section 12(d)(1) in order to engage in a transaction that might otherwise violate such provision.

\(^{511}\) See section I.L.C.3.d, noting that as of June 2018, we identified 231 three-tier structures for which both the first- and second-tier funds invested in other funds beyond the limits in section 12(d)(1) that may need to restructure their holdings over time to continue to maintain the same investment, to the extent that the acquired funds in such structures invest more than 10% of their assets in underlying funds, exclusive of investments in underlying funds that are made pursuant to the enumerated exceptions described above; see also 2018 FOF Proposing Release, supra footnote 6, at 150.

\(^{512}\) Fidelity Comment Letter (referring to Fidelity Rutland Square Trust, et al., Investment Company Act Release Nos. 28259 (Apr. 30, 2008) (notice) and 28287 (May 28, 2008) (order)). See FTI Letter 12(d)(1)(A) and 12(d)(1)(B), as well as from section 17(a) for the purchase of the guaranteed rate investment contract issued by an affiliate. As described above, we are rescinding only the portion of the exemptive orders granting fund of funds relief that falls within the scope of rule 12d1–4.

\(^{513}\) See section V.C.1.i for an analysis of the anticipated benefits and costs of rescinding exemptive orders; see also section V.D.1 for the economic analysis of retaining existing exemptive orders.

\(^{514}\) See, e.g., Voya Comment Letter.

\(^{515}\) Nationwide Comment Letter (referring to Nationwide Life Insurance Co., Investment Company Act Release Nos. 26141 and 25528 (Apr. 16, 2002) (notice) and 25528 (Feb. 21, 2002) (order)).

\(^{516}\) Voya Comment Letter (referring to ING Partners Inc., et al., Investment Company Release Nos. 27116 (Oct. 12, 2005) (notice) and 27142 (Nov. 8, 2005) (order)).
In many cases, this relief relates to fund reorganizations.\textsuperscript{517} This transaction-specific relief does not involve ongoing fund of funds arrangements where the concerns underlying section 12(d)(1) are most pronounced and where the conditions of rule 12d1-4 will serve to protect investors against those concerns. As a result, we do not believe it is necessary to rescind such relief.

Grantor Trusts. One commenter requested we retain an exemptive order pertaining to current and future automatic common exchange security ("ACES") trusts.\textsuperscript{518} ACES trusts are limited-life, grantor trusts. We have previously granted exemptive relief to funds and private funds to invest in a grantor trust (typically structured as a closed-end fund) in excess of the section 12(d)(1) limits, along with related relief.\textsuperscript{519} The grantor trusts in this line of exemptive orders are not marketed to provide investors with either professional investment asset management or the benefits of investment in a diversified pool of assets. As a result, they do not result in the pyramiding of funds or the related potential abuses that the rule is designed to address, and therefore we are not rescinding this relief.

Fund of Funds Arrangements with Managed Risk Provision and other Relief Related to Section 12(d)(1)(E). One commenter requested that we not rescind a fund of funds exemptive order that permits a "managed risk" fund structure.\textsuperscript{520} This commenter stated that the relief allows an insurance series fund that invests in one underlying fund in excess of the limits in section 12(d)(1)(A) also to invest in cash, cash equivalents, and certain hedging instruments in connection with a risk-management strategy that is specifically designed to reduce the volatility of the acquiring fund. Because of the fund's investment in certain hedging instruments, the fund cannot rely on section 12(d)(1)(E) of the Act for purposes of an exception from the general prohibition against three tiers. We are not rescinding exemptive relief from sections 12(d)(1)(A) and (B) of the Act to the extent that the relief effectively allows a feeder fund to rely on section 12(d)(1)(E) without complying with certain aspects of section 12(d)(1)(E) of the Act.

Accordingly, we believe this relief is outside the scope of rule 12d1-4 with respect to the treatment of a fund for purposes of the three-tier prohibition.\textsuperscript{521} We continue to believe that the one-year period for the termination of our fund of funds exemptive relief is sufficient to give adequate time for funds relying on impacted exemptive orders to bring their future operations into conformity with section 12(d)(1)(G) or rule 12d1-4.

The Commission does not believe that it is necessary to give individual hearings to the holders of the prior orders or to any other person.\textsuperscript{522} This rule is prospective in effect and is intended to set forth for the entire industry the Commission's exemptive standards for these types of fund of funds arrangements. Funds are able to request Commission approval to operate as a fund of funds that does not meet the requirements of the rule.

As discussed in the 2018 FOF Proposing Release, our staff has previously stated that it would not recommend that the Commission take enforcement action in certain situations relating to section 12(d)(1). The 2018 FOF Proposing Release noted that the staff in the Division of Investment Management were reviewing staff letters relating to sections 12(d)(1) to detertmine whether any such letters should be withdrawn in connection with any adoption of this rule. As we noted in the 2018 FOF Proposing Release, some of the letters may be moot, superseded, or otherwise inconsistent with the rule and, therefore, will be withdrawn.

The staff of the Division of Investment Management has issued a line of letters stating that the staff would not recommend enforcement action to the Commission under sections 12(d)(1)(A) or (B) of the Act if a fund acquires the securities of other funds in certain circumstances. We understand that certain industry practices have developed in connection with these letters. In particular, we understand that: (i) Some funds have created three-tier master-feeder structures for tax management, cash management, or portfolio management purposes; (ii) other funds have invested in assets that may not be securities, but have otherwise complied with the restrictions in rule 12d1-2;\textsuperscript{523} (iii) sponsors of UITs have deposited units of existing trusts into portfolios of future UIT series; (iv) foreign pension funds and profit sharing funds, and foreign subsidiaries and feeder funds have invested in other funds beyond the limits of section 12(d)(1); and (v) foreign funds have invested in other funds under section 12(d)(1) to the same extent as private funds.

In the 2018 FOF Proposing Release, we asked that commenters detail their concerns with the withdrawal of any of the letters. Commenters stated preferences for retaining certain no-action letters, including those that relate to three-tier structures, subject to the circumstances described in those letters.\textsuperscript{524} Some commenters requested that no-action letters relating to a feeder fund that invests in a U.S. fund to comply with section 12(d)(1)(A)(i) but not sections 12(d)(1)(A)(ii) and (iii) not be withdrawn.\textsuperscript{525} Other Commenters suggested that certain no-action letters be retained related to the status of investment vehicles domiciled outside the U.S., where such foreign funds are

\textsuperscript{517} See, e.g., Allied Capital Corporation, et al., Investment Company Act Release Nos. 22962 (Nov. 21, 1997) (notice) and 22941 (order) (granting relief under sections 12(d)(1)(A) and 12(d)(1)(C), among other provisions, to allow for the acquisition of investment company subsidiaries in a merger).

\textsuperscript{518} DPW Comment Letter (citing Goldman, Sachs & Co., Investment Company Act Release Nos. 32460 (Jan. 31, 2017) (notice) and 32545 (Feb. 28, 2017) (order)).

\textsuperscript{519} See, e.g., Goldman ACES Order; see also J.P. Morgan Securities Inc., Investment Company Act Release Nos. 24060 (Sept. 29, 1999) (notice) and 24112 (Oct. 26, 1999) (order).

\textsuperscript{520} See Capital Group Comment Letter (referring to the “managed risk fund provision” in American Funds Insurance Series, et al., Investment Company Act Release Nos. 31677 (June 17, 2015) (notice) and 31715 (July 14, 2015) (order)).

\textsuperscript{521} In addition, we did not propose to rescind exemptive relief related to section 12(d)(1)(F) and are not doing so. See FOF Proposing Release supra footnote 6 at 95.

\textsuperscript{522} See also id. at 97 (stating that “The Commission does not believe that it is necessary to give individual hearings to the holders of the prior orders or to any other person.”).

\textsuperscript{523} The Commission has previously issued exemptive orders to funds that rely on section 12(d)(1)(G) to allow those funds to invest in futures contracts and other financial instruments. See, e.g., KP Funds, et al., Investment Company Act Release Nos. 30545 (June 7, 2013) [78 FR 34143 (June 7, 2013)] (notice) and 30586 (July 1, 2013) (order); Financial Investors Trust and Hanson McClain Strategic Advisors, Inc., Investment Company Act Release Nos. 30521 (May 15, 2013) [78 FR 30346 (May 17, 2013) (notice) and 30554 (order). Following those orders, the staff of the Division of Investment Management issued a no-action letter stating that it would recommend enforcement action to the Commission under section 12(d)(1)(A) or (B) of the Act against a fund of funds that meets all of the provisions of section 12(d)(1)(G) and rule 12d1-2, except to the extent that it invests in assets that might not be securities under the Act, see, e.g., Northern Lights Letter supra footnote 504.

\textsuperscript{524} See, e.g., Thrivent Comment Letter; ICI Comment Letter.

\textsuperscript{525} Vanguard Comment Letter. The Commission previously stated that a foreign fund that uses U.S. jurisdictional means in the offering of securities it issues and relies on section 12(c)(1) or 3(c)(7) of the Act will be treated as a private fund for purposes of section 12(d)(1). See 2018 FOF Proposing Release, at footnote 52, citing “Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers,” Investment Advisers Act Release Nos. 2222 note 294 and accompanying text [June 22, 2011] [76 FR 39646 (July 6, 2011)]. Staff no-action letters stating that the staff would not recommend enforcement action if a foreign fund that uses securities of U.S. funds in excess of the limits of section 12(d)(1) under certain facts and circumstances will not be withdrawn. See, e.g., Dechert LLP, SEC No-Action Letter (publ. avail. Aug. 4, 2009).
The Commission shall consider whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors. The following analysis considers, in detail, the potential economic effects that may result from the final rule, including the benefits and costs to investors and other market participants as well as the broader implications of the final rule for efficiency, competition, and capital formation.

A. Introduction

Rule 12d1–4 will allow funds to acquire the securities of another fund in excess of the limits in section 12(d)(1) of the Act without obtaining an exemptive order from the Commission. We are also rescinding rule 12d1–2 under the Act and certain exemptive relief, and amending rule 12d1–1 and Form N–CEN.532

The final rule will affect funds’ investment flexibility, increase regulatory consistency and efficiency, and eliminate the need for acquiring and acquired funds to obtain an exemptive order from the Commission and incur the associated costs and delays. At the same time, the final rule will impose one-time costs on funds that will need to assess whether their operations are consistent with the final rule. In addition, the conditions in rule 12d1–4 will impose certain ongoing costs on funds, such as compliance, monitoring, and recordkeeping costs. Finally, certain funds will be required to restructure additional investments in other funds and incur the associated costs, such as transaction costs, to ensure compliance with the final rule.

B. Economic Baseline

The baseline against which the costs, benefits, and the effects on efficiency, competition, and capital formation of the final rule are measured consists of the current state of the fund market and the current regulatory framework for funds of funds.

533 For purposes of this section, we use the term “final rule” to refer collectively to rule 12d1–4, the rescission of rule 12d1–2 and the exemptive orders, the amendment to rule 12d1–1, and the amendments to Form N–CEN.

532 We expect that the amendments to Form N–CEN will have immaterial economic effects. In particular, we expect that the amendments to Form N–CEN will increase the annual estimated burden hours associated with preparing and filing Form N–CEN by approximately 0.1 hours for each fund (see infra section V.I.H). In addition, the amendments to Form N–CEN will facilitate the supervision and regulation of the fund industry, which will ultimately benefit fund investors, but any such effects are likely small. Hence, the economic analysis focuses on the economic effects of rule 12d1–4, the rescission of rule 12d1–2 and the exemptive relief, and the amendment to rule 12d1–1.

4. Cost-Benefit Analysis

We are mindful of the costs imposed by, and the benefits obtained from, our actions. Under the Act and certain exemptive provisions, the Office of Information and Regulatory Affairs has designated this rule a “major rule,” as defined by 5 U.S.C. 804(2). If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

V. Economic Analysis

We are mindful of the costs imposed by, and the benefits obtained from, the Commission’s actions. Pursuant to the Congressional Review Act, the Office of Information and Regulatory Affairs has designated this rule a “major rule,” as defined by 5 U.S.C. 804(2). If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

The following analysis considers, in detail, the potential economic effects that may result from the final rule, including the benefits and costs to investors and other market participants as well as the broader implications of the final rule for efficiency, competition, and capital formation.

A. Introduction

Rule 12d1–4 will allow funds to acquire the securities of another fund in excess of the limits in section 12(d)(1) of the Act without obtaining an exemptive order from the Commission. We are also rescinding rule 12d1–2 under the Act and certain exemptive relief, and amending rule 12d1–1 and Form N–CEN.532

The final rule will affect funds’ investment flexibility, increase regulatory consistency and efficiency, and eliminate the need for acquiring and acquired funds to obtain an exemptive order from the Commission and incur the associated costs and delays. At the same time, the final rule will impose one-time costs on funds that will need to assess whether their operations are consistent with the final rule. In addition, the conditions in rule 12d1–4 will impose certain ongoing costs on funds, such as compliance, monitoring, and recordkeeping costs. Finally, certain funds will be required to restructure additional investments in other funds and incur the associated costs, such as transaction costs, to ensure compliance with the final rule.

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The baseline against which the costs, benefits, and the effects on efficiency, competition, and capital formation of the final rule are measured consists of the current state of the fund market and the current regulatory framework for funds of funds.

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funds in Form N–CEN is a fund that acquires securities issued by any other investment company in excess of the amounts permitted under paragraph (A) of section 12(d)(1) of the Act but does not include a fund that acquires securities issued by money market funds solely in reliance on rule 12d1–1 under the Act.535  

A trade association representing regulated investment companies globally provided the Commission with the results of a survey of its U.S. members and found that as of 2018, there were 1,359 funds of funds with $2.8 trillion in assets under management.536 Of those funds, the survey observed that 31% (i.e., 423 out of 1,359) of the funds of funds, representing $829 billion in assets, will not be affected by the final rule because they are structured solely in reliance on sections 12(d)(1)(E), 12(d)(1)(F), or 12(d)(1)(G), and the remaining 69% (i.e., 936 out of 1,359) of the funds of funds, representing $2.0 trillion in assets, will need to comply with the rule 12d1–4 conditions or restructure their investments.537

Another commenter, representing asset managers, conducted a survey of its members and found that all 15 surveyed sponsors, representing 655 funds of funds and assets of $1.8 trillion, stated that they rely on a variety of authorities (often in combination) including sections 12(d)(1)(F) (i.e., five sponsors), section 12(d)(1)(G) (i.e., 14 sponsors), rule 12d1–2 (i.e., 14 sponsors), exemptive orders (i.e., 14 sponsors), and/or structure funds of consistent with Commission staff no-action letters (i.e., three sponsors).538

All 15 sponsors indicated that they sponsor funds that invest in affiliated open-end funds and UITs; 539 13 sponsors indicated that they sponsor funds that invest in unaffiliated open-end funds and UITs; four sponsors indicated that they sponsor funds that invest in affiliated central funds; two sponsors indicated that they sponsor funds that invest in unaffiliated closed-end funds; one sponsor indicated that it sponsors funds that invest in unaffiliated BDCs; and one sponsor indicated that it sponsors funds that invest in unaffiliated registered funds.

### Table 1—Descriptive Statistics for All Funds and Acquiring Funds Using Form N–CEN Filings

<table>
<thead>
<tr>
<th>Funds</th>
<th>Number</th>
<th>Net assets (bn $)</th>
<th>Acquiring funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open-end funds</td>
<td>13,135</td>
<td>26,328</td>
<td>1,687</td>
</tr>
<tr>
<td>ETFs registered as open-end funds</td>
<td>2,184</td>
<td>5,689</td>
<td>105</td>
</tr>
<tr>
<td>ETMFs registered as open-end funds</td>
<td>28</td>
<td>14</td>
<td>2</td>
</tr>
<tr>
<td>Closed-end funds</td>
<td>736</td>
<td>320</td>
<td>29</td>
</tr>
<tr>
<td>UITs</td>
<td>720</td>
<td>2,237</td>
<td></td>
</tr>
<tr>
<td>Variable annuity separate accounts registered as UITs</td>
<td>430</td>
<td>1,561</td>
<td></td>
</tr>
<tr>
<td>Variable life insurance separate accounts registered as UITs</td>
<td>243</td>
<td>165</td>
<td></td>
</tr>
<tr>
<td>ETMFs registered as UITs</td>
<td>47</td>
<td>509</td>
<td></td>
</tr>
<tr>
<td>Management company separate accounts</td>
<td>14</td>
<td>225</td>
<td>3</td>
</tr>
</tbody>
</table>

N–CEN currently does not require a UIT to identify whether it is a fund of funds, and so we lack information on UITs using Form N–CEN data. We use the most recent Form N–CEN filing with the Commission for each fund between September 2018 and May 2020 for this analysis (i.e., the first and last month with Form N–CEN data available as of the data collection date). We use all available Form N–CEN filings to also capture delinquent filers in our analysis. Approximately 5% of the funds in Table 1 were terminated during our sample period. Open-end funds, ETFs organized as open-end funds, and ETMFs are registered on Form N–1A. ETFs and ETMFs are identified using Item C.3.a.i and C.3.a.ii in Form N–CEN filings. Closed-end funds are registered on Form N–2. Variable annuity separate accounts organized as UITs are series, or classes of series, of trusts registered on Form N–4. Variable life insurance separate accounts organized as UITs are series, or classes of series, of trusts registered on Form N–6. ETFs registered as UITs are series, or classes of series, of trusts registered on Form N–8. Non-ETF UITs are trusts registered on Forms N–4 or N–6. Management company separate accounts are trusts registered on Form N–3. The statistics in Table 1 are generally consistent with statistics on funds of funds provided by commenters. See, e.g., ICI Comment Letter. One exception is a commenter that stated that as of March 2019, there were 496 closed-end funds with 236 billion in net assets. See Advent Comment Letter. We lack detailed information on commenter’s estimation of these statistics but we believe that these statistics are lower than the statistics in Table 1 likely due to the different data sources and sample period used. See Table 4 of the Proposing Release for statistics of the number of acquiring funds by investment category.

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538 Hence, acquiring funds in Table 1 includes: Funds of funds that were structured in reliance on section 12(d)(1)(G); funds of funds that were structured in reliance on section 12(d)(1)(E) and section 12(d)(1)(F) and rule 12d1–2; funds of funds that were structured in reliance on exemptive relief on which rule 12d1–4 is based; and funds of funds that were structured considering Commission staff no-action letters.539 For the purposes of this survey, a fund of funds is defined as a fund that invests in at least one other fund in excess of the limits of section 12(d)(1)(A) but does not include funds that only invest in money market funds. Hence, our definition of acquiring fund in Table 1 is similar to the definition of acquiring fund in the ICI survey. The ICI survey sample appears to be a subset of the sample of acquiring funds in Table 1. That is, the ICI sample represents approximately 79% of the acquiring funds in Table 1 (79% = 1,359 funds of funds in the ICI survey/1,719 acquiring funds in Table 1). See ICI Comment Letter. Our data does not allow us to distinguish whether the acquiring funds in Table 1 have been structured in reliance on section 12(d)(1)(F); in reliance on section 12(d)(1)(G); in reliance on section 12(d)(1)(E) and rule 12d1–2; in reliance on an exemptive order; or considering Commission staff no-action letters.540 See SIFMA AMG Comment Letter. For purposes of this survey, a fund of funds is a fund that invests substantially all of its assets (i.e., > 85% of fund assets) in shares of other investment companies. The survey also requested information regarding funds that make investments in other investment companies beyond the limits of section 12(d)(1)(A) but where those investments, in the aggregate, represent less than 85% of fund assets. Fifty-nine of those funds hold more than 3% of an acquired fund’s shares. Eight out of the 15 respondents sponsor funds that invest less than 85% of their assets in other funds, and those funds rely on a variety of authorities (often in combination), including section 12(d)(1)(F) (i.e., three sponsors), section 12(d)(1)(G) (i.e., seven sponsors), rule 12d1–1 (i.e., three sponsors), exemptive orders (i.e., eight sponsors), and/or rule 12d1–2 (i.e., eight sponsors). All 8 sponsors indicated that they sponsor funds that invest in affiliated open-end funds and UITs; seven sponsors indicated that they sponsor funds that invest in unaffiliated open-end funds and UITs; three sponsors indicated that they sponsor funds that invest in affiliated central funds; two sponsors indicated that they sponsor funds that invest in unaffiliated closed-end funds; two sponsors indicated that they sponsor funds that invest in unaffiliated BDCs; one sponsor indicated that it sponsors funds that invest in affiliated registered funds; and one sponsor indicated that it sponsors funds that invest in unaffiliated registered funds. The data provided by the commenter is sponsor-level (rather than fund-level) data and so we cannot use this data to estimate how many of the acquiring and acquired funds in our sample will be affected by the final rule.539 According to the survey, the funds of funds that invest in affiliated open-end funds in reliance on section 12(d)(1)(G) also invest in unaffiliated money market funds, unaffiliated registered investment companies, individual securities such as stocks and bonds, and non-securities such as certain derivatives or real estate.
This table reports descriptive statistics for all funds and acquiring funds using data from Form N–CEN filings with the Commission as of May 2020. A fund of funds is a fund that acquires securities issued by any other investment company in excess of the amounts permitted under paragraph (A) of section 12(d)(1) of the Act but does not include a fund that acquires securities issued by money market funds solely in reliance on rule 12d1–1 under Item C.3.e (in Form N–CEN filings). Master-feeder funds are excluded from this analysis (see Item C.3.f in Form N–CEN). The UIT section of Form N–CEN currently does not require a UIT to identify if it is a fund of funds so information on acquiring UITs is marked as missing in this Table. For open-end funds, closed-end funds, and management company separate accounts, total net assets is the sum of monthly average net assets across all funds in the sample during the reporting period (see Item C.19.a in Form N–CEN). For UITs, we use the total assets as of the end of the reporting period (see Item F.11 in Form N–CEN), and for UITs with missing total assets information, we use the aggregated contract value for the reporting period instead (see Item F.14.c in Form N–CEN).

