

rule 2a-7 under the Act,⁵⁴ and (ii) undertake to comply with all the other provisions of rule 2a-7.⁵⁵ In addition, the acquiring fund would have to reasonably believe that the unregistered money market fund operates like a registered money market fund and that it complies with certain provisions of the Act.⁵⁶ Finally, the unregistered money market fund's adviser would be required to register as an investment adviser with the Commission.⁵⁷ This final requirement would allow the Commission to examine the activities of the unregistered money market fund to ensure that it is meeting the requirements of the rule.

(d) *Closed-End Funds of Funds.* The restrictions of section 12(d)(1) on a fund of funds also apply to closed-end funds and business development companies,⁵⁸ which are closed-end funds that are exempted from registration under the Act.⁵⁹ We have issued several

exemptive orders to closed-end funds, subject to similar conditions as open-end funds.⁶⁰ Today, we propose to make the new rule available to both types of funds so that either can invest available cash in a money market fund.⁶¹ Would business development companies benefit from this exemption? Are there reasons not to extend the exemption to business development companies?

(e) *Unregistered Funds of Funds.* Unregistered funds also are subject to the section 12(d)(1) restrictions on the acquisition of shares of registered funds.⁶² The proposed rule would permit unregistered funds to invest their cash in shares of a registered money market fund.⁶³ Thus, a hedge fund could sweep its cash into a registered money market fund pending investment or distribution of the cash to investors. We request comment on whether any special concerns arise with respect to unregistered funds' use of registered money market funds in cash sweep arrangements.

2. Conditions

We propose to eliminate most of the conditions included in the exemptive orders provided to cash sweep arrangements.⁶⁴ We would not, for example, preclude a fund from investing more than 25 percent of its assets in shares of money market funds and would, instead, rely on a fund's own investment restrictions to provide appropriate limitations. We also would not require directors to make any special findings that investors are not paying multiple advisory fees for the same services. A fund could pay duplicative fees if an adviser invests a fund's cash in a money market fund (which itself pays an advisory fee) without reducing its advisory fee by an amount it was compensated to manage

the cash.⁶⁵ Fund directors have fiduciary duties,⁶⁶ which obligate them to protect funds from being overcharged for services provided to the fund, regardless of any special findings we might require.⁶⁷ Moreover, and as we describe in more detail below, we would require a registered fund of funds to disclose to shareholders expenses paid by both the acquiring and acquired funds so that shareholders may better evaluate the costs of investing in a fund with a cash sweep arrangement.⁶⁸

⁵⁴ Our earlier orders required the acquiring fund's adviser to waive that portion of the advisory fee attributable to the management service that would be performed by the adviser to the acquired fund. See, e.g., The Brinson Funds, Investment Company Act Release No. 21814 (Feb. 12, 1996) [61 FR 6398, 6399 (Feb. 20, 1996)] (notice), Investment Company Act Release No. 21741 (Mar. 11, 1996) (order); Janus Investment Fund, Investment Company Act Release No. 21042 (May 4, 1995) [60 F.R. 24955, (May 10, 1995)] (notice), Investment Company Act Release No. 21103 (May 31, 1995) (order).

⁵⁵ See 15 U.S.C. 80a-35(a). See generally, 2 Tamar Frankel, *The Regulation of Money Managers*, § 9.05 (2001). Section 15(c) of the Act requires the board of directors to evaluate the terms (which would include fees, or the elimination of fees, for services provided by an acquired fund's adviser) of any advisory contract. See 15 U.S.C. 80a-15(c). Moreover, we believe that, section 36(b) [15 U.S.C. 80a-35(b)], which imposes on fund advisers a fiduciary duty with respect to their compensation, would require an adviser to waive that portion of its fee that represents compensation for services being performed by another person, such as the adviser to an acquired money market fund. See *SEC v. American Birthright Trust Management Company, Inc.*, Litigation Release No. 9266 (Dec. 30, 1980), available in LEXIS, Fedsec Library, Litrel File (settlement of civil injunctive action in which defendant investment adviser was permanently enjoined from engaging in acts and practices that would constitute violations of sections 36(a) and (b) of the Act, and in which the Commission alleged that the compensation paid to fund's adviser was excessive in light of the services performed, and that most of the advisory services had been provided by a "sub-adviser" retained by the adviser).

