

Fund of Funds Flexibility

by W. John McGuire and Holly Hunter-Ceci

On July 19, 2006, the Securities and Exchange Commission (SEC) adopted the long-awaited “funds of funds” rules that were originally proposed in October 2003 (Adopting Release).¹ New Rules 12d1-1, 12d1-2, and 12d1-3 under the Investment Company Act of 1940 (1940 Act) (New Rules) provide greater flexibility to funds by permitting (1) cash sweep arrangements with registered and unregistered funds, (2) affiliated funds of funds to invest in shares of unaffiliated funds and other securities, and (3) funds of funds that rely on Section 12(1)(F) to impose a sales load and distribution fee structure that complies with the NASD limits. Forms N-1A, N-2, N-3, N-4, and N-6 (Forms) were also amended to require disclosure of the underlying funds’ fees and expenses.

The New Rules and Form amendments became effective July 31, 2006. Both new registration statements and post-effective amendments that are annual updates to effective registration statements filed on or after January 2, 2007, must reflect the new Form amendments.

In general, the New Rules provide much greater flexibility to funds that invest only a portion of their assets in other funds and to true funds of funds. The New Rules add flexibility in structuring sales loads, implementing investment strategies, and using cash sweep vehicles, including using unregistered funds for cash sweeps. The SEC also has eliminated many of the conditions contained in prior section 12(d)(1) exemptive orders. However, the SEC reiterated its position that fund boards, though not strictly required, should carefully review the funds of funds arrangements for conflicts of interest and duplicative advisory expenses.

W. John McGuire is a Partner and Holly Hunter-Ceci is an Associate with Morgan, Lewis & Bockius LLP in Washington, DC. Copyright © 2006 Morgan, Lewis & Bockius LLP.

Background: Sections 12(d)(1)(A) and (B)

Congress enacted Section 12(d)(1) (then Section 12(c)(1)) of the 1940 Act as a result of the SEC’s Investment Trust Study.² The Investment Trust Study found that companies could create complicated pyramid investment company structures by obtaining control of one investment company and causing it to invest in another investment company, and so forth until the company at the pyramid’s top was able to control multiple levels of investment companies and their assets. In addition, the value of a pyramid investment company’s shares was subject to extreme volatility because of the impact of leverage on multiple levels of investment companies. Further, fund of fund shareholders, due to the complexity of the pyramid structures, had little idea of who controlled the pyramids and how these control persons exerted their influence to cause the fund to buy shares of affiliated companies and provide underwriting opportunities to affiliated brokers.³ As a result of the Investment Trust Study’s findings, the 1940 Act has always contained restrictions in Section 12 on how much a registered investment company could purchase of another investment company.⁴

Congress amended Section 12 in 1970 to close a loophole exploited by foreign-based fund holding companies.⁵ Before the amendment, the Section's restrictions applied to only *registered* investment companies, which meant that *unregistered* investment companies could invest, without limit, in shares of registered investment companies. In the aftermath of the activities of these unregistered fund holding companies, the SEC's report to Congress, *Public Policy Implications of Investment Company Growth* (PPI Report) described fund of fund abuses that included (1) the threat of large-scale redemptions of the acquired fund's shares; (2) layering of fees and expenses (such a sales loads, advisory fees, and administrative costs); (3) "largely illusory" diversification benefits; and (4) unnecessary complexity.⁶ As a result of the PPI Report, Congress revised Section 12(d)(1) to be the present Sections 12(d)(1)(A) and 12(d)(1)(B).⁷

Section 12(d)(1)(A) restricts an investment company's ownership of other investment companies. It prohibits (1) an investment company, including an unregistered investment company, and any other companies it controls, from acquiring securities of a registered investment company and (2) a registered investment company, and any other

companies it controls, from acquiring securities of an investment company, including an unregistered investment company, if such securities exceed the following limits:

1. 3 percent of the total outstanding voting stock of the acquired company;
2. More than 5 percent of the total assets of the acquiring company; or
3. More than 10 percent of the total assets of the acquiring company, together with the securities of any other investment companies.