Table 2 below shows the number and size of funds, acquiring funds, and acquiring funds using data from Form N–PORT filings with the Commission as of May 2020.542 Form N–PORT is only filed by registered management investment companies and ETFs that are organized as UITs. Hence, the sample of funds in Table 2 (i.e., registered management investment companies and ETFs organized as UITs) is narrower than the sample of funds in Table 1 (i.e., all registered investment companies) because Form N–CEN and Form N–PORT do not apply to the same scope of funds.542 Each acquiring fund represented in Table 2 is a registered management investment company or ETF organized as a UIT that invests a non-zero percentage of its assets in registered investment companies or BDCs, while each acquired fund is a registered investment company in which a registered management investment company or ETF organized as a UIT invests.543 Hence, the definition of acquiring funds in Table 2 is broader than the definition of acquiring funds in Table 1.544

Untabulated analysis shows that out of the 4,750 acquiring funds in Table 2, 1,435, or 30%, invested in at least one acquired fund beyond the limits of section 12(d)(1).545 These 1,435 acquiring funds invested, on average, in nine unique acquired funds beyond the section 12(d)(1) limits. Also, untabulated analysis shows that 954, or 20%, of all acquiring funds in Table 2 appear to be relying on the statutory exemption in section 12(d)(1)(G) to structure a fund of funds arrangement.546 Finally, untabulated analysis shows that from the 16,797 acquiring-acquired fund pairs in Table 2, for which the acquiring fund invests in the acquired fund beyond the limits of section 12(d)(1)(A), 7,400 acquiring-acquired fund pairs have a different primary investment adviser.547

As Table 2 shows, there were 2,151 unique top-tier acquiring funds in multi-tier (i.e., more than two-tier) fund of funds structures and 986 unique second-tier acquiring funds in multi-tier fund of funds structures.548 Out of the 2,151 unique top-tier acquiring funds in multi-tier structures in Table 2, untabulated analysis shows that 721 are top-tier acquiring funds in structures that are five tiers or more, 149 are top-tier acquiring funds in structures that are five tiers or more, and 78 are top-tier acquiring funds in structures that are six tiers.549 In the case of four-tier structures, the average investment of the top-tier acquiring fund in the fourth-tier acquiring funds is equal to 0.0006% of the top-tier acquiring fund’s assets; in the case of five-tier structures, the average investment of the top-tier acquiring fund in the fifth-tier acquiring fund is equal to 0.00006% of the top-tier acquiring fund’s assets; and in the case of six-tier structures, the average investment of the top-tier acquiring fund is less than 0.00006% of the top-tier acquiring fund’s assets.546 The 2,151 top-tier acquiring funds in structures that are six tiers or more are organized as UITs.542

542 The reported net assets of ETFs registered as open-end funds in Table 1 likely are overstated because reporting on whether or not a fund is an ETF on Form N–CEN is at the series level, not the class level. Hence, all share classes within an open-end fund that has ETF share classes are attributed to the ETF category.543 BDCs do not file reports on Form N–PORT and are therefore excluded from the definition of acquiring funds in Tables 2 and 3. We use the most recent Form N–PORT filing with the Commission for each fund filed between May 2019 and May 2020 for this analysis (i.e., the first and last month with Form N–PORT data available as of the data collection date). See supra footnote 534 for definition of fund categories. Total net assets in Form N-CEN may be different from total net assets in Form N–CEN because Form N-CEN reports average assets estimated over the reporting period while Form N–PORT reports point-in-time assets as of the reporting date.
fund in the sixth-tier acquired funds is practically zero.\textsuperscript{550} When looking at only multi-tier structures in which at least one acquiring fund in each level invests in at least one acquired fund beyond the limits of section 12(d)(1), there are 23 top-tier acquiring funds in structures that are three tiers or more and one top-tier acquiring fund in a structure that is four tiers.\textsuperscript{551} In the case of the 23 top-tier acquiring funds in multi-tier structures that are three tiers or more, the average investment of the top-tier acquiring fund in the third-tier acquired funds is equal to 2.93% of the top-tier acquiring fund’s assets, and in the case of the one top-tier acquiring fund in a multi-tier structure that is four tiers, the average investment of the top-tier acquiring fund in the fourth-tier acquired funds is equal to 0.00003% of the top-tier acquiring fund’s assets.\textsuperscript{552}

A commenter also observed that as of 2018, out of the 1,359 funds of funds representing $2.8 trillion in assets under management, 198 funds of funds representing $287 billion in assets under management utilized a multi-tier structure.\textsuperscript{553} Another commenter found that out of the 655 funds of funds\textsuperscript{554} that were sponsored by 15 survey respondents, 223, or 34%, hold more than 3% of an acquired fund’s shares.\textsuperscript{555} The commenter also found that out of the 15 surveyed sponsors, eight sponsors, or 53%, indicated that they employ multi-tier structures.\textsuperscript{556} Out of the eight sponsors that employ multi-tier structures, seven sponsors employ three-tiered structures, and one sponsor employs a four-tiered structure. Seven sponsors operate these multi-tier structures pursuant to exemptive orders; three sponsors rely on section 12(d)(1)(G); three sponsors rely on rule 12d1–2; two sponsors rely on section 12(d)(1)(A); two sponsors structure funds considering staff no-action letters; one sponsor relies on section 12(d)(1)(F); and one sponsor relies on rule 12d1–1.\textsuperscript{557}

\textbf{TABLE 2—DESCRIPTIVE STATISTICS FOR FUNDS, ACQUIRING FUNDS, AND ACQUIRED FUNDS USING FORM N–PORT FILINGS}

<table>
<thead>
<tr>
<th>Funds</th>
<th>Acquiring funds</th>
<th>Acquired funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>Net assets (bn $)</td>
<td>Number</td>
</tr>
<tr>
<td>Open-end funds</td>
<td>11,170</td>
<td>24,458</td>
</tr>
<tr>
<td>ETFs</td>
<td>1,898</td>
<td>6,361</td>
</tr>
<tr>
<td>ETMFs</td>
<td>21</td>
<td>18</td>
</tr>
<tr>
<td>Closed-end funds</td>
<td>600</td>
<td>310</td>
</tr>
<tr>
<td>ETFs registered as UITs</td>
<td>5</td>
<td>436</td>
</tr>
<tr>
<td>UITs registered as separate accounts</td>
<td>13</td>
<td>208</td>
</tr>
<tr>
<td>Management company separate accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>11,788</td>
<td>25,412</td>
</tr>
</tbody>
</table>

\textbf{Panel A: Statistics on Funds, Acquiring Funds, and Acquired Funds}

\textbf{Panel B: Statistics on Multi-Tier Structures}

\textsuperscript{550} We estimate the top-tier acquiring fund’s investment in the bottom-tier acquired funds by accounting for the top-tier acquiring fund’s investment in the second-tier acquired funds, the second-tier acquired funds’ investments in the third-tier acquired funds, and so on. For example, in the case of three-tier structures, if the top-tier acquiring fund invests 5% of its assets in one second-tier acquired fund, and the second-tier acquired fund invests 5% of its assets in one third-tier acquired fund, then the top-tier acquiring fund’s investment in the bottom-tier acquired fund is equal to 0.25% = 5% \times 5%.\textsuperscript{551} We define acquiring funds that invest in at least one acquired fund beyond the limits of section 12(d)(1) using Form N–CEN data as of May 2020. There are no multi-tier funds of funds beyond four tiers that are structured beyond the limits of section 12(d)(1). Our data does not allow us to distinguish whether the identified multi-tier structures were structured in reliance on one of the exceptions to Form N–CEN data, and the difference may be due to the different samples used for the two analyses.\textsuperscript{552} \textsuperscript{553} See ICI Comment Letter. \textsuperscript{554} See SIFMA AMG Comment Letter. The proportion of acquiring funds that are top-tier acquiring funds in multi-tier structures in Table 2 (i.e., 45% = 2,151/4,750) is different from the proportion of acquiring funds that are top-tier acquiring funds in multi-tier structures provided by the commenter (i.e., 15% = 198/1,359) potentially due to different definitions of acquiring funds and top-tier acquiring funds in multi-tier structures. In particular, the commenter defines acquiring funds as funds that invest in at least one other fund in excess of the limits of section 12(d)(1)(A) while Table 2 defines acquiring funds as funds that invest a non-zero percentage of their assets in other funds. The commenter does not provide information on how it defines top-tier acquiring funds in multi-tier structures.\textsuperscript{555} See supra footnote 317 for the commenter’s definition of funds of funds.\textsuperscript{556} See SIFMA AMG Comment Letter. The 34% (= 223/655) of acquiring funds that invest in other funds beyond the limits in section 12(d)(1) provided by the commenter is higher than our 30% (= 1,435/4,750) estimate using Form N–PORT data and Form N–CEN data, and the difference may be due to the different samples used for the two analyses.\textsuperscript{557} See SIFMA AMG Comment Letter. The data provided by the commenter is sponsor-level (rather than fund-level) data and so we cannot use this data to estimate how many of the multi-tier structures in our sample will be affected by the final rule or the extent to which they will be affected. In addition, our data does not allow us to distinguish whether the multi-tier structures in our sample were created in reliance on sections 12(d)(1)(A), 12(d)(1)(F), 12(d)(1)(G), rule 12d1–2, exemptive orders, or considering staff no-action letters.
Our review of BDC filings show that as of December 2019, there were 83 BDCs with $123 billion in total gross assets, out of which 45 BDCs with $83 billion in total gross assets were listed on a national securities exchange. Approximately 44% of the BDCs were acquiring BDCs and 60% were acquired BDCs in fund of funds structures. We have not granted exemptive relief to BDCs as acquiring funds so we believe that all acquiring BDCs invest in other funds within the 12(d)(1)(i) limits. Table 3 below shows the percentage of acquiring funds that invest between 0 and 5%, 5 and 10%, 10 and 25%, 25 and 50%, 50 and 75%, 75 and 90%, 90 and 95%, and above 95% of their total assets in other funds as of May 2020. The table shows that the majority of acquiring funds invest either less than 10% or more than 95% of their assets in other funds. The reason for the concentration of acquiring funds below the 10% level is likely that a 10% investment in other funds is within the section 12(d)(1)(A) statutory limits. Funds that invest above the 95% threshold likely rely either on section 12(d)(1)(C) or (F) or on exemptive orders to invest in other funds beyond the section 12(d)(1)(A) statutory limits.

Table 3—Percentage of Acquiring Funds That Invest Certain % of Their Assets in Other Funds

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>[0-5%]</th>
<th>(5-10%)</th>
<th>(10-25%)</th>
<th>(25-50%)</th>
<th>(50-75%)</th>
<th>(75-90%)</th>
<th>(90-95%)</th>
<th>above 95%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open-end funds</td>
<td>47</td>
<td>8</td>
<td>7</td>
<td>8</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>17</td>
</tr>
<tr>
<td>ETFs</td>
<td>70</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>4</td>
<td>6</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>ETMFs</td>
<td>25</td>
<td>25</td>
<td>0</td>
<td>25</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Closed-end funds</td>
<td>82</td>
<td>6</td>
<td>7</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Management company separate accounts</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

This table reports the percentage of acquiring funds by fund type that invest between 0 and 5%, 5 and 10%, 10 and 25%, 25 and 50%, 50 and 75%, 75 and 90%, 90 and 95%, and above 95% of their total assets in other funds using data from Form N–PORT filings with the Commission as of May 2020. ETFs, except for ETFs registered as UITs, do not file Form N–PORT filings with the Commission and thus are excluded from this table. We have not identified any ETFs registered as UITs that are acquiring funds. Fund investments in money market funds and master-feeder structures are excluded from this analysis. Percentages may not sum up to 100 due to rounding error.

The total net assets of funds of funds have generally increased over time. According to the 2020 ICI Fact Book, the total net assets of open-end funds of funds increased from $680 billion to $2.54 trillion between December 2009 and December 2019, and the total net assets of exchange-traded funds of funds increased from $824 million to $13.444 billion between December 2009 and December 2019. Table 4 Panel A shows descriptive statistics for the expense ratio, front-end load, and deferred charges for single-tier funds (i.e., all funds excluding acquiring funds), and Table 4 Panel B shows descriptive statistics for the expense ratio, front-end load, and deferred charges for acquiring funds of July 2020. The expense ratio in Table 4 includes acquired fund fees and other expenses.

558 Estimates of the number of BDCs and their gross assets are based on a staff analysis of Form 10-K and Form 10-Q filings as of December 2019, which are the most recent available filings as of the data collection date. Our estimates exclude BDCs that may be delinquent or have filed extensions for their filings, wholly owned subsidiaries of other BDCs, and BDC additional to the 14 acquiring BDCs identified using Form N–PORT data only becomes available in 2019 but similar to Table 3 and Figure 1 of the Proposing Release. The reason is that Form N–CEN and Form N–PORT data, instead of Form N–CEN or Form N–PORT data, similar to Table 3 and Figure 1 of the Proposing Release. The reason is that Form N–CEN and Form N–PORT data only becomes available in 2019 but the analysis in Figure 1 requires identification of acquiring funds starting from 2015. We use the same data to identify acquiring funds in both Table 4 and Figure 1 to allow for data comparability in the fee and expense analysis. We define acquiring BDCs as BDCs that reported non-zero AFFEs in Forms 497, N–2, or N–2A filed with the Commission between January 2019 and May 2020, 44% = 14 BDCs that reported non-zero AFFEs in Forms 497, N–2, or N–2A with the Commission between January 2019 and May 2020 yielded one acquiring BDC additional to the 14 acquiring BDCs identified from our review of Forms 497, N–2, or N–2A. We believe that the number of acquiring BDCs using Form N–PORT filings as of May 2020, 60% = 50 BDCs acquired BDCs identified using Form N–PORT data as of May 2020/83 BDCs that filed forms 10–K or 10–Q as of December 2019. In addition to other funds, acquiring funds may invest in private funds, cash and cash equivalents, derivatives, individual equity and debt securities, asset-backed securities, etc. We do not aggregate fund holdings across advisory groups for the purposes of this analysis. Open-end funds of funds are open-end funds that invest primarily in other open-end funds. ETF funds of funds are ETFs that invest primarily in other ETFs. See 2020 ICI Fact Book, supra footnote 4, at 206 and 244.

561 In Table 4 and Figure 1 of this release (i.e., fee and expense analysis), we identify acquiring funds (excluding BDCs using Morningstar Holdings data instead of Form N–CEN or Form N–PORT data, similar to Table 3 and Figure 1 of the Proposing Release. The reason is that Form N–CEN and Form N–PORT data only becomes available in 2019 but the analysis in Figure 1 requires identification of acquiring funds starting from 2015. We use the same data to identify acquiring funds in both Table 4 and Figure 1 to allow for data comparability in the fee and expense analysis. We define acquiring BDCs as BDCs that reported non-zero AFFEs in Forms 497, N–2, or N–2A filed with the Commission between January 2019 and May 2020 (see supra footnote 559). The number of observations in Table 4 is different than the number of observations in Table 1 because (i) we lack expense data for some of the funds; and (ii) there are differences in the unit of observation in Morningstar and Form N–CEN (see infra footnote 564).
expenses. Untabulated analysis based on the expense data in Table 4 shows that the equal-weighted average expense ratio for acquiring open-end funds, UITs, and ETFs is statistically significantly higher than the equal-weighted average expense ratio for single-tier open-end funds, UITs, and ETFs, respectively.563 For BDCs and registered closed-end funds, there is no statistically significant difference in the operating expenses of acquiring and single-tier funds. There are no acquiring ETMFs with expense data in our sample. Our results are qualitatively similar when we compare the value-weighted (instead of the equal-weighted) average of the expense ratio for single-tier and acquiring funds. Nevertheless, the results of the statistical comparison of the expense ratio for single-tier and acquiring funds should be interpreted with caution because our analysis does not control for differences in the characteristics of single-tier and acquiring funds, such as differences in their investment strategy, which could potentially affect fund fees and expenses.

563 We use a two-tailed t-test and a 95% confidence interval to examine whether the differences in the equal-weighted averages of fees and expenses for acquiring and single-tier funds are statistically significant. A 95% confidence interval is frequently used for hypothesis testing in scientific work (see, e.g., David H. Kaye & David A. Freedman, Reference Guide on Statistics, in The Reference Manual on Scientific Evidence (2nd ed., 2000), at 83).

564 The difference in the number of UITs reported in Table 1 compared to Table 4 is likely due to the fact that Form N-CEN data (i.e., Table 1) is aggregated at the trust level while Morningstar (i.e., Table 4) reports unique UIT series, which we are unable to aggregate at the trust level due to data limitations.

### Table 4—Expense Ratio, Front-End Load, and Deferred Charges for Single-Tier and Acquiring Funds

<table>
<thead>
<tr>
<th>Expense Ratio:</th>
<th>Equal-weighted mean</th>
<th>Value-weighted mean</th>
<th>Median</th>
<th>Standard deviation</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panel A: Single-Tier Funds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Open-end funds</td>
<td>0.92</td>
<td>0.47</td>
<td>0.89</td>
<td>0.47</td>
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<tr>
<td></td>
<td>UITs</td>
<td>0.32</td>
<td>0.30</td>
<td>0.26</td>
<td>0.30</td>
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<td></td>
<td>ETFs</td>
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<td>0.13</td>
<td>0.49</td>
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<td>ETMFs</td>
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<td>0.77</td>
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<td>Closed-end funds</td>
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<td>1.96</td>
<td>1.86</td>
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<td></td>
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<td>0.35</td>
<td>0.32</td>
<td>0.03</td>
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<td></td>
<td>BDCs</td>
<td>12.00</td>
<td>11.00</td>
<td>12.20</td>
<td>4.17</td>
</tr>
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<td></td>
<td>Front-End Load:</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Open-end funds</td>
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<td>1.67</td>
<td>0.83</td>
<td>1.44</td>
</tr>
<tr>
<td></td>
<td>UITs</td>
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<td>3.16</td>
<td>3.90</td>
<td>1.04</td>
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<tr>
<td></td>
<td>ETFs</td>
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<td>1.96</td>
<td>1.44</td>
<td>0.52</td>
</tr>
<tr>
<td></td>
<td>ETMFs</td>
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<td>1.61</td>
<td>1.57</td>
<td>1.97</td>
</tr>
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<td></td>
<td>Closed-end funds</td>
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<td>2.92</td>
<td>2.00</td>
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<td>Deferred Charges:</td>
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<td>Open-end funds</td>
<td>0.12</td>
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<td>UITs</td>
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<tr>
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<td>0.03</td>
<td>0.07</td>
</tr>
<tr>
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<td>ETMFs</td>
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<td>0.09</td>
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<tr>
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<td>BDCs</td>
<td>2.09</td>
<td>2.14</td>
<td>2.25</td>
<td>0.46</td>
</tr>
</tbody>
</table>

565 The BDC expense ratio statistics are higher in Table 4 of this release compared to Table 3 of the 2018 FOI Proposing Release. In the 2018 FOI Proposing Release we collected BDC expense data from the most recent available Forms 497, N–2, or N–2A, while in this release we collect BDC expense data only from Forms 497, N–2, or N–2A that were filed between January 2019 and May 2020 to avoid using stale data in our analysis.
There is some evidence of a decrease in the expense ratio for certain funds of funds over time. In particular, according to an ICI report, the equal-weighted (value-weighted) average of the expense ratio of target date open-end funds has decreased from 1.23% (0.67%) in 2008 to 0.78% (0.37%) in 2019.\textsuperscript{566} Figure 1 Panels A–C below show the equal-weighted average of the expense ratio for acquiring open-end funds, ETFs, and closed-end funds between 2015 and 2019.\textsuperscript{567} Due to data limitations, the expense ratio in Figure 1 does not include acquired fund fees and expenses. As Panel A shows, the expense ratio for open-end acquiring funds has decreased from 0.91 in 2015 to 0.80 in 2019, but this decrease is not statistically significant.\textsuperscript{568} As Panel B shows, the expense ratio for acquiring ETFs has increased from 0.51 in 2015 to 0.53 in 2019, with a peak equal to 0.57 in 2016, but this decrease is not statistically significant. Finally, as Panel C shows, the expense ratio of closed-end acquiring funds has monotonically increased from 1.39 in 2015 to 2.31 in 2019 and this increase is statistically significant at the 1% level. The time-series trends for the expense ratio of acquiring ETFs and closed-end funds are qualitatively similar when we examine the value-weighted (instead of the equal-weighted) average of the expense ratio whereas the trend for the expense ratio of acquiring open-end funds exhibits a slight increase although this is not statistically significant.
Figure 1: Equal-weighted average of acquiring funds’ expense ratio over time

Panel A: Open-end acquiring funds

Panel B: Exchange-traded acquiring funds
This figure reports the equal-weighted average of the expense ratio for acquiring funds by fund type between 2015 and 2019. Panel A shows the average expense ratio for open-end funds, Panel B for ETFs, and Panel C for closed-end funds. There are no acquiring ETFs with expense data in our sample and there is no historical structured data for the expense ratio of UITs and BDCs. The analysis is conducted at the fund level using asset-weighted average values for multiple-class portfolios. Expense ratio is the percentage of fund assets, net of reimbursements, used to pay for operating expenses and management fees, including 12b-1 fees, administrative fees, and all other asset-based costs incurred by the fund, except brokerage costs. The expense ratio is retrieved from the acquiring fund’s annual report and it does not include the acquired funds’ fees and expenses. We identify acquiring funds using Morningstar Holdings data. Expense data is retrieved from Morningstar Direct and is winsonized at the 1 and 99% levels.

569 We identify funds that held a shareholder meeting in 2019 as funds that filed at least one Form DEF14A with the Commission in 2019. Our sample of funds is the same as in Table 1 above. Acquired funds are defined as in Table 2 above. Separate accounts are excluded from this analysis because rule 12d1–4 will not include specific voting provisions when an insurance product separate account is part of the acquiring fund advisory group or acquiring fund sub-advisory group.

570 Our sample of acquired funds is the same as in Table 2 above.

571 Based on Item 5.D. of Form ADV filed with the Commission as of March 2020.

572 Based on Item C.9. of Form N–CEN filed with the Commission as of May 2020. Our sample of acquiring funds is the same as in Table 1 above and the sample of acquired funds is the same as in Table 2 above. BDCs do not file Form N–CEN and thus are excluded from this analysis.

573 Based on Items F.1 and F.4 of Forms N–CEN filed with the Commission as of May 2020. We lack data on acquiring UITs and so we do not provide counts of depositors and sponsors to acquiring UITs (see supra Tables 1 and 2).


575 See supra section II.C and infra section V.C.1.b for detailed discussion of the exemptive order conditions.

576 See supra section I.A for detailed discussion of the relevant statutory provisions and rules and supra sections II.C.3.d and III for detailed discussion of relevant staff no-action and interpretive letters.
ETF fund of funds applications that received novel products. When we exclude non-transparent ETFs, which are relatively fewer, applications are skewed upwards by applications for non-transparent ETFs, which are relatively novel products. When we exclude non-transparent ETF applications that received novel products. When we exclude non-transparent ETF fund of funds applications that received novel products, the average number of filings was 2. There is variation in the duration of the exemptive order process from the date of the initial filing to the date the order is issued. For non-ETF (ETF) fund of funds applications that received exemptive orders in 2019, the average number of filings was 1.5 (3). On July 6, 2020, the Commission adopted amendments to establish an expedited review procedure for applications for orders that are substantially identical to recent precedent as well as a rule to establish an internal timeframe for review of applications outside of such expedited procedure. As a result, we expect that future delays associated with the application process, including for any funds of funds applications, will decrease significantly following the effective date of these amendments.

Until the Commission grants exemptive relief, fund advisers/sponsors are not permitted to create certain funds of funds and so acquiring funds must forgo certain investments in other funds. In addition, the exemptive order process may lead to uncertainty regarding whether the fund will be able to obtain exemptive relief and regarding the exact terms of the exemptive relief.

As a result of the direct and indirect costs of the exemptive order process, acquiring funds might forgo certain investments in other funds of funds might not be launched in the first place because the fund may conclude that the costs of seeking an exemptive order exceed the anticipated benefits of the investment in another fund beyond the limits of section 12(d)(1).

Funds relying on exemptive orders to develop funds of funds also must comply with the terms and conditions of the exemptive relief. These terms and conditions are designed to prevent the historical abuses that led Congress to enact section 12(d)(1). Existing orders include conditions designed to mitigate the risks of undue influence, duplicative and excessive fees, and overly complex structures.

As an alternative to obtaining an exemptive order, some funds have relied on statutory provisions and rules, and have considered staff-level views expressed in staff no-action letters to structure fund of funds arrangements beyond the limits of section 12(d)(1)(A) and (B). In particular, funds of funds can rely on section 12(d)(1)(G) and rule 12d1–2, section 12(d)(1)(E), and 12(d)(1)(F). In addition, the staff of the Division of Investment Management has issued a line of letters stating that the staff would not recommend enforcement action to the Commission under sections 12(d)(1)(A) or (B) of the Act if a fund acquires the securities of other funds in certain circumstances.

We understand that certain industry practices have developed in connection with the staff-level views provided in these letters.

C. Benefits and Costs and Effects on Efficiency, Competition, and Capital Formation

Where possible, we have attempted to quantify the costs, benefits, and effects on efficiency, competition, and capital formation expected to result from the final rule. In some cases, however, we are unable to quantify the economic effects because we lack the information necessary and commenters have not made data available to provide a reasonable estimate. For example, we are unable to estimate the number of new funds of funds that potentially will be created as a result of the adoption of the final rule, because we do not have information about the extent to which the exemptive order application process and the conditions associated with exemptive relief limit the creation of funds of funds. Further, we do not have information needed to estimate likely changes in investor demand for funds of funds following the adoption of the final rule. In those circumstances, in which we do not have the requisite data to assess the impact of the final rule quantitatively, we have qualitatively analyzed the economic impact of the final rule.
1. Benefits and Costs
   a. General Economic Effects
      i. Change in Funds’ Investment Flexibility
         The final rule will have opposing effects on funds’ investment flexibility. On one hand, rule 12d1–4 will expand funds’ investment flexibility by expanding the scope of permissible acquiring and acquired funds relative to the current exemptive orders. In particular, our current exemptive orders permit registered funds to invest only in certain other funds beyond the limits of section 12(d)(1), but rule 12d1–4 will expand the scope of permissible acquired funds by permitting both registered funds and BDCs to invest in all other registered funds and BDCs beyond the limits of section 12(d)(1) subject to certain conditions. Hence, relative to current exemptive orders, rule 12d1–4 will additionally allow (i) open-end funds to invest in unlisted BDCs and registered closed-end funds; (ii) UITs to invest in unlisted closed-end funds and listed and unlisted BDCs; (iii) closed-end funds to invest in open-end funds’ UITs, and listed and unlisted BDCs and registered closed-end funds; (iv) BDCs to invest in open-end funds, UITs, ETMFs, and listed and unlisted BDCs and registered closed-end funds; and (v) ETFs to invest in ETMFs and unlisted BDCs and registered closed-end funds. By expanding the scope of permissible acquiring and acquired funds, rule 12d1–4 will enhance acquiring funds’ investment flexibility and will increase acquired funds’ access to financing.

