

SEC Proposes Changes to Regulatory Framework of Fund of Funds Arrangements and Requests Comments on Potential Changes to AFFE Disclosure Requirements

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The Securities and Exchange Commission voted on December 19, 2018 to propose Rule 12d1-4 (proposed rule) and related amendments to the regulatory framework governing funds that invest in other funds (“fund of funds” arrangements).¹ The proposed rule would allow a registered investment company or a business development company (acquiring fund) to acquire shares of any other registered investment company or business development company (acquired fund) in excess of the limitations currently imposed by the Investment Company Act of 1940 without obtaining individual exemptive relief from the SEC.

The SEC is also proposing to rescind Rule 12d1-2 under the 1940 Act as well as most exemptive orders granting relief from sections 12(d)(1)(A), (B), (C) and (G) of the 1940 Act. Further, the SEC is proposing to make related amendments to Rule 12d1-1 and Form N-CEN.

Although the proposed rule would allow fund groups to establish fund of funds arrangements without undergoing the costly and time-consuming process of obtaining individual exemptive relief from the SEC, the proposed rule and related amendments would, if adopted as proposed, limit a number of the fund of funds arrangements currently in place (namely, certain three-tiered fund of funds arrangements). However, the proposed rule would also permit new types of fund of funds arrangements, including fund of funds arrangements involving listed and unlisted business development companies (BDCs) and closed-end funds.

Further, in potential foreshadowing of the adoption of changes to the “Acquired Fund Fees and Expenses” (AFFE) disclosure requirements for which the BDC industry has been advocating since 2014,² the Proposing Release solicits comments on potential revisions to these requirements, including whether the SEC should “exempt certain types of acquired funds from the definition of acquired funds for the purposes of AFFE disclosure” and “[i]f so, which types of acquired funds should be exempted and why[.]”

The comment period for the proposed rule is 90 days following its publication in the Federal Register. As of the date of this *OnPoint*, the proposed rule has not yet been published in the Federal Register.

The following provides an overview of fund of funds arrangements and the components of the SEC's proposals.

Fund of Funds Arrangements

Registered investment companies, such as mutual funds, exchange-traded funds, closed-end funds and BDCs, have increasingly invested in other funds for a variety of reasons (e.g., to achieve asset allocation or diversification, target

¹ See Fund of Funds Arrangements, Investment Company Act Rel. No. 33329 (Dec. 19, 2018) (Proposing Release).

² In 2014, Standard and Poor's and Russell Investment Group removed BDCs from the indices administered by them (e.g., the S&P 500 and the Russell 2000) as a result of concerns cited by registered index funds regarding the impact of the AFFE disclosure requirements on the expense ratios of the registered index funds due to the inclusion of BDCs.

exposure to a particular market, or equitize cash). In the Proposing Release, the SEC estimates that nearly half of all registered funds are invested in other funds.

Section 12(d)(1) of the 1940 Act places limits on the size of investments that funds may make in other funds. Specifically, section 12(d)(1)(A) prohibits a registered fund or BDC from: (i) acquiring more than 3% of the outstanding voting securities of another fund or BDC; (ii) investing more than 5% of its total assets in any one fund or BDC; or (iii) investing more than 10% of its total assets in funds or BDCs generally.³ Section 12(d)(1)(B) imposes complementary restrictions and limits the ability of registered open-end funds to knowingly sell their shares to an acquiring fund in violation of such section. Section 12(d)(1)(C) limits the ability of any fund or BDC to acquire shares issued by a closed-end fund if the acquiring fund, together with other investment companies that have the same investment adviser, owns more than 10% of the total outstanding voting securities of the closed-end fund. These limits were designed to address concerns regarding undue influence by the acquiring fund and its affiliates over the acquired fund and its affiliates, the pyramiding of control, the layering of fees and overly complex fund structures.⁴

Over the years, various statutory exceptions and exemptive rules have been created to permit different types of fund of funds arrangements, subject to certain conditions. For example, in 1996, Congress added section 12(d)(1)(G) to the 1940 Act, which allows a registered open-end fund or unit investment trust (UIT) to invest – *without limit* – in other open-end funds and UITs that are in the same “group of investment companies,” subject to certain conditions. Under this section, however, a fund’s investments are limited *solely* to: (i) other funds and UITs that are in the same “group of investment companies;” (ii) government securities; and (iii) short-term paper. The SEC subsequently adopted Rule 12d1-2, which expanded this universe of potential investments and permits a fund that relies on section 12(d)(1)(G) to also invest in: (i) other funds that are *not* in the same “group of investment companies” in reliance on section 12(d)(1)(A) or (F); (ii) non-fund assets (e.g., stocks, bonds and other securities); and (iii) money market funds in reliance on Rule 12d1-1. The adoption of Rule 12d1-2 greatly expanded the utility of the section 12(d)(1)(G) exemption from the 3%/5%/10% limits.

