MUTUAL FUND DIRECTORS FORUM

The FORUM *for* FUND INDEPENDENT DIRECTORS

May 2, 2019

Ms. Vanessa Countryman
Acting Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Fund of Funds Arrangements (File No. S7-27-18)

Dear Ms. Countryman:

The Mutual Fund Directors Forum ("the Forum")[1] welcomes the opportunity to comment on the Commission's recent rule proposals regarding Fund of Funds Arrangements.[2]

The Forum is an independent, non-profit organization for investment company independent directors and is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through education and other services, the Forum provides its members with opportunities to share ideas, experiences and information concerning critical issues facing investment company independent directors and also serves as an independent vehicle through which Forum members can express their views on matters of concern.

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While fund-of-funds arrangements were once viewed skeptically by both Congress and by regulators, they now play an important role in providing investment options for mutual fund investors and have been an important source of innovation in the fund industry. For example, absent relief from the statutory limits, key innovations that offer both increased choice and increased efficiency for investors such as target date funds would be more difficult to establish and more limited in scope. Relief from the restrictions on fund-of-funds arrangements also provides important efficiencies to acquiring funds that seek easier access to different investment strategies, asset classes or fund managers through their purchase of underlying funds.

Today, relief from the statutory restrictions on fund-of-funds arrangements is largely provided through a series of orders granted to individual funds or individual fund complexes.

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1 The Forum's current membership includes over 1120 independent directors, representing 136 mutual fund groups. Each member group selects a representative to serve on the Forum's Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum's Board of Directors, although it does not necessarily represent the views of all members in every respect.

2 Proposed Rulemaking: Fund of Funds Arrangements, Release No. IC-33329, 84 Fed. Reg. 1286 (February 2, 2019) ("Proposing Release").

Because of the benefits that this established form of relief can provide to the industry and investors, we strongly support the Commission's efforts to establish a uniform approach to fund-of-funds arrangements by rule. As described in the Proposing Release, there is no evidence that the arrangements permitted by order are being used to harm investors or that fund of funds otherwise risk the results that originally led Congress to prohibit them. Indeed, now-allowed fund-of-funds arrangements have increased the investment options available to individual investors, and we believe that expanding the availability of these arrangements is clearly beneficial to investors and in the public interest.

More specifically, working together with fund management companies, independent directors, whether they serve as the directors of acquiring or acquired funds, have been able successfully to oversee fund-of-funds arrangements to help prevent them from harming investors.[3] While the Commission's rule proposal would alter in some ways the manner in which these arrangements are regulated, we broadly support the proposed approach. Our support is rooted in our belief in three essential policy goals.

First, as we have stated in prior comment letters, we strongly believe that the Commission should codify long-standing exemptive relief. Once the Commission has determined that a particular form of exemptive relief is generally permissible, and that reliance on it (subject to appropriate conditions) by funds, fund managers and fund boards does not pose any notable risks to fund investors or the investing public generally, we believe that there is little reason not to proceed to codifying the relief. By doing so, the Commission helps establish a level competitive playing field among all fund groups by making relief broadly available and helping ensure that all funds are managed pursuant and subject to a single, consistent regulatory system.

We also note that codifying noncontroversial relief will help smaller and midsize funds and complexes remain competitive in an industry that has become increasingly cost-conscious and that has continued to consolidate in recent years. Obtaining an exemptive order on an individual basis can be a costly and time-consuming process. Relieving smaller complexes of this burden will permit them to compete more effectively and offer potentially innovative products to their investors. Given that competition tends to provide individual investors with greater investment choice and lower costs, we believe that codifying relief such as the fund-of-funds orders at the heart of this Proposing Release can also provide investors with important systemic benefits.

Second, we strongly agree with the Commission's proposal to withdraw existing fund-of-funds relief. Not surprisingly, as the Commission grants successive exemptive orders and learns how funds operate under that relief, it tends to modify the scope of the relief or the conditions that those relying on the relief must satisfy. However, once the Commission has become comfortable with a specific approach to the relief through a series of orders, we agree that it makes sense to standardize both the scope of the relief and the terms and conditions under which the relief is

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[3] In this context, we note that we also support the Commission's initial conclusion to not extend the proposed relief to private, foreign or otherwise unregistered funds. In addition to the reasons that the Commission points to in the Proposing Release, we also believe that having independent directors on both sides of a fund-of-funds arrangements helps protect the shareholders of both the acquiring and acquired fund from the risks that these arrangements might otherwise pose.

available. Doing so ensures that all funds and fund complexes are subject to the same set of rules and conditions, and thus helps establish the level playing field that promotes effective competition.

