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August 14, 2017

Douglas J. Scheidt, Esq.
Associate Director and Chief Counsel
U.S. Securities and Exchange Commission
Division of Investment Management, Chief Counsel's Office
100 F Street N.E.
Washington D.C. 20549

Re: Mutual of America Capital Management LLC

Dear Mr. Scheidt:

We request that you advise us that the staff of the Division of Investment Management (the "Staff") will not recommend that the Securities and Exchange Commission (the "SEC" or "Commission") take enforcement action under Section 17(d) of the Investment Company Act of 1940, as amended (the "1940 Act"), and Rule 17d-1 thereunder if investment companies for which Mutual of America Capital Management LLC (the "Adviser") serves as investment adviser allocate certain non-advisory operating expenses of these funds to underlying funds in which they invest and which are also advised by the Adviser, as described below.[1] For the reasons discussed below, we do not believe that the proposed allocation of expenses should be subject to Section 17(d) and Rule 17d-1.

Facts

Mutual of America Life Insurance Company ("Mutual of America") is a mutual life insurance company organized under the Insurance Law of New York. As a mutual life insurance company, Mutual of America does not have shareholders. Rather, it is operated for the benefit of its policyholders who are the participants in the retirement plans funded through Mutual of America's group annuity products and the owners of its individual annuity products.

[1] There may be situations in which funds in the Mutual of America fund complex in which the investment companies do not invest would also bear expenses of these investment companies. This situation differs from the situation in which the underlying funds which bear the fund of funds expenses are purchased by the fund of funds, in that those underlying funds derive a direct benefit from the fund of funds in the form of the enhanced sales of their shares that arise from the funds of funds' asset growth. Nonetheless, even in the situation in which funds that are not underlying funds in a funds of funds structure would pay expenses of a fund of funds that does not purchase the fund's shares, the funds that are not purchased by the fund of funds can benefit from the lowering of expense ratios that could arise from the growth of the overall fund complex.

The Adviser (Mutual of America Capital Management LLC) is an investment adviser registered with the SEC under the Investment Advisers Act of 1940, as amended, and it is an indirect, wholly owned subsidiary of Mutual of America. For all intents and purposes, the policyholders are the owners of Mutual of America and the Adviser. The Adviser provides investment advisory services to registered investment companies, to institutional investors (including pension and profit sharing plans, state and local government retirement plans, endowments and foundations, charitable organizations, and other institutional investors), and to Mutual of America and its family of companies.

Mutual of America Investment Corporation ("Investment Corporation") is a Maryland corporation registered under the 1940 Act as an open-end management investment company. The Investment Corporation is organized as a series fund with multiple series (each a "Fund" and collectively, the "Funds"). There are currently twenty-five Funds. The Funds serve as investment vehicles for account balances under variable insurance products issued by Mutual of America. Additionally, certain of the Funds serve as investment vehicles for account balances under certain variable annuity contracts and variable life insurance policies issued by a former indirect, wholly-owned subsidiary of Mutual of America.

Eleven (11) of the Funds invest directly in securities and other investments to meet the Funds' stated investment objectives (the "Underlying Funds"). The other fourteen (14) Funds invest solely in shares of Underlying Funds (the "Funds of Funds").[2] The Funds have a common board of directors (the "Board"), a majority of whom are not "interested persons" of the Investment Corporation under section 2(a)(19) of the 1940 Act (the "Independent Directors").

The Funds or the Independent Directors may want to consider having the non-advisory operating expenses of the Funds of Funds borne by the Underlying Funds. These include costs of legal and compliance services, costs of printing and distribution of Fund prospectuses and shareholder reports, as well as certain licensing fees and directors, legal and auditing, and custodial fees. There is no immediate intention to implement this expense allocation methodology and, prior to implementation, it would be subject to approval by the Funds' Board, including the Independent Directors, and periodically monitored by the Board.

This allocation of expenses, if implemented, would be disclosed to all Fund shareholders. The amounts of these expenses are expected to be immaterial to all Funds involved in that the amounts are never expected to exceed one half cent per share for any Fund.[3] It is anticipated that

[2] Certain of the Funds of Funds are target date funds that periodically rebalance their investments in the Underlying Funds as they approach their target dates. These Funds pay an annual advisory fee to the Adviser. The remaining Funds of Funds maintain a static allocation among the Underlying Funds and do not pay an advisory fee.

[3] Materiality exists if there is a substantial likelihood that a reasonable shareholder would consider a fact important. TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976). Though mutual funds are traditionally priced to the

all Funds, including the Underlying Funds, would benefit from this expense allocation. The Funds of Funds are primarily a means of distributing the Underlying Funds in that each of the Funds of Funds provides a more convenient means of investing in a number of the Underlying Funds. By attracting new assets to the entire Fund complex, the Funds of Funds would reduce the expense ratios of all of the Funds, including all of the Underlying Funds, by an amount that exceeds the extra expenses that would be borne by the Underlying Funds under the possible expense allocation arrangement.