         In addition, rule 12d1–4 will expand funds’ investment flexibility and, more specifically, their ability to create multi-tier structures in the following way. Our current exemptive orders provide an exception from the three-tier limitation for investments in funds that are wholly-owned and controlled by the acquired fund as long as the investment adviser to the acquired fund is also the investment adviser to the wholly-owned subsidiary, while rule 12d1–4 does not include the requirement that the acquired fund and the wholly-owned subsidiary share the same investment adviser.

         Finally, an existing staff no-action letter considers acquired fund investments of up to 10% of its assets in other funds, including “central funds,” subject to certain conditions, including a condition that the acquired fund would not exceed the 5% limit in section 12(d)(1)(A)(ii) with respect to an investment in shares of a single central fund. In contrast, rule 12d1–4 will permit an acquired fund to invest up to 10% of its assets in other funds, regardless of the size of the investment in any one fund, the affiliation with the acquired fund, or the purpose of the investment. Hence, rule 12d1–4 will expand funds’ investment flexibility relative to the baseline by (i) permitting acquired funds’ investments in both affiliated and unaffiliated funds (i.e., compared to the no-action letter, which only regards acquired fund investments in affiliated funds); and (ii) not imposing the 5% limit on investments in any single fund. On the other hand, the conditions of rule 12d1–4, the rescission of rule 12d1–2, and the withdrawal of certain staff letters will decrease certain funds’ investment flexibility by restricting their ability to create certain multi-tier structures, and thus may require certain acquiring funds to change their investments in acquired funds over time compared to the baseline.

         In particular, our current exemptive orders prohibit an acquired fund from investing in other funds beyond the limits in section 12(d)(1), but they do not expressly prohibit a fund from investing in an acquiring fund beyond the limits of section 12(d)(1). In addition, section 12(d)(1)(G) requires an acquired fund to have a policy that prohibits it from acquiring any securities of a registered open-end fund or UIT in reliance on section 12(d)(1)(G) or (F), but section 12(d)(1)(G) does not require the acquired fund to have a policy that prohibits it from acquiring the securities of a fund in excess of the limits in section 12(d)(1)(A) in reliance on an exemptive order issued by the Commission.

         Further, our exemptive orders permit acquired funds to invest in other funds beyond the statutory limits for short-term cash management purposes. Some of these orders have allowed an acquired fund to invest in short-term bond funds for these purposes. Rule 12d1–4 will permit acquired funds to invest in funds in reliance on rule 12d1–1 beyond the statutory limits, regardless of the purpose of the investment. This condition of rule 12d1–4 will increase funds’ investment flexibility to create multi-tier structures to the extent that acquired funds invest in funds in reliance on rule 12d1–1 above the statutory limits for purposes other than cash management. An acquired fund could also invest up to 10% of its assets in short-term bond funds pursuant to the 10% Bucket. However, this condition of rule 12d1–4 will decrease funds’ flexibility to create multi-tier structures relative to existing exemptive orders to the extent an acquired fund may no longer rely on a cash management exception to invest in excess of the statutory limits in short-
term bond funds. Accordingly, on balance, the rule preserves substantial flexibility for acquired funds to invest in underlying funds for cash management purposes with an exception for investments in underlying funds pursuant to rule 12d1–1 and a separate 10% bucket for investments in underlying funds that do not comply with the terms of rule 12d1–1. Nevertheless, our analysis of multi-tier structures should be interpreted with care because we lack data that would allow us to identify whether existing multi-tier structures that were created under the complex structures conditions in our exemptive orders or in consideration of the existing no-action letters will comply with the conditions of rule 12d1–4. Further, like the limits under section 12(d)(1)(I) of the Act, the complex structures investment prohibitions of rule 12d1–4 are applicable at acquisition. Accordingly, only funds that seek to increase their investments in other funds beyond the statutory limits will be limited by the rule’s complex structures prohibitions.

Several commenters argued that the rescission of rule 12d1–2 will decrease the investment flexibility of funds that currently rely on section 12(d)(1)(G) and rule 12d1–2 to structure affiliated fund of funds arrangements. Funds that currently rely on section 12(d)(1)(I) and rule 12d1–2 can now rely on rule 12d1–4 to structure the same arrangements instead. In particular, rule 12d1–4, unlike section 12(d)(1)(I), does not limit acquiring funds’ ability to invest in securities other than securities issued by affiliated funds. Thus, a fund that wishes to invest in affiliated funds beyond the limits of section 12d(1)(I) can also invest in (i) unaffiliated fund securities up to the limits in section 12(d)(1)(A) or (F); (ii) securities of money market funds in reliance on rule 12d1–1; and (iii) stocks, bonds, and other securities subject to the conditions of rule 12d1–4, rather than section 12(d)(1)(G) and rule 12d1–2. The funds that will choose to operate in accordance with rule 12d1–4, however, will need to comply with the rule’s conditions and incur the costs associated with these conditions. In addition, we believe that many of the commenter concerns related to potential changes in funds’ investment flexibility as a result of the rescission of rule 12d1–2 will be alleviated because we are not adopting the proposed redemption limit. The final rule will require some existing funds of funds to change their portfolios to ensure compliance with the final rule, and these portfolio changes may impose the following costs on acquiring funds: (i) Legal and transaction costs to restructure their portfolios; (ii) sale of the shares of acquired funds at potentially depressed prices; (iii) tax implications, which will depend on whether the acquiring fund will sell shares of acquired funds at a gain or a loss; (iv) disruption in the acquired funds’ investment strategy; and (v) disclosure costs to the extent that funds will limit their investment strategy. The prohibition of certain multi-tier structures may also result in less efficient fund of funds structures (i.e., funds of funds with fewer investment options, higher administrative costs, higher transaction costs, and/or lower returns) to the detriment of acquiring fund investors.

The final rule will also impose costs on acquired funds that will lose the investments of the acquiring funds in them. As a result, acquired funds may be unable to achieve economies of scale in portfolio management, resulting in decreased efficiencies and increased operating costs for acquired fund shareholders. Acquired funds will also bear costs associated with selling assets in their portfolios to meet any redemptions by acquiring funds, assuming that acquiring fund redemptions are not made in kind. Finally, certain funds may opt for more complex, costly, and unregulated structures to avoid the rule 12d1–4 conditions.

For example, some funds may opt to invest directly in multiple securities, rather than investing in other funds that hold such securities, which may increase the funds’ complexity and cost of operations. Nevertheless, we believe that any such costs to funds and their investors will be moderated by benefits associated with improved investor protection, and a more efficient regulatory framework for funds of funds, under the final rule.

ii. Eliminate the Need To Apply for an Exemptive Order

Rule 12d1–4 will permit prospective acquiring funds to acquire the securities of other funds beyond the limits of section 12(d)(1)(A) of the Act and will permit prospective acquired funds to sell their shares to acquiring funds beyond the limits of section 12(d)(1)(B) of the Act without the expense and delay of obtaining an exemptive order, subject to certain conditions. Assuming that the number of exemptive orders granted by the Commission is less than the number of orders that would be granted in the absence of rule 12d1–4, funds that currently rely on section 12d(1)(I) and rule 12d1–2 will only be required to restructure their portfolio if they choose to continue relying on section 12d(1)(I) to avoid compliance with the conditions of rule 12d1–4. See, e.g., Allianz Comment Letter (stating that funds “may be compelled to restructure to avoid the most challenging aspects of the Proposal.”).

We do not quantify these costs because we lack data that would allow us to provide meaningful estimates of the costs and commenters did not provide any relevant data. Some additional difficulties with quantification are: (i) The magnitude of certain costs depends on market conditions and market conditions are unpredictable (e.g., sale of shares at depressed prices); (ii) certain costs are inherent and difficult to quantify because they are not well defined (e.g., disruption in the acquiring funds investment strategy); and (iii) funds have some discretion as to whether and when they will incur the costs associated with the restructuring of their portfolios (i.e., the rule imposes an acquisition test) and so it is difficult to predict the magnitude of the costs associated with restructuring.
would stay the same absent the final rule. We estimate that by removing the need to obtain an exemptive order, the final rule will eliminate annual aggregate administrative costs of approximately $4.2 million relative to the baseline. Any cost savings to prospective acquiring and acquired funds derived from eliminating the need to apply for an exemptive order likely will be more pronounced for smaller funds or smaller fund complexes because (i) the administrative cost of the exemptive order application process likely does not vary with fund size, and thus may constitute a higher percentage of a smaller fund’s assets; and (ii) the same exemptive order can be used by multiple funds within a fund complex, and there may be fewer funds to benefit from an exemptive order within smaller fund complexes.

Rule 12d1–4 also will remove the delay incurred by funds and their sponsors when applying for an exemptive order. As mentioned above, the average time it took a non-ETF (ETF) fund to obtain exemptive relief in 2019 was 127 (378) days. If funds are not required to apply for an exemptive order, prospective acquiring funds will not be required to forgo investments in other funds while awaiting exemptive relief, which ultimately will permit these funds to achieve an efficient allocation of fund assets sooner and will permit these funds to better time their investments in other funds (i.e., potentially purchase shares at more favorable prices). Further, by removing the delay associated with the exemptive order process, prospective acquiring funds will be able to bring new products to the market faster, which will expand investors’ investment opportunities and may therefore foster capital formation. Prospective acquired funds also will benefit because the acquiring funds’ investments in them will increase their assets more quickly, and as a result the acquired funds may achieve economies of scale more quickly, ultimately benefitting the existing and future shareholders of the acquired funds, which may also foster capital formation.

Rule 12d1–4 also will remove the uncertainty associated with the exemptive order process. Uncertainty related to the exemptive order process may negatively affect fund investment decisions, thus potentially suppressing fund investment and growth. Nevertheless, the effects of the final rule on uncertainty likely will be limited by the fact that the terms of exemptive relief for funds of funds have become to a large extent standardized and the approval of applications for exemptive relief has become somewhat routine. Investors may benefit from these direct and indirect cost reductions. For example, fund advisers, sponsors, and other service providers may pass cost savings associated with no longer having to request exemptive relief through to investors by lowering fees and expenses. The degree of potential reduction of fund fees and expenses depends on the level of competition in the fund industry. To the extent that the fund industry is competitive, we believe that fund advisers, sponsors, and other service providers will pass on to investors a higher percentage of cost savings arising from the final rule. Conversely, if the level of competition is low, fund advisers, sponsors, and other service providers will retain a higher percentage of cost savings arising from the final rule rather than passing these cost savings on to investors. Academic literature provides conflicting evidence regarding the level of competition in the fund industry. On one hand, several papers provide some evidence that the U.S. fund industry is competitive and that greater competition in the fund industry is associated with lower fund fees and expenses. The other hand, several papers suggest that price competition is not prevalent in the fund industry. We believe there are two potential explanations as to why prior literature provides conflicting evidence on the level of competition in the fund industry. First, prior literature uses different sample periods, focuses on different market segments, and uses different units of observation (i.e., individual funds versus fund families). Second, it is possible that funds do not compete solely on fees, but instead compete on performance and services.

Further, the cost savings to prospective funds associated with avoiding the exemptive order process under rule 12d1–4 may potentially increase the rate at which new funds of funds become available to investors. The Commission granted 4 non-ETF fund of funds orders and 38 ETF fund of funds orders in 2019. We are unable to estimate the number of new funds of funds that will be created following the adoption of the final rule, but we believe that the number of new funds of funds will be higher than the number of funds of funds that were created as a result of the exemptive orders granted in 2019 because the final rule permits the establishment of funds.

604 In 2019, the Commission granted 4 non-ETF fund of funds orders and 38 ETF fund of funds orders (see supra footnote 578 for the source of the exemptive order data). Hence, the final rule could result in annual aggregate administrative cost savings to funds of funds equal to $4,200,000, i.e., $4,200,000 = (4 non-ETF fund of funds orders + 38 ETF fund of funds orders) × $100,000 administrative cost per exemptive order. The cost savings associated with removing the need to apply for exemptive relief for ETF fund of funds arrangements as discussed here are separate from the cost savings associated with removing the need to apply for exemptive relief for ETFs as discussed in the ETF adopting release. See 2019 ETF Adopting Release, supra footnote 25, at 57207. The direct administrative costs associated with the need to apply for an exemptive order are one-time costs and each exemptive order can be used by multiple funds within the same fund complex.

605 See, e.g., MFDF Comment Letter for a similar argument.

606 See supra footnote 578 for the source of the exemptive order data.
of funds with the cost of the
exemptive order process.

Academic research suggests that investment decisions are sensitive to the number of available investment opportunities. Hence, investor demand for funds may increase as a result of the increased number of funds of funds under the final rule. In particular, investors may increase their investments in funds of funds by either decreasing their investments in other asset classes or increasing their investment rate. More specifically, as an alternative to investing in funds of funds, investors may meet their investment objectives by assembling a portfolio of funds through non-discretionary or discretionary separate accounts with a broker/dealer or investment adviser or by investing directly in funds without the intermediation of broker/dealers or investment advisers. Nevertheless, funds of funds may represent an efficient alternative to such a strategy because fund of funds investors can avoid minimum investment requirements, invest in funds that have been closed to new investors, invest in funds that are restricted to a particular investor type, avoid certain transaction costs, and enjoy lower recordkeeping and monitoring costs relative to investors that directly invest in multiple funds. As a result, the entry of new funds of funds that do not replicate existing investment opportunities may increase investor demand for funds of funds because those funds will provide investors the opportunity to obtain diversified exposure to different asset classes through a single, professionally managed portfolio at a potentially lower cost compared to investing in a portfolio of funds through discretionary or non-discretionary separate accounts.

iii. Assess Compliance With the Final Rule

Existing acquired and acquiring funds relying on exemptive orders on which rule 12d1–4 is based will incur a one-time administrative assessment to determine whether their operations are consistent with rule 12d1–4 by examining differences between the exemptive order conditions they are currently required to meet and the conditions of rule 12d1–4. Further, existing acquiring funds currently relying on section 12(d)(1)(G) and rule 12d1–2 to structure funds of funds will be required to decide whether to continue relying on section 12(d)(1)(G) and amended rule 12d1–1 or instead operate in accordance with rule 12d1–4 and comply with the rule’s conditions. We believe this assessment will result in a one-time cost equal to $3,315 per fund and an aggregate one-time cost of $7.6 million for all affected funds.617

617 We estimate that assessing the requirements of rule 12d1–4 will require 5 hours of a compliance manager ($304 per hour) and 5 hours of a compliance attorney ($359 per hour), resulting in a cost of $3,155 ($5 × $304 + 5 × $359) per fund. The Commission’s estimates of the relevant wage rates in tables below are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association’s Office Salaries in the Securities Industry, 2013. The estimated wage figures are modified by Commission staff to account for an 1,800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, overhead, and adjusted to account for the effects of inflation. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry, 2013 (“SIFMA Report”) for the source of salary data. The total cost for the 1,211 acquiring and 1,069 acquired funds that will be subject to rule 12d1–4 is $7.6 million ($7.6 million = (1,211 acquiring funds + 1,069 acquired funds) × 5.35). Our calculation assumes that the commenter’s estimate of acquiring funds that will be subject to rule 12d1–4 is also applicable to acquired funds.

b. Effects of New and Omitted Conditions

Rule 12d1–4 will include new conditions relative to the conditions in our current exemptive orders and rule 12d1–2, and will alter conditions contained in our exemptive orders that are not necessary in light of the new conditions of rule 12d1–4. The new conditions of rule 12d1–4 are designed to limit the acquiring funds’ undue influence over the acquired funds, limit duplicative fees for acquiring fund investors, limit the creation of complex fund structures, and ultimately encourage effective oversight of fund of funds structures. The rule 12d1–4 conditions augment certain conditions in our exemptive orders, which will likely enhance investor protections. We expect, however, that the implementation and monitoring of these new conditions will impose certain incremental one-time and ongoing costs on funds and their investors.618 We discuss the benefits and costs of each of the new conditions of rule 12d1–4 and the conditions of existing exemptive orders that rule 12d1–4 omits in detail below.619

12(d)(1) × 69% of acquired funds that have investments from other funds in them beyond the 3% limit of section 12(d)(1) and will be subject to rule 12d1–4 as estimated by a commenter (see supra footnote 537 and associated text). Our calculation assumes that the commenter’s estimate of acquiring funds that will be subject to rule 12d1–4 is also applicable to acquired funds.

618 See also Guggenheim Comment Letter (noting that the conditions of rule 12d1–4 will “likely result in significant additional compliance, investment and practical costs and burdens that ultimately may result in increased fund expenses. We note that the proposed regulations may also necessitate meaningful investments in technology, personnel, training and other compliance-related resources to monitor holdings of acquired funds, particularly when such ‘acquisitions’ involve large diversified financial services institutions.”). Some of the costs discussed by the commenter may be no longer relevant given the changes in the rule’s conditions relative to the 2018 FOF Proposing Release.

619 See supra section II.C for discussion of the rule’s conditions. In this section, we compare the conditions of rule 12d1–4 to the conditions of our current exemptive orders. Hence, the discussion in this section describes the effects of rule 12d1–4 on (i) funds that currently rely on our exemptive orders to invest in other funds beyond the limits of section 12(d)(1) but will be subject to rule 12d1–4 following the rescission of our exemptive orders; and (ii) funds that would otherwise choose to rely on our exemptive orders in the future to invest in other funds beyond the limits of section 12(d)(1) but will be subject to rule 12d1–4 following the final rule adoption. Any effects discussed in this section will be more pronounced for funds that currently rely on section 12(d)(1)(G) and rule 12d1–2 to invest in affiliated funds beyond the limits of section 12(d)(1) but will be subject to rule 12d1–4 following the final rule adoption, because those funds would have section 12(d)(1)(G) and rule 12d1–2 costs less costly than the conditions in our current exemptive orders. In particular, in contrast to our exemptive conditions of 12(d)(1) × 69% of acquired funds that have investments from other funds in them beyond the 3% limit of section 12(d)(1) and will be subject to rule 12d1–4 as estimated by a commenter (see supra footnote 537 and associated text). Our calculation assumes that the commenter’s estimate of acquiring funds that will be subject to rule 12d1–4 is also applicable to acquired funds.
i. Undue Influence—Control

Rule 12d1–4 mandates that the acquiring fund and its advisory group will not control (individually or in the aggregate) an acquired fund. Control is presumed if the acquiring fund owns more than 25% of the voting securities of another fund. The control condition does not apply to affiliated fund of funds structures. The control condition of rule 12d1–4 is consistent with the conditions of our current exemptive orders and thus will not have an economic effect relative to the baseline.620

ii. Undue Influence—Voting Conditions

Rule 12d1–4 will require an acquiring fund and its advisory group to vote their shares of an acquired open-end fund or UIT using mirror voting if the acquiring fund and its advisory group (in the aggregate): (i) hold more than 25% of the outstanding voting securities of an acquired open-end fund or UIT due to a decrease in the outstanding securities of the acquired fund; or (ii) hold more than 10% of the outstanding voting securities of an acquired closed-end fund or BDC.621

Acquired open-end funds and UITs. Our current exemptive orders require an acquiring fund and its advisory group to vote their shares of an acquired open-end fund or UIT using mirror voting only if the acquiring fund and its advisory group hold more than 25% of the acquired fund’s outstanding voting securities due to a decrease in the outstanding securities of the acquired fund. Hence, for acquiring funds that hold shares of open-end funds or UITs beyond the section 12(d)(1) limits, the voting condition of rule 12d1–4 is the same as the voting condition in our exemptive orders, and so we expect that this aspect of the rule will not impose additional costs on funds relative to the exemptive orders.

Acquired BDCs and registered closed-end funds. Rule 12d1–4 differs from our current exemptive orders for acquiring funds that invest in acquired registered closed-end funds or BDCs beyond the limits of section 12(d)(1) because (i) it imposes a 10% (instead of 3% in the exemptive orders) voting threshold; and (ii) it only allows mirror voting (instead of either mirror or pass-through voting in the exemptive orders) for all funds within the acquired funds’ advisory group.622 Hence, rule 12d1–4 is less restrictive than our current exemptive orders in terms of the voting threshold but more restrictive than our current exemptive orders in terms of permissible voting methods for acquiring funds that invest in acquired BDCs and registered closed-end funds.

The voting conditions of rule 12d1–4 with respect to acquired BDCs and registered closed-end funds may have the following costs. First, we estimate that all acquiring funds that invest in registered closed-end funds or BDCs in reliance on rule 12d1–4 will incur a one-time cost to update their proxy voting policies to reflect that the fund is potentially subject to the voting provisions of the rule. Our analysis shows that only one of the existing acquiring funds invests in at least one registered closed-end fund beyond the 10% voting threshold.623 Hence, for funds that invest in registered closed-end funds or BDCs in reliance on rule 12d1–4, we expect that the one-time cost to update their proxy voting policies will be immaterial. Nevertheless, we estimate that the one-time cost for acquiring funds that invest in BDCs and registered closed-end funds beyond the 10% voting threshold to update their proxy voting policies will be equal to $1,257 per fund.624

Second, the cost of the more restrictive voting methods (i.e., the rule generally permits only mirror voting) of rule 12d1–4 relative to our current exemptive orders is that the rule may increase economic distortions in the voting process since mirror voting requires the acquiring fund shareholders to vote their shares of open-end funds or UITs in the same proportion as the vote of all other holders of the acquired fund shares.625 The economic effect of any distortions in the voting process is unclear and will depend on: (i) the percentage of acquired fund shares that are held by non-fund shareholders and funds that are not subject to the voting conditions; (ii) the composition of the acquiring fund shareholders (e.g., retail versus institutional investors);626 and (iii) how frequently votes are close and some acquiring fund shareholders may determine the outcome of the vote.

Relatedly, the mirror voting requirement applicable to acquiring fund holdings in excess of 10% of an acquired BDC or registered closed-end fund may require advisers to revise existing proxy voting policies and procedures, including those of other members of the advisory group and their respective clients.627 Additionally, a more restrictive voting method may require an acquiring fund and its advisory group to follow a less flexible proxy voting policy, subject to the other legal requirements that are applicable to an investment adviser’s proxy voting responsibilities.628 However, this effect

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620 Comments agreed with the assertion that the control condition of rule 12d1–4 is consistent with the conditions of the existing orders. See, e.g., ICI Comment Letter. A commenter argued that “many advisers already have systems in place to monitor holdings at the ‘advisory group level,’” which would decrease any potential compliance costs associated with this aspect of the final rule. See Invesco Comment Letter.

621 The voting condition of rule 12d1–4 is not applicable when an acquiring fund is within the same group of investment companies as an acquired fund or the acquiring fund’s investment sub-adviser or any person controlling, controlled by, or under common control with such investment sub-adviser acts as the acquired fund’s investment adviser or depositary. See rule 12d1–4(b)(1)(iii). In circumstances where all holders of the outstanding voting securities of the acquired fund are required by rule 12d1–4 or otherwise under section 12(d)(1) to mirror vote the securities of the acquired fund, the acquiring fund will be in the pass-through condition instead of mirror voting. See rule 12d1–4(b)(1)(ii). Our exemptive orders do not include such a condition. Our analysis shows no existing acquired funds that will be subject to this condition (i.e., acquired funds that are only held by acquiring funds that are subject to the voting conditions of rule 12d1–4). Hence, we expect that the economic effects of this aspect of the rule will be immaterial.