Section 12(d)(1)(B) restricts investment company pyramiding by limiting the amount a registered investment company can sell to another investment company. It prohibits a registered open-end investment company, its principal underwriter, and any other broker-dealer from selling the investment company's shares to another investment company, including an unregistered investment company, if the sale will cause:

1. The acquiring company to own more than 3 percent of the acquired company's voting stock; or
2. More than 10 percent of the acquired company's voting stock to be owned by investment companies generally.

The result of Sections 12(d)(1)(A) and (B) acting together are that investment companies are permitted to take only small positions in other investment companies.

ASPEN PUBLISHERS



© 2006 by Aspen Publishers. All Rights Reserved

The Investment Lawyer (ISSN 1075-4512) (USPS P0000-062) is published monthly for \$410 per year, \$697 for two years, \$984 for three years, and a single issue is \$41 by Aspen Publishers, at 76 Ninth Avenue, New York, NY 10011. Postmaster: Send address changes to *The Investment Lawyer*, Aspen Publishers Distribution Center 7201 McKinney Circle, Frederick, MD 21704.

Permission requests: For information on how to obtain permission to reproduce content, please go to the Aspen Publishers website at www.aspenpublishers.com/permissions. **Purchasing reprints:** For customized article reprints, please contact *FosteReprints* at 866-879-9144 or go to the *FosteReprints* website at www.fostereprints.com.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other professional assistance is required, the services of a competent professional person should be sought.—From a *Declaration of Principles* jointly adopted by Committee of the American Bar Association and a Committee of Publishers and Associations.

Visit Aspen's Web site www.aspenpublishers.com

Cash Sweeps: Rule 12d1-1

Over the years, and as a result of more than 80 exemptive applications,⁸ the SEC became convinced that cash sweep money market fund arrangements (when a fund invests excess cash in a money market fund for a short period of time) did not present the abuses set forth in the PPI Report or the Investment Trust Study.⁹ New Rule 12d1-1 permits investment companies, including closed-end funds, unregistered funds, and business development companies, to invest in registered and unregistered money market funds (provided that the unregistered money market fund complies with certain conditions as described subsequently) without limit.¹⁰

Registered Money Market Funds

However, the SEC noted that a fund's investment in money market funds would subject the

investing fund to the potential layering of expenses. As a result, the Rule prohibits the fund from paying a sales load, distribution fees, or service fees on acquired money market fund shares, unless the fund's adviser waives a sufficient amount of its fee to cover the cost of the money market fund's sales load or distribution fees.¹¹

Unregistered Money Market Funds

As previously stated, for a fund to invest in an unregistered money market fund beyond the Section 12(d)(1) limits, the unregistered Money Market fund must comply with certain conditions. These conditions, while less onerous than the conditions found in the cash sweep exemptive orders, remain significant.

First, an unregistered money market fund's investment adviser must be registered with the SEC. In addition, the investing fund must "reasonably believe" that the unregistered money market fund operates in compliance with Rule 2a-7, Sections 17(a), 17(d), 17(e), Section 18, and Section 22(e) and has adopted procedures designed to ensure compliance with those provisions (Procedures).¹² The SEC noted that the investing fund could receive a representation from the money market fund or its adviser certifying that the money market fund would comply in all material aspects with the Rule's applicable requirements. So long as the fund has no reason to believe that the money market fund is not complying with its representation, the fund could be assured that it met the Rule's standard of reasonable belief.¹³

The unregistered money market fund must also maintain books and records describing the Procedures, maintain the records required by Rules 31a-1(b)(1), 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9), and preserve permanently, the first two years in an easily accessible place, all books and records required to be made under the Procedures (collectively, Required Records). The unregistered money market fund is also required to make these Required Records available to the SEC and its staff.