The SEC has also issued many exemptive orders permitting fund of funds arrangements in excess of the 3%/5%/10% limits described above. However, the process of obtaining exemptive relief can be costly and time consuming, and the conditions of such relief differed from those included in other fund of funds arrangements, including fund of funds arrangements that rely on section 12(d)(1)(G) and Rule 12d1-2.

According to the SEC, the myriad of statutory exceptions, exemptive rules and individual exemptive orders has resulted in a regulatory regime whereby similarly managed fund of funds arrangements are operated subject to differing conditions. The proposed rule, together with the related amendments (namely the proposed rescission of Rule 12d1-2 and certain fund of funds exemptive orders), are designed, in part, to “create a consistent and efficient rules-based regime for the formation and oversight of funds of funds.”

Proposed Rule 12d1-4

The proposed rule would permit an acquiring fund to acquire the shares of any acquired funds in excess of the 3%/5%/10% limits, subject to certain conditions. Importantly, the proposed rule would expand the scope of

³ Section 60 of the 1940 Act makes these limits applicable to a BDC to the same extent as if it were a registered closed-end fund.

⁴ See Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Report No. 2337, 89th Cong., 2d Sess., at 311-324 (1966) (PPI Report).

permissible fund investments for all types of registered funds and BDCs beyond what is currently allowed under existing exemptive orders (although private funds and foreign funds would not be able to rely on the proposed rule).

Currently, an acquiring fund's ability to invest in an acquired fund in excess of the 3%/5%/10% limits described above varies greatly depending upon the type of acquiring fund. The following table summarizes the types of fund of funds arrangements that have been permitted under previous SEC exemptive orders:

Acquiring Fund under Exemptive Orders	Acquired Fund under Exemptive Orders
Open-end funds	Open-end funds UITs ETFs Exchange traded managed funds (ETMFs) Listed closed-end funds Listed BDCs
UITs	Open-end funds UITs ETFs ETMFs Listed closed-end funds
Closed-end funds (listed and unlisted)	ETFs ETMFs
BDCs (listed and unlisted)	ETFs
ETFs	Open-end funds UITs ETFs Listed closed-end funds Listed BDCs

The proposed rule would create a uniform framework for all registered funds and BDCs. The following table summarizes the types of fund of funds arrangements that would be permitted under the proposed rule:

Acquiring Fund under Proposed Rule	Acquired Fund under Proposed Rule
Open-end funds UITs Closed-end funds (listed and unlisted) BDCs (listed and unlisted) ETFs ETMFs	Open-end funds UITs Closed-end funds (listed and unlisted) BDCs (listed and unlisted) ETFs ETMFs

As indicated above, in addition to the fund of fund arrangements allowed by the SEC's current exemptive orders, the proposed rule would allow open-end funds, UITs and ETFs to invest in *unlisted* closed-end funds and *unlisted* BDCs beyond the current limits. The proposed rule would also increase permissible investments for closed-end funds beyond ETFs and ETMFs to allow closed-end funds to invest in open-end funds, UITs, other closed-end funds, and BDCs, in excess of the 3%/5%/10% limits. BDCs would also be allowed to invest in open-end funds, UITs, closed-end funds, other BDCs, and ETMFs in excess of the 3%/5%/10% limits.

The SEC has requested comment as to the scope of the proposed rule – specifically, whether the proposed rule should include all registered funds and BDCs within the scope of “acquired funds” and “acquiring funds,” or whether those terms should be defined more broadly (e.g., to include private funds and foreign funds as potential acquiring funds) or more narrowly (e.g., to exclude unlisted closed-end funds and unlisted BDCs as potential acquired funds).

In order to limit the hardship on existing fund of fund arrangements, the SEC has proposed a one-year period after the effective date of the proposed rule before Rule 12d-1-2 and current exemptive orders are rescinded. The SEC believes that one year is an adequate time for funds to bring their future operations into conformity with the new requirements, but they have also asked for comments as to whether or not this time period is appropriate.

