

# SEC Adopts New Rules and Disclosure Requirements for Fund of Funds Investments

BY ERIC PINCISS

On June 20, 2006, the SEC adopted three new rules and amendments to several forms under the Investment Company Act of 1940 (the “1940 Act”) that address fund of funds arrangements. The new rules codify several exemptions from the 1940 Act that the SEC has issued over the years, while the forms are intended to provide greater transparency of investor expenses in these arrangements.

**Rule 12d1-1:** Permits a fund to engage in “cash sweep arrangements,” under which a fund may purchase shares of affiliated or unaffiliated, registered or unregistered money market funds in excess of the 1940 Act’s Section 12(d)(1) limitations. An acquired money market fund cannot charge an acquiring fund a sales load, distribution fee, or service fee without a waiver by the acquired money market fund’s investment adviser to offset the cost of the loads or distribution fees. The rule also provides exemptions from Section 17(a) of the 1940 Act and Rule 17d-1 thereunder, which otherwise would restrict a fund’s ability to enter into transactions and joint arrangements with affiliates.

**Rule 12d1-2:** Permits greater flexibility to fund of funds arrangements that invest exclusively or primarily in funds in the same fund group in reliance on Section 12(d)(1)(G). In particular, the rule allows an affiliated fund of funds (i) to acquire shares of funds that are not part of the same group of investment companies, subject to the limits in Section 12(d)(1)(A) or Section 12(d)(1)(F); (ii) to invest directly in stocks, bonds, and other types of securities (i.e., securities not issued by a fund); and (iii) to invest in affiliated or unaffiliated money market funds in reliance on Rule 12d1-1.

**Rule 12d1-3:** Rule 12d1-3 allows greater flexibility for a fund that invests small amounts in many unaffiliated funds to structure the sales load it charges without complying with the sales load limitation in Section 12(d)(1)(F), which caps an acquiring fund’s sales load at 1.5%. Under the new rule, an acquiring fund (and its affiliates) may purchase up to 3% of an acquired fund as long as the acquiring fund does not charge a sales load exceeding the limits on sales loads established by NASD Sales Charge Rule 2830(d)(3).

Form Amendments: Forms N-1A, N-2, N-3, N-4, and N-6 were amended to require a registered fund that invests any of its assets in another fund, including an unregistered fund such as a hedge fund, to disclose in its fee table the cumulative amount of expenses charged by the fund and any fund in which it invests.

New Rules 12d1-1, 12d1-2, and 12d1-3 became effective on July 31, 2006. All new registration statements on the indicated forms, and all post-effective amendments that are annual updates to effective registration statements on any of those forms filed on or after January 2, 2007, must include the disclosure required by the form amendments.



## Congratulations

**Shaunda Patterson-Strachan** is the 2006 Chair of the Life Insurance Law Committee of the Tort Trial and Insurance Practice Section (TIPS) of the American Bar Association. Her term officially began at the ABA annual meeting in August.

**Elizabeth Bohn** has been elected a member of The Fellows of the American Bar Foundation. Established in 1952, the mission of the Foundation is to advance justice through research on law, legal institutions, and legal processes.