IDC Independent Directors Council

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February 1, 2021

Federal Trade Commission
Office of the Secretary
April Tabor, Acting Secretary
600 Pennsylvania Avenue, NW Suite CC-5610 (Annex J)
Washington DC 20580

Re: Premerger Notification; Reporting and Waiting Period Requirements; RIN 3084-AB46 – Notice of Proposed Rulemaking and Advanced Notice of Proposed Rulemaking (16 CFR Parts 801-803: Hart-Scott-Rodino Coverage, Exemption, and Transmittal Rules; Project No. P110014)

Dear Ms. Tabor:

The Independent Directors Council ("IDC")[1] submits these comments in response to the Federal Trade Commission's (the "FTC" or "Commission") December 1, 2020 Notice of Proposed Rulemaking and Advanced Notice of Proposed Rulemaking (the "Proposal") with respect to the Premerger Notification Rules that implement the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act").[2] IDC appreciates this opportunity to comment on the Proposed Rules, and believes that the information in our letter will be useful to the Commission in understanding the impact of the Proposal on regulated investment companies and their shareholders.

IDC represents fund independent directors who serve on the boards of mutual funds, closed-end funds, exchange-traded funds, and other investment companies ("registered funds") registered under the Investment Company Act of 1940, as amended ("1940 Act"). Independent directors and their fund boards represent the interests of more than 100 million shareholders who invest in registered funds for

[1] IDC serves the US-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute ("ICI") member funds. ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI's members manage total assets of $27.7 trillion in the United States, serving more than 100 million US shareholders, and $8.3 trillion in assets in other jurisdictions. There are approximately 1,600 independent directors of ICI-member funds.

[2] 85 Fed. Reg. 77053, 85 Fed. Reg. 77042 (Dec. 1, 2020).

retirement, college savings, and other financial goals. Therefore, IDC is uniquely positioned to provide insight into the impact of the Proposal on funds and their shareholders.

Under the current HSR rules, an acquiring "person" is limited to entities that are under common control, including: (1) the entity that proposes to acquire the voting securities in the transaction; (2) its "ultimate parent entity;"[3] and (3) any entity controlled by the ultimate parent entity, *i.e.*, "affiliates."[4] Therefore, current HSR filing requirements are appropriately limited to entities controlled by the single ultimate parent entity of the acquiring entity.

In contrast, the Proposed Aggregation Rule[5] would dramatically expand the definition of an acquiring person to also include additional "associates" which are entities *not under the control* of the ultimate parent entity, including: (1) any entity that manages the investments of the acquiring entity (the "managing entity"), (2) any other entity whose investments are managed by the managing entity, and (3) any other entity that is under common control with the managing entity.

In the registered fund context, such a change in the definition of an acquiring "person" would have an extensive impact. The Proposed Aggregation Rule would aggregate every registered fund and other client account for which an investment adviser provides investment management services, resulting in potentially hundreds or thousands of different accounts being aggregated with a registered fund for purposes of compliance with the HSR Act and its rules.

IDC is submitting these comments because we are concerned that the Proposed Aggregation Rule would significantly and adversely impact fund shareholders, without any demonstrated need for such broad application of the rule. In particular, the Proposed Aggregation Rule would inappropriately extend its reach beyond its intended purpose and in contravention to the governance structure, operations, and stringent regulatory framework of registered funds.

Each registered fund, including funds in the same complex, is subject to strict governance requirements under the 1940 Act, has distinct investment strategies and shareholders, and is individually and extensively regulated by the Securities and Exchange Commission (the "SEC"). Under the federal securities laws, the adviser to each fund has a fiduciary duty to act in the best interest of each fund. Treating each fund managed by an adviser, along with the adviser's non-fund clients, as if they were a single acquisition vehicle operating for the benefit of the investment adviser would be inconsistent with this reality. As discussed in more detail below, we have strong concerns regarding the application of the Proposed Aggregation Rule to the registered fund context and recommend that the Commission modify the Proposal in light of the unique structure of registered funds and the role of fund boards.