622 Similar to the rule’s voting condition, our current exemptive orders require non-fund entities within the advisory group to use mirror voting. Results are the same when aggregating fund holdings across funds sharing the same adviser or sub-adviser. We lack structured data on BDCs’ outstanding shares and so BDCs are excluded from this analysis. Our data does not allow us to identify whether acquiring funds hold voting or non-voting securities of the acquired funds, which may result in misclassification of holding funds that hold an investment in at least one closed-end fund or BDC beyond the 10% voting threshold. This data limitation applies to all analysis in section V that uses voting share information.

623 See supra footnote 161 and associated text for related discussion.

would be mitigated by the fact that, as discussed below, we believe that the majority of acquiring funds that invest in registered closed-end funds or BDCs beyond the limits of section 12(d)(1) in reliance on our exemptive orders already use mirror voting. Third, the more restrictive voting methods will impose more voting restrictions on acquiring funds, and thus may decrease funds’ incentives to acquire larger blocks of shares (i.e., blocks of shares in excess of the section 12(d)(1) limits but below the 10% threshold of the rule) and thereby potentially support value-increasing actions through their voting.629

The voting conditions of rule 12d1–4 for acquired BDCs and registered closed-end funds may have the following benefits. First, the less restrictive voting threshold of rule 12d1–4 relative to the exemptive orders (i.e., 10% instead of 3%) may decrease economic distortions in the voting process since the voting provision will not apply until an acquiring fund holds a greater percentage of the voting securities of an acquired fund. Second, the less restrictive voting threshold of rule 12d1–4 relative to the exemptive orders will impose fewer voting restrictions on acquiring funds, and thus may increase funds’ incentives to acquire larger blocks of shares and thereby potentially support value-increasing actions through their voting.630

Third, assuming no difference between the permissible voting methods under the rule and the exemptive orders, the voting threshold of the rule may decrease ongoing costs associated with voting because it is less restrictive than the voting threshold in existing exemptive orders (i.e., 10% under the rule versus 3% under the exemptive orders). Similarly, holding the voting threshold constant, the more restrictive voting methods of the rule may decrease ongoing costs for funds associated with voting because pass-through voting is more costly to implement than mirror voting.631 Nevertheless, we expect any such cost decreases to be small because we believe that the majority of acquiring funds that invest in registered closed-end funds or BDCs beyond the limits of section 12(d)(1) in reliance on our exemptive orders already use mirror voting, and we expect those funds to continue using mirror voting following the final rule adoption.632

Fourth, the additional restriction on voting methods (i.e., only allow mirror voting) may enhance the protection of the acquired fund investors from the acquiring funds’ undue influence. Pass-through voting may not provide the same level of protection from acquiring funds’ undue influence as mirror voting because acquiring fund investors may vote in line with the recommendations of the acquiring fund investment adviser and board when the acquiring fund uses pass-through voting.633

631 See Table 5 in infra section VI.B.1. Under pass-through voting, acquiring funds must seek voting instructions from their security holders and vote such proxies in accordance with their instructions. Under mirror voting, acquiring funds must vote the acquired fund shares in the same proportion as the vote of all other holders of the acquired fund.

632 Two commenters noted that mirror voting is generally preferable to pass-through voting, and other commenters noted that the expense and logistical challenges associated with pass-through voting make pass-through voting impractical. See Invesco Comment Letter (noting that mirror voting is “typically preferable to pass-through voting”); SIFMA AMG Comment Letter (noting that “registered funds would likely mirror vote shares held in any [closed-end funds] subject to the voting condition”). See also ICI Comment Letter (noting that “[i]n some situations, the expense and logistical challenges of mirror voting also may be undesirable.”); Voya Comment Letter (noting that “the use of pass-through voting would increase the costs and logistical challenges of proxy solicitations...”); if these acquiring funds determine to implement pass-through voting, the costs of obtaining approvals of shareholder proposals could increase significantly, without corresponding benefit to the acquiring fund’s shareholders.; Charles Schwab Comment Letter (noting that “[g]enerally speaking, the expense and logistical challenges make pass-through voting impractical”)

633 See, e.g., Advent Comment Letter; Comment Letter of Franklin Square Holdings (May 2, 2019) (“Franklin Comment Letter”); Skadden Comment Letter; ABA Comment Letter (arguing that pass-through voting does not provide the same level of protection from undue influence as mirror voting).
following the acquiring fund’s initial investment in the acquired fund.\textsuperscript{635} Hence, rule 12d1–4 will differ from the undue influence conditions in our exemptive orders in the following main ways. First, the undue influence requirement of rule 12d1–4 will only apply to acquired funds, while the policies and procedures requirement in our exemptive orders is applicable to both acquiring and acquired funds.\textsuperscript{636} Second, the undue influence requirement of rule 12d1–4 will apply to both affiliated and unaffiliated funds of funds, while the policies and procedures requirement in our exemptive orders only applies to unaffiliated funds of funds. Third, the undue influence requirement of rule 12d1–4 will only apply prior to the initial acquisition of the acquired fund shares, while the policies and procedures requirement for acquired funds in our exemptive orders applies periodically (i.e., at least annually). Fourth, the undue influence requirement of rule 12d1–4 will apply to funds’ investment advisers, while the policies and procedures requirement in our exemptive orders applies to funds’ boards of directors.

Rule 12d1–4 imposes the undue influence requirement only on acquired funds. The benefit of such an approach is that it will reduce ongoing costs to acquiring funds relative to our exemptive orders because acquiring funds will not be required to adopt policies and procedures to prevent undue influence over the acquired fund. Such an approach, however, may be weaker from an investor protection standpoint to the extent that acquiring funds are no longer required to make findings to prevent undue influence over the acquired fund. We believe that these concerns are mitigated by the rule’s additional conditions related to undue influence, including voting requirements, the fund of funds investment agreement requirement, and the fact that the rule will prohibit an acquiring fund and its advisory group from controlling an acquired fund.

Rule 12d1–4 will impose the undue influence requirement on both affiliated and unaffiliated funds of funds, which may enhance investor protection.\textsuperscript{637} At the same time, by imposing the undue influence requirement to both affiliated and unaffiliated funds of funds, the undue influence requirement of rule 12d1–4 will be more costly to implement than the policies and procedures in our exemptive orders because a larger number of acquired funds (i.e., both affiliated and unaffiliated funds) will be required to incur the costs associated with the undue influence requirement.\textsuperscript{638} In commenting requiring an undue influence finding only at initial acquisition, rule 12d1–4 will reduce costs for acquired funds relative to our exemptive orders because acquired funds will no longer be required to periodically make findings and adopt procedures related to undue influence. While this rule condition does not require periodic evaluation of acquiring funds’ investments in acquired funds, the board may require more frequent subsequent reporting under the fund’s compliance program.

Rule 12d1–4 also allocates the responsibility of making undue influence findings to the acquired fund’s investment adviser, subject to the board’s oversight.\textsuperscript{639} As discussed above, our current exemptive orders require the board to approve certain procedures to prevent overreaching and undue influence by the acquiring fund and its affiliates.\textsuperscript{640} While rule 12d1–4 does not require the adoption of specific procedures, rule 38a–1 requires funds to adopt written compliance policies and procedures reasonably designed to prevent a violation of the federal securities laws by the fund.\textsuperscript{641} Accordingly, we believe that the economic effect of this difference between our exemptive rule and rule 12d1–4 will be limited because funds will be required to maintain similar policies and procedures, and compliance with the exemptive orders is generally facilitated by the fund’s investment adviser at the direction of the board.\textsuperscript{642} We believe investor protection concerns that had been addressed by the conditions in our exemptive orders will be more effectively addressed by the protective conditions of the final rule, such as the requirement that an acquiring fund investment adviser evaluate the complexity of the structure and find that the acquiring fund’s fees and expenses do not duplicate the fees and expenses of the acquired fund and that certain funds enter into a fund of funds investment agreement.\textsuperscript{643}

The undue influence finding requirement of rule 12d1–4 will impose one-time costs on acquired funds to review the rule’s requirement and modify, as necessary, their policies and procedures to comply with the rule, and these costs may be borne by investors in acquired funds.\textsuperscript{644} These estimated costs include the costs of acquiring funds’ investment advisers to review rule 12d1–4 and modify their policies and procedures to comply with the rule, as well as the costs of the acquired fund’s investment adviser to review the rule and modify the acquired fund’s policies and procedures to comply with rule 12d1–4. These estimated costs are subject to other rule conditions, such as the requirement to enter into a fund of funds investment agreement and the evaluation of the complexity of the structure and findings regarding the aggregate fees and expenses associated with the acquiring fund’s investment in the acquired fund.

635 Under our exemptive orders, in cases when the investment adviser to the fund assists the board with the findings and procedures to prevent overreaching and undue influence by the acquiring fund and its affiliates, the investment adviser periodically reports its findings to the fund’s board of directors. Hence, the reporting requirement in rule 12d1–4 will be more burdensome than reporting practices under our exemptive orders.

636 See rule 12d1–4(b)(2)(i)(B). Acquiring funds are nevertheless subject to other rule conditions, such as the requirement to enter into a fund of funds investment agreement and the evaluation of the complexity of the structure and findings regarding the aggregate fees and expenses associated with the acquiring fund’s investment in the acquired fund.

637 Several commentators stated that affiliated funds of funds do not raise the concerns that section 12(d)(1) was enacted to address. See, e.g., PIMCO Comment Letter; Allianz Comment Letter; Thrivent Comment Letter. Academic literature, however, provides results of empirical analysis consistent with the idea that affiliated funds of funds suffer from conflicts of interest. See, e.g., Utpal Bhattacharya, Joon Hoon Lee, & Veronika K. Pool, Conflictting Values in Mutual Fund Families, 68 J. Fin. 173 (2013); Jung Hoon Lee, Information Flows in Mutual Fund Families [Working Paper], available at https://papers.ssrn.com/sol3/papers.cfm?abstract-id=2148075. See also, e.g., Diane Del Guercio, Egegenie Egie, & Hai Tran, Playing Favorites: Conflicts of Interest in Mutual Fund Management, 128 J. Fin. Econ. 535 (2018); Jose-Miguel Gaspar, Massimo Massa, & Pedro Matos, Favoritism in Mutual Fund Families/Evidence on Strategic Cross-Fund Subsidization, 61 J. Fin. 73 (2006); Luis Goncalves-Pinto, Juan Sotes-Paladino, & Jing Xu, The Invisible Hand of Internal Markets in Mutual Fund Families, 89 J. Banking & Fin. 105 (2018). See also CFA Comment Letter for similar arguments. Any evidence consistent with the idea of conflicts of interest in affiliated fund complexes is seen, i.e., not necessarily affiliated funds of funds. See also CFA Comment Letter for similar arguments. Any such conflicts of interest are, at least partially, mitigated by the board’s oversight.

638 See rule 12d1–4(b)(2). For example, our orders require an unaffiliated acquired fund board to adopt procedures reasonably designed to monitor purchases by the unaffiliated acquired fund in an underwriting in which an affiliate of the acquiring fund is the principal underwriter. In addition, the acquiring fund’s board of directors, including a majority of its independent directors, is required by our orders to adopt procedures reasonably designed to assure that the acquiring fund’s investment adviser does not take into account consideration received from an unaffiliated acquired fund (or any of the unaffiliated acquired fund’s affiliates).

639 See supra footnote 59 and associated text.

640 Some commentators argued that allocating more responsibilities to the fund’s investment adviser subject to the board’s oversight will be beneficial to fund investors because this approach is consistent with the board’s current oversight responsibilities. See IDC Comment Letter; Hancock Comment Letter; MFDF Comment Letter; ABA Comment Letter.

641 In addition, the acquired fund’s board and adviser are subject to ongoing fiduciary obligations and the acquired fund’s board must determine an appropriate level of subsequent reporting under the acquired fund’s compliance program.

642 Acquired funds will bear the costs associated with rule 12d1–4 only if they permit acquiring fund investments in excess of the section 12(d)(1) limits
costs are attributable to the following activities: (i) Reviewing the rule’s finding requirement; (ii) developing new (or modifying existing) policies and procedures to align with the finding requirement of rule 12d1–4; (iii) integrating and implementing those policies and procedures into the rest of the funds’ activities; and (iv) preparing new training materials and administering training sessions for staff in affected areas.

The undue influence requirement of rule 12d1–4 also will impose ongoing costs on an acquired fund’s investment adviser each time a new acquiring fund invests in the acquired fund. Our current exemptive orders require fund boards to make certain findings and adopt procedures to prevent overreaching and undue influence by the acquiring fund and its affiliates, and some of those processes and procedures may be similar to the rule’s requirements. Consequently, to the extent that investment advisers can leverage some of the existing board processes and procedures to comply with the rule’s requirements, any ongoing costs will be mitigated. We generally believe that the undue influence finding of rule 12d1–4 is as comprehensive as the policies and procedures in our exemptive orders because both rule 12d1–4 and our exemptive orders allow funds flexibility to determine the undue influence concerns, and to consider factors applicable to those concerns, that may be relevant to each fund of funds structure.645

Our staff estimates that the annual costs necessary to comply with the undue influence finding requirement of rule 12d1–4 for acquired management companies will be equal to $45,193 per acquired management company and will result in an aggregate ongoing burden equal to $131 million for all affected acquired management companies.646

We expect that the costs associated with the finding requirement of rule 12d1–4 will be incurred by the acquired fund’s investment adviser and the acquired fund’s board of directors but, depending on market competition and other factors, may partially or fully be borne by the acquired fund shareholders in the form of higher management fees and/or operating expenses.

iv. Layering of Fees and Expenses

Our current exemptive orders contain a set of conditions designed to prevent duplicative and excessive fees and expenses in fund of funds structures. In particular, for management companies, our exemptive orders: (i) Limit sales charges and service fees charged by the acquiring fund to those set forth in the FINRA’s sales charge rule; (ii) require an acquiring fund’s adviser to waive fees otherwise payable to it by the acquiring fund in an amount at least equal to any compensation received from an acquired fund that is not part of the same group of investment companies by the adviser, or an affiliated person of the adviser, other than advisory fees paid to the adviser or its affiliated person by such an acquired fund, in connection with the investment by the acquiring fund in such acquired fund; and (iii) require the acquiring fund board to find that advisory fees are based on services provided that are in addition to, rather than duplicative of, the services provided by an adviser to an acquired fund. For UITs, our exemptive orders: (i) Limit sales charges and service fees charged by the acquiring fund to those set forth in FINRA’s sales charge rule; and (ii) require UIT depositors to deposit only acquired funds that do not assess a sales load or that waive any sales loads. The conditions in our exemptive orders apply to both investments in affiliated and unaffiliated funds of funds.

Rule 12d1–4 will replace the above-mentioned conditions with the following requirements that will also apply to both affiliated and unaffiliated funds of funds. For management companies, rule 12d1–4 will require the acquiring fund’s adviser to evaluate the complexity of the structure and the aggregate fees and expenses associated with the acquiring fund’s investment in acquired funds and find that the acquiring fund’s fees and expenses do not duplicate the fees and expenses of the acquired fund. As part of this evaluation, the acquiring fund’s adviser should consider, among others, whether such fees incurred by the acquiring fund are based on services that are in addition to, rather than duplicative of, services provided by the acquiring fund’s investment adviser. For UITs, rule 12d1–4 will require the principal underwriter or depositor of a UIT to analyze the complexity of the structure associated with the UIT’s investment in acquired funds, and find that the arrangement does not result in duplicative fees and expenses. For all acquiring funds, similar to the finding requirement related to undue influence,647 rule 12d1–4 will require the evaluation of aggregate fees and expenses prior to the initial acquisition of an acquired fund in excess of the limits in section 12(d)(1).

Management companies. In the case of management companies, rule 12d1–4 will replace the specific conditions in our exemptive orders with a broader requirement that the investment adviser to the acquiring fund consider both the complexity and the aggregate fees and expenses of the fund of funds arrangement. We believe that the omission of the specific conditions in our exemptive orders will not compromise investor protection for the following reasons.

First, the omission of the FINRA sales charge limitation from rule 12d1–4

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645 See supra section V.C.1.b.iii.
646 This estimate is based on the following calculation: $131 million ÷ $45,193 initial and annual internal and external burden per fund × 2,900 acquired management companies that will be subject to rule 12d1–4, $45,193 × $14,994 initial and annual internal burden per fund + $35,220 initial external burden per fund (see Table 7 in infra section VI.B.3.)—equals the upper bound of the costs imposed by the final rule because they capture the total rather than the incremental cost of the rule’s requirements. 2,900 acquired management companies that will be subject to rule 12d1–4 are 4,203 acquired management companies × 69% of acquired management companies that will be subject to rule 12d1–4 as estimated by a commenter (see supra footnote 537 and associated text). Our calculation assumes that the commenter’s estimate of acquiring funds that will be subject to rule 12d1–4 is also applicable to acquired funds. 4,203 acquired management companies = 3,392 acquired registered investment companies (see supra Table 2) ÷ 14,605 registered investment companies (see Table 1 in supra section V.B.1). This estimate assumes that acquired management companies with investments from acquiring funds beyond the limits of section 12(d)(1) will be subject to rule 12d1–4 at the same rate as the acquired management companies with investments from acquiring funds within the limits of section 12(d)(1) following the rule adoption.

647 See supra section V.C.1.b.iii.
likely will not have an economic effect because the FINRA sales charge rule remains applicable to certain funds (i.e., open-end funds and certain closed-end funds) regardless of the rule’s requirements. 

Second, rule 12d1–4 will replace the requirements in our exemptive orders that (i) the acquiring fund’s adviser should waive advisory fees under certain circumstances; and (ii) the acquiring fund’s board should make certain findings regarding advisory fees, with a broader requirement that the investment adviser should consider whether fees and expenses are duplicative. We believe that the fee waiver condition of the existing orders is unnecessary in light of the existing duties and obligations of the fund boards of directors. In addition, the requirement in the exemptive orders that the acquiring fund board find that advisory fees are based on services provided that are in addition to, rather than duplicative of, the services provided by an adviser to an acquired fund is covered by a fund board’s fiduciary duties and statutory obligations.

The benefit of the broader fee and expense conditions of rule 12d1–4 relative to the more specific conditions of the exemptive orders is that the acquiring fund’s investment adviser will be able to tailor the evaluation of the complexity and the findings regarding aggregate fees and expenses of the fund of funds structure to the needs of each structure, including the consideration of any additional factors that may be appropriate under the circumstances. As a result, the fee conditions of rule 12d1–4 may better protect acquiring fund shareholders from duplicative fees than the conditions in the exemptive orders.

At the same time, the broader fee and expense conditions of rule 12d1–4 relative to the exemptive orders may be more costly to implement and monitor relative to the conditions in the exemptive orders. In particular, rule 12d1–4 will impose one-time costs on funds to review the rule’s requirement and modify, as necessary, their policies and procedures to comply with this aspect of rule 12d1–4.

The incremental initial and ongoing costs that management companies will incur whenever they invest for the first time in an acquired fund under rule 12d1–4 include: (i) Advisers’ initial evaluation of the complexity of the structure and analysis supporting the finding regarding aggregate fees and expenses associated with their investments in acquired funds; (ii) advisers’ preparation and reporting of their evaluations, findings, and the basis for their evaluations or findings to the acquiring fund’s board of directors; (iii) board time to review the reports prepared by the investment advisers; and (iv) costs of counsel to the independent directors to review the reports prepared by the investment advisers.

The Commission staff estimates that the one-time and ongoing annual costs necessary to comply with the fee and expense conditions of rule 12d1–4 for acquiring management companies will be equal to $45,193 per acquiring management company and will result in an aggregate ongoing burden equal to $148.1 million for all affected acquiring management companies.

UITs. With respect to acquiring UITs, rule 12d1–4 will replace the specific conditions related to sales charges in the exemptive orders with a broader requirement that on or before the date of initial deposit of portfolio securities, the UIT’s principal underwriter or depositor evaluate the complexity of the structure and find that the UIT’s fees and expenses do not duplicate the fees and expenses of the acquired funds that the UIT holds or will hold at the date of deposit. Similar to the fee and expense conditions of rule 12d1–4 for management companies, the benefit of the broader requirement of rule 12d1–4 for UITs relative to the more specific conditions of the exemptive orders is that the acquiring UIT’s depositor or underwriter will be able to tailor the evaluation of the complexity and finding regarding the aggregate fees and expenses of the fund of funds structure to the needs of each structure and augment, whenever appropriate, the exemptive order conditions with additional appropriate factors. As a result, the UIT fee and expense conditions of rule 12d1–4 may better protect acquiring fund shareholders from duplicative fees than the conditions in the exemptive orders.

At the same time, the broader UIT fee and expense conditions of rule 12d1–4 relative to the exemptive orders may be more costly to implement and monitor relative to the conditions in the exemptive orders. In particular, rule 12d1–4 will impose one-time costs on funds to review the rule’s requirement and modify, as necessary, their policies and procedures to comply with the rule. Our staff estimates that the one-time costs necessary to comply with the finding requirement related to fees and expenses of rule 12d1–4 will be equal to $13.187 per acquiring UIT and will result in an aggregate ongoing burden equal to $2.6 million for all affected acquiring UITs. UITs will not bear any ongoing implementation or monitoring costs because they are only required to evaluate the complexity of the structure and make a finding regarding the aggregate fees and expenses associated with the UIT’s investment in an acquired fund at the time of initial deposit.

To the extent that the fee and expense conditions of rule 12d1–4 will increase operating costs for management

\[651\] This estimate is based on the following calculation: $2.6 million = $13,187 initial internal and external burden per fund × 200 acquiring UITs that will be subject to rule 12d1–4. $13,187 initial internal and external burden per fund = $12,253 initial internal burden per fund + $2,400 initial external burden per fund (see Table 8 in infra section V.B.1) × (1—10% of the total burden that is associated with the recordkeeping requirements of rule 12d1–4) × 2.378 acquiring management companies that will be subject to rule 12d1–4. 2.378 acquiring management companies that will be subject to rule 12d1–4 = 4,750 acquiring management companies (see Table 2 in supra section V.B.1) × 99% of acquiring management companies that will be subject to rule 12d1–4 as estimated by a commenter (see supra footnote 534 and associated text). 40% of funds that are acquiring funds = 4,750 acquiring funds (see Table 2 in supra section V.B.1) × 1,788 funds (see Table 2 in supra section V.B.1). This estimate assumes that acquiring UITs with current investments in other funds beyond the limits of section 12(d)(1) will be subject to rule 12d1–4 at the same rate as the acquiring management companies with current investments in other funds within the limits of section 12(d)(1) following the rule adoption. This estimate also assumes that the percentage of management companies that are acquiring funds is the same as the percentage of UITs that are acquiring funds.
companies and UITs, management companies and UITs could pass through to investors any such cost increases in the form of higher operating expenses.

**Variable Annuity Separate Accounts.** With respect to separate accounts funding variable insurance contracts, the rule’s fees and expenses requirement is the same as the requirement in our current exemptive orders, and thus will not have a significant economic effect. However, to the extent that some insurance companies currently do not provide the same certification to acquiring funds (e.g., because the acquiring funds are able to rely upon section 12(d)(1)(C) and rule 12d1–2 or their orders permit certifications with a different scope), acquiring funds will incur costs to request and insurance companies will incur costs to provide this certification. We lack data that would allow us to estimate how many insurance companies currently do not provide this certification. Relatedly, a commenter stated that its exemptive order requires that the insurance company make a representation to the Commission, rather than the acquiring fund, that the aggregate fees and expenses of the structure are reasonable. We believe that providing a certification to the acquiring fund rather than the Commission will impose minimal additional costs on insurance companies.