In addition to exempting a fund from Sections 12(d)(1)(A) and 12(d)(1)(B), the Rule provides an exemption from Section 17(a) and Rule 17d-1, which govern affiliated and joint transactions, respectively,¹⁴ and provides an exemption from certain monitoring and recordkeeping requirements under Rule 17e-1. The exemptions from Rule 17e-1 provide that if a fund becomes affiliated with a broker, or more precisely, becomes an affiliate of an affiliate of the broker because the

fund owns more than 5 percent of a money market fund (and the broker and the money market fund are otherwise affiliates), the fund's commissions paid to the affiliated broker will be deemed as not exceeding the usual and customary broker's commission under Section 17(e)(2)(A). Therefore, if a fund becomes affiliated with a broker simply because both the fund and broker are affiliates of the money market fund in which the fund invests, any commissions the fund pays to the affiliated broker are not subject to the Fund's Rule 17e-1 procedures.¹⁵

However, the SEC has not made corresponding amendments to Form N-1A disclosure requirements. An open-end fund will have to report the commissions paid to these "affiliated" brokers in its statement of additional information (SAI) as part of the requirements of Item 16.¹⁶ As a result, open-end funds will have to monitor these inadvertent broker affiliations in order to disclose them in the SAI. One relatively easy method for determining which brokers a fund needs to track is to review the money market fund's most recent SAI for a list of affiliated brokers. Of course, it is significantly more difficult for open-end funds to monitor their affiliations with unregistered money market funds, which have no requirement to annually update their offering materials. In general, the information unregistered funds typically provide to investors is less transparent. Therefore, it will be difficult for an open-end fund to obtain information about an unaffiliated and unregistered money market fund's affiliated brokers without cooperation from the money market fund.

Changes from Existing Exemptive Orders

The new Rule codifies many of the conditions of numerous exemptive orders the SEC has granted over the years, but generally provides greater flexibility. For example, prior exemptive order conditions limited a fund's investment to 25 percent of the investing fund's total assets and required the fund to "determine," rather than the Rule's lesser standard of "reasonably believe," that an unregistered money market fund complied with Rule 2a-7, adopted and complied with the Procedures, and adhered to the recordkeeping requirements identified.¹⁷

Prior orders also required the fund's adviser to provide the fund's board (Board) with specific information regarding the approximate cost of managing the fund's investment of idle cash. The Board was required to review this information as part of its approval of the investment advi-

sory agreement as required by Section 15(c) (15(c) Meeting). In reviewing the information, the Board was required to consider whether the investment advisory fees should be reduced as a consequence of duplicative management services provided by the cash sweep. The 15(c) Meeting's minutes were also required to reflect the Board's consideration and findings regarding the potential advisory fee duplication.

Now, instead of requiring the Board to make such a determination and memorialize it in the 15(c) Meeting minutes, the SEC stated in the Adopting Release that Fund directors should exercise their fiduciary duties in overseeing the fees charged by the cash sweep arrangement. In a footnote, however, the SEC reiterated the conditions of prior orders, stating that "to the extent advisory services are being performed by another person, such as the adviser to an acquired money market fund, [the Board's] fiduciary duty would require an acquiring fund's adviser to reduce its fee by the amount that represents compensation for the services performed by the other person."¹⁸ Nonetheless, for the Board to be able to consider whether the advisory fees of the Fund and cash sweep are duplicative, the Board will need information on these fees. Moreover, the most likely time for this review to occur would be at the 15(c) Meeting. It also seems likely that this discussion would be part of the 15(c) Meeting minutes or in the shareholder reports as part of the disclosure of the Board's approval of the advisory contract(s).¹⁹ Therefore, while not part of the Rule, the SEC appears to have grafted at least some of prior exemptive orders' conditions onto the Rule by this footnote in the Adopting Release.