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[3] The term "ultimate parent entity" means an entity which is not controlled by any other entity.

[4] Under current HSR definitions, "control" exists only when one entity holds majority governance rights in another entity.

[5] As used herein, the "Proposed Aggregation Rule" refers to the Commission's proposal to re-define "person" under 16 C.F.R. § 801.1(a)(1) to include "all associates of the ultimate parent entity."

I. The Unique Governance Structure and Regulation of Registered Funds

Under the Commission's discussion of "Fund Vehicles" in its Notice of Proposed Rulemaking, registered funds (and other client accounts managed by the fund's adviser) would simply be viewed as acquisition vehicles operating for the benefit of the investment adviser.[6] This characterization does not take into account the governance and regulatory structure of registered funds and the contractual arrangements under which registered funds employ investment advisers. Therefore, we do not believe that a registered fund should be aggregated with and treated as the same person as other funds and clients managed by the same investment adviser.

A registered fund is a separate legal entity organized under state law with a unique and effective governance structure mandated under the 1940 Act, including a board of directors or trustees with fiduciary duties to oversee the fund and its shareholders' interests. A registered fund invests in a pool of stocks, bonds, and other investments in which each investor (or shareholder) owns a proportionate interest in the pool. Like operating companies, registered funds have officers and boards of directors or trustees. In contrast to operating companies, however, registered funds are generally externally managed, meaning they typically have no employees and no assets other than their investments and cash. Accordingly, registered funds rely on third-party service providers, such as the fund's investment adviser, administrator, transfer agent, and others, to carry out the day-to-day operation of the fund's affairs.

The investment adviser to a registered fund is, in the vast majority of cases, a separate entity (with its own governance and employees) that makes investment decisions for the fund subject to the oversight of the fund's board and detailed investment restrictions and limitations. The adviser must be registered under the Investment Advisers Act of 1940, and Section 206 of that Act imposes a fiduciary duty on the adviser to act in the best interests of each of its separate clients. Pursuant to a contract between the adviser and the registered fund – under the board's supervisory oversight – the adviser renders investment management services. A registered fund's investment adviser, on behalf of the fund, may engage one or more sub-advisers to manage the fund's portfolio. Importantly, the governing body and employees of an investment adviser are distinct from the board of directors of the registered funds they advise.

Director independence is essential to registered fund governance, and is built into the 1940 Act,[7] with the significant majority of fund boards having a super-majority of independent directors.[8] "The

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[6] 85 Fed. Reg. 77053 at 77055-77056.

[7] *See* 15 U.S.C. § 80a–10(a); 17 CFR § 270.0-1.

[8] Independent directors make up three-quarters of boards in 84 percent of fund complexes. *See* Overview of Fund Governance Practices, 1994-2018, Investment Company Institute, available at https://www.idc.org/pdf/19_pub_fund_governance.pdf. Virtually all boards of registered funds are composed of at least a majority of independent directors to comply with 1940 Act requirements under Rule 0-1 of the 1940 Act. 17 CFR § 270.0-1.

structure and purpose of the [1940 Act] indicate that Congress entrusted to the independent directors of investment companies . . . primary responsibility for looking after the interests of the funds' shareholders,"[9] and independent directors have a fiduciary duty to act in the best interests of the fund. Moreover, independent directors have been characterized by the courts as "'watchdogs' to protect shareholders' interests."[10]

Among independent directors' many responsibilities, one of the most important is to annually evaluate and approve the contract with the fund's investment adviser(s).[11] The advisory contract renewal process is under the control and at the discretion of the fund's independent directors, because the 1940 Act requires that a majority of the independent directors approve any contracts with investment advisers.[12] In order to be classified as "independent," a director may not be an employee or officer of, may not hold any securities issued by, and may not have any material business or professional relationship with, the fund's investment adviser.[13]

In addition, under the 1940 Act, registered funds are subject to extensive and robust regulations that restrict transactions with its investment advisers and other funds advised by that same adviser, and the 1940 Act prohibits an adviser from causing a registered fund to act in concert with the adviser or the adviser's other clients in a joint enterprise,[14] ensuring that such funds are managed solely for the benefit of their shareholders.

