

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 274, and 275

[Release Nos. 33–8297; IC–26198; File No. S7–18–03]

RIN 3235–A130

Fund of Funds Investments

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Commission is proposing three new rules under the Investment Company Act of 1940 that address the ability of an investment company to acquire shares of another investment company. Section 12(d)(1) of the Act prohibits, subject to certain exceptions, so-called “fund of funds” arrangements, in which one investment company invests in the shares of another. The proposed rules would broaden the ability of an investment company to invest in shares of another investment company consistent with the protection of investors and the purposes of the Act. The Commission also is proposing amendments to forms used by investment companies to register under the Investment Company Act and offer their shares under the Securities Act of 1933. The proposed amendments would improve the transparency of the expenses of funds of funds by requiring that the expenses of the acquired funds be aggregated and shown as an additional expense in the fee table of the fund of funds.

DATES: Comments must be received by December 3, 2003.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by hard copy or e-mail, but not by both methods. Comments sent by hard copy should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically to the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–18–03; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission’s Public Reference Room, 450 5th Street, NW., Washington, DC 20549. Electronically submitted comment letters will be posted on the Commission’s Internet Web site (<http://www.sec.gov>).¹

FOR FURTHER INFORMATION CONTACT:

Penelope W. Saltzman, Senior Counsel, or C. Hunter Jones, Assistant Director, Office of Regulatory Policy, (202) 942–0690, Division of Investment Management, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the “Commission”) today is proposing for public comment new rules 12d1–1 [17 CFR 270.12d1–1], 12d1–2 [17 CFR 270.12d1–2], and 12d1–3 [17 CFR 270.12d1–3] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the “Investment Company Act” or the “Act”) that address the ability of an investment company (“fund” or “acquiring fund”) registered under the Act to invest in shares of another investment company (“fund” or “acquired fund”). We also are proposing amendments to Forms N–1A [17 CFR 239.15A; 17 CFR 274.11A], N–2 [17 CFR 239.14; 17 CFR 274.11a–1], N–3 [17 CFR 239.17a; 17 CFR 274.11b], N–4 [17 CFR 239.17b; 17 CFR 274.11c], and N–6 [17 CFR 239.17c; 17 CFR 274.11d] to require that prospectuses of funds of funds disclose all of the expenses investors in the fund will bear, including those of any acquired funds. Forms N–1A and N–2 are the registration forms used by open-end management funds and closed-end management funds, respectively, to register under the Act and to offer their shares under the Securities Act of 1933 [15 U.S.C. 77a] (“Securities Act”). Form N–3 is the registration form used by separate accounts that are organized as management investment companies and offer variable annuity contracts to register under the Act and to offer their shares under the Securities Act. Forms N–4 and N–6 are the forms used by separate accounts organized as unit investment trusts (“UITs”) that offer variable annuity and variable life insurance contracts, respectively, to register under the Act and to offer their shares under the Securities Act.

Table of Contents

- I. Background
- II. Discussion
 - A. Rule 12d1–1: Investments in Money Market Funds
 - 1. Scope of Exemption
 - 2. Conditions
 - B. Rule 12d1–2: Affiliated Funds of Funds
 - 1. Investments in Unaffiliated Funds
 - 2. Investments in Other Types of Issuers
 - 3. Investments in Money Market Funds
 - C. Rule 12d1–3: Unaffiliated Funds of Funds

from electronic submissions. Submit only information you wish to make publicly available.

- D. Amendments to Forms N–1A, N–2, N–3, N–4, and N–6
- III. General Request for Comments
- IV. Cost-Benefit Analysis
 - A. Background on Proposed Rules 12d1–1, 12d1–2, and 12d1–3
 - 1. Benefits
 - 2. Costs
 - B. Proposed Amendments to Forms N–1A, N–2, N–3, N–4, and N–6
 - 1. Benefits
 - 2. Costs
 - C. Request for Comments
- V. Paperwork Reduction Act
 - A. Proposed Rule 12d1–1
 - B. Forms for Registration Statements
 - 1. Form N–1A
 - 2. Form N–2
 - 3. Form N–3
 - 4. Form N–4
 - 5. Form N–6
 - C. Request for Comments
- VI. Consideration of Promoting of Efficiency, Competition, and Capital Formation
 - A. Proposed Rules 12d1–1, 12d1–2, and 12d1–3
 - B. Proposed Amendments to Forms N–1A, N–2, N–3, N–4, and N–6
 - C. Request for Comment
- VII. Summary of Initial Regulatory Flexibility Analysis
- VIII. Statutory Authority
- Text of Proposed Rules and Form Amendments

I. Background

Today, the federal securities laws restrict substantially the ability of a fund to invest in shares of other funds. Before the enactment of the Investment Company Act in 1940, however, a fund was free to purchase an unlimited number of shares of another fund. These “fund of funds” arrangements yielded numerous abuses, which were catalogued in the Commission’s study of funds that preceded the Act (“Investment Trust Study”).²

Using a relatively small amount of money, individuals could acquire control of a fund and use its assets to acquire control of the assets of another fund, which, in turn, could use its assets to control a third fund.³ As a result, a few individuals effectively could control millions of dollars in shareholder assets invested in various acquired funds. These “pyramiding” schemes were used to enrich the individuals at the expense of fund shareholders in a number of ways. In some cases, controlling individuals caused the acquired funds to purchase securities in companies in which the

² Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, pt. 3, ch. 7, H.R. Doc. No. 136, 77th Cong., 1st Sess. 2721–95 (1941).

³ See Investment Trust Study, *supra* note 2, pt. 3, ch. 4, at 1031–39 and 1040–41, nn. 58–59 (discussing how individuals and other investors were able to make relatively small investments and gain control of funds); ch. 7, at 2742–50.

¹ We do not edit personal, identifying information, such as names or E-mail addresses,