Greater Flexibility for Affiliated Fund of Funds Arrangements: Rule 12d1-2

Section 12(d)(1)(G)

The National Securities Market Improvement Act of 1996 added Section 12(d)(1)(G) to the 1940 Act.²⁰ Section 12(d)(1)(G) permits open-end funds and unit investment trusts (UITs) to purchase shares of other open-end funds and UITs, respectively, in excess of the limits of Section 12(d)(1)(A) provided that the funds and/or UITs are part of the same group of investment companies (*i.e.*, part of the same fund family). Under the section, these affiliated funds of funds can only invest in funds in the same fund family, US Government

securities, and short-term paper. In addition, sales loads and distribution fees, aggregated at the first and second tier levels, must not exceed the NASD limits set forth in Conduct Rule 2830(d) (Sales Charge Limits).²¹

Rule 12d1-2: Investments in Unaffiliated Funds and Other Securities

New Rule 12d1-2 provides much greater flexibility to affiliated funds of funds. It permits these funds to invest in other securities, such as stocks and bonds and unaffiliated funds, provided that the investment in unaffiliated funds is in reliance on, and within the limits of, Section 12(d)(1)(A) or Section 12(d)(1)(F) (Section 12(d)(1)(F) is discussed in more detail *infra*). In addition, (1) the fund's investment in unaffiliated funds must be consistent with its investment policies, (2) the total distribution and sales expenses aggregated for the acquired and acquiring fund must not exceed the Sales Charge Limits, and (3) each underlying affiliated fund, except any underlying money market funds, must have a policy that prohibits it from acquiring any securities of registered investment companies or UITs in reliance on Section 12(d)(1)(G) or (F), and any rules thereunder. Rule 12d1-2(a)(3) also provides that a fund of funds may invest in money market funds in accordance with Rule 12d1-1 (*i.e.*, beyond the Section 12(d)(1)(a) limits).

Changes from Exemptive Orders. As with cash sweep exemptive orders, there have been several exemptive orders allowing funds of funds otherwise relying on Section 12(d)(1)(G) to invest in other securities and unaffiliated funds. Rule 12d1-2 is less restrictive than the conditions of those prior exemptive orders.²² For example, prior orders required a fund that inadvertently obtained control through a decrease in an unaffiliated acquired fund's shares to vote its shares in proportion with the other acquired fund shareholders (in the case of a separate account, it also could seek voting instructions from its contract owners). In addition, a fund of funds or its affiliates could not receive any compensation from an unaffiliated fund or an unaffiliated fund affiliate in connection with any services, transactions, or the investment by the fund of funds in the unaffiliated fund.

Consistent with exemptive orders for cash sweeps, prior exemptive orders also required the investing fund's board to consider at its 15(c) Meeting whether the investment advisory fees should be reduced to account for reduced services being provided by the underlying funds. The minutes of the

15(c) Meeting were required to discuss the board's consideration and findings.²³ All of these prior conditions have been completely discarded.²⁴

Greater Flexibility and Greater Potential Conflicts. While Rule 12d1-2 offers much greater flexibility to a fund of funds relying on Section 12(d)(1)(G) by permitting investments in securities and unaffiliated funds, those funds need to be sensitive to the greater potential for conflicts of interest. For example, an affiliated fund of funds previously had little or no choice but to invest in affiliated funds. Now, however, there is an option to invest in an unaffiliated fund, and the unaffiliated fund may be cheaper and have a better performance record than its affiliated equivalent. Further, exchange traded funds (popularly known as ETFs) tend to have lower expense ratios than actively-managed funds and, in some instances, index mutual funds.

Greater Flexibility in Structuring Sales Loads: Rule 12d1-3

Section 12(d)(1)(F), which has been part of the 1940 Act since its adoption, provides an exception from the limits of Section 12(d)(1). It permits registered investment companies, including open-end and closed-end funds, and their affiliates to purchase up to 3 percent of an underlying fund's securities provided that the fund's sales load does not exceed 1.5 percent.²⁵ Section 12(d)(1)(F) also provides that the acquired fund is not obligated to redeem its securities, held by a fund relying on this section, in an amount exceeding one percent of its total outstanding securities during a 30-day period. Finally, the acquiring fund must either vote its underlying fund shares in proportion with the other outstanding underlying fund shares, or it must seek voting instructions from its shareholders.