**v. Fund of Funds Investment Agreement**

Our current exemptive orders require a participation agreement between unaffiliated acquiring and acquired funds under which the funds agree to fulfill their responsibilities under the exemptive order. Unless the acquiring and acquired funds have the same investment adviser, rule 12d1–4 will require the acquiring and acquired funds to enter into a fund of funds investment agreement before the acquiring fund acquires securities of the acquired fund in excess of the limits of section 12(d)(1). The investment agreement must include: (i) Any material terms necessary for the adviser, underwriter, or depositor to have made the finding regarding the acquiring fund’s investment in the acquired fund; (ii) a termination provision whereby either party can terminate the agreement with advance written notice within a period no longer than 60 days; and (iii) a provision whereby the acquired fund must provide the acquiring fund with fee and expense information to the extent reasonably requested. Hence, the fund of funds investment agreement in rule 12d1–4 is more comprehensive than the participation agreement in our exemptive orders because it (i) applies to both affiliated and unaffiliated fund of funds structures (unless the acquiring and acquired funds share the same primary investment adviser) while the participation agreement in our exemptive orders only applies to unaffiliated funds; and (ii) encompasses a broader set of conditions.

The benefit of a more comprehensive fund of funds investment agreement relative to the participation agreement is that it will enhance investor protection. First, the fund of funds investment agreement will protect investors in both certain affiliated and unaffiliated fund of funds structures from acquiring funds’ undue influence, duplicative fees, and complex fund of funds structures. Second, it will allow acquiring and acquired fund boards to monitor better investment advisers’ conflicts of interest and the findings of the acquiring and acquiring fund investment advisers in the context of the fund of funds arrangement.

The fund of funds investment agreement will provide a mechanism for acquiring and acquired funds to terminate the arrangement if it is no longer in their respective best interest. Finally, the fund of funds investment agreement will require acquired funds to provide fee and expense information to the acquiring fund, which will assist the acquiring fund’s adviser with assessing the impact of fees and expenses associated with an investment in an acquired fund.

By requiring fund of funds investment agreements for both affiliated and unaffiliated funds of funds, rule 12d1–4 will level the playing field for small and large fund complexes relative to the exemptive orders. Funds in smaller complexes are less likely to have sufficient investment opportunities within the fund complex than funds in larger complexes, and thus are more likely to structure unaffiliated funds of funds and bear the costs associated with a participation agreement. Under our current exemptive orders, participation agreements are only required in the case of unaffiliated funds of funds, which may impose a relatively higher burden on funds in smaller complexes. Rule 12d1–4 will require funds to enter into a fund of funds investment agreement both in the case of unaffiliated and affiliated funds of funds (except when the acquiring and acquired funds share the same primary adviser), which will level the playing field for funds that are more likely to structure unaffiliated funds of funds, that is, smaller fund complexes.

The disadvantage of a more comprehensive set of conditions in the fund of funds investment agreements relative to the participation agreements is that fund of funds investment agreements will be more costly to implement and monitor than the participation agreements. In addition, funds of funds will bear incremental ongoing costs to implement the terms of and monitor compliance with the fund of funds investment agreements. Hence, the one-time and ongoing annual costs borne by acquiring and acquired funds as a result of the requirement to enter into fund of funds investment agreements will be $12,142 for each fund that enters into a fund of funds investment agreement and will result in an aggregate burden equal to $112.2 million for all funds that enter into a fund of funds investment agreement.

As noted above, fund of funds investment agreements entered into under the rule will be considered material contracts and thus must be filed as exhibits to each fund’s registration statement. While we believe currently that some funds may similarly file participation agreements that are entered into under our exemptive orders as exhibits, this certainty regarding fund of funds investment agreements could result in increased costs to ensure that they are filed. Several commenters argued that the cost of entering into a participation agreement is small, especially because of the standardization of terms and the broad use of participation agreements in the industry. See, e.g., Fidelity Comment Letter; Hancock Comment Letter. We expect that the costs associated with preparing and monitoring the fund of funds investment agreements may decrease over time as the fund of funds investment agreements become more standardized.

This estimate is based on the following calculation: $112.2 million = ($9,364 internal burden per fund + $2,778 external burden per fund (see infra Table 6 in section VI.B.2)) × 9,240 acquiring-acquired fund pairs that do not share the same investment adviser and will be subject to rule 12d1–4, 9,240 acquiring-acquired fund pairs that do not share the same investment adviser × 69% of acquiring.
The current exemptive orders prohibit an acquired fund from investing in other investment companies beyond the limits in section 12(d)(1), but they do not prohibit an acquiring fund from investing in an acquiring fund beyond the limits in section 12(d)(1). In line with our current exemptive orders, rule 12d1–4 will prohibit an acquired fund from investing beyond the statutory limits in both registered funds and private funds subject to limited exceptions. Nevertheless, the final rule will also expand the complex structures prohibitions included in the exemptive orders in the following ways. First, rule 12d1–4 will prohibit a fund from acquiring in excess of the limits in section 12(d)(1)(G) or rule 12d1–4 will the outstanding voting securities of an acquiring fund.663

Second, the rescission of the current exemptive orders will result in the prohibition of multi-tier structures formed in reliance on section 12(d)(1)(G) or those exemptive orders.664

The additional complex structures prohibitions of the final rule will limit

acquired fund pairs that will be subject to rule 12d1–4 as estimated by a commenter (see supra footnote 334 and associated text). 13,391 acquiring-acquired fund pairs that do not share the same investment adviser = 30,548 acquiring-acquired fund pairs × 44% of the acquiring-acquired fund pairs that do not share the same investment adviser. We use data from Item C.9 of Form N-CEN to identify a fund’s investment adviser. 30,548 acquiring-acquired fund pairs = 24,689 acquiring-acquired fund pairs identified using Form N-PORT data × 145 registered investment companies (see Table 1 in supra section V.B.1) + 83 BDCs (see supra footnotes 558 and 559 and associated text) / [11,786 management companies (see Table 2 in supra section V.B.1) + 83 BDCs (see supra footnotes 558 and 559 and associated text)]. We lack data that would allow us to identify acquiring-acquired fund pairs, for which the acquiring fund is a BDC or a registered investment company that is not a management company. Hence, we assume that acquiring BDCs and acquiring registered investment companies that are not management companies invest in the same number of unique acquired funds as the management companies. Our estimate also assumes that acquiring-acquired fund pairs that are structured beyond the limits of section 12(d)(1) will be subject to rule 12d1–4 at the same rate as acquiring-acquired fund pairs that are structured within the limits of section 12(d)(1) following the rule adoption. Our estimate is likely an upper bound of the cost associated with fund of funds investment agreements because funds of funds that currently have participation agreements in place will only be required to enter into a fund of funds investment agreement if the acquiring fund purchases additional shares of the acquired fund in reliance on the rule.

As discussed above, an acquiring fund relying on section 12(d)(1)(G) currently can invest in an acquired fund that invests in another fund beyond the limits of section 12(d)(1) in reliance on an exemptive order.

The creation of multi-tier structures that historically were associated with investor confusion and duplicative and excessive fees before the enactment of section 12(d)(1).665 Hence, the complex structures conditions of the final rule will enhance investor protection. At the same time, the final rule will impose costs on funds that may be required to reallocate their portfolio to ensure compliance with the rule. In particular, multi-tier structures that have been formed in reliance on exemptive orders or a combination of exemptive orders and section 12(d)(1)(G) will need to be restructured to the extent that the acquiring fund chooses to invest additional amounts in the existing acquired funds in reliance on this rule. In particular, the top-tier acquiring funds will be required to reallocate their investments to funds that do not invest in underlying funds beyond the 10% limit of rule 12d1–4. Alternatively, the top-tier acquiring funds can invest in the same acquired funds, but those acquired funds will incur costs to reduce their investments in other funds to comply with the limits of rule 12d1–4. Our analysis shows 23 multi-tier structures that are at least three tiers and one multi-tier structure that is four-tiers, for which there is at least one acquiring fund in each level that invests beyond the limits of section 12(d)(1) in at least one acquired fund.666 For those 23 top-tier acquiring funds, 3.56% of their assets are invested in the second-tier acquired funds that invest in a third-tier acquired fund, and 2.93% of their assets are invested in the third-tier acquired funds, on average. Our analysis, however, should be interpreted with caution because our data does not allow us to distinguish how many of these 23 multi-tier structures are consistent with the exceptions to the complex structures prohibitions of rule 12d1–4.

Section VLC.1.a above provides a detailed discussion of the costs associated with portfolio reallocations. Any costs that funds will incur to restructure their investments will be moderated by the fact that funds will have a period to bring their operations into compliance with the final rule.667 In addition, funds that will operate in accordance with rule 12d1–4 to create fund of funds structures will need to implement policies and procedures to monitor their investments in other funds beyond the limits of section 12(d)(1) to ensure compliance with the complex structures conditions of rule 12d1–4.

Finally, as discussed in detail in Section V.C.1.i above, the restrictions on multi-tier structures will affect both current and prospective funds by restricting their investment flexibility, thus reducing investment options available to fund investors.

vi. Complex Structures

Our exemptive orders generally require the unaffiliated acquiring and acquired funds to maintain (i) records of the exemptive order; (ii) records of the participation agreement; and (iii) a list of the names of each fund of funds affiliate and underwriting affiliate. Further, our exemptive orders require the unaffiliated acquired funds to maintain a written copy of the policies and procedures (and any modifications to such policies and procedures) that the acquired funds put in place to monitor any purchases of securities from the acquiring fund or its affiliates. The recordkeeping requirements in our exemptive orders are for a period of not less than six years, and the records must be maintained in an easily accessible place in the first two years.

Rule 12d1–4 will require both affiliated and unaffiliated acquiring and acquired funds to maintain (i) a copy of each fund of funds investment agreement; (ii) for management companies and UITs, a written record of the acquiring and acquired funds’ evaluations and findings, and the basis for such evaluations and findings; and (iii) for separate accounts funding variable insurance contracts, the certification provided by the insurance company. Rule 12d1–4 will require 5 years of recordkeeping and, similar to the orders, it will require records to be maintained in an easily accessible place in the first two years.

The recordkeeping requirements of rule 12d1–4 are more extensive than the recordkeeping requirements in our

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663 See rule 12d1–4(b)(3)(ii).
664 As discussed above, an acquiring fund relying on section 12(d)(1)(G) currently can invest in an acquired fund that invests in another fund beyond the limits of section 12(d)(1) in reliance on an exemptive order.
665 As discussed above in section I.C.3.h, multi-tier structures may be difficult for investors to understand even with comprehensive disclosures. Accordingly, the rule includes a general prohibition on three-tier structures, subject to enumerated exceptions and the 10% bucket for acquired fund investments in other investment companies. See rule 12d1–4(b)(3).
666 See supra footnote 551 and associated text.
667 See supra section III.
exemptive orders because (i) they apply to both affiliated and unaffiliated funds of funds while the recordkeeping requirements in our exemptive orders only apply to unaffiliated funds of funds; and (ii) they apply to both acquiring and acquired funds while only certain of the recordkeeping requirements in our exemptive orders apply to both acquiring and acquired funds. At the same time, the recordkeeping requirements of rule 12d1–4 have a shorter duration than the recordkeeping requirements of our exemptive orders (i.e., five years under the rule instead of six years under the orders). Further, the undue influence findings of rule 12d1–4 are only required prior to the initial acquisition of the acquired fund shares while the determinations in our exemptive orders apply periodically (i.e., at least annually). Consequently, the associated recordkeeping of rule 12d1–4 will be less burdensome than the associated recordkeeping in our exemptive orders. The benefit of any more extensive recordkeeping requirements is that they will allow for Commission examinations of investment advisers’ investing decisions, which may ultimately benefit fund investors. The disadvantage of any more extensive recordkeeping requirements of rule 12d1–4 relative to our exemptive orders is that it will impose higher costs on funds and their investors. We estimate that each acquiring and acquired management company will bear annual recordkeeping costs equal to $5,021, each acquiring UIT will bear annual recordkeeping costs equal to $1,465, each separate account will bear annual recordkeeping costs equal to $65, and each fund that enters into a fund of funds investment agreement will bear annual recordkeeping costs equal to $954, which will result in aggregate ongoing annual recordkeeping costs equal to $40.1 million.669

2. Effects on Efficiency, Competition, and Capital Formation

i. Efficiency

Efficiency of current and prospective acquiring funds’ asset allocation. The final rule will have opposing effects on the efficiency of current and prospective acquiring funds’ asset allocation. More specifically, the final rule may promote the efficiency of funds’ asset allocation for the following reasons. First, the final rule will eliminate the need for funds to apply for an exemptive order to structure certain funds of funds. By eliminating the need for funds of funds to apply for an exemptive order, the final rule will reduce certain frictions in funds’ asset allocation that are caused by the expense and delays associated with the exemptive order process, and thus may promote the efficient allocation of funds’ assets.670

Second, rule 12d1–4 may increase the efficiency of certain funds’ asset allocation. This is because rule 12d1–4 may increase funds’ investment flexibility by expanding the scope of permissible acquiring and acquired funds relative to the current exemptive orders and broadening some of the exemptions to the complex structures prohibitions relative to the current exemptive orders and staff no-action letters, and thus may make it easier for funds to create an investment portfolio that better meets their investors’ risk-return preferences. Third, the final rule will create a more consistent and efficient regulatory framework for funds of funds than the existing regulatory framework for the following reasons. First, rule 12d1–4 provides the same investment flexibility to all registered funds and BDCs. Second, under the existing regulatory framework, substantially similar funds of funds are subject to different conditions. For example, an acquiring fund currently can rely on section 12(d)(1)(G) and rule 12d1–2 to invest in an acquired fund within the same group of investment companies or, alternatively, can rely on relief provided by the Commission to achieve the same investment objectives. The final rule will eliminate the existing overlapping and potentially inconsistent conditions for funds of funds and harmonize conditions across different fund arrangements.673 This may remove obstacles to funds’ investments and operations to the extent that regulatory consistency and efficiency decreases compliance and operating costs. By reducing compliance and operating costs, the final rule will further reduce frictions in asset allocation and may

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668 The recordkeeping requirements in our exemptive orders related to purchases in affiliated undertakings only apply to acquired funds.

669 This estimate is based on the following calculation: $40.1 million = $14.6 million recordkeeping cost associated with the undeclared influence finding of rule 12d1–4 for acquiring management companies + $16.5 million recordkeeping cost associated with the fee and expense finding of rule 12d1–4 for acquiring management companies + $0.01 million recordkeeping cost associated with the fee and expense finding of rule 12d1–4 for acquiring management companies + $16.5 million calculation: $40.1 million = $14.6 million

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670 See supra section V.B.2.a for discussion of costs associated with the exemptive order process.

671 Second, rule 12d1–4 may increase the efficiency of certain funds’ asset allocation. This is because rule 12d1–4 may increase funds’ investment flexibility by expanding the scope of permissible acquiring and acquired funds relative to the current exemptive orders and broadening some of the exemptions to the complex structures prohibitions relative to the current exemptive orders and staff no-action letters, and thus may make it easier for funds to create an investment portfolio that better meets their investors’ risk-return preferences.

672 First, rule 12d1–4 provides the same investment flexibility to all registered funds and BDCs.

673 In particular, affiliated funds of funds currently can be structured either under section 12(d)(1)(G) and rule 12d1–2 or under exemptive orders, and each alternative subject affiliated funds of funds to different conditions. In addition, funds that are structured under different exemptive orders may be subject to somewhat different conditions. Finally, unlike rule 12d1–4, exemptive orders provide relief from section 12(d)(1) to a subset of registered investment companies and BDCs, and thus provide different levels of flexibility depending on the fund type.
promote the efficient allocation of funds’ assets.

At the same time, the final rule may decrease the efficiency of certain funds’ asset allocation by prohibiting certain existing funds of funds and requiring the restructuring of additional investments in other funds to ensure compliance with the rule. The new prohibition on certain fund structures may leave certain funds less able to diversify their investment portfolio or efficiently determine the funds in which they invest or their allocation of assets.

In addition, the new conditions of rule 12d1–4, and the rule’s omission of certain conditions contained in our exemptive orders, will also affect the cost of operations of funds of funds. Nevertheless, the net effect of the new and omitted conditions on the funds’ cost of operations is unclear because we are unable to quantify the effect of many of these conditions. To the extent that the net effect of the new and omitted conditions will be to increase the cost of operations for funds of funds, those conditions may ultimately reduce the efficient allocation of acquiring fund assets.

Efficiency of the asset allocation of current and prospective acquiring fund investors. The final rule may promote the efficiency of investors’ asset allocation. First, rule 12d1–4 will reduce the cost of setting up a fund of funds by eliminating the need to apply for an exemptive order. To the extent that the fund industry is competitive, fund advisers/sponsors might pass through to investors the cost savings associated with eliminating the need to apply for an exemptive order, which might result in lower fees and expenses for acquiring fund investors. Lower fees and expenses, in turn, might result in improved efficiency of investors’ asset allocation because investors can achieve the same investment objectives at a potentially lower cost. Similarly, the final rule will create a more consistent and more efficient regulatory framework. Fund advisers/sponsors might also pass through to investors any cost savings associated with a more consistent and efficient regulatory framework, which might result in lower fees and expenses, and more efficient allocation of acquiring fund investors’ assets.

Second, rule 12d1–4 may increase funds’ investment flexibility by expanding the scope of permissible acquiring and acquired funds relative to the current exemptive orders and broadening some of the exemptions to the complex structures prohibitions relative to the current exemptive orders and staff no-action letters. The rule will therefore increase the diversity of available funds of funds and may promote the efficient allocation of acquiring fund investors’ assets because investors will be better able to achieve their investment objectives. Third, having one uniform rule that applies to registered investment companies and BDCs may improve acquiring fund investors’ ability to efficiently allocate their assets because it will be easier for these investors to understand fund of funds operations and it will simplify across-fund comparisons of various fund characteristics (e.g., liquidity) because investors will no longer be required to adjust for differences in regulatory requirements across funds when making cross-fund comparisons for investment decision-making purposes.

On the other hand, there are ways in which the final rule might reduce the efficiency of investors’ asset allocation. In particular, the final rule may increase the costs of operations for acquiring and acquired funds because the cost of implementation and monitoring of the rule’s conditions may be higher than the cost of implementation and monitoring of the conditions in our current exemptive orders. To the extent that any increased costs are passed through to investors, the fees and expenses for acquiring and acquired fund investors may increase. Higher fees and expenses, in turn, might negatively affect the efficiency of investors’ asset allocation. In addition, rule 12d1–4 might decrease the diversity of funds of funds’ investment strategies because it might reduce acquiring funds’ investment flexibility by decreasing their ability to create certain multi-tier structures. A decrease in the diversity of available funds of funds may reduce the efficient allocation of investors’ assets because investors may be less able to achieve their investment objectives.

Efficiency of prices of acquired funds and their underlying assets. The final rule may have opposing effects on the efficiency of prices of acquired funds and their underlying assets. In particular, the final rule may have a positive impact on the efficiency of the prices of acquired funds and their underlying assets. More specifically, rule 12d1–4 may (i) increase the diversity of certain funds of funds by expanding the scope of permissible acquiring and acquired funds; (ii) increase the number of available funds of funds by eliminating the need to apply for an exemptive order and by creating a more consistent and more efficient regulatory framework; and (iii) enhance investor protection against acquiring funds’ undue influence, duplicative fees, and complex structures. The potential increase in the diversity and number of funds of funds and the enhancement of investor protection may increase the attractiveness of funds of funds, and thus might increase investors’ demand for funds of funds. The increased investor demand for funds of funds may increase investment rates, increase investments in acquiring funds, and thus increase investments in the acquired funds and the acquired funds’ underlying assets (i.e., stocks, bonds, etc.). An increased investment in the acquired funds and the acquired funds’ underlying assets may increase trading interest for those assets. Higher trading interest might lead to higher liquidity, lower trading costs, improved information production, and thus more efficient prices for those assets.

In addition, the final rule may increase the price efficiency of listed acquired funds (i.e., ETFs, ETMFs, listed closed-end funds, and listed BDCs) because investors may increase their investments in those funds through investments in funds of funds rather than investing directly in those funds. Consequently, the funds’ investor base may shift from individual investors to acquiring funds. A shift of certain funds’ investor base to more financially sophisticated investors may in turn result in more efficient prices for listed acquired funds.
sophisticated investors may improve price efficiency through both aggressive and passive trading.682 For example, financially sophisticated investors may tend more frequently to trade based on information obtained through their research and analysis (i.e., aggressive trading). To the extent they perceive a potentially profitable trading opportunity, they must execute their trades while the security remains potentially mispriced before their information gets impounded into prices. Hence, financially sophisticated investors that trade on information may tend to place aggressive orders that move prices closer to fundamentals. Financially sophisticated investors may also improve price efficiency by providing liquidity to uninformed traders (i.e., passive trading). More specifically, to the extent financially sophisticated investors may be able to distinguish between informed and uninformed investors, financially sophisticated investors may be more willing to provide liquidity to uninformed investors, and thus improve price efficiency by enhancing market liquidity.

On the other hand, any potential increase in acquiring and acquired funds’ cost of operations as a result of the more comprehensive conditions of rule 12d1–4 relative to the conditions in the exemptive orders and rule 12d1–2, and any potential decrease in available fund of funds structures due to additional prohibitions on multi-tier structures, will have the opposite effect on the efficiency of prices of acquired funds and their underlying assets.

ii. Competition

Certain aspects of the final rule may have opposing effects on fund competition. On one hand, the final rule might promote competition in the fund industry for the following reasons. First, to the extent that rule 12d1–4 increases acquiring funds’ investment flexibility, the final rule might promote competition in the fund industry because it will increase the diversity of available funds of funds.683 Second, the final rule will level the playing field for funds by expanding the scope of permissible acquiring and acquired funds, mandating the same conditions for similar funds of funds, and imposing more similar conditions on affiliated and unaffiliated fund of funds structures.684 A more level playing field might increase competition in the fund industry because it will allow various funds to operate under similar regulatory restrictions and thus funds will bear similar costs associated with regulatory restrictions. To the extent that regulatory inefficiencies and inconsistencies might hamper funds’ investment and growth, an increase in regulatory consistency and efficiency might result in the creation of more funds of funds, which might increase competition in the fund industry. Fourth, rule 12d1–4 will remove the need to apply for an exemptive order and thus will decrease the cost of setting up a fund of funds. To the extent that a decrease in the cost of setting up a fund of funds may lower the barriers to entry for new funds of funds, it thus might increase competition in the fund industry.685

At the same time, to the extent that the final rule will decrease certain funds’ investment flexibility or increase the cost of operations for certain funds that will operate in accordance with rule 12d1–4, it might reduce competition among funds of funds because it will decrease the diversity of available funds of funds.

iii. Capital Formation

The impact of the final rule on capital formation is unclear. On one hand, the final rule might have a positive effect on capital formation if it causes investors to commit more of their financial resources to investments in securities in aggregate. Specifically, the potential increase in fund investment flexibility, the potential leveling of the playing field as a result of the final rule, the increase in regulatory consistency and efficiency, and the potential decrease in the operating costs of prospective funds of funds as a result of removing the need to apply for an exemptive order may increase the number and diversity of funds of funds. An increase in the number and diversity of funds of funds may attract additional investment in funds of funds, and ultimately increase demand for the funds of funds’ underlying securities. Investor demand for funds of funds also may increase as a result of the new conditions of rule 12d1–4, which will enhance investor protection. As a result of the increased demand for the firms’ equity and debt securities, companies might be able to issue new debt and equity at higher prices, and therefore decrease the cost of capital of firms, thus facilitating capital formation.686

On the other hand, to the extent that single-tier funds and funds of funds are purely substitute investments, an increase in investors’ demand for funds of funds may decrease the demand for single-tier fund structures, leaving aggregate demand for the underlying securities unchanged. Consequently, under this scenario, there will be no change in the amount of money that flows to issuers and there will be no impact on capital formation as a result of the final rule. In addition, a potential increase in the operating costs of acquiring and acquired funds as a result of the rule’s conditions may reduce capital formation to the extent that there is a decrease in the amount of money available to be employed in value-generating activities. At the same time, the potential decrease in fund investment flexibility and the potential increase in the funds’ cost of operations as a result of the final rule may have the opposite effect on capital formation. In particular, the potential decrease in fund investment flexibility and the potential increase in the funds’ cost of operations may decrease the number and diversity of funds of funds. A decrease in the number and diversity of funds of funds may discourage investments in funds of

682 Funds can choose to compete through prices or through product differentiation. See, e.g., Avner Shaked & John Sutton, Relaxing Price Competition Through Product Differentiation, 49 Rev. Econ. Stud. 3 (1982).
683 See, e.g., Morningstar Comment Letter. As discussed in supra section I, the combination of statutory exemptions, Commission rules, and the exemptive orders has created a regime where substantially similar funds of funds are subject to different conditions. The final rule will level the playing field for funds because it will create a regime where similar funds of funds are subject to the same conditions. At the same time, any effects of leveling the playing field will be limited by the fact that different funds face different levels of restrictions on their investments that are unrelated to rule 12d1–4 (see, e.g., supra footnote 39 for restrictions on BDC investments).
684 Any potential effect of the rule on competition may be muted to the extent that existing funds of funds may incur costs to comply with the rule conditions (e.g., costs associated with portfolio restructuring).
685 Academic literature provides evidence consistent with the idea that higher demand for a firm’s securities could lead to lower cost of capital. See, e.g., Douglas W. Diamond & Robert E. Verrecchia, Disclosure, Liquidity, and the Cost of Capital, 46 J. Fin. 1325 (1991).
funds, and ultimately decrease demand for the funds of funds’ underlying securities. As a result of the decreased demand for the firms’ equity and debt securities, companies may be forced to issue new debt and equity at lower prices, and therefore increase the cost of capital of firms, thus impeding capital formation.