Private Funds and Foreign Funds

Private funds are not included within the scope of proposed rule's definition of acquiring funds.⁵ According to the SEC, it would not be appropriate to permit private funds to rely on the proposed rule because they: (i) are not registered with the SEC; (ii) would not be subject to the proposed reporting requirements on Form N-CEN (as discussed below); (iii) are not subject to the reporting requirements on Form N-PORT; and (iv) are not subject to the recordkeeping requirements under the 1940 Act.

For similar reasons, unregistered investment companies, such as foreign funds, also are excluded from the scope of the proposed rule.⁶ The SEC noted that investments by unregistered foreign funds in U.S. registered funds were a concern⁷ that led Congress to amend section 12(d)(1) in 1970 to include unregistered investment companies.⁸ The

⁵ A “private fund” is an issuer that would be an “investment company,” as defined in section 3 of the 1940 Act, but for section 3(c)(1) or 3(c)(7) of that Act. A company relying on section 3(c)(1) or 3(c)(7) is therefore not an “investment company” under the 1940 Act and not directly subject to the limits of section 12(d)(1)(A). However, sections 3(c)(1) and 3(c)(7) provide that such a company is nonetheless an “investment company” for purposes of the 3% limitation described in section 12(d)(1)(A) and (B), but only with respect to the company's purchase of shares issued by any registered fund or BDC and the sale of shares by any registered open-end fund to the company. Accordingly, no more than 3% of the voting shares of a registered fund or BDC may knowingly be purchased by, or sold to, a company relying on section 3(c)(1) or 3(c)(7) (i.e., the 5% and 10% limitations do not apply). Section 12(d)(1) does not limit a registered fund's or BDC's purchase of shares of companies relying on section 3(c)(1) or 3(c)(7) (although such investments may be illiquid for purposes of a registered open-end fund's 15% limit on investments in illiquid investments under Rule 22e-4, and will be “bad” BDC assets under the 70% “good” BDC asset test).

⁶ A “foreign fund” generally refers to an investment company 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. The SEC has taken the position that a foreign fund that uses U.S. jurisdictional means in the private offering of its securities and that relies on section 3(c)(1) or 3(c)(7) would be a private fund. Foreign funds that are not private funds are subject to the 3%/5%/10% limits. However, the Staff of the SEC has issued a number of no-action letters to permit fund of funds arrangements involving foreign funds in excess of these limits. See Dechert LLP, SEC No-Action Letter (pub. avail. Aug. 4, 2009) and Dechert LLP, SEC No-Action Letter (pub. avail. Mar. 8, 2017).

⁷ See PPI Report, *supra* note 4.

⁸ The language of section 12(d)(1) applies to all “investment companies.” However, as originally enacted, section 12(d)(1) applied only to U.S. registered funds. Because foreign funds were not registered, there was no limitation on their ability to invest in shares of a U.S. fund. In 1970, Congress amended Section 12(d)(1) to further limit the “pyramiding” of funds and to apply new limitations on investments by foreign funds. See Investment Company Amendments Act of 1970, Pub. L. No. 91-547, §7, 84 Stat. 1417 (codified at 15 U.S.C. 80a-12(d)(1)(a)). See also Investment Company Amendments Act of 1970, H.R. Report No. 1382, 91st Cong., 2d Sess. (1970).

SEC believes it is appropriate for unregistered investment companies to continue to request exemptive relief, and for such arrangements to be evaluated on a case-by-case basis.⁹

The SEC specifically requested comments regarding this aspect of the proposed rule. For example, the SEC asked whether, if a private fund was permitted to rely on the proposed rule, the private fund should be managed by an investment adviser registered under the Investment Advisers Act of 1940 or should be required to report its holdings in acquired funds to the SEC on a periodic basis. Given the potential benefits of investments by private funds and foreign funds in registered funds, as well as the ability to adopt conditions that could address the pyramiding concerns that led to the enactment of section 12(d)(1), industry participants are likely to comment on this aspect of the proposed rule.

Conditions of the Proposed Rule

The proposed rule includes certain conditions, largely based on the existing fund of funds exemptive relief, which are designed to address the pyramiding concerns that led to the enactment of section 12(d)(1).

Control and Voting

The proposed rule would prohibit an acquiring fund (and its “advisory group”) from *controlling* an acquired fund. The 1940 Act defines “control” to mean the power to exert a controlling influence on the management or policies of a company. In addition, the 1940 Act creates a rebuttable presumption that any person who beneficially owns (directly or indirectly) more than 25% of the voting securities of a company controls that company, and that any person who does not own more than 25% of the voting securities does not control the company.