New Rule 12d1-3 provides that funds relying on Section 12(d)(1)(F) may charge a sales load greater than 1.5 percent, so long as an investor's total distribution and sales expenses do not exceed the Sales Charge Limits. This codifies the conditions of exemptive orders in permitting funds to charge sales load and distribution expenses up to the Sales Charge Limits.²⁶

Amendments to the Forms

Until now, the Forms did not necessarily contemplate disclosure regarding investments in other funds. Now, whether a fund is relying on one of the New Rules, or otherwise investing in other funds, the amendments to the Forms now require

specific disclosure regarding those investments. The amendments to each Form are substantially similar. Any registered investment company that invests in shares of another fund must include in the fee table of the prospectus an additional line item, "Acquired Fund Fees and Expenses," although a fund may use another term to describe the acquired fund. This line item should appear directly above the line item "Total Annual Fund Operating Expenses," or the Form's equivalent.

The expenses of the underlying fund (including a feeder fund, in case of a master-feeder arrangement) should include not only the total annual operating expenses of the underlying fund, but also any transaction fees, such as redemption fees or purchase fees, paid over the past year, using the average invested balance and the number of actual days invested in each underlying fund. These underlying fund expenses should be based on the underlying funds' net expenses (which would include any waivers) as reported in their most recent shareholder report. As a result, the total annual operating expenses may not match the expense ratio set forth in the financial highlights, because the ratio in the financial highlights does not take into account the underlying fund operating expenses or transaction fees. Each Form provides that a fund may elect to disclose this inconsistency in a footnote to the fee table.

If the underlying fund is new and has not provided a shareholder report, the acquiring fund should use the ratio of expenses to average net assets for the underlying fund's most recent communication to the fund.²⁷ A new acquiring fund should estimate the underlying fund expenses based on those underlying funds in which it intends to invest, and disclose in a footnote that the expense is an estimate.

If the underlying fund expenses do not exceed 0.01 percent of the average net assets of the acquiring fund, the line item may be omitted from the fee table. Instead, any underlying fund expenses would be included in the "Other Expenses" line item.

As with the other Forms, the Form N-2 amendments require a registered closed-end fund of funds to disclose, as a separate line item in the fee table, its fees and expenses incurred by investing in underlying funds. Particularly relevant to closed-end funds of hedge funds, these underlying fund fees and expenses should include performance fees, management fees and expenses, transaction fees, and any incentive allocations (fees based on appreciation, capital gains, or a share of income) charged by the underlying funds.²⁸ These underlying fund fees and expenses should not include any performance fees

that are calculated solely on the realization and/or distribution of gains or the sum of the realization and/or distribution of gains and unrealized appreciation of assets distributed in-kind.²⁹

The fund of funds must determine the expenses it paid to the underlying funds over the past fiscal year in addition to any proposed investments financed with the proceeds of its present offering, as calculated based on what they would have been for the past fiscal year. Funds must include a footnote disclosing the underlying funds' typical incentive fees and a statement that incentive fees may be higher or lower based on the performance of the underlying funds, which may fluctuate over time.³⁰

Summary

The New Rules provide much needed flexibility to fund of funds arrangements, particularly for cash sweeps and affiliated fund of funds. Although many funds of funds have improvised methods to disclose the expense of investing in underlying funds, the Form amendments will provide investors with a uniform method of providing for transparency of expenses. Arguably, this uniform disclosure could lead to more competitive pricing for fund of funds. However, even with the New Rules and the Form amendments, funds and their Boards should remain sensitive to potential conflicts of interests and the unnecessary duplication of advisory fees.