Nevertheless, we do not expect that the final rule will have significant effects on investors’ investment rates.

D. Reasonable Alternatives

1. Retain Existing Exemptive Relief

As discussed in section III above, we are rescinding, as proposed, the exemptive relief permitting fund of funds arrangements that fall within the scope of rule 12d1–4. Alternatively, we could allow existing funds of funds to choose whether to operate indefinitely under the existing exemptive relief or rule 12d1–4, and require only new funds of funds to comply with rule 12d1–4. The benefit of such an alternative would be that existing funds of funds would not incur the one-time switching costs from the exemptive order conditions to the conditions of rule 12d1–4 and will not incur costs associated with reduced investment flexibility as a result of the complex structure conditions of the rule relative to the exemptive orders, which could ultimately benefit those funds’ investors. At the same time, however, this alternative would subject existing funds of funds and new funds of funds to different sets of conditions. For example, existing funds of funds would be exempt from the rule’s new requirements relating to fund of funds investment agreements, findings, and multi-tier structures. Consequently, unlike the rule, this alternative would establish a less uniform regulatory framework governing fund of funds arrangements and would not include the benefit of enhanced investor protection that is afforded by the rule’s conditions.

2. Retain Rule 12d1–2

We considered not rescinding rule 12d1–2 but instead allowing funds to operate under either rule 12d1–4 or section 12(d)(1)(G) and rule 12d1–2. The advantage of such an approach would be that funds that choose to operate in accordance with section 12(d)(1)(G) and rule 12d1–2 will not be required to modify their operations to comply with the conditions of rule 12d1–4 and incur the associated costs or potentially restructure their investments to comply with the amended regulatory framework. The main disadvantages of such an alternative would be that (i) various funds would not operate under a consistent and efficient regulatory framework because similar funds of funds would operate under different conditions; and (ii) investors in affiliated funds of funds would not enjoy the enhanced investor protection afforded by the conditions of rule 12d1–4.

3. Allow Private and Unregistered Investment Companies To Rely on Rule 12d1–4

As discussed above, rule 12d1–4 will permit certain registered investment companies and BDCs to invest in certain registered investment companies and BDCs beyond the scope of section 12(d)(1). Alternatively, we could expand the scope of rule 12d1–4 to allow private funds and unregistered investment companies to rely on the rule as acquiring funds. Expanding rule 12d1–4 in this manner would (i) increase investment flexibility for private and unregistered acquiring funds and their investors; (ii) level the playing field across registered and private and unregistered acquiring funds because they would enjoy the same investment flexibility and be subject to the same conditions; and (iii) benefit acquired registered investment companies and BDCs by increasing private and unregistered funds’ investments in them, thus enhancing their liquidity and increasing their scale, which would result in efficiency gains for those acquired funds.

Nevertheless, we continue to believe that there are risks associated with

Many commenters opposed the rescission of rule 12d1–2. See, e.g., Allianz Comment Letter; Invesco Comment Letter; Thrivent Comment Letter; PIMCO Comment Letter; Fidelity Rutland Comment Letter; Schwab Comment Letter; NYC Bar Comment Letter; PGIM Comment Letter; BlackRock Comment Letter; ABA Comment Letter; SIFMA AMG Comment Letter; Capital Group Comment Letter. See supra section II.D.1 for detailed discussion of arguments raised by commenters. Some of the commenter concerns may have been addressed given that the rule will not include a redemption limit and the rules will permit acquired funds to invest up to 10% of their assets in other funds.

Supporting this alternative.

See supra footnote 53.

4. Codify Current Conditions in Existing Exemptive Orders

As discussed above, rule 12d1–4 will not include certain conditions contained in current exemptive orders that we believe are not necessary to prevent the abuses that led Congress to enact section 12(d)(1). Second, private funds and unregistered investment companies are not subject to the governance and compliance requirements under the Investment Company Act, which are designed to protect investors and reduce conflicts of interest that are inherent in a fund structure and are integral to the oversight and monitoring provisions of rule 12d1–4 for registered funds. Third, unregistered foreign funds’ investments in U.S. registered funds have raised concerns of abuse and undue influence in the past, which gave rise to Congress’s amendments to section 12(d)(1) in 1970. Finally, as commenters noted, the Commission does not have experience with this type of fund of funds arrangement because it has not yet extended exemptive relief allowing such funds to acquire other investment companies in excess of the section 12(d)(1) limits. Without that experience, the Commission is not able to determine at this time that the rule’s conditions and protections would apply as appropriately to private funds and unregistered investment companies or be properly tailored to prevent the abuses that led Congress to enact section 12(d)(1).

4. Codify Current Conditions in Existing Exemptive Orders

As discussed above, rule 12d1–4 will not include certain conditions contained in current exemptive orders that we believe are not necessary to prevent the abuses that led Congress to enact section 12(d)(1) seeks to curtail in light of the new conditions being adopted. Rule 12d1–4 also will include new conditions to address the potential for undue influence, complex structures, or duplicative fees. Alternatively, we could
codify the conditions contained in existing exemptive orders rather than replacing certain conditions with alternative conditions as contained in rule 12d1–4.695

This alternative approach would not impose the costs associated with the new conditions in rule 12d1–4, but it might impose costs to the extent that the conditions in the orders on which some funds of funds rely might not be identical to the conditions in this alternative rule because of cross-sectional variation in the conditions of the exemptive orders. We also believe that this alternative approach would not be as effective at preventing the abuses that section 12(d)(1) seeks to curtail while eliminating conditions that are not necessary in light of the new conditions of rule 12d1–4. In particular, we believe that the conditions in rule 12d1–4 may enhance investor protection relative to the exemptive orders by imposing certain requirements (i.e., findings and fund of funds investment agreement) on both affiliated and unaffiliated funds of funds and by prohibiting certain multi-tier structures.

5. Restrict the Ability of an Acquiring Fund and Its Advisory Group To Invest in an Acquired Fund Above a Lower or Higher Limit Than the Adopted Control Limit

As discussed in section II.C.1.a above, to address concerns about one fund exerting undue influence over another fund, rule 12d1–4 is not available when an acquiring fund together with its advisory group controls the acquired fund. Rule 12d1–4 relies on the definition of “control” in the Act, including the rebuttable presumption that any person who directly or indirectly beneficially owns more than 25% of the voting securities of a company controls that company. Rule 12d1–4 includes an exception for funds that are in the same group of investment companies. Rule 12d1–4 also includes an exception when the acquiring fund’s investment sub-adviser or any person controlling, controlled by, or under common control with such investment sub-adviser acts as the acquired fund’s investment adviser or depositor. As an alternative means of preventing undue influence, we could instead restrict the ability of an acquiring fund and its advisory group to invest in an acquired fund above a lower limit than the 25% limit used to define “control” in the Act.696 A lower limit could provide additional assurance that rule 12d1–4 would protect investors from the abusive practices that section 12(d)(1) was designed to prevent because a lower percentage of ownership would reduce the risk that the acquiring fund could exercise undue influence over the acquired fund’s strategy, management, or governance.697 However, a lower limit could hamper the acquiring fund’s ability to achieve its investment strategy in an efficient and cost effective manner.698

We also could impose a lower limit while narrowing the scope of entities that would be assessed for the purposes of the ownership threshold.699 In particular, the ownership limit could apply only to the acquiring fund and other funds advised by the same adviser or by the adviser’s control affiliates. As a result, acquiring funds would not be required to consider their non-fund affiliates’ holdings when assessing whether they control an acquired fund, which would lessen compliance burdens for the acquiring funds. Nevertheless, our exemptive orders define control in terms of a fund and its advisory group. Consequently, funds likely already have established policies and procedures to monitor compliance with the aggregation requirement embedded in the rule’s definition of an acquiring fund’s “advisory group.” In addition, other provisions of the Act and our rules also extend to affiliated persons of an investment adviser, and so frequently subject to investor activism. See, e.g., Gabelli Comment Letter; Comment Letter of John Birch (April 22, 2019); Comment Letter of Kuni Nakamura (April 25, 2020); Advent Comment Letter. See also footnotes 121 and 122. Other commenters, however, argued that the 25% threshold is appropriate because investor activism can be beneficial to fund investors. See, e.g., Saba Comment Letter. As a response to commenters that argued that investor activism for closed-end funds is harmful, we note that academic literature provides evidence consistent with the idea that investor activism can be beneficial for closed-end fund investors because it has the potential to increase the market value of closed-end funds and mitigate managerial entrenchment. See, e.g., Matthew E. Souther, The Effects of Takeover Defenses: Evidence from Closed-End Funds, 119 J. Fin. Econ. 420 (2016); Michael Bradley et al., Activist Arbitrage: A Study of Open-Ended Attempts of Closed-End Funds, 95 J. Fin. Econ. 1 (2010).

As discussed in section II.B above, section 17 of the Act generally restricts a fund’s ability to enter into transactions with affiliated persons and thus provides some protection to acquired funds from acquiring funds’ undue influence. Rule 12d1–4 also contains a number of conditions aimed at protecting acquired funds from acquiring funds’ undue influence.

The control condition could, for example, limit an acquiring fund from obtaining the optimal level of risk exposure to another fund. Acquiring funds potentially could obtain similar levels of risk exposure at a higher cost by investing in multiple funds.698

For example, a family of target date funds tends to invest in different proportional allotments of the same underlying funds.

Alternatively, concerns of investor confusion could be addressed by increasing disclosure requirements regarding multi-tier structures. However, we believe that enhanced disclosure requirements may not be sufficient to mitigate concerns of investor confusion.
redeeming, submitting for redemption, or tendering for repurchase more than 3% of an acquired fund’s total outstanding shares in any 30-day period. The purpose of this prohibition was to address concerns that an acquiring fund could threaten large-scale redemptions to unduly influence an acquired fund. Using data from Form N-PORT filings that were filed with the Commission between May 2019 and July 2020, we find that 1,304 funds out of a total of 3,654 held more than 3% of any acquired fund’s shares at the end of a reporting period, and thus could have been affected by the proposed redemption limit. Our analysis also shows that the average (median) 30-day redemption was 0.32% (0.011%); The average (median) 30-day redemption for listed acquired funds was 0.13% (0.003%) and for unlisted acquired funds was 0.45% (0.027%). Finally, there were 1,961 instances in which an acquiring fund redeemed more than 3% of an acquired fund’s shares in any 30-day period, representing 578 unique funds. When looking at fund redemptions in March 2020, a presumed period of market stress, the average (median) 30-day redemption was 0.69% (0.033%). An acquiring fund that holds 25% of the outstanding shares of an acquired fund (i.e., up to the control limit) and can only redeem 3% of the acquired fund shares in every 30-day period (i.e., up to the redemption limit) would take 10 months to fully unwind its investment in the acquired fund, assuming no other concurrent changes in the number of acquired fund shares outstanding that are unrelated to the acquiring fund’s redemptions. It would take longer than 10 months for an acquiring fund to redeem the acquired fund shares if other investors were concurrently redeeming the shares of the acquired fund due to, for example, changes in market conditions or if the acquiring fund held more than 25% of the shares of an affiliated acquired fund.

Various commenters provided statistics showing that the redemption limit would be frequently binding. We summarize those statistics in the table below.

<table>
<thead>
<tr>
<th>Commenter</th>
<th>Sample period for number of funds or instances exceeding redemption limit</th>
<th>Number of acquiring funds holding &gt; 3% of at least one acquired fund’s outstanding shares</th>
<th>Number of acquiring funds or instances of redemptions &gt; 3% limit within a 30-day period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nationwide</td>
<td>January 1, 2016–December 31, 2018</td>
<td>32 acquiring funds</td>
<td>all 32 acquiring funds in at least one instance and some on as many as four separate instances.</td>
</tr>
<tr>
<td>ICI</td>
<td>2016–2018</td>
<td>516 acquiring funds with $1.8 trillion in assets under management.</td>
<td>228 acquiring funds in 1,399 instances.</td>
</tr>
<tr>
<td>John Hancock</td>
<td>January 1, 2016–December 31, 2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>JP Morgan</td>
<td>past 3 years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TRP</td>
<td>2016–2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFS</td>
<td>January 1, 2016–March 31, 2019</td>
<td>223 out of 655 surveyed acquiring funds</td>
<td>at least 7 out of the 13 acquiring funds in the commenter’s fund complex at least once, and most on a number of occasions.</td>
</tr>
<tr>
<td>Voya</td>
<td>2016–2018</td>
<td>1,591 acquiring funds with $1 billion in assets.</td>
<td></td>
</tr>
<tr>
<td>Fidelity</td>
<td>2016–2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allianz</td>
<td>since December 2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIFMA</td>
<td>January 1, 2018–March 1, 2019</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morningstar</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

703 Our analysis is limited by data availability. In particular, we only have monthly data on acquiring funds’ holdings and our sample period is primarily a stable period of rising market prices (with the exception of the March to July 2020 period of market stress). Any effects of the redemption limit would be more pronounced during periods of market stress. See also 2018 FOF Proposing Release, supra note 6, at 125 and accompanying text for similar statistics using data from Morningstar Holdings. Some commenters argued that the low frequency of large-scale redemptions suggests that the redemption limit is unnecessary because funds do not engage frequently in large-scale redemptions that would raise undue influence concerns. See, e.g., Dechert Comment Letter.

704 See, e.g., Vanguard Comment Letter (stating that “by way of example, Vanguard offers an acquiring fund that would be subject to the Proposed Rule, but not subject to the control condition, that holds approximately 60% of an underlying Vanguard fund. We estimate that it would take approximately 2.5 years for this acquiring fund to fully unwind its investment in the underlying fund, assuming there was no other shareholder activity during the period.”).

705 A commenter stated that “[f]or three of the five [funds of funds in its group], a majority of each such Fund’s investments in Underlying Funds represent more than three-percent of the Underlying Fund’s outstanding shares.” See Russell Comment Letter.

706 See Nationwide Comment Letter.

707 The survey sample included 1,359 funds of funds with $2.8 trillion in assets under management, out of which 936 funds of funds with $2 trillion in assets under management would be subject to rule 12d1–4 and be required to comply with the rule’s conditions. The reported survey statistics excluded holdings and redemptions of money market funds. See ICI Comment Letter.

708 Out of all survey respondents, 394 funds of funds with $1.7 trillion in assets under management were able to provide complete or partial information on their fund redemptions for the period 2016–2018. 122 funds of funds with $147 billion in assets under management were unable to provide any information on their redemptions. Further, some complexes were able to analyze only some of their funds (e.g., larger or affiliated) or were able to analyze a shorter time frame (e.g., a quarter rather than three years).

709 See John Hancock Comment Letter.

710 See JP Morgan Comment Letter.

711 See TRP Comment Letter.

712 Statistics exclude redemptions from affiliated money market funds.

713 See MFS Comment Letter.

714 See Voya Comment Letter.

715 See Fidelity Comment Letter.

716 Approximately one third of the 149 redemptions were out of unaffiliated acquired funds (non-ETFs). During the same period, another of the commenter’s fund of funds categories redeemed more than 3% of an affiliated fund’s total outstanding shares in a rolling 30-day period a total of 172 times. All redemptions were out of affiliated open-end funds.

717 See Allianz Comment Letter.

718 See SIFMA AMG Comment Letter.

719 For purposes of this survey, a fund of funds is a fund that invests substantially all of its assets (i.e., > 85% of fund assets) in shares of other investment companies. In the same survey, there are 59 funds that invest less than 85% of their assets in other funds, and for these funds of funds there have been “dozens of redemptions of more
Most of the commenters’ statistics do not distinguish between fund redemptions in the secondary market, which would not have been subject to the redemption limit, and fund redemptions directly with the acquired fund. We are unable to reconcile our statistics with the statistics provided by commenters because we only have monthly data on fund holdings while commenters’ holdings information likely is more granular, and we lack complete information regarding commenters’ research design choices (e.g., whether the statistics include money market funds).

Commenters raised a number of issues associated with the proposed redemption limit, some of which we discussed in the 2018 FOF Proposing Release. These concerns included (1) operational or administrative challenges; (2) the redemption limit’s potential effects on the acquiring fund’s investment objectives and its ability to respond timely to changing economic or market conditions; (3) the impact on competition and innovation; (4) whether funds in the same group of investment companies should be subject to the requirements; (5) concerns relating to liquidity; and (6) the cost of the proposed limits.

We have addressed the issues raised by commenters by not adopting the redemption limit and instead imposing alternative conditions to guard against undue influence.

b. Uniform Voting Conditions for all Funds

We proposed to impose the same voting conditions on all funds. In particular, proposed rule 12d1–4 would have required the same ownership threshold that would trigger the voting condition (i.e., 3% of outstanding voting securities of the acquired fund) and the same manner of voting (i.e., pass-through or mirror voting) for all funds that would be subject to rule 12d1–4. One advantage of uniform voting conditions would be a less complex rule, which would facilitate rule compliance. Another advantage would be imposing the same conditions on all

acquired funds, which would level the playing field across acquired funds because all acquired funds would enjoy the same levels of protection from acquiring funds’ undue influence. The disadvantage of such an approach would be that it would not consider the unique characteristics of each fund category. In particular, open end funds and UITs hold shareholder meetings infrequently and are rarely the subject of investor activism, while closed-end funds may be required to hold shareholder meetings annually and historically have been the target of activist investors. Hence, concerns of undue influence may differ across fund categories. For this reason, rule 12d1–4 will impose different voting thresholds with respect to acquired funds that are open-end funds and UITs versus BDCs and registered closed-end funds.

c. Disclosure Requirement

We proposed to require a fund that operates in accordance with rule 12d1–4 to disclose in its registration statement that it is (or at times may be) an acquiring fund for purposes of the rule. The advantage of such a disclosure would be that it would put other funds seeking to operate in accordance with rule 12d1–4 on notice that a fund they seek to acquire is itself an acquiring fund, and thus prevent the creation of complex fund of funds structures. This requirement would impose some ongoing costs on funds to prepare and provide those disclosures. Commenters generally opposed the proposed disclosure requirement, predicting that (i) funds would abysmally disclose that they may rely upon rule 12d1–4, which would reduce the number of available potential acquired funds; (ii) it would be costly for acquiring funds to monitor continuously the disclosure of potential acquired funds; and (iii) time lags between when an acquired fund decides to operate in accordance with the rule and become an acquiring fund and when it updates its registration statement could cause violations of the rule. Further, commenters suggested that such an approach could reduce the number of funds willing to become acquired funds and create fewer investment opportunities for funds of funds.

As mentioned above, the proposed disclosure requirement was designed to put funds on notice that a fund would be subject to rule 12d1–4 as an acquiring fund. Under rule 12d1–4, this function will be filled by the fund of funds investment agreement, which an acquiring fund and acquired fund must execute before the acquiring fund may invest in the acquired fund in excess of the limits imposed by section 12(d)(1). Since rule 12d1–4 imposes the fund of funds investment agreement condition, it does not include such a disclosure requirement.

VI. Paperwork Reduction Act

A. Introduction

Rule 12d1–4 will result in a new “collection of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”). In addition, the adoption of rule 12d1–4 will affect the current collection of information burden of rule 0–2 under the Act. The amendments to Form N–CEN also will affect the collection of information burden under that form.

The title for the new collection of information for rule 12d1–4 will be: “Rule 12d1–4 Under the Investment Company Act of 1940, Fund of Funds Arrangements.” The titles for the existing collections of information are: “Rule 0–2 under the Investment Company Act of 1940, General Requirements of Papers and Applications” (OMB Control No. 3235–0636); and “Form N–CEN” (OMB Control No. 3235–0730). The Commission is submitting these collections of information to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

We published notice soliciting comments on the collection of information requirements in the 2018 FOF Proposing Release and submitted the proposed collections of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. We received one comment on the collection of information requirements.
B. Rule 12d1–4

Rule 12d1–4 will permit certain registered funds and BDCs that satisfy certain conditions to acquire shares of another fund in excess of the limits of section 12(d)(1) of the Act without obtaining an exemptive order from the Commission. These conditions include (1) adherence to certain voting provisions, (2) for most funds, entering into a fund of funds investment agreement, (3) for management companies, certain evaluations and findings that are reported to a fund’s board, (4) for UITs, an evaluation by the principal underwriter or depositor, and (5) for separate accounts funding variable insurance contracts, the acquiring fund obtaining a certification by the insurance company offering the separate account. These requirements are collections of information for purposes of the PRA. These are the same collections we identified in the 2018 FOF Proposing Release, with two exceptions based upon changes to the rule from the proposal. We have removed the disclosure requirements that were included in the proposed estimate and added the fund of funds investment agreement element of the collection.

The respondents to rule 12d1–4 will be registered funds or BDCs.732 The collection of information will be mandatory only for entities that wish to operate in accordance with the new rule. Information provided to the Commission in connection with staff examinations or investigations will be kept confidential subject to the provisions of applicable law.


Under rule 12d1–4, where an acquiring fund and its advisory group (in the aggregate) hold more than 25% of the outstanding voting securities of an acquired fund that is a registered open-end investment company or registered UIT, the acquiring fund will be required to vote those securities using mirror voting, unless certain exceptions apply.733 If the acquired fund is a closed-end fund, the acquiring fund and its advisory group must vote its securities using mirror voting if they, in the aggregate, hold more than 10% of the outstanding voting securities, unless certain exceptions apply.734 We estimate that 430 acquiring funds will be subject to these requirements, 440 of which will be utilizing mirror voting and 10 of which will be utilizing pass-through voting in limited circumstances.735

5,922 acquiring registered investment companies and BDCs = [4,750 acquiring management companies (see supra Table 2 in section V.B.1) + 37 acquiring BDCs (see supra footnotes 558 and 559 and accompanying text)] × [14,605 registered investment companies (see supra Table 1 in section V.B.1) + 83 BDCs (see supra footnotes 554 and 555 and associated text)]/[11,788 management companies (see supra Table 2) + 83 BDCs (see supra footnotes 558 and 559 and accompanying text)]. We lack structured data that would allow us to estimate the percentage of acquiring funds that are within the same group of investment companies as the acquired fund or the acquiring fund’s investment sub-adviser or any person controlling, controlled by, or under common control with such investment sub-adviser acts as the acquired fund’s investment adviser or depositor, and thus will be subject to the rule’s voting condition. To avoid underestimating the costs associated with this aspect of rule 12d1–4, we assume that all 450 acquiring funds will be subject to this rule’s conditions. Further, the circumstances of an acquiring fund utilizing pass-through voting in the final rule are limited and may be only for certain investments. See supra footnote 621 and accompanying text.