⁵⁶ We also would eliminate the prohibition on an acquired money market fund investing in other funds in excess of the limits in section 12(d)(1)(A). This would permit the money market fund itself to have a cash sweep arrangement. As discussed above, we do not believe that investments in money market funds create the concerns that led to the limitations in section 12(d)(1). See *supra* notes 38-39 and accompanying text. We also would omit a condition that the acquiring fund's investment in the acquired money market fund must be consistent with the policies set forth in the acquiring fund's registration statement. We believe that the fund already is required to make investments consistent with those policies without an additional requirement in the rule. For a discussion of the other conditions, see *supra* notes 43-44 and accompanying text.

⁵⁷ Although not contained in the text of proposed rule 12d1-1, the proposed disclosure requirements are a critical element of the relief we are proposing today and of our decision that the proposal omit required directors' findings from the rule. We note that when it enacted section 12(d)(1)(G) in 1996, Congress did not include any provision addressing the duplication of advisory fees, although it understood that our previous exemptive orders to permit these arrangements included a requirement

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⁵⁴ Proposed rule 12d1-1(c)(3)(ii)(A).

⁵⁵ Proposed rule 12d1-1(c)(3)(ii)(B).

⁵⁶ Proposed rule 12d1-1(b)(2)(i)(A), (B). The acquiring fund would be required to reasonably believe that the unregistered money market fund (i) operates in compliance with rule 2a-7, (ii) complies, as if it were a registered open-end fund, with provisions of the Act that limit affiliate transactions (sections 17(a), (d), and (e)), issuance of senior securities (section 18), and suspension of redemption rights (section 22(e)), (iii) has adopted, and periodically reviews, procedures designed to ensure compliance with these requirements, and maintains books and records describing the procedures, and (iv) maintains and preserves the books and records required under rules 31a-1(b)(1) [17 CFR 31a-1(b)(1)], 31a-1(b)(2)(ii) [17 CFR 31a-1(b)(2)(ii)], 31a-1(b)(2)(iv) [17 CFR 31a-1(b)(2)(iv)], and 31a-1(b)(9) [17 CFR 31a-1(b)(9)]. Proposed rule 12d1-1(b)(2)(i). The proposed rule would require that the acquiring fund "reasonably believe" that, among other things, the acquired money market fund complies with rule 2a-7 in order to avoid the acquiring fund's loss of the exemption as the result of a minor or inadvertent violation of rule 2a-7 by the acquired money market fund.

⁵⁷ Proposed rule 12d1-1(b)(2)(ii). If an unregistered money market fund does not have a board of directors (because, for example, it is organized as a limited partnership), the proposed rule also would require the fund's investment adviser to perform the duties required of a money market fund's board of directors under rule 2a-7. Proposed rule 12d1-1(c)(3)(ii)(B).

⁵⁸ A business development company is any closed-end company that: (i) Is organized under the laws of, and has its principal place in, any state or states; (ii) is operated for the purpose of investing in securities described in section 55(a)(1)-(3) of the Act [15 U.S.C. 80a-54(a)(1)-(3)] and makes available "significant managerial assistance" to the issuers of those securities, subject to certain conditions; and (iii) has elected under section 54(a) of the Act to be subject to the sections addressing activities of business development companies under the Act. See 15 U.S.C. 80a-2(a)(48). Section 60 of the Act [15 U.S.C. 80a-59] extends the limits of section 12(d) to a business development company to the same extent as if it were a registered closed-end fund.

⁵⁹ Section 6(f) of the Act [15 U.S.C. 80a-6(f)] exempts business development companies that have made the election under section 54 [15 U.S.C. 80a-53] from registration and other provisions of the Act.

⁶⁰ See, e.g., Pioneer Notice and Order, *supra* note 49; Credit Suisse Notice and Order, *supra* note 48.

⁶¹ The amount of assets a business development company could invest in a money market fund may be limited by Section 55 of the Act [15 U.S.C. 80a-54].

⁶² See 15 U.S.C. 12(d)(1)(A); 15 U.S.C. 12(d)(1)(B). In the case of unregistered investment companies (such as a foreign fund or business development company) the full restrictions of sections 12(d)(1)(A) and (B) apply. Companies that are unregistered because they are excepted from the definition of investment company under sections 3(c)(1) and 3(c)(7) of the Act are prohibited from acquiring more than three percent of a registered fund. Both section 3(c)(1) and section 3(c)(7) deem issuers that rely on these sections to be investment companies for the purposes of sections 12(d)(1)(A)(i) and 12(d)(1)(B)(i) with respect to their acquisition of registered funds. As a result, these companies cannot acquire more than three percent of the shares of a registered fund. See 15 U.S.C. 80a-3(c)(1); 15 U.S.C. 80a-3(c)(7)(D).

⁶³ Proposed rule 12d1-1(a).

⁶⁴ See *supra* note 36.