NOTES

1. Final Rule: Fund of Funds Investments, Investment Company Act Rel. No. 27399 (July 19, 2006) (Adopting Release).
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. The Investment Company Act of 1940, Alfred Jaretzki, Jr., Washington University Law Quarterly, Vol. XXVI, p.325 (April, 1941).
4. *Id.*
5. In the 1960s, Fund of Funds Ltd., an unregistered fund operated in Geneva, Switzerland and marketed to US military personnel stationed overseas, engaged in many of the abuses detailed by the Investment Trust Study, including charging shareholders duplicative fees, directing underwriting and other brokerage business to a funds of fund affiliate, and charging sales loads at multiple levels. See Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess., 312-24 (1996) (PPI Study).
6. *Id.*
7. In addition to Sections 12(d)(1)(A) and 12(d)(1)(B), Congress also added Section 12(d)(1)(E), which permits mas-

ter-feeder arrangements, as well as insurance company separate accounts and contractual plans organized as UITs to invest all of their assets in investment company shares.

8. Proposed Rules: Fund of Funds Investments, Investment Company Act Rel. No. 26198 (Oct. 8, 2003) (Proposing Release) at Section II.A.
9. In the Proposing Release, the SEC staff noted that it was convinced by exemptive applications that cash sweep programs could achieve "greater efficiencies, reduce fund management expenses, and increase returns" as well as permit the fund's portfolio manager to concentrate on the principal investment strategies of the fund, rather than on cash management. The staff also noted that a fund's investment in money market funds do not present the opportunity to unduly influence the money market fund by accumulating a control position, given the large flows into and out of money market funds. *Id.*
10. Unregistered funds do not need an exemption from Sections 12(d)(1)(A) or 12(d)(1)(B) to purchase unregistered funds, but they do need an exemption from the Section to purchase registered funds.
11. See the Proposing Release, *supra* n.8. The Proposing Release defined Rule 12b-1 fees, sales loads or services fees as "Administrative Fees." However, this was eliminated in the adopted Rule 12d1-1 as the term was used elsewhere.
12. Any provision of Rule 2a-7 that requires board action can be performed by the unregistered money market fund's adviser, if the fund does not have a board.
13. See the Adopting Release, *supra* n.1 at Section IV.A.1. In addition, if the unregistered money market fund did not comply with its representation and the fund had no reason to know of the noncompliance, the fund would not lose the Rule 12d1-1 exemption.
14. Section 17(a) generally prohibits sales or purchases of securities between a registered investment company and any affiliated person of the company, including "first tier" affiliates (affiliates of the registered investment company) and "second tier" affiliates (affiliated persons of the first tier affiliates). Section 2(a)(3) defines an "affiliated person" of another person to include any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the other person, and any person directly or indirectly controlling, controlled by, or under common control with, such other person. Section 17(d) prohibits first and second-tier affiliates, and affiliated persons of the registered investment company's principal underwriter, acting as principal, from effecting any transaction in which the registered investment company, or its controlled company, is a joint or a joint and several participant with the affiliate in contravention of SEC rules. Rule 17d-1 prohibits first and second-tier affiliates, acting as principal, to participate in or effect any transaction in connection with a joint enterprise or other joint arrangement in which the registered investment company is a participant, without prior SEC approval.
15. Rule 17e-1 includes a set of conditions that, if satisfied, provides that the brokerage commission shall be deemed as not exceeding the usual and customary broker's commission for purposes of Section 17(e)(2)(A).
16. Item 16(b) of Form N-1A requires funds to identify each affiliated broker and disclose the aggregate dollar amount of brokerage commissions paid over the last three fiscal years. In addition, funds must disclose (i) the percentage of brokerage

commissions paid to the affiliated broker during the most recent fiscal year, (ii) the percentage of the fund's aggregate dollar amount of transactions involving the payment of commissions effected through the broker during the most recent fiscal year, and (iii) the reason for any material differences in brokerage commissions paid (including dollar amount of brokerage transactions) to an affiliated broker over the last three fiscal years.