732 See supra footnote 617 for the source of salary data.

733 See rule 12d1–4(b)(1)(ii) and (iv). As described above, in mirror voting, the acquiring fund votes the shares it holds in the same proportion as the vote of all other holders. In circumstances where acquiring funds are the only shareholders of an acquired fund, however, pass-through voting may be used.

734 See rule 12d1–4(b)(1)(iii) and (iv).

735 450 acquiring funds that will invest in open-end funds or UITs in reliance on rule 12d1–4 and beyond the 25% voting threshold = 4,086 acquiring funds that will invest in other funds in reliance on rule 12d1–4 x 11% of acquiring funds that invest in at least one open-end fund or UIT beyond the 25% voting threshold of the rule. 4,086 acquiring funds that will invest in other funds in reliance on rule 12d1–4 = 5,922 acquiring registered investment companies and BDCs x 69% of acquiring funds that will be subject to rule 12d1–4 as estimated by a commenter [see supra footnote 533 and associated text]. This estimate assumes that acquiring funds with current investments in other funds beyond the limits of section 12(d)(1) will be subject to rule 12d1–4 at the same rate as the acquiring funds with current investments in other funds within the limits of section 12(d)(1) following the rule adoption.

Table 5 summarizes the final PRA estimates for internal and external burdens associated with this requirement. This estimate is as proposed, except that we (1) lowered the relative amount of funds that are expected to use pass-through voting given the changes to that requirement, (2) lowered the amount of funds estimated to be subject to these provisions due to the raised threshold of when pass-through or mirror voting will be required and (3) also lowered the expected number of votes per year based upon updated analysis.736

736 The 2018 FOF Proposing Release contemplated that 809 funds would be subject to this requirement based upon a 3% threshold, rather than the 25% and 10% threshold we are adopting. See 2018 FOF Proposing Release, supra footnote 6, at n.349 and accompanying text. See also supra footnotes 735 and 621 and footnotes 569 through 570 and accompanying text (outlining updated voting analysis).
### Table 5: Voting Provisions PRA Estimates

<table>
<thead>
<tr>
<th></th>
<th>Internal Hour Burden</th>
<th>Wage Rate²</th>
<th>Internal Time Costs</th>
<th>Annual External Cost Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROPOSED ESTIMATES FOR MIRROR VOTING</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Update proxy voting policies and disclosures</td>
<td>3 hours</td>
<td>×</td>
<td>$392 (in-house attorney)</td>
<td>$1,176</td>
</tr>
<tr>
<td>Evaluate other votes and vote accordingly (per vote x 3.6 votes)</td>
<td>3 hours</td>
<td>× 3.6</td>
<td>$392 (in-house attorney)</td>
<td>$1,176</td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>13.8 hours</td>
<td></td>
<td>$5,409.60</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>× 793</td>
<td></td>
<td>× 793</td>
<td></td>
</tr>
<tr>
<td>Total proposed burden for mirror voting</td>
<td>10,943.4 hours</td>
<td></td>
<td>$42,891,812.80</td>
<td></td>
</tr>
<tr>
<td>PROPOSED ESTIMATES FOR PASS-THROUGH VOTING</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Update proxy voting policies and disclosures</td>
<td>3 hours</td>
<td>×</td>
<td>$392 (in-house attorney)</td>
<td>$1,176</td>
</tr>
<tr>
<td>Communicate with shareholders and vote accordingly (per vote x 3.6 votes)</td>
<td>30 hours</td>
<td>× 3.6</td>
<td>$392 (in-house attorney)</td>
<td>$11,760</td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>111 hours</td>
<td></td>
<td>$43,512</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>× 16</td>
<td></td>
<td>× 16</td>
<td></td>
</tr>
<tr>
<td>Total proposed burden for pass-through voting</td>
<td>1,776 hours</td>
<td></td>
<td>$696,192</td>
<td></td>
</tr>
<tr>
<td>FINAL ESTIMATES FOR MIRROR-VOTING</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Update proxy voting policies and disclosures</td>
<td>3 hours</td>
<td>×</td>
<td>$419 (in-house attorney)</td>
<td>$1,257</td>
</tr>
<tr>
<td>Conduct voting procedure (per vote x 1 vote)</td>
<td>3 hours</td>
<td>× 1</td>
<td>$419 (in-house attorney)</td>
<td>$1,257</td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>6 hours</td>
<td></td>
<td>$2,514</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>× 440</td>
<td></td>
<td>× 440</td>
<td></td>
</tr>
<tr>
<td>Total final burden for mirror voting</td>
<td>2,640 hours</td>
<td></td>
<td>$1,106,160</td>
<td></td>
</tr>
<tr>
<td>FINAL ESTIMATES FOR PASS-THROUGH VOTING</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Update proxy voting policies and disclosures</td>
<td>3 hours</td>
<td>×</td>
<td>$419 (in-house attorney)</td>
<td>$1,257</td>
</tr>
<tr>
<td>Communicate with shareholders and vote accordingly (per vote x 1 vote)</td>
<td>30 hours</td>
<td>× 1</td>
<td>$419 (in-house attorney)</td>
<td>$12,570</td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>33 hours</td>
<td></td>
<td>$12,570</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>× 10</td>
<td></td>
<td>× 10</td>
<td></td>
</tr>
<tr>
<td>Total final burden for pass-through voting</td>
<td>330 hours</td>
<td></td>
<td>$125,700</td>
<td></td>
</tr>
</tbody>
</table>

### TOTAL ESTIMATED BURDENS FOR VOTING PROVISIONS
2. Fund of Funds Investment Agreements

As discussed in section II.C.2.4 above, unless the acquiring fund’s adviser acts as the acquired fund’s investment adviser, the rule will require that the acquiring fund enter into an agreement containing certain provisions with the acquired fund effective for the duration of the funds’ reliance on the rule. Funds subject to this requirement must maintain a copy of these agreements.\textsuperscript{737} We estimate that 9,240 fund pairs will be subject to this requirement.\textsuperscript{738} Table 6 summarizes the final PRA estimates for internal and external burdens associated with this requirement. This element of the rule was not included in the proposal.

### Table 6: Fund of Funds Investment Agreements PRA Estimates

<table>
<thead>
<tr>
<th></th>
<th>Internal Hour Burden\textsuperscript{1}</th>
<th>Wage Rate\textsuperscript{2}</th>
<th>Internal Time Costs</th>
<th>Annual External Cost Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiating and</td>
<td>20 hours</td>
<td>$444.33 (blended rate for in-house attorney, deputy general counsel, and compliance manager)\textsuperscript{3}</td>
<td>$8,886.6</td>
<td>$978</td>
</tr>
<tr>
<td>memorializing agreement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Establishing recordkeeping policies and procedures</td>
<td>3 hours × $63 (general clerk)</td>
<td>$189</td>
<td></td>
<td>$1,800</td>
</tr>
<tr>
<td></td>
<td>3 hours × $96 (senior computer operator)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recordkeeping</td>
<td>6 hours × $63 (general clerk)</td>
<td>$378</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>6 hours × $96 (senior computer operator)</td>
<td></td>
<td></td>
<td>$576</td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>38 hours</td>
<td></td>
<td>$10,317.6</td>
<td>$2,778</td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>× 9,240</td>
<td></td>
<td>× 9,240</td>
<td>× 9,240</td>
</tr>
<tr>
<td>Total burden</td>
<td>351.120 hours</td>
<td>$95,334.624</td>
<td>$25,668.720</td>
<td></td>
</tr>
</tbody>
</table>

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. See SIFMA Report, supra footnote 617.
3. The $444.33 wage rate reflects current estimates of the blended hourly rate for an in-house attorney ($419), deputy general counsel ($602) and compliance manager ($312). $444.33 is based on the following calculation: ($419+602+312) / 3 = $444.33.

3. Management Companies—Fund Findings

In cases where the acquiring fund is a management company, rule 12d1–4 will require, prior to the initial acquisition of an acquired fund in reliance on the rule, the acquiring fund’s investment adviser to evaluate the complexity of the structure and fees and expenses associated with the acquiring fund’s investment in the acquired fund, and find that the acquiring fund’s fees and expenses do not duplicate the fees and expenses of the acquired fund. In cases where the acquired fund is a management company, rule 12d1–4 will require, prior to the initial acquisition of the acquired fund in reliance on the rule, the acquired fund’s investment adviser to find that any undue influence concerns associated with the acquiring fund’s investment in the acquired fund are reasonably addressed and, as part of this finding, the investment adviser must consider at a minimum certain enumerated factors. The rule will

\textsuperscript{737} Rule 12d1–4(b)(2)(iv) and (c).

\textsuperscript{738} See supra footnote 661 and accompanying text.
further require that each investment adviser report its evaluation, finding, and the basis for its evaluation or finding to the fund’s board of directors no later than the next regularly scheduled meeting of the board of directors. The rule also will require the acquiring and acquired funds participating in fund of funds arrangements in accordance with the rule to maintain and preserve a copy of each fund of funds investment agreement that is in effect, or was in effect in the past five years, and a written record of the relevant Fund Findings (and the basis for the Fund Findings) made under the rule. We estimate 6,178 funds will be subject to this requirement.

Table 7 summarizes the final PRA estimates for internal and external burdens associated with this requirement. We have made some changes to the estimate from the proposal based upon changes to the rule as adopted. We increased the number of funds responding to this collection since the final rule will require both the acquiring and acquired funds to make certain findings under the rule. We have also increased our estimated burdens regarding initial hour and cost burdens due to the increased amount of factors that advisers would need to consider as part of this collection. In response to a commenter, we adjusted our estimates regarding the hours and wage rates to conduct evaluations and the creation, review, and maintenance of written materials. Lastly, we reduced the estimates regarding annual hour burdens, and eliminated the estimate of external annual costs, due to the elimination of the requirement to conduct on-going evaluations.

Table 7: Management Company Findings PRA Estimates

<table>
<thead>
<tr>
<th>Conduct evaluations and creation, review, and maintenance of written materials</th>
<th>Initial Internal Burden Hours</th>
<th>Annual Internal Hour Burden</th>
<th>Wage Rate¹</th>
<th>Internal Time Costs</th>
<th>Initial External Cost Burden</th>
<th>Annual External Cost Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 hours + 6 hours ×</td>
<td>$352 (compliance attorney)</td>
<td>$7,392</td>
<td>$17,610</td>
<td>$5,870</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 hours ×</td>
<td>$317 (senior portfolio manager)</td>
<td></td>
<td>$3,170</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 hours ×</td>
<td>$511 (chief compliance officer)</td>
<td></td>
<td>$2,555</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 hours ×</td>
<td>$61 (general clerk)</td>
<td></td>
<td>$305</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 hours ×</td>
<td>$94 (senior computer operator)</td>
<td></td>
<td>$470</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>30 hours</td>
<td>10 hours</td>
<td>$13,892</td>
<td>$17,610</td>
<td>$11,740</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds × 3,373</td>
<td>× 3,373</td>
<td>× 3,373</td>
<td>× 3,373</td>
<td>× 3,373</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total proposed burden</td>
<td>101,190 hours</td>
<td>33,730 hours</td>
<td>$46,857,716</td>
<td>$59,398,530</td>
<td>$39,599,020</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Conduct evaluations and creation, review, and maintenance of written materials</th>
<th>Final Estimates</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>20 hours + 8 hours ×</td>
<td>$293 (blended rate for compliance attorney and senior accountant)²</td>
<td>$8,204</td>
<td>$35,220</td>
</tr>
<tr>
<td>10 hours ×</td>
<td>$332 (senior portfolio manager)</td>
<td>$3,320</td>
<td></td>
</tr>
<tr>
<td>5 hours ×</td>
<td>$535 (chief compliance officer)</td>
<td>$2,675</td>
<td></td>
</tr>
</tbody>
</table>

⁷³⁹ Rule 12d1–4(b)(2)(i) and (c).
⁷⁴⁰ See supra footnotes 651 and 646.
⁷⁴¹ See 2018 FOFProposing Release, supra footnote 6, at nn.365–369 and accompanying text.
⁷⁴² See Guggenheim Comment Letter.
4. UITs—Principal Underwriter or Depositor Evaluations

The rule will require that, in cases where the acquiring fund is a UIT, the UIT’s principal underwriter or depositor must evaluate the complexity of the structure associated with the UIT’s investment in acquired funds, and find that the UIT’s fees and expenses do not duplicate the fees and expenses of the acquired funds that the UIT holds or will hold at the date of deposit. The UIT is also required to keep records of the finding, and any basis for the finding.\textsuperscript{743} We estimate 200 funds will be subject to this requirement.\textsuperscript{744} Table 8 summarizes the final PRA estimates for internal and external burdens associated with this requirement. We decreased the total number of respondents to this item based upon updated analysis as described above. Also, in response to a commenter,\textsuperscript{745} we adjusted our estimates regarding the hours and wage rates to conduct evaluations and the creation, review, and maintenance of written materials.\textsuperscript{746}

\begin{tabular}{|c|c|c|c|}
\hline
 & 5 hours & $\times$ & 63 (general clerk) \\
\hline
\multicolumn{2}{|c|}{\$315} \\
\hline
\multicolumn{2}{|c|}{5 hours \, $\times$ \, \$96 (senior computer operator)} & $\times$ & 480 \\
\hline
\hline
Total burden per fund & 35 hours & 13 hours & $14,994$ \, $35,220$ \, $0$ \\
\hline
Total number of affected funds & $\times \, 6,178$ & $\times \, 6,178$ & $\times \, 6,178 \, \times \, 6,178$ \\
\hline
Total final burden & 216,230 hours & 80,314 hours & $92,632$ \, $217,589.16$ \, $0$ \, $0$ \\
\hline
\end{tabular}

\begin{tabular}{|c|c|c|c|}
\hline
TOTAL ESTIMATED BURDENS FOR FUND FINDINGS \\
\hline
Proposed burden estimates & 101,190 hours & 33,730 hours & $46,857,716$ \, $59,398,530$ \, $39,599,020$ \\
\hline
Proposed total respondents & 3,373 \\
\hline
Revised burden estimates & 216,230 hours & 80,314 hours & $92,632$ \, $217,589.16$ \, $0$ \, $0$ \\
\hline
Revised total respondents & 6,178 \\
\hline
\end{tabular}

Notes:
1. See SIFMA Report, supra footnote 617.
2. The $293 wage rate reflects current estimates of the blended hourly rate for a compliance attorney (\$368) and senior accountant (\$218). \$293 is based on the following calculation: (\$368+\$218) / 2 = \$293.
### Table 8: UIT Evaluation PRA Estimates

<table>
<thead>
<tr>
<th>conduct evaluations and creation, review, and maintenance of written materials</th>
<th>Initial Internal Burden Hours</th>
<th>Annual Internal Hour Burden</th>
<th>Wage Rate</th>
<th>Internal Time Costs</th>
<th>Initial External Cost Burden</th>
<th>Annual External Cost Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 hours</td>
<td>$352 (compliance attorney)</td>
<td>$5,280</td>
<td>$2,400</td>
<td>$0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 hours</td>
<td>$317 (senior portfolio manager)</td>
<td>$3,170</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 hours</td>
<td>$511 (chief compliance officer)</td>
<td>$2,555</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 hours</td>
<td>$61 (general clerk)</td>
<td>$152.50</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 hours</td>
<td>$94 (senior computer operator)</td>
<td>$235</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>30 hours</td>
<td>5 hours</td>
<td>$11,392.50</td>
<td>$2,400</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>$306</td>
<td>$306</td>
<td>$306</td>
<td>$306</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total proposed burden</td>
<td>9,180 hours</td>
<td>1,530 hours</td>
<td>$3,486,105</td>
<td>$734,400</td>
<td>$0</td>
<td></td>
</tr>
</tbody>
</table>

### TOTAL ESTIMATED BURDENS FOR UIT EVALUATIONS

|Proposed burden estimates| 9,180 hours| 1,530 hours| $3,486,105 | $734,400 | $|
|Proposed total respondents| 306| |

### FINAL ESTIMATES

<table>
<thead>
<tr>
<th>conduct evaluations and creation, review, and maintenance of written materials</th>
<th>Initial Internal Burden Hours</th>
<th>Annual Internal Hour Burden</th>
<th>Wage Rate</th>
<th>Internal Time Costs</th>
<th>Initial External Cost Burden</th>
<th>Annual External Cost Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 hours</td>
<td>$293 (blended rate for compliance attorney and senior accountant)</td>
<td>$5,860</td>
<td>$2,400</td>
<td>$0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 hours</td>
<td>$332 (senior portfolio manager)</td>
<td>$3,320</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 hours</td>
<td>$535 (chief compliance officer)</td>
<td>$2,675</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 hours</td>
<td>$63 (general clerk)</td>
<td>$157.50</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 hours</td>
<td>$96 (senior computer operator)</td>
<td>$240</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total burden per fund</td>
<td>35 hours</td>
<td>5 hours</td>
<td>$12,252.50</td>
<td>$2,400</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>Total number of affected funds</td>
<td>$200</td>
<td>$200</td>
<td>$200</td>
<td>$200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total final burden</td>
<td>7,000 hours</td>
<td>1,000 hours</td>
<td>$2,450,500</td>
<td>$480,000</td>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

---

1. Wage Rate
2. Blended rate for compliance attorney and senior accountant
5. Separate Accounts Funding Variable Insurance Contracts—Certification

Lastly, the rule will require that, with respect to a separate account funding variable insurance contracts that invests in an acquiring fund, the acquiring fund must obtain a certification from the insurance company offering the separate account. The certification must state that the insurance company has determined that the fees and expenses borne by the separate account, acquiring fund, and acquired fund, in the aggregate, are consistent with the standard set forth in section 26(f)(2)(A) of the Act. The acquiring fund will be required to keep a record of this certification.\textsuperscript{747} We estimate 191 funds will be subject to this requirement.\textsuperscript{748}

Table 9 summarizes the final PRA estimates for internal and external burdens associated with this requirement. We decreased the total number of respondents to this item based upon updated analysis as described above. Also, we increased the proposed internal hour burden and time costs to account for likely attorney and compliance review of the required certification.\textsuperscript{749}

<table>
<thead>
<tr>
<th>Table 9: Separate Account Certification PRA Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Internal Hour Burden\textsuperscript{1}</strong></td>
</tr>
<tr>
<td><strong>PROPOSED ESTIMATES</strong></td>
</tr>
<tr>
<td>Obtain certificates and maintain records</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total burden per fund</td>
</tr>
<tr>
<td>Total number of affected funds</td>
</tr>
<tr>
<td><strong>Total proposed burden</strong></td>
</tr>
<tr>
<td><strong>FINAL ESTIMATES</strong></td>
</tr>
<tr>
<td>Obtain certificates and maintain records</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total burden per fund</td>
</tr>
<tr>
<td>Total number of affected funds</td>
</tr>
<tr>
<td><strong>Total final burden</strong></td>
</tr>
<tr>
<td><strong>TOTAL ESTIMATED BURDENS FOR SEPARATE ACCOUNT CERTIFICATION</strong></td>
</tr>
<tr>
<td>Proposed burden estimates</td>
</tr>
<tr>
<td>Proposed total respondents</td>
</tr>
<tr>
<td>Revised burden estimates</td>
</tr>
<tr>
<td>Revised total respondents</td>
</tr>
</tbody>
</table>

Notes:
1. Includes initial burden estimates annualized over a three-year period. 2. See SIFMA Report, supra footnote 617.

\textsuperscript{747} Rule 12d1–4(b)(2)(iii) and (c).  \textsuperscript{748} See 2018 FOF Proposing Release, supra footnote 6, at nn.373–377 and accompanying text. The rule will not subject an insurance company to a collection of information as section 26(f)(2)(A) of the Act already requires insurance companies to collect this information.

\textsuperscript{749} See supra footnote 669.
6. Rule 12d1–4 Total Estimated Burden

As summarized in Table 10 below, we estimate that the total hour burdens and time costs associated with rule 12d1–4, amortized over three years, would result in an average aggregate annual burden of 578,084 hours and an average aggregate annual monetized time cost of $191,773,875. We also estimate that, amortized over three years, there would be external costs of $243,953,880 associated with this collection of information. Therefore, each fund operating in accordance with the rule will incur an average annual burden of approximately 35.55 hours, at an average annual monetized time cost of approximately $11,794.94, and an external cost of $15,004.24 to comply with it.

Table 10: Rule 12d1-4 Total PRA Estimates

<table>
<thead>
<tr>
<th>Voting Provisions</th>
<th>Internal burden</th>
<th>Internal burden time cost</th>
<th>External burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund of Funds Investment Agreements</td>
<td>2,970 hours</td>
<td>$1,231,860</td>
<td>$216,000</td>
</tr>
<tr>
<td>Management Company Findings</td>
<td>351,120 hours</td>
<td>$95,334,624</td>
<td>$25,668,720</td>
</tr>
<tr>
<td>UIT Evaluations</td>
<td>216,230 hours</td>
<td>$92,632,932</td>
<td>$217,589,160</td>
</tr>
<tr>
<td>Separate Account Certificates</td>
<td>7,000 hours</td>
<td>$2,450,500</td>
<td>$480,000</td>
</tr>
<tr>
<td>Total annual burden</td>
<td>578,084 hours</td>
<td>$191,773,875</td>
<td>$243,953,880</td>
</tr>
<tr>
<td>Number of funds</td>
<td>16,259</td>
<td>16,259</td>
<td>16,259</td>
</tr>
<tr>
<td>Average annual burden per fund</td>
<td>35.55 hours</td>
<td>$11,794.94</td>
<td>$15,004.24</td>
</tr>
</tbody>
</table>

C. Rule 0–2

Rule 0–2 under the Act, entitled “General Requirements of Papers and Applications,” prescribes general instructions for filing an application seeking an order from the Commission under any provision of the Act. Rule 12d1–4 will alleviate some of the burdens associated with rule 0–2 because it will reduce the number of entities that require exemptive relief in order to operate. Table 11 summarizes the final PRA estimates for internal and external burdens associated with this requirement. We reduced our estimated burdens from what we proposed because of the intervening adoption of rule 6c–11, which also reduced the number of entities that require exemptive relief in order to operate.

Table 11: Rule 0-2 PRA Estimates

<table>
<thead>
<tr>
<th>Number of Responses</th>
<th>Annual hours</th>
<th>Annual internal time cost</th>
<th>Annual external cost burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016 approved inventory</td>
<td>184</td>
<td>5,340</td>
<td>$2,029,200.60</td>
</tr>
<tr>
<td>2018 FOF Proposing Release estimate</td>
<td>122</td>
<td>3,551</td>
<td>$1,349,418</td>
</tr>
<tr>
<td>Approved inventory after rule 6c-11</td>
<td>184</td>
<td>3,738</td>
<td>$1,420,440.42</td>
</tr>
<tr>
<td>Revised estimate</td>
<td>129</td>
<td>2,617</td>
<td>$994,308.29</td>
</tr>
</tbody>
</table>

D. Form N–CEN

Form N–CEN is a structured form that requires registered funds to provide census-type information to the Commission on an annual basis. We are amending Form N–CEN to require management companies and UITs to report whether they relied on section 12(d)(1)(G) or rule 12d1–4 during the reporting period.

Table 12 summarizes the final PRA estimates for internal and external burdens associated with this requirement. We have adjusted these estimates due to the intervening adoption of rule 6c–11, which also added items to Form N–CEN.


751 We proposed an approximate reduction of one-third from the 2016 approved burdens. See 2018 FOF Proposing Release, supra footnote 6, at nn.381–386 and accompanying text. In the 2019 ETF Adopting Release, we reduced the 2016 approved burdens by 30%. See 2019 ETF Adopting Release, supra footnote 25, at nn.691–692 and accompanying text. We are reducing the estimates from the 2019 ETF Adopting Release a further 30% as rule 12d1–4 will reduce a different type of application than those addressed by rule 6c–11.