Similar to current exemptive relief, when determining control, an acquiring fund’s investment in an acquired fund would be aggregated with investments made by the acquiring fund’s advisory group.¹⁰ However, the proposed rule would not require aggregation between an acquiring fund’s advisory and sub-advisory groups, but would instead require each of these groups to separately consider its ownership percentage and be subject to the same voting provisions.¹¹

If an acquiring fund and its advisory group, in the aggregate, holds more than 3% of an acquired fund’s outstanding voting securities, the acquired fund and each other member of the advisory group would be required to vote those securities in the manner prescribed by section 12(d)(1)(E)(iii)(aa). Under section 12(d)(1)(E)(iii)(aa), an acquiring fund is required to either: (i) seek instructions from its shareholders as to the voting of all proxies with respect to the acquired fund shares and to vote such proxies only in accordance with their instructions (*i.e.*, “pass through” voting); or (ii) vote the shares held by it in the same proportion as the vote of all other shareholders (*i.e.*, “echo” voting). This limitation is designed to minimize the influence that an acquiring fund may exercise over an acquired fund.

⁹ However, the SEC acknowledges that, to date, its exemptive orders have not permitted unregistered funds to invest in registered funds beyond the limits in section 12(d)(1)(A). See Proposing Release, at note 55.

¹⁰ The term “advisory group” would mean either: (i) 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 (ii) an acquiring fund’s investment sub-adviser and any person controlling, controlled by, or under common control with such investment sub-adviser.

¹¹ In the event that an acquiring fund or its advisory group becomes a holder of more than 25% of the outstanding voting securities of an acquired fund as a result of a decrease in the outstanding voting securities of the acquired fund, the proposed rule would not require the acquiring fund to dispose of acquired fund shares. However, the acquiring fund would not be able to rely on the proposed rule to acquire additional acquired fund shares.

The control and voting conditions would not apply to: (i) an acquiring fund that is part of the same “group of investment companies”¹² as the acquired fund; or (ii) an acquiring fund that has a sub-adviser that acts (or whose control affiliate acts) as adviser to the acquired fund. These proposed exceptions are designed to include arrangements that do not raise concerns of undue influence.¹³

Limits on Redemptions

In order to address the concern that an acquiring fund could threaten an acquired fund with large-scale redemptions as a means of exerting control over the acquired fund, the proposed rule would impose a condition limiting an acquiring fund’s ability to quickly redeem or tender for repurchase a large volume of acquired fund shares. The proposed rule would prohibit an acquiring fund that holds more than 3% of an acquired fund’s total outstanding shares from redeeming (or tendering for repurchase) more than 3% of the acquired fund’s total outstanding shares in any 30-day period.¹⁴

This condition, which the SEC acknowledges is “more protective” than certain conditions included in current exemptive orders, would *only* apply to the extent an acquiring fund holds acquired fund shares in excess of the 3% limit (and not the 5% and 10% limits). This condition would not, however, prevent or otherwise limit an acquiring fund from selling acquired fund shares in secondary market transactions. Therefore, acquiring funds that invest in ETFs and listed closed-end funds and BDCs would not be subject to any limits on their ability to sell the shares of those acquired funds on an exchange.

Notably, this condition applies to the extent an acquiring fund holds acquired fund shares in excess of the 3% limit, regardless of whether the acquiring fund and acquired fund are in the same “group of investment companies.” Industry participants are likely to comment on this aspect of the proposed rule, given the SEC’s historical view that the concern of undue influence and control is not present where the acquiring funds and acquired funds are managed by entities under common control.

Duplicative and Excessive Fees

The proposed rule contains certain conditions designed to prevent duplicative and excessive fees in fund of funds arrangements by requiring an acquiring fund’s investment adviser (rather than its board of trustees/directors, as required under current SEC exemptive orders) to: (i) evaluate the aggregate fees associated with the acquired fund investment and the complexity of the fund of funds arrangement; and (ii) determine that the acquired fund investment is in the best interests of the acquiring fund.¹⁵ The proposed rule would require the adviser to make this determination before investing in acquired funds in reliance on the proposed rule, and thereafter with such frequency as the acquiring fund’s board of trustees/directors deems reasonable and appropriate (but no less frequently than annually). The proposed rule would also require an acquiring fund’s investment adviser to report its finding, as well as

¹² The phrase “group of investment companies” would mean any two or more registered investment companies or BDCs that hold themselves out to investors as related companies for purposes of investment and investor services.