17. See Adopting Release, *supra* n.1 at note 25, *citing* Vanguard Group, Inc., *et al.*, Investment Company Act Rel. Nos. 26406 (Mar. 29, 2004) (notice) and 26436 (Apr. 23, 2004) (order), Putnam American Government Income Fund, *et al.*, Investment Company Act Rel. Nos. 26200 (Oct. 1, 2003) (notice) and 26414 (Apr. 9, 2004) (order); Credit Suisse Asset Management, LLC, *et al.*, Investment Company Act Rel. Nos. 25789 (Oct. 29, 2002) (notice) and 25832 (Nov. 22, 2002) (order).

18. See Adopting Release, *supra* n.1 at note 52.

19. See Final Rule: Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, Investment Company Act Rel. No. 26486 (June 30, 2004).

20. The National Securities Market Improvement Act also added Section 12(d)(1)(J) to the 1940 Act. Section 12(d)(1)(J) authorizes the SEC to grant exemptions to Section 12(d)(1), by rule or by order, provided that such exemptions were in the public interest and consistent with investor protection. Pub. L. No. 104-290, 111 Stat. 3416 (1996).

21. Sections 12(d)(1)(G)(i)(III)(aa) and 12(d)(1)(G)(i)(III) (bb), read together, provide that the sales loads and distribution expenses cannot be excessive under SEC or NASD rules. NASD Conduct Rule 2830(d) sets forth the applicable limits.

22. See Proposing Release, *supra* n.8 at note 72, *citing* Scudder Kemper Investments, Inc., Investment Company Act Rel. Nos. 23691 (Feb. 11, 1999) (notice) and 23731 (Mar. 8, 1999) (order) and Nations Fund Trust, Investment Company Act Release Nos. 24781 (Dec. 1, 2000) (notice) and 24804 (Dec. 27, 2000) (order).

23. *Id.*

24. It will be interesting to see if these lack of conditions in the Rule will result in fewer conditions or at least a change in the standard conditions found in other exemptive orders under Section 12(d)(1). See, e.g., SPDR Trust, Series 1, Investment Company Act Rel. Nos. 26392 (March 23, 2004) (notice) and 26419 (April 19, 2004) (order); BLDRS Index Funds Trust, Investment Company Act Rel. Nos. 26386 (March 15, 2004) (notice) and 26415 (April 9, 2004) (order); iShares Trust, Investment Company Act Rel. Nos. 25969 (March 21, 2003) (notice) and 26006 (April 15, 2003) (order); and PADCO Advisors, Inc., Investment Company Act Rel. Nos. 24678 (October 5, 2000) (notice) and 24722 (October 31, 2000) (order).

25. Because this structure is explicitly permitted by the Act, these funds are often called "statutory funds of funds."

26. See the Proposing Release, *supra* n.8 at note 87, *citing* Investec Ernst Company, Investment Company Act Rel. Nos. 25552 (Apr. 24, 2002) (notice) and 25552 (Apr. 24, 2002) (order) and Lifetime Achievement Fund, Inc., Investment Company Act Rel. Nos. 24453 (May 12, 2000) (notice) and 24489 (June 7, 2000) (order).

27. In this case, the underlying fund expenses should include increases resulting from brokerage service and expense offset arrangements and reductions resulting from advisory or sponsor fee waivers or reimbursements. Funds should not include any expense, such as a performance fee, that is incurred solely on the realization and/or distribution of a gain. If the underlying fund has no performance, funds should use the fee payable to the underlying fund's investment adviser or its affiliates as stated in the underlying fund's prospectus, offering materials, or similar documents.

28. See Instruction 10 to Item 3.1 of Form N-2.

29. See Adopting Release, *supra* n.1 at p.28 *citing* Instruction 10.d to Item 3.1 of Form N-2.

30. See Instruction 3.10(g) of Form N-2.