To further protect the fund's investors against self-dealing and potential conflicts of interest, and to ensure that a fund's assets are managed in the interests of the fund's shareholders, a fund's investment adviser and any sub-advisers are required to have a robust compliance program, including detailed policies and procedures, designed to ensure compliance with all applicable federal securities laws. The compliance program must be overseen by a single Chief Compliance Officer (CCO) that reports directly to the fund's board of directors. Rule 38a-1 under the 1940 Act, requires that, among other things, all funds must adopt and implement written policies and procedures and obtain the approval of such procedures by the fund's board of directors, including a majority of the independent directors. Importantly, Rule 38a-1 "strengthens the hand of compliance personnel by establishing a direct line of reporting to fund boards that is not controlled by management."[15]

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[9] *Chill v. Calamos Advisors LLC*, 417 F. Supp. 3d 208, 218 (S.D.N.Y. 2019) (quoting *Burks v. Lasker*, 441 U.S. 471, 484 (1979)).

[10] *Burks v. Lasker*, 441 U. S. 471, 485 (1979).

[11] 15 U.S.C. § 80a-15(c).

[12] *Id.*

[13] 15 U.S.C. § 80a–2(a)(19).

[14] 15 U.S.C. §80a-17(d); 17 CFR § 270.17d-1.

[15] *See* Compliance Programs of Investment Companies and Investment Advisers, SEC Release Nos. IA-2204 and IC-26299 (Dec. 17, 2003) (Adopting Release).

The Commission's Proposed Aggregation Rule would effectively ignore the longstanding legal and governance structure for registered funds by defining a new acquiring person in a way that would aggregate hundreds and potentially thousands of different entities.[16] This appears to be based on the perception that a common investment adviser serving multiple separate registered fund clients and other clients effectively is able to use those entities as acquisition vehicles to serve the common investment adviser's purposes. In reality, however, the fund's board, pursuant to its fiduciary duty, approves the fund's contract with the investment adviser, which then has its own fiduciary duty to the fund. And all throughout, the fund's board of directors – including the independent directors – oversees the interests of the fund's shareholders and serves as an independent check on the investment adviser to the fund.

II. The Proposed Aggregation Rule Should Not Apply to Registered Funds

A. The Premise Underlying the Proposed Aggregation Rule is Inconsistent with the Structure and Operation of Registered Funds

As discussed above, rather than the registered fund acting as an acquisition vehicle for the investment adviser, the investment adviser to the registered fund acts as an agent to manage the assets of the fund under the oversight of the fund's board of directors, investing on behalf of the fund's shareholders to which both the board and the investment adviser owe a fiduciary duty. The nature of this relationship between a registered fund (and its board of directors) and the external investment adviser is contrary to the Proposed Aggregation Rule's assumption that a registered fund serves as an acquisition vehicle for the investment adviser. As a result, the Proposal could practically treat thousands of separately managed entities and accounts that are not under common control – regardless of their inherent governance structure – as a single entity.

Likewise, the Proposed Aggregation Rule is inconsistent with the congressional intent behind the HSR Act. In 1976, Congress built exemptions into the HSR Act to exclude ordinary course transactions made solely for the purpose of investment by funds and other financial entities.[17] Consistent with this Congressional intent, the Commission built exemptions into the HSR rules for transactions made by funds solely for the purpose of investment. In particular, under current HSR rules, registered funds can qualify under the 802.64 Institutional Investor exemption.[18] In carving out an exemption for registered funds, the sponsors of the HSR Act anticipated the burdens attendant to aggregating registered funds

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[16] It is not uncommon for a single investment adviser to maintain a diverse array of separate client relationships, including but not limited to, clients such as individuals, funds, corporations, pension and profit-sharing plans, endowments, charitable organizations, other investment advisers, and government entities.