752 See Reporting Modernization Adopting Release, supra footnote 56.

753 See supra Section III.1.

754 We proposed an increase of 0.1 hours per response. See 2018 FOF Proposing Release, supra footnote 6, at nn.387–395 and accompanying text. The 2019 ETF Adopting Release also added 0.1 hours, but per ETF, to the estimated burden. See 2019 ETF Adopting Release, supra footnote 25, at nn.691–692 and accompanying text.
Table 12: Form N-CEN PRA Estimates

<table>
<thead>
<tr>
<th></th>
<th>Number of Responses</th>
<th>Annual hours</th>
<th>Wage Rate</th>
<th>Annual internal time cost</th>
<th>Annual external cost burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016 approved inventory</td>
<td>3,113</td>
<td>74,425</td>
<td>$324</td>
<td>$19,204,128</td>
<td>$2,088,176</td>
</tr>
<tr>
<td>2018 FOF Proposing Release estimate</td>
<td>3,038</td>
<td>74,729</td>
<td>$335.50</td>
<td>$25,070,000</td>
<td>$2,088,176</td>
</tr>
<tr>
<td>Approved inventory after rule 6c-11</td>
<td>3,113</td>
<td>74,598</td>
<td></td>
<td></td>
<td>$2,088,176</td>
</tr>
<tr>
<td>Revised estimate</td>
<td>3,113</td>
<td>74,909.3 hours</td>
<td>$335.50</td>
<td>$25,132,070.20</td>
<td>$2,088,176</td>
</tr>
</tbody>
</table>

Notes:
1. See SIFMA Report, supra footnote 617.

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VII. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with section 4(a) of the Regulatory Flexibility Act ("RFA"). It relates to final rule 12d1–4 and the amendments to Form N-CEN under the Investment Company Act. In connection with the new rule, the Commission is rescinding rule 12d1–2 under the Act and certain exemptive relief that has been granted from sections 12(d)(1)(A), (B), (C), and (G) of the Act. Finally, the Commission is adopting related amendments to rule 12d1–1 under the Act. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and is included in the 2018 FOF Proposing Release.

A. Need for and Objectives of the Rule and Form Amendments

As described more fully above, rule 12d1–4 will permit registered funds and BDCs that satisfy certain conditions to acquire shares of another fund in excess of the limits of section 12(d)(1) of the Act without obtaining an exemption order from the Commission. The rule is designed to streamline and enhance the regulatory framework applicable to funds of funds arrangements. In addition, we are rescinding rule 12d1–2 under the Act and certain exemptive relief that has been granted from sections 12(d)(1)(A), (B), (C), and (G) of the Act to create a more consistent and efficient rules-based regime for the formation and oversight of funds of funds. We also are amending rule 12d1–1 to allow funds that rely on section 12(d)(1)(G) of the Act to invest in money market funds that are not part of the same group of investment companies in reliance on that rule. Finally, our amendments to Form N-CEN will allow the Commission to evaluate the impact on the proposed rule and amendments. We also requested comment on the broader impact of the proposed rule and amendments on all relevant entities, regardless of size.

B. Significant Issues Raised by Public Comments

In the 2018 FOF Proposing Release, we requested comment on every aspect of the IRFA, including the number of small entities that would be affected by the proposed rule and amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis and how to quantify the impact of the proposed rule and amendments. We also requested comment on the broader impact of the proposed rule and amendments on all relevant entities, regardless of size.

We proposed adopting a redemption limit that would prohibit an acquiring fund that acquires more than 3% of an acquired fund’s outstanding shares from redeeming, submitting for redemption, or tendering for repurchase more than 3% of an acquired fund’s total outstanding shares in any 30-day period. Among the comments received on this topic, one commenter stated that the redemption limit could discourage acquiring funds from gaining exposure to non-traditional asset classes with more volatile in- and out-flows and smaller asset bases, resulting in a less desirable mix of assets being made available to investors. Commenters also stated that the redemption limit could discourage acquiring funds from gaining exposure to non-traditional asset classes with more volatile in- and out-flows and smaller asset bases, resulting in a less desirable mix of assets being made available to investors.
likely exist primarily in smaller funds, would not be as attractive to an acquiring fund as they otherwise would be because of liquidity concerns accompanying the redemption condition. Commenters noted the potential that this provision would affect smaller funds disproportionately since funds of funds would likely migrate out of smaller funds into larger funds in order to dilute their position. Further, commenters noted the possible impact of this provision on smaller funds achieving scalable asset sizes. Finally, some commenters raised administrative and compliance challenges associated with tracking the outstanding voting securities of numerous acquired funds.

As discussed in more detail above, we are not adopting the proposed redemption limit.

Commenters also noted that codifying certain categories of existing exemptive relief would benefit smaller and midsize fund complexes by relieving them of the cost burden of obtaining an exemptive order. In addition to not adopting the proposed redemption limit, after consideration of the comments we received on the proposed rule and amendments, we are adopting the rule and amendments with several modifications that are designed to reduce certain operational challenges that commenters identified, while maintaining protections for investors and providing useful disclosures regarding fund of funds arrangements. Revisions to the estimates below also are based on updated figures regarding the number of small entities impacted by the rule and amendments and updated estimated wage rates.

C. Small Entities Subject to the Rule

An investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year. Commission staff estimates that, as of December 2019, there were 46 open-end funds (including 8 ETFs), 30 closed-end funds, 2 UITs, and 14 BDCs that would be considered small entities that may be subject to rule 12d1–4. For the purposes of this analysis, we estimate that, of those 92 total entities, 8 entities (1 open-end fund, 5 closed-end funds, and 2 UITs) invest in other funds and thus may be subject to the rule.

D. Projected Board Reporting, Recordkeeping, and Other Compliance Requirements

We are adopting new rule 12d1–4 to streamline and enhance the regulatory framework applicable to fund of funds arrangements, the rescission of rule 12d1–2 and certain exemptive relief, and an amendment to rule 12d1–1 to create a more consistent and efficient rules-based regime for the formation and oversight of fund of funds arrangements. We are also adopting amendments to Form N–CEN to allow the Commission to better monitor funds’ reliance on rule 12d1–4 and section 12(d)(1)(G) and assist the Commission with its accounting, auditing, and oversight functions.

Rule 12d1–4 will permit registered funds and BDCs that satisfy certain conditions to acquire shares of another fund in excess of the limits of section 12(d)(1) of the Act without obtaining an exemptive order from the Commission. These conditions include (1) adherence to certain voting provisions, (2) for some funds, entering into a fund of funds investment agreement, (3) for management companies, the adviser making certain evaluations and findings that are reported to the fund’s board, (4) for UITs, a finding by the principal underwriter or depositor, and (5) for separate accounts funding variable insurance contracts, the acquiring fund obtaining a certification by the insurance company offering the separate account.

To harmonize the overall regulatory structure in view of rule 12d1–4, we are rescinding rule 12d1–2, which would eliminate the flexibility of funds relying on section 12(d)(1)(G) to: (i) acquire the securities of other funds that are not part of the same group of investment companies, subject to the limits in section 12(d)(1)(A) or 12(d)(1)(F); and (ii) invest directly in stocks, bonds and other securities. Similarly we are rescinding certain exemptive relief that has been granted from sections 12(d)(1)(A), (B), (C), and (G) of the Act for the same reasons. In addition, we are amending rule 12d1–1 to allow funds relying on section 12(d)(1)(G) to invest in money market funds that are not part of the same group of investment companies in reliance on that rule. Finally, we are amending Form N–CEN to require management companies and UITs to report whether they relied on section 12(d)(1)(G) or rule 12d1–4 during the reporting period.

New rule 12d1–4, the rescission of rule 12d1–2 and certain exemptive relief that has been granted from sections 12(d)(1)(A), (B), (C), and (G) of the Act, and the amendments to rule 12d1–1 and Form N–CEN would change current reporting requirements for small entities that choose to rely on the rule. Entities eligible to rely on rule 12d1–4 are required to comply with the requirements of the rule only if they wish to rely on the rule’s exemptions. Additionally, entities that are management companies or UITs and are relying on rule 12d1–4 are required to report this reliance on Form N–CEN. For purposes of this analysis, Commission staff estimates, based on outreach conducted with a variety of funds, that small fund groups will incur approximately the same initial and ongoing costs as large fund groups. As discussed above, we estimate that each entity that relies on rule 12d1–4 (and is subject to rule 12d1–4’s voting provision) would incur the following annual time and cost burdens (with initial burdens amortized over the initial three years): (a) 6 internal burden hours and $400 in external costs to satisfy the new voting provisions related to mirror voting and 33 internal burden hours and $4,000 in external costs to satisfy the new voting provisions related to pass-through voting; (b) 38 internal burden hours and $2,778 in external costs to satisfy the requirement that acquiring fund enter into an agreement containing certain provisions with the acquired fund effective for the duration of the funds’ reliance on the rule. If the acquiring fund and the acquired fund do not share the same

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760 See, e.g., Invesco Comment Letter; Chamber of Commerce Comment Letter.
761 Id.
762 See, e.g., Nationwide Comment Letter.
763 See, e.g., Fidelity Comment Letter; Ropes Comment Letter.
764 See, e.g., MFDF Comment Letter.
765 See rule 0–10(a) under the Investment Company Act.
766 This estimate is derived from analysis of data obtained from Morningstar Direct as well as data reported to the Commission for the period ending December 31, 2019. There are currently no ETMFs or face-amount certificate companies that would be considered small entities. We believe that no BDCs that are small entities invest in other funds outside the limits of 12(d)(1). See supra section V.B.1.
767 Id.
768 We estimate that no separate accounts funding variable insurance contracts would be treated as small entities for purposes of this analysis. See also Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts, Investment Company Act Release No. 33814 (May 1, 2020) [FR 24964 (May 1, 2020)] (noting that the Commission expects that few, if any, separate accounts would be treated as small entities).
769 See supra Section V.B.1. For purposes of this analysis, we assume that all small entities will utilize mirror voting. See also supra footnote 735 and footnotes 569 through 570 and accompanying text (outlining updated voting analysis).
investment adviser; 770 (c) for management companies, 35 internal burden hours and $35,220 in external costs initially, 771 and in cases where the acquired fund is a management company, 13 internal burden hours and $0 in external costs per year on an ongoing basis to satisfy the considerations associated with their Fund Findings; 772 and (d) for UITs, 35 internal burden hours and $2,400 in external costs to satisfy the proposed complex structure and aggregate fees analysis. 773

Furthermore, as discussed above, we estimate that each entity that relies on the new rule would incur an additional annual time burden of 0.1 hours to comply with the amendments to Form N–CEN. 774

Therefore, in the aggregate, we estimate that small entities would incur an annual internal burden of 570 additional hours and an annual external cost burden of $100,664 to comply with the requirements of rule 12d1–4. This estimate is based on the following calculations:

<table>
<thead>
<tr>
<th>Internal burden</th>
<th>External cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mirror Voting</td>
<td>6 hours</td>
</tr>
<tr>
<td>Small Entities</td>
<td>x 8</td>
</tr>
<tr>
<td>Total Voting Provisions</td>
<td>48 hours</td>
</tr>
<tr>
<td>Fund of Funds Investment Agreements</td>
<td>38 hours</td>
</tr>
<tr>
<td>Small Entities</td>
<td>x 8</td>
</tr>
<tr>
<td>Total Agreements</td>
<td>304 hours</td>
</tr>
<tr>
<td>Management Company Findings</td>
<td></td>
</tr>
<tr>
<td>Initially (Annualized over a 3 year-period)</td>
<td>11.67 hours</td>
</tr>
<tr>
<td>Annually</td>
<td>13 hours</td>
</tr>
<tr>
<td>Small Entities</td>
<td>x 6</td>
</tr>
<tr>
<td>Total Management Cos.</td>
<td>148</td>
</tr>
<tr>
<td>UIT Evaluations</td>
<td>35 hours</td>
</tr>
<tr>
<td>Small Entities</td>
<td>x 2</td>
</tr>
<tr>
<td>Total UITs</td>
<td>70 hours</td>
</tr>
</tbody>
</table>

Total annual burden 570 hours $100,664

Furthermore, in the aggregate, we estimate that small entities would incur an annual burden of an additional 0.8 hours to comply with the amendments to Form N–CEN. 775

We do not otherwise expect the proposal to generate significant economic impacts on smaller entities that are disproportionate to the general economic impacts, including compliance costs and burdens, discussed in sections VI and VII above.

E. Agency Action To Minimize Effect on Small Entities

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. We considered the following alternatives for small entities in relation to the disclosure, findings, board reporting, and recordkeeping requirements: (i) Exempting small entities from some or all of the requirements to rely on rule 12d1–4, or establishing different disclosure or reporting requirements, or different disclosure frequency, for small entities to account for different levels of resources available to small entities; (ii) clarifying, consolidating, or simplifying the compliance requirements under rule 12d1–4 for small entities; and (iii) using performance rather than design standards.

In addition, as discussed above, we proposed a redemption limitation applicable to fund of funds investments in an acquired fund to address concerns that an acquiring fund could threaten large-scale redemptions to unduly influence an acquired fund. In response to concerns raised by comments received on this redemption limit, including comments regarding the significant impact the proposed requirement would have on small entities, we are not adopting the redemption limit as part of rule 12d1–4.

Further, as discussed above, any cost savings to prospective acquiring and acquired funds derived from eliminating the need to apply for an exemptive order likely will be more pronounced for smaller funds because (i) the administrative cost of the exemptive order application process likely does not vary with fund size, and thus may constitute a higher percentage of a smaller fund’s assets; and (ii) the same exemptive order can be used by multiple funds within a fund complex, and there may be fewer funds to benefit

770 See supra Section VI.B.2.
771 See supra Section VI.B.3.
772 Id.
773 See supra Section VI.B.4.
774 See supra Section V.I.D.
775 This estimate is based on the following calculations: 0.1 hours × 8 small entities = 0.8 hours.
from an exemption within smaller fund complexes.776

We do not believe that exempting or establishing different requirements for any subset of funds, including funds that are small entities, from rule 12d1–4, the amendments to rule 12d1–1 and Form N–CEN, or the rescission of rule 12d1–2 would permit us to achieve our stated objectives. Nor do we believe that clarifying, consolidating or simplifying the various aspects of the final rule for small entities would satisfy those objectives. In particular, we do not believe that the interest of investors would be served by these alternatives. We believe that all investors, including investors in entities that are small entities, will benefit from the rule and form amendments. We believe that this rulemaking strikes the right balance between allowing funds to engage in fund of funds arrangements while protecting such entities from the abuses that Congress sought to curtail in adopting section 12(d)(1). We believe that the new requirements are vital to that balance and important to all investors, irrespective of the size of the entity. Existing fund of funds exemptive orders do not distinguish between small entities and other funds. Finally, we determined to use performance rather than design standards for all funds, regardless of size, because we believe that providing funds with the flexibility to determine how to implement the requirements of the rule allows them the opportunity to tailor these obligations to the facts and circumstances of the entities themselves.

VIII. Statutory Authority

The Commission is adopting new rule 12d1–4 pursuant to the authority set forth in sections 6(c), 12(d)(1)(G) and (J), 17(b) and 38(a) of the Investment Company Act (15 U.S.C. 80a–6(c), 80a–12(d)(1)(G) and (J), 80a–17(b), and 80a–37(a)). The Commission is adopting amendments to rule 12d1–1 pursuant to the authority set forth in sections 6(c), 12(d)(1)(J), and 38(a) of the Act (15 U.S.C. 80a–6(c), 80a–12(d)(1)(J), and 80a–37(a)). The Commission is adopting an amendment to Form N–CEN under the authority set forth sections 8(b), 30(a), and 38(a) of the Investment Company Act (15 U.S.C. 80a–8(b), 80a–29(a), and 80a–37(a)).

List of Subjects in 17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rules and Form Amendments

For the reasons set out in the preamble, we are amending Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for part 270 continues to read, in part, as follows:


2. Amend section 270.12d1–1 by revising paragraph (a) to read as follows:

§ 270.12d1–1 Exemptions for investments in money market funds.

(a) Exemptions for acquisition of money market fund shares. If the conditions of paragraph (b) of this section are satisfied, notwithstanding sections 12(d)(1)(A), 12(d)(1)(B), 12(d)(1)(G), 17(a), and 57 of the Act (15 U.S.C. 80a–12(d)(1)(A), 80a–12(d)(1)(B), 80a–12(d)(1)(G), 80a–17(a), and 80a–56)), and § 270.17d–1: (1) An investment company (acquiring fund) may purchase and redeem shares issued by a money market fund; and (2) A money market fund, any principal underwriter thereof, and a broker or a dealer may sell or otherwise dispose of shares issued by the money market fund to any acquire fund.

3. Remove and reserve section 270.12d1–2.

4. Section 270.12d1–4 is added to read as follows:

§ 270.12d1–4 Exemptions for investments in certain investment companies.

(a) Exemptions for acquisition and sale of acquired fund shares. If the conditions of paragraph (b) of this section are satisfied, notwithstanding sections 12(d)(1)(A), 12(d)(1)(B), 12(d)(1)(C), 17(a), 57(a)(1)–(2), and 57(d)(1)–(2) of the Act (15 U.S.C. 80a 12(d)(1)(A), 80a–12(d)(1)(B), 80a–17(a), 80a–56(a)(1)–(2), and 80a–56(d)(1)–(2)): (1) A registered investment company (other than a face-amount certificate company) or business development company (an acquiring fund) may purchase or otherwise acquire the securities issued by another registered investment company (other than a face-amount certificate company) or business development company (an acquired fund);

776 See supra section V.C.1.i.(ii) (citing MFDF Comment Letter for a similar argument).
Findings and agreements. (i) Management companies. (A) If the acquiring fund is a management company, prior to the initial acquisition of an acquired fund in excess of the limits in section 12(d)(1)(A)(i) of the Act (15 U.S.C. 80a–12(d)(1)(A)(i)), the acquiring fund’s investment adviser must evaluate the complexity of the structure and fees and expenses associated with the acquiring fund’s investment in the acquired fund, and find that the acquiring fund’s fees and expenses do not duplicate the fees and expenses of the acquired fund; (B) If the acquired fund is a management company, prior to the initial acquisition of an acquired fund in excess of the limits in section 12(d)(1)(A)(i) of the Act (15 U.S.C. 80a–12(d)(1)(A)(i)), the acquired fund’s investment adviser must find that any undue influence concerns associated with the acquiring fund’s investment in the acquired fund are reasonably addressed and, as part of this finding, the investment adviser must consider at a minimum the following items: (1) The scale of contemplated investments by the acquiring fund and any maximum investment limits; (2) The anticipated timing of redemption requests by the acquiring fund; (3) Whether and under what circumstances the acquiring fund will provide advance notification of investments and redemptions; and (4) The circumstances under which the acquiring fund may elect to satisfy redemption requests in kind rather than in cash and the terms of any such redemptions in kind; and (C) The investment adviser to each acquiring or acquired management company must report its evaluation, finding, and the basis for its evaluations or findings required by paragraphs (b)(2)(i)(A) or (B) of this section, as applicable, to the fund’s board of directors, no later than the next regularly scheduled board of directors meeting. (ii) Unit investment trusts. If the acquiring fund is a unit investment trust (UIT) and the date of initial deposit of portfolio securities into the UIT occurs after the effective date of this section, the UIT’s principal underwriter or depositor must evaluate the complexity of the structure associated with the UIT’s investment in acquired funds and, on or before such date of initial deposit, find that the UIT’s fees and expenses do not duplicate the fees and expenses of the acquired funds that the UIT holds or will hold at the date of deposit. (iii) Separate accounts. The acquiring fund’s investment in variable insurance contracts. With respect to a separate account funding variable insurance contracts that invest in an acquiring fund, the acquiring fund must obtain a certification from the insurance company offering the separate account that the insurance company has determined that the fees and expenses borne by the separate account, acquiring fund, and acquired fund, in the aggregate, are consistent with the standard set forth in section 26(f)(2)(A) of the Act (15 U.S.C. 80a–26(f)(2)(A)). (iv) Fund of funds investment agreement. Unless the acquiring fund’s investment adviser acts as the acquired fund’s investment adviser and such adviser is not acting as the sub-adviser to either fund, the acquiring fund must enter into an agreement with the acquired fund effective for the duration of the funds’ reliance on this section, which must include the following: (A) Any material terms regarding the acquiring fund’s investment in the acquired fund necessary to make the finding required under paragraph (b)(2)(i) through (ii) of this section; (B) A termination provision whereby either the acquiring fund or acquired fund may terminate the agreement subject to advance written notice no longer than 60 days; and (C) A requirement that the acquired fund provide the acquiring fund with information on the fees and expenses of the acquired fund reasonably requested by the acquiring fund. (3) Complex fund structures. (i) No investment company may rely on section 12(d)(1)(G) of the Act (15 U.S.C. 80a–12(d)(1)(G)) or this section to purchase or otherwise acquire, in excess of the limits set forth in section 12(d)(1)(A) of the Act (15 U.S.C. 80a–12(d)(1)(A)), the outstanding voting securities of an investment company (a second-tier fund) that relies on this section to acquire the securities of an acquired fund, unless the second-tier fund makes investments permitted by paragraph (b)(3)(ii) of this section; and (ii) No acquired fund may purchase or otherwise acquire the securities of an investment company or private fund if immediately after such purchase or acquisition, the securities of investment companies and private funds owned by the acquired fund have an aggregate value in excess of 10 percent of the value of the total assets of the acquired fund; provided, however, that the 10 percent limitation of this paragraph shall not apply to investments by the acquired fund in: (A) Reliance on section 12(d)(1)(E) of the Act (15 U.S.C. 80a–12(d)(1)(E)); (B) Reliance on § 70.12d1–1; (C) A subsidiary that is wholly-owned and controlled by the acquired fund; (D) Securities received as a dividend or as a result of a plan of reorganization of a company; or (E) Securities of another investment company received pursuant to exemptive relief from the Commission to engage in interfund borrowing and lending transactions. (c) Recordkeeping. The acquiring and acquired funds relying upon this section must maintain and preserve for a period of not less than five years, the first two years in an easily accessible place, as applicable: (1) A copy of each fund of funds investment agreement that is in effect, or at any time within the past five years was in effect, and any amendments thereto; (2) A written record of the evaluations and findings required by paragraph (b)(2)(i) of this section, and the basis therefor within the past five years; (3) A written record of the finding required by paragraph (b)(2)(ii) of this section and the basis for such finding; and (4) The certification from each insurance company required by paragraph (b)(2)(iii) of this section. (d) Definitions. For purposes of this section: Advisory group means either: (1) An acquiring fund’s investment adviser or depositor, 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. Basket has the same meaning as in 17 CFR 270.6c–11(a)(1). Exchange-traded fund means a fund or class, the shares of which are listed and traded on a national securities exchange, and that has formed and operates in reliance on § 6c–11 or under an exemptive order granted by the Commission. Group of investment companies means any two or more registered investment companies or business development companies that hold themselves out to investors as related companies for purposes of investment and investor services. Private fund means an issuer that would be an investment company under section 3(a) of the Act but for the exclusions from that definition provided for in section 3(c)(1) or section 3(c)(7) of the Act (15 U.S.C. 80a–3(c)(1) or 80a–3(c)(7)).
5. The general authority citation for part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, 80a–29, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

6. Amend Form N–CEN (referenced in §274.101), by:

a. In Part C, revising Item C.7. and adding paragraphs l. and m.; and


The revisions and additions read as follows:

Note: The text of Form N–CEN does not and the amendments will not appear in the Code of Federal Regulations.

FORM N–CEN
ANNUAL REPORT FOR REGISTERED INVESTMENT COMPANIES

Part C. Additional Questions for Management Investment Companies

Item C.7. Reliance on certain statutory exemption and rules. Did the Fund rely on the following statutory exemption or any of the rules under the Act during the reporting period? (check all that apply)

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>l. Rule 12d1–4 (17 CFR 270.12d1–4):</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Part F. Additional Questions for Unit Investment Trusts

Item F.18. Reliance on rule 12d1–4. Did the Registrant rely on rule 12d1–4 under the Act (17 CFR 270.12d1–4) during the reporting period? [Y/N]


* * * * *

By the Commission.


Vanessa A. Countryman
Secretary.

[FR Doc. 2020–23355 Filed 11–18–20; 8:45 am]

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