Third, we agree with the position taken in the Commission's proposal that the proper role of the Board is one of oversight. Specifically, we agree that the Commission should generally seek to avoid imposing specific obligations on independent directors. Rather, as has been the case since the adoption of Rule 38a-1, directors are better able to exercise their business judgment and effectively oversee the operation of funds when they adopt policies and procedures and engage in ongoing oversight of the effectiveness of those policies and procedures. Requiring directors to make specific findings or approve individual transactions tends to inhibit directors' ability to focus on the issues and concerns they find most fundamental to the oversight of the funds for which they are responsible. We therefore support the requirement of having the adviser to the acquiring fund provide the Board with a periodic report of its finding that a given fund-of-funds arrangement is in the best interests of the fund and the basis for its finding, thereby enabling appropriate Board oversight.[4]

As the staff appear to have recognized in recent industry-wide grants of no-action relief, this approach, combined with reports to the board from its CCO and other personnel, more effectively facilitates board oversight.[5] We appreciate that the Commission has extended this approach in this proposal and commend the Commission both for not imposing new, specific requirements on directors as well as for eliminating existing required findings, such as the requirement in many orders that directors approve a "Participation Agreement" between the acquiring and acquired fund.

That said, in spite of our broad support for the rule, we have concerns about certain restrictions that the proposal would place on the ability of acquiring funds to manage the positions they take in underlying funds. Specifically, we are troubled by the potential impact of the Commission's proposed restriction that acquiring funds that own in excess of 3% of an acquired fund would be prohibited from redeeming more than 3% of the acquired fund at any one time. Our concern arises for a number of reasons.

- First, this restriction will complicate the ability of acquiring funds to comply with the Commission's liquidity management rule, as the portion of a stake above 3% in an acquired fund will likely have to be treated as illiquid under the that rule. This effect, combined with the potential impact on an acquiring fund's ability to meet redemptions, could unduly limit an acquiring fund's investment options.

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4 We note that as described by the Commission, advisers would need to provide best findings interest findings to the Board "with such frequency as the board of directors of the acquiring funds, by resolution, deems reasonable and appropriate, but in any case, no less frequently than annually." We believe it would be preferable and more consistent with the proposed rule as a whole to require the frequency of reporting to be set forth in a relevant policy and procedure of the fund, as adopted and approved by the Board under Rule 38a-1.

5 *See, e.g.,* Independent Directors Council No-Action Letter (February 28, 2019) and Independent Directors Council No-Action Letter (October 12, 2018).

- Second, because the restriction may limit the desire of acquiring funds to buy large stakes in acquired funds, the rule will potentially disincentivize innovation and limit the choices available to investors.[6]
- Third, while these impacts might be warranted if the Commission offered any evidence of abuses justifying the restriction, the Proposing Release does not offer any such evidence. Indeed, it characterizes the proposed condition as "more protective" than the conditions typically found in current orders but does not suggest that those orders have been subject to abuse or that abuses would be likely to occur in the absence of redemption restrictions.

In sum, we are concerned that the restrictions that the proposed rule would place on the ability of acquiring funds to liquidate stakes greater than 3% would stifle innovation and increase the difficulties of complying with the recently-adopted liquidity rule. By making it more difficult to manage fund-of-funds arrangements, the rule, as proposed, may ultimately limit the availability of these types of funds, and unnecessarily limit the choices available to investors. In our view, there is little reason to believe that acquiring funds will use the threat of a large redemption to pressure underlying funds to take actions not in their own interests; instead, we believe that acquiring funds will typically redeem out of underlying funds in response to their changing investment needs or the redemption activities of their own investors. Absent any indication that acquiring funds will engage in abusive practices, we encourage the Commission to consider less restrictive approaches to the redemption activities of acquiring funds.

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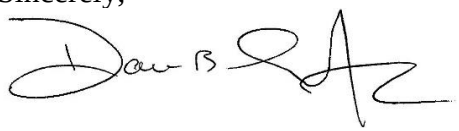
In conclusion, for the reasons outlined above, we strongly support the Commission's proposed fund-of-funds rule and encourage the Commission both to loosen the proposed restrictions on redemptions and move promptly towards adopting a final rule. We would welcome the opportunity to further discuss our views with you. Please feel free to contact Susan Ferris Wyderko, the Forum's President, at 202-507-4490 or David Smith, the Forum's General Counsel, at 202-507-4491 if you should like to do so.

Sincerely,



David B. Smith, Jr.
Executive Vice President and General Counsel

[6] For managers that continue to offer fund-of-funds that rely on the rule, this restriction could have numerous other negative impacts, including limiting the ability of the acquiring fund's investment adviser to change the underlying fund lineup to address poor investment performance by an underlying fund, to address other material changes at the underlying manager (including material changes to its leadership, portfolio management or compliance program), or to otherwise execute a tactical or strategic reallocation.