[17] *See* 15 USC § 18a(c)(9) and (c)(11).

[18] The 802.64 Institutional Investor exemption currently permits funds to invest in issuers in the ordinary course of business and solely for the purpose of investment without requiring an HSR notification filing and applies only if the acquiring person holds 15% or less of an issuer's outstanding voting securities. 16 CFR § 802.64.

with other clients advised by the same investment adviser and thus instructed the Commission not to aggregate in such a way when developing the HSR rules.[19]

The Proposed Aggregation Rule is in direct conflict with Congressional intent and would contravene the intention of the sponsors of the HSR Act with respect to its instructions not to aggregate holdings across entities under a common adviser. This should come as no surprise to the Commission; it considered these very same issues when proposing the original HSR rules in 1978. When adopting definitions of "person," "affiliate" and "control" in the HSR rules in 1978, the Commission explicitly rejected proposals that would aggregate investment funds with their investment advisers, because such proposals would be inconsistent with Congressional intent and would create administrative problems.[20]

B. The Proposed Aggregation Rule Would Disrupt Portfolio Management in Registered Funds to the Detriment of Fund Shareholders

The Proposed Aggregation Rule could significantly limit the ability of registered funds to pursue their investment objectives and strategies. Portfolio management of registered funds by asset managers must be consistent with the investment strategy disclosed in the fund prospectus. Portfolio management is a continuous process, requiring a portfolio to be adjusted in response to market conditions, investor flow activity, and rebalancing and reallocation needs, typically involving open market transactions for which timing and flexibility is critical.

Subjecting such transactions to the 30-day HSR waiting period would substantially reduce the efficiency and effectiveness of portfolio management for registered funds and put the execution of the fund's investment strategy – and the financial goals of its shareholders – at undue risk. Should a 30-day waiting period be required, investment opportunities would be lost, and portfolio rebalancing and reallocations could be disrupted. As a corollary impact, because the Proposed Aggregation Rule is so expansive, investment advisers might modify their investment management decisions to limit or cap holdings in particular issuers to avoid triggering filing obligations entirely. Shareholders, and the asset management industry, would suffer from the imposition of such artificial limitations that have no nexus to the portfolio management considerations that are fundamental to the fund's investment objectives.

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[19] *See* 122 Congressional Record SI5417 (daily ed. September 8, 1976).

[20] *See* 43 Fed. Reg. 33450 at 33460. ("The concept of affiliation arising from a less-than-control relationship has been entirely deleted. The final rules thus incorporate a suggestion made by several comments . . . that affiliation be defined no more broadly than the concept of control. The final rules make this change because of what appeared to be potential administrative problems involved in any definition of affiliation that included less-than-control relationships."). *See also* 43 Fed. Reg. 33450 at 33457 (rejecting a definition of "control" that would "regard an investment adviser that advises several separate mutual funds as controlling the funds."); *id.* at 33460 (rejecting definitions of "affiliate" that would "aggregate the holdings of mutual funds, investment companies, or other institutions that are clients of the same investment adviser.").

We also note that the Commission is considering the definition of "solely for the purposes of investment."[21] Consistent with the concerns articulated above that the Proposed Aggregation Rule would have unwarranted negative impacts on the portfolio management of registered funds, the Commission should approach the definition of "solely for the purpose of investment" in a manner that accommodates a registered fund and its adviser's ability to engage with the management of issuers in ways that advance investment decisions in the best interest of the fund's shareholders. Specifically, we believe that an approach that aligns the Commission's definition with that of the SEC's concept of a passive investor for purposes of Rule 13d-1 under the Securities Exchange Act of 1934, as amended, would facilitate appropriate diligence and engagement on behalf of registered fund shareholders, such as with respect to social or public interest issues, without danger that such engagement would cross the line into the type of influence that could implicate competition or antitrust concerns.