¹³ In the PPI Report to Congress, the SEC stated that the concern of undue influence and control is simply *not* present where the acquiring funds and acquired funds are managed by entities under common control. In the SEC’s view, these arrangements “present no threat of control because [the acquiring funds and acquired funds] are organized, operated by, and under the control of, the same management.” See PPI Report, *supra* note 4, at note 43.

¹⁴ This condition may (but will not necessarily) impact the liquidity classification of the acquired fund’s shares under Rule 22e-4 under the 1940 Act (liquidity risk management rule).

¹⁵ The proposed rule contains similar conditions that are designed specifically for UITs and separate accounts that fund variable insurance contracts.

the basis for the finding, to the board, which would continue to have a role in overseeing fund of funds arrangements.¹⁶

When assessing the complexity of a particular fund of funds arrangement, the SEC noted that an adviser should: (i) compare the complexity of an acquiring fund's investment with a direct investment in similar assets; (ii) consider whether the resulting arrangement would make it difficult for shareholders to appreciate the acquiring fund's exposures and risks; (iii) consider whether an acquired fund investment would circumvent the acquiring fund's investment restrictions; and (iv) consider whether the acquired fund invests in other funds.

The SEC also noted that an adviser, when evaluating the aggregate fees in a particular fund of funds arrangement, should: (i) "consider the fees of all tiers in the fund of funds arrangement with an eye towards duplication"; (ii) consider whether the acquired fund's advisory fees are duplicative; (iii) consider whether sales charges and other fees (e.g., recordkeeping, sub-transfer agency services, and sub-accounting services fees) are duplicative or excessive; and (iv) "consider reviewing acquired fund share classes to ensure that the acquiring fund is not holding a more expensive share class if a less expensive one is available to the acquiring fund." The SEC noted, however, that although fee waivers are not required under the proposed rule, they "would be one way to mitigate the duplicative fee concerns."

The proposed rule would not require an acquiring fund's investment adviser to make these evaluations and findings in connection with every acquired fund investment. The SEC noted, for example, that "in developing policies and procedures reasonably designed to prevent violations of the federal securities laws by the fund, an adviser to a fund that invests regularly in acquired funds as part of its strategy could consider establishing parameters for routine investments in acquired funds, and review individual transactions that are outside of those parameters."

"Acquired Fund Fees and Expenses" Disclosures

Under current disclosure requirements, an acquiring fund is required to disclose in its prospectus fee table the fees and expenses it incurs indirectly from investing in other funds. These fees and expenses are known as "acquired fund fees and expenses". The SEC is requesting comments on AFFE disclosures generally, a topic of particular importance to BDCs. These disclosure requirements were intended to allow investors to better understand the costs of investing in a fund that invests in another fund. However, various industry participants have expressed concerns with these disclosure requirements as they apply to investments in BDCs. For example, some industry participants have asserted¹⁷ that the requirements overstate the expenses of registered funds that invest in BDCs, and have consequently made these investments less attractive. Listed BDCs were removed from several major stock indices in 2014 by stock index providers as a result of the requirements.¹⁸ Among other things, the SEC asked whether "AFFE disclosure [is] appropriate for every type of fee and expense of every type of acquired fund or [whether] specific types of acquired fund fees or expenses [should] be excluded from the disclosure[.]"

¹⁶ However, an acquiring fund's board of trustees/directors would no longer be required to make certain findings that are required by the SEC's current exemptive orders, including the finding that the advisory fees of the acquiring fund are based on services provided that are in addition to, rather than duplicative of, the services provided by an adviser to an acquired fund.

¹⁷ Private Equity Titans Seek Washington's Help to Propel a Risky Credit Boom, Elizabeth Dexheimer, Bloomberg LP (December 12, 2018); The Coalition for Business Development, Apollo Investment Management, L.P., Ares Capital Management LLC. (2018) *Form 40-APP*. Retrieved from SEC EDGAR website <http://www.sec.gov/edgar.shtml> (requesting exemptive relief from the AFFE requirements).

¹⁸ See supra note 2.

Complex Structures

The proposed rule would limit: (i) the ability of other funds to acquire a fund that relies on the proposed rule; and (ii) the ability of an acquired fund to itself invest in other funds, except in limited circumstances (e.g., for short-term cash management purposes, certain interfund lending or borrowing transactions, or investments in funds that are wholly owned and controlled subsidiaries). These conditions, which are designed to limit unduly complex structures, would significantly limit the ability to structure a three-tiered fund of funds arrangement.

