

Press Release

SEC Proposes Rule Changes for Fund of Funds Arrangements

FOR IMMEDIATE RELEASE

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Washington D.C., Dec. 19, 2018 — The Securities and Exchange Commission today voted to propose a new rule and related amendments designed to streamline and enhance the regulatory framework for fund of funds arrangements. Funds of funds are created when a mutual fund or other type of fund invests in shares of another fund.

"Mutual funds, exchange-traded funds (ETFs) and other types of funds have become increasingly important for Main Street investors to save for retirement and meet their other financial goals," said SEC Chairman Jay Clayton. "These funds invest in other funds for a variety of reasons, including to achieve asset allocation or diversification in an efficient manner, as well as to hedge and otherwise manage risk. However, depending on the size of the investments, funds may be required to seek an exemptive order, causing costs and delays, and resulting in a regulative regime where substantially similar fund of funds arrangements may be subject to different conditions. This proposal would create a consistent, rules-based framework for fund of funds arrangements while providing robust protections for investors."

The Commission's proposal would allow a fund to acquire the shares of another fund in excess of the limits of the Investment Company Act without obtaining an individual exemptive order from the Commission. In order to rely on the rule, funds must comply with conditions designed to enhance investor protection, including conditions restricting funds' ability to improperly influence other funds, charge excessive fees, or create overly complex fund of funds structures.

Because the proposed rule would create a new, comprehensive exemptive rule for funds of funds to operate, the Commission is proposing to rescind rule 12d1-2 as well as most exemptive orders permitting fund of funds arrangements.

The SEC will seek public comment on the proposal for 90 days.

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FACT SHEET

Fund of Funds Rule Proposal

SEC Open Meeting

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Action

The Commission is proposing a new rule and amendments under the Investment Company Act of 1940 designed to streamline and enhance the regulatory framework for funds that invest in other funds ("fund of funds" arrangements). The Commission also is proposing to rescind rule 12d1-2 under the Act and most exemptive orders granting relief from sections 12(d)(1)(A), (B), (C), and (G) of the Act. Finally, the Commission is

proposing related amendments to rule 12d1-1 under the Act and Form N-CEN. This proposal reflects the Commission's decades of experience with fund of funds arrangements and would create a consistent and efficient rules-based regime for the formation and oversight of funds of funds.

Highlights of the Proposal

Proposed Rule 12d1-4

Proposed rule 12d1-4 would permit a registered investment company or business development company (referred to as "acquiring funds") to acquire the securities of any other registered investment company or business development company (referred to as "acquired funds") in excess of the limits in section 12(d)(1) of the Investment Company Act of 1940. While the proposed rule is based on the Commission's current exemptive orders permitting fund of funds arrangements, it is tailored to enhance investor protections while providing funds with flexibility to meet their investment objectives in an efficient manner. The proposed rule's conditions include the following:

- **Control and Voting.** Proposed rule 12d1-4 would prohibit an acquiring fund from controlling an acquired fund and would require an acquiring fund that holds more than 3 percent of an acquired fund's outstanding voting securities to vote those securities in a prescribed manner in order to minimize the influence that an acquiring fund may exercise over an acquired fund. An acquiring fund that is part of the same fund group as the acquired fund and an acquiring fund that has a sub-adviser that acts as adviser to the acquired fund would not be subject to the control and voting conditions.
- **Redemption Limits.** To address concerns that an acquiring fund could threaten large-scale redemptions as a means to exert undue influence over an acquired fund, the proposed rule would prohibit an acquiring fund that acquires more than 3 percent of an acquired fund's outstanding shares from redeeming more than 3 percent of the acquired fund's total outstanding shares in any 30-day period.
- **Excessive Fees.** The proposed rule includes conditions designed to prevent duplicative and excessive fees in fund of funds arrangements by requiring an evaluation of aggregate fees associated with the investment in the acquired fund and the complexity of the fund of funds arrangement.
- **Complex Structures.** To limit funds' ability to use fund of funds arrangements to create overly complex structures, proposed rule 12d1-4 generally would prohibit funds from creating three-tier fund of funds structures, except in certain limited circumstances.

Proposed Rescission of Rule 12d1-2 and Certain Exemptive Relief, and Proposed Amendments to Rule 12d1-1

To help create a consistent and streamlined regulatory framework for fund of funds arrangements, the Commission also proposes several related actions:

- **Proposed Rescission of Rule 12d1-2 and Certain Exemptive Relief.** The Commission is proposing to rescind rule 12d1-2, which permits funds that primarily invest in funds within the same fund group to invest in unaffiliated funds and non-fund assets. The Commission also is proposing to rescind the Commission's exemptive orders permitting fund of funds arrangements, with limited exceptions. As a result, funds wishing to create certain types of fund of funds arrangements that exceed the statutory limitations would be required to rely on proposed rule 12d1-4 and comply with its associated conditions.
- **Proposed Amendments to Rule 12d1-1.** The proposal also recommends amending rule 12d1-1 to allow funds that primarily invest in funds within the same fund group to continue to invest in unaffiliated money market funds.

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Proposed Amendments to Form N-CEN

The proposal also includes amendments to Form N-CEN to require funds to report whether they relied on rule 12d1-4 or the statutory exception in section 12(d)(1)(G) of the Investment Company Act during the applicable reporting period.

What's Next?

The comment period for the proposed rule and amendments will be 90 days after publication in the Federal Register.

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