

cause the acquiring fund to lose its exemption, while a strict standard of compliance could result in the acquiring fund's loss of the exemption. The proposed rule does not include certain conditions imposed in the orders that we believe are addressed by other provisions of the Act or rules thereunder, and with which the unregistered fund would have to comply.

Proposed rule 12d1-2 would codify our exemptive orders that permit an affiliated fund of funds to acquire securities issued by a fund in a different fund group under section 12(d)(1)(F) or 12(d)(1)(A). The proposed rule also would permit an affiliated fund of funds to acquire securities not issued by a fund. An affiliated fund of funds that invests in another fund under section 12(d)(1)(A) or (F) could acquire no more than 3 percent of the shares of any acquired fund in a different fund group. An acquiring fund that invests in securities issued by a fund in a different group under section 12(d)(1)(A) could invest no more than 5 percent of its assets in any one fund in a different group, or 10 percent of its assets in funds in a different group (or groups) in the aggregate. A fund that acquires securities under section 12(d)(1)(F) would not be limited in the amount of assets it could invest in funds in a different fund group. The acquiring fund would, however, be limited to charging a 1½ percent sales load on its shares, subject to voting restrictions with respect to acquired fund securities, and limited in the amount of an acquired fund's securities it could redeem in any period of less than 30 days.<sup>123</sup> The proposed rule would allow funds to choose from one of two sets of conditions under which they may invest in funds outside the fund group. We believe that there may be benefits to permitting funds the ability to invest under either section, whichever may be more beneficial to the fund, and we seek comment on this issue.

Proposed rule 12d1-3 codifies the exemptive orders we have issued permitting funds relying on section 12(d)(1)(F) to charge a sales load in excess of 1½ percent, provided the aggregate sales load and distribution fees on acquiring and acquired fund shares are not excessive under the NASD Sales Charge Rule. This exemption also would be available to an affiliated fund of funds relying on proposed rule 12d1-2 to invest in funds in a different fund group.<sup>124</sup> We seek

comment on the benefits and costs of this proposal.

We anticipate that funds and their shareholders would benefit from the proposed rules. As discussed above, funds increasingly have sought exemptive orders (which the Commission has granted) to engage in most of the activities the proposed rules would permit. The application process involved in obtaining exemptive orders imposes direct costs on funds, including preparation and revision of an application, as well as consultations with the staff. The proposed rules would benefit funds and their shareholders by eliminating the direct costs of applying to engage in activities permitted under the rule.<sup>125</sup> The proposed rules would further benefit funds by eliminating the uncertainty that a particular applicant might not obtain relief to engage in the activities permitted under the proposed rules.

The exemptive application process also involves other indirect costs. Funds that apply for an order to permit additional investments forego beneficial investments until they receive the order, while other funds forego the investment entirely rather than seek an exemptive order because the cost would exceed the anticipated benefit of the investment. Eliminating direct and indirect costs of the proposed activities also eliminates factors that discriminate against smaller funds, for which the cost of an exemptive application consistently exceeds the potential benefit.

## 2. Costs

We do not believe that the proposed rules would impose mandatory costs on any fund. As discussed above, the rules are exemptive, and we believe that no fund would rely on any of them if the benefits did not outweigh the costs of relying on the rule.

We believe the costs of relying on the proposed rules would be the same as or less than the costs to a fund that relies on an existing exemptive order because

each of the proposed rules includes the same or fewer conditions than existing orders that provide equivalent exemptive relief.<sup>126</sup> As noted earlier, we assume a fund would only bear the costs of obtaining and complying with an order if the benefits of the order outweighed those costs.

The rule will affect different types of funds in different ways. For a fund that has not sought and would not seek exemptive relief from the statute, the proposed rules would have no effect. For a fund that currently relies on an exemptive order there may be one-time "learning costs" in determining the difference between the order and the rule. After making this determination, the costs of relying on any of the rules would be the same as or less than the costs of relying on an order providing similar exemptive relief. In addition, a fund that currently relies on an exemptive order could satisfy all the conditions of any of the proposed rules that provide similar exemptive relief without changing its operation. In the case of rule 12d1-1, the fund would simply be satisfying conditions that are no longer required.

A fund that has not relied on an exemptive order and that intends to rely on one of the proposed rules in the future would have to determine how that rule fits into the fund's business model and the potential costs associated with complying with the rule. Nevertheless, if the Commission never promulgated the rule, those funds would bear the same costs if they considered applying for an exemptive order. Moreover, in the absence of the proposed rules, if these funds applied for exemptive orders and obtained them, their total costs would be the same as or greater than the costs associated with the proposed rules.

## B. Proposed Amendments to Forms N-1A, N-2, N-3, N-4, and N-6

Forms N-1A, N-2, and N-3 currently do not require registered funds to disclose information regarding the expenses associated with acquired funds. The proposed amendments to Form N-1A would require a registered

<sup>125</sup> For example, in calendar years 2001 and 2002, 24 funds sought exemptive relief to invest uninvested cash and/or cash collateral from securities lending activities in money market funds, and 8 of those funds also sought exemptive relief to invest cash collateral in unregistered money market funds. In the past 5 years, 13 funds investing in other funds in the same fund group in reliance on section 12(d)(1)(G) have sought exemptive relief to invest in securities other than government securities or short-term paper. During that time, 11 funds investing in other funds in reliance on section 12(d)(1)(F) have sought exemptive relief to charge a sales load greater than 1½ percent, subject to the NASD Sales Charge Rule. The cost to a fund for submitting one of these applications ranges from approximately \$7,000 to \$67,000. These figures are based on conversations with attorneys and fund employees who have been involved in submitting applications to the Commission.

<sup>123</sup> See *supra* note 114.

<sup>124</sup> See *supra* note 123 and accompanying text.

<sup>126</sup> Under the current system, a fund could obtain the proposed relief by obtaining an exemptive order and complying with the conditions in the order, and a fund incurs costs in obtaining exemptive relief under this system. Our analysis compares the costs a fund would bear to comply with the proposed rules with the costs a fund would bear under the current system to obtain equivalent exemptive relief. Because the conditions in the proposed rules are the same or less onerous than the conditions in the exemptive orders, the costs discussed in this section primarily are costs that a fund would bear to obtain an exemptive order and comply with its conditions.