Limitations on Other Funds' Acquisitions of Acquiring Funds

To limit three-tiered fund of funds arrangement, the proposed rule would prohibit an acquiring fund that is relying on section 12(d)(1)(G) or the proposed rule from acquiring, in excess of the 3%/5%/10% limits, the outstanding voting securities of a fund that discloses in its most recent registration statement that it may be an acquiring fund in reliance on the proposed rule. Towards that end, the proposed rule would require a fund to disclose in its registration statement that it is relying – or that it may rely – on the proposed rule. The proposed disclosure requirement is designed to put other funds seeking to rely on the proposed rule on notice that a fund they seek to acquire is itself an acquiring fund, which would allow the fund to limit its investments accordingly.

As a consequence of this condition, there would be a prohibition against a common three-tiered fund of funds arrangement whereby an acquiring fund invests, in reliance on section 12(d)(1)(G), in acquired funds that themselves invest in other acquired funds (which, in practice, often are ETFs) in excess of the 3%/5%/10% limitations in reliance on an exemptive order. However, not all three-tiered fund of funds arrangements would be prohibited.¹⁹

Limitations on Acquired Funds' Acquisition of Other Funds and Private Funds

Under the proposed rule, an acquired fund would be prohibited from investing in other acquired funds or private funds in excess of the 3%/5%/10% limitations, except in limited circumstances, including where the acquired fund invests in: (i) other funds for short-term cash management purposes or in connection with interfund lending or borrowing transactions; (ii) a “master” fund in a master-feeder arrangement; or (iii) a wholly-owned and controlled subsidiary.²⁰ These limited exceptions are largely consistent with the SEC’s current exemptive orders (although the exemptive orders may vary). BDCs will likely request that the final rule exclude private funds from this limitation, or to include private funds in the limited exceptions thereto, given that: (i) BDCs frequently invest in the private funds of the private equity sponsors from which they source a significant part of their investment opportunities in excess of the 3% limitation; and (ii) the 1940 Act does not otherwise prohibit any registered fund or BDC from doing so.

Amendments to Existing Regulatory Regime

The SEC is also proposing to modify its current rules with respect to fund of funds arrangements in order to facilitate a more cohesive regulatory framework for such arrangements. In this regard, the SEC is proposing to rescind Rule 12d1-2, as well as the exemptive relief previously granted with respect to fund of funds arrangements (other than exemptive relief related to interfund lending arrangements). The rescission of Rule 12d1-2 will significantly curtail the

¹⁹ For example, an acquiring fund could invest, in reliance on section 12(d)(1)(E) (which offers an exemption for master-feeder arrangements) or (F), in acquired funds that themselves invest in other acquired funds in excess of the 3%/5%/10% limitations in reliance on the proposed rule. In addition, a fund could invest in other funds that rely on the proposed rule up to the 3%/5%/10% limitations.

²⁰ The exceptions would also permit an acquired fund to receive fund shares as a dividend or as a result of a plan of reorganization.

utility of the section 12(d)(1)(G) exemption, as funds relying on that section would no longer be able to invest in stocks, bonds or other securities, or in other funds that are not part of the “same group of investment companies.”²¹ Instead, such funds would be forced to rely on the proposed rule and its conditions in order to continue investing in those other instruments. Effectively, by rescinding Rule 12d1-2 as well as the exemptive relief, the SEC is attempting, to the maximum extent feasible, to “herd” existing and future fund of funds arrangements into a single, uniform framework with identical conditions.

Finally, the SEC stated that the Division of Investment Management “is reviewing staff no-action and interpretative letters relating to section 12(d)(1) to determine whether any such letters should be withdrawn in connection with any adoption of this proposal.” However, the SEC did not identify which no-action letters could be withdrawn. The potential withdrawal of these no-action letters has the potential to significantly impact existing fund of funds arrangements.

Amendments to Form N-CEN

Form N-CEN requires registered investment companies to annually report certain census-type information to the SEC in a structured data format. The SEC is proposing to amend Form N-CEN to require funds to report whether they relied on the proposed rule or section 12(d)(1)(G) during the applicable reporting period.

²¹ Due to other amendments proposed by the SEC, a fund that relies on section 12(d)(1)(G) would be permitted to rely on Rule 12d1-1 to invest in money market funds that are both within and outside of the “same group of investment companies.”

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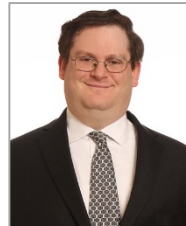
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