

regarding shares of acquired funds.¹¹⁴ Finally, section 12(d)(1)(G) allows a registered open-end fund or UIT to invest any amount of its own assets in one or more other registered funds or UITs in the same group of investment companies.¹¹⁵ These affiliated funds of funds are limited to investing in government securities and short-term paper in addition to funds in the same fund group.¹¹⁶ The exemption also limits sales loads and distribution charges on fund shares, and requires that the acquired fund have a policy that it cannot acquire other fund shares in reliance on section 12(d)(1)(F) or 12(d)(1)(G) of the Act.¹¹⁷

We also have issued a number of exemptive orders that have broadened the ability of funds to invest in other funds. Over the past decade, we have issued over 80 orders that permit registered funds to invest in a money market fund advised by the same adviser.¹¹⁸ Many of those orders also have permitted funds to invest in an unregistered fund operated as a money market fund.¹¹⁹ In addition to these

orders, we have permitted an affiliated fund of funds relying on section 12(d)(1)(G) to invest in funds outside the same fund group subject to the limitations of section 12(d)(1)(F), as well as in other securities not issued by a fund.¹²⁰

The orders discussed above provide exemptions from statutory limitations. A fund that obtains the benefit of the exemption incurs costs of applying for an exemptive order as well as costs of satisfying any conditions imposed in the order. The application costs are primarily legal and include costs of drafting the application and analyzing the ways in which the conditions fit the fund's business model. By contrast, the costs of satisfying conditions include ongoing compliance costs of meeting those conditions. We assume that a fund only seeks an exemptive order if the benefits of the additional flexibility provided by the exemption outweigh the costs of obtaining and satisfying the conditions of an order.

money market fund (or the fund with approval of its board of directors) adopts and monitors the procedures described in rule 2a-7 and takes the other actions required to be taken under the procedures; (iii) an acquiring fund purchases shares of an unregistered money market fund only if the unregistered fund's adviser determines on an ongoing basis that the unregistered money market fund is in compliance with rule 2a-7 and preserves for a period of not less than six years from the date of determination, the first two years in an easily accessible place, a record of the determination and the basis on which it was made, and the record is subject to examination by Commission staff; (iv) the unregistered money market fund complies with the requirements of sections 17(a), (d), and (e), 18, and 22(e) of the Act as if it were a registered open-end fund; (v) the investment adviser to the unregistered money market fund adopts procedures designed to ensure that the fund complies with those provisions of the Act, periodically reviews and updates as appropriate the procedures, and maintains books and records describing those procedures; (vi) the investment adviser to the unregistered money market fund maintains the records required by rules 31(a)-1(b)(1), 31a-1(b)(ii)(2), and 31a-1(b)(9) under the Act for a period of not less than six years from the end of the fiscal year in which any transaction occurred, the first two years in an easily accessible place and subject to examination by Commission staff; (vii) the net asset value per share with respect to unregistered money market fund shares is determined by dividing the value of the assets belonging to the fund, less the liabilities of the fund, by the number of outstanding shares of the fund; (viii) the acquiring fund purchases and redeems shares of the unregistered money market fund as of the same time and at the same price, and receives dividends and bears its proportionate share of expenses on the same basis, as other shareholders of the unregistered money market fund; and (ix) a separate account is established in the shareholder records of the unregistered money market fund for the account of the acquiring fund.

¹²⁰ The orders permitting affiliated funds of funds to invest in funds outside the fund group have required that the acquiring fund's board of directors, including the independent directors, must find that the fees charged under the acquiring fund's advisory contract are based on services that are not duplicative of services provided under any acquired fund's advisory contract.

1. Benefits

Proposed rule 12d1-1 would codify our orders that permit a fund to acquire an unlimited number of shares of a registered money market fund. The proposed rule would retain only one condition included in the orders: no sales load, distribution-related fees, or service fees could be imposed on the acquisition of money market fund shares unless the adviser waived an equivalent amount of its fee. The proposed rule would not limit a fund to investing 25 percent of its assets in a money market fund. We believe that any restrictions on an acquiring fund's investments in money market funds should be governed by the fund's investment policies and limitations. Consequently, the proposed rule may provide some additional flexibility to certain funds. We do not know whether many funds are likely to invest more than 25 percent of their assets in money market funds as a result of this change, and we seek comment on the issue.

Under the proposed rule, funds also would be allowed to invest in money market funds advised by a different adviser. We believe that this would allow all funds, particularly small funds without a money market fund in their fund group, the opportunity currently available to large funds to acquire money market fund shares. This might allow smaller funds to be more competitive with larger funds. We seek comment on whether many funds are likely to invest in money market funds outside their fund group.¹²¹

Proposed rule 12d1-1 also would codify our orders permitting funds to invest cash in unregistered money market funds that comply with rule 2a-7. The proposed rule would require the acquiring fund to "reasonably believe" that the unregistered money market fund operates in compliance with rule 2a-7, complies with certain provisions of the Act,¹²² as well as other requirements. This standard is slightly different than the condition in our exemptive orders, which requires the acquired fund's compliance with rule 2a-7 and certain provisions of the Act. An acquiring fund could "reasonably believe" that an acquired fund is complying with these provisions even if there is a minor or inadvertent violation of one by the acquired fund. In those circumstances, the violation would not

¹²¹ The other conditions included in our exemptive orders are addressed by requirements under the Act and rules thereunder. Thus, we do not believe that any benefits or costs are associated with eliminating those conditions in the proposed rule.

¹²² See *supra* note 119.

¹¹⁴ See 15 U.S.C. 80a-12(d)(1)(F). The acquiring fund is subject to the voting restrictions imposed under section 12(d)(1)(E). See *supra* note 112. In addition, no issuer of securities held by the acquiring fund is obligated to redeem more than 1 percent of its securities during any period of less than 30 days.

¹¹⁵ See 15 U.S.C. 80a-12(d)(1)(G).

¹¹⁶ See 15 U.S.C. 80a-12(d)(1)(G)(III).

¹¹⁷ See 15 U.S.C. 80a-12(d)(1)(G)(III), (IV). Section 12(d)(1)(G)(III) provides that either (i) the acquiring company does not pay any distribution-related charges with respect to the acquired shares or the acquiring fund does not charge sales loads or distribution-related fees itself, or (ii) sales loads and distribution-related charges with respect to acquiring fund shares and acquired fund shares, when aggregated, are not excessive under rules adopted under section 22(b) or 22(c) of the Act by a securities association registered under section 15A of the Securities Exchange Act or the Commission.

¹¹⁸ See *supra* note 36. These orders have included the following conditions: (i) Shares of the acquired money market fund are not subject to sales loads, distribution-related fees, or service fees, or if they are, the acquiring fund's adviser will waive its advisory fee in an amount to offset the amount of fees incurred by the acquiring fund; (ii) before approving any advisory contract for the acquiring fund, its board of directors, including a majority of independent directors, considers the extent to which (if any) the advisory fees charged by the adviser should be reduced to account for reduced services as a result of investing cash in the money market fund; (iii) the acquiring fund's investment in money market funds is limited to 25 percent of the acquiring fund's total assets; (iv) the acquiring fund's investment in the money market fund is consistent with the acquiring fund's policies as set forth in its registration statement; (v) the acquiring fund and money market fund are advised by the same adviser; and (vi) the acquired money market fund cannot acquire securities in another fund in excess of the limits of section 12(d)(1)(A) of the Act.

¹¹⁹ Investments in unregistered funds have been subject to the following conditions: (i) The unregistered money market fund complies with rule 2a-7; (ii) the investment adviser to the unregistered