C. Filing Costs and Compliance Challenges Resulting from the Proposal Would Be Substantial Without A Commensurate Benefit

The effect of the Proposed Aggregation Rule would be to require a registered fund to aggregate its holdings with all other funds and other entities advised by the same investment adviser. This could potentially include hundreds or thousands of independent entities not under common control. The filing burdens and associated costs on registered funds and their advisers, which could be passed along to shareholders, could be substantial. With the minimum size of transaction threshold at only $94 million – and the fee per HSR filing currently ranging from $45,000 to $280,000 – the costs associated with multiple filings could be enormous.[22] Accordingly, as a result aggregation across many more accounts, shareholders in the registered fund industry would be subjected to a significant increase in the number of HSR filings, their filing fees, attorneys' fees, and other attendant costs.[23]

Simply administering the Proposed Aggregation Rule in the context of the registered fund industry could present highly complex and costly challenges, such as identifying the various entities that would be considered "associates" of a registered fund. For example, it is not uncommon, due to investment adviser specialization, for a single registered fund to employ multiple investment advisers or sub-advisers to manage different portions of a fund's portfolio or different funds in a trust. A single registered fund thus could have multiple "managing entities" and would have to be aggregated across all funds and clients of multiple investment advisers. Legal expertise and counsel may also be continuously required to assess a fund's investment opportunities, and systems would need to be built or contracted for to keep track of a fund's holdings to determine whether a filing would be required. For a small fund

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[21] *See* 85 Fed. Reg. 77042 at 77047.

[22] 85 Fed. Reg. 4984 (Feb. 27, 2020).

[23] In addition to increased filing fees, regulated funds will face increased expenses related to, among other things, attorneys, compliance professionals, and service providers needed to prepare the filings, and expenses to purchase or upgrade compliance programs to monitor holdings.

complex that gets caught up in the Proposed Aggregation Rule due to its business relationship with or as a sub-adviser,[24] the costs could be substantial.

It is also unclear how the Proposal would work with multiple unaffiliated advisers that operate under separate compliance systems. Significant, perhaps insurmountable, barriers exist regarding the required sharing of confidential and sensitive information about unrelated client's holdings among them in order to prepare the required HSR filings – or simply to monitor whether a filing is required in the first place. This, in turn, could inhibit a fund from changing advisers or sub-advisers when a fund board deems such action to be in shareholder interests, or to seek to change adviser relationships, to avoid filing burdens.

III. Conclusion

The unique governance and regulatory structure of registered funds under the 1940 Act calls into question the scope and intent of the Proposed Aggregation Rule. Each registered fund is a separate legal entity that is overseen by a board of directors, subject to their fiduciary duty and comprehensive and stringent governance and compliance requirements in place for the benefit of fund shareholders. One of the most important responsibilities of the independent directors of a fund board is to annually evaluate and approve the contract with its investment advisers.[25]

The proposed aggregation of registered funds with all other investment vehicles and accounts paints with too broad a brush, while imposing real and detrimental consequences. Among them, portfolio management subject to the investment strategy disclosed in the fund's prospectus could be materially disrupted. Significant filing expenses and potentially insurmountable data-gathering requirements also would harm the interests of registered funds and their shareholders. We therefore express very strong concerns regarding the Proposed Aggregation Rule and its impact on fund shareholders.

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[24] For funds of any size, the Proposed Aggregation Rule would result in ambiguities as to how sub-advisers would be treated.

[25] 15 U.S.C. § 80a-15(c).

We appreciate the opportunity to comment on the Proposed Rules. If you have any questions regarding our comment letter or would like additional information, please contact Lisa Hamman, Associate Managing Director, at (202) 371-5405 or me at (202) 326-5463.

Sincerely,

Thomas T. Kim
Managing Director
Independent Directors Council