Analysis

Section 17(d) of the 1940 Act generally prohibits an affiliated person or second-tier affiliate of a registered investment company, acting as principal, from effecting any transaction in which the registered investment company is a joint or a joint and several participant, in contravention of such rules as the SEC may prescribe for the purpose of limiting or preventing participation by the registered investment company on a basis different from or less advantageous than that of such other participant. Rule 17d-l under the 1940 Act generally prohibits participation in any "joint enterprise or other joint arrangement or profit-sharing plan," as defined in the rule, without prior approval by the SEC by order upon application. Rule 17d-1(c) defines "joint enterprise or other joint arrangement or profit-sharing plan" as any plan, contract, authorization or arrangement, or any practice or understanding concerning an enterprise or undertaking, under which a registered investment company and any of its affiliated persons or affiliated persons of such person have a joint or joint and several participation in the profits (a "Joint Transaction").

SEC Commissioner Robert Healy described in his testimony the kind of abuse that Section 17(d) (originally drafted as Section 17(a)-4) was intended to cover:

> Investment companies have been compelled to finance banking clients of the insiders, and companies in which they were personally interested. Some investment companies are organized to be operated essentially as discretionary brokerage accounts, with the insiders obtaining the brokerage commissions. In many instances the abuses are more subtle but just as injurious to the investor. The public's funds are used to further the banking business of the insiders to

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penny, courts have found that a reasonable investor would not find a penny difference important, as it "does not conform in all cases to the Supreme Court's definition of materiality." SEC v. Steadman, 967 F.2d 636, 643 (D.C. Cir. 1992).

> obtain control of various industrial enterprises, banks and insurance companies, so that the emoluments of this control will flow to these controlling persons.[4]

Given that history, the broad outline of Section 17 was easy to articulate. As the chief counsel for the SEC's study of investment trusts testified: "[T]his bill says that you cannot sit on both sides of the table when you are dealing with an investment trust."[5] Rule 17d-1 would be impermissibly vague[6] without this limiting principle on its application, so that the Rule should be applied only to those situations where an affiliate takes affirmative action with an element of self-dealing, conflict of interest and profit motive.

The application of Section 17(d) and Rule 17d-1 to the proposed expense allocation turns on whether (1) the Funds are affiliated persons of one another within the meaning of Section 2(a)(3) of the 1940 Act[7] and (2) the expense allocation is a Joint Transaction. If the Staff does not agree that the Funds are not affiliated persons of each other or that the expense allocation should not be regarded as a Joint Transaction, the lack of conflicts of interest and potential abuse presented by this arrangement should nonetheless support no action relief.

The Funds should not be considered affiliated with each other for purposes of the proposed expense allocations. As the SEC has stated, "rule [17d-1] does not represent a Commission finding that investment companies having common officers, directors or investment advisers are always affiliated persons or affiliated persons of an affiliated person. They may or may not be, depending on the facts."[8] Further, positions taken in proposed rule revisions (which have never been officially withdrawn) contemplated a change in the definition of the term "affiliated person" to exclude investment companies affiliated merely by virtue of a common investment adviser.[9] In most instances in which funds are deemed to be affiliated with each other by virtue of being managed by the same adviser, the conduct at issue is directed by the adviser. For example, when joint trading or investment is involved, the adviser acts for the funds involved. Affiliation in these cases arises from the funds being under the common control of the adviser. In this case, however, there is no such control by the adviser. If anyone "controls" the

[4] Investment Company Act of 1940; Hearings on S.3580 Before a Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess. pt. I at 37 (1940).

[5] Id. pt. 1, at 130.

[6] Fox Television Stations, Inc. v. FCC, 613 F.3d 317 (2d Cir. 2010).

[7] Section 2(a)(3) of the 1940 Act provides that an "affiliated person" of another person means, among other things, any person directly or indirectly controlling, controlled by, or under common control with such other person.

[8] See SEC Inv. Co. Act Release No. 11053, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) 82,452, at 82,906 n.2 (Feb. 19, 1980).

[9] See [1966-1967 Transfer Binder] Fed. Sec. L. Rep. (CCH) 77,477 (Mar. 11, 1967).

funds in this case, it is their Independent Directors. But the role of independent directors has never been held to be sufficient to create affiliation among funds.

Even if the Staff were to take the position that the Funds are affiliated persons of each other, we do not believe that the proposed expense allocation should be prohibited by Section 17(d) and Rule 17d-1. The abuses that Section 17(d) were designed to prevent are simply not present and expense allocation decisions by Independent Directors should not represent a "joint enterprise or other joint arrangement or profits-sharing plan" within the meaning of Rule 17d-1 that would require an exemptive order under the Rule to effect.

The Commission has acknowledged that there is considerable uncertainty about the scope of Section 17(d) and Rule 17d-1. In a 1967 release, the Commission wrote that in some circumstances it is "unclear whether an application should or should not be filed," and this uncertainty greatly taxed the Commission's resources. While there have been attempts to reform the regulatory treatment of joint transactions, the "uncertainty as to the range of transactions covered by [Section 17(d)]" remains unchanged to this day.[10] In order to add clarity to Section 17(d) and Rule 17d-1, the Commission and the Courts have indicated that an element of profit motive by an affiliated person must be present for Section 17(d) and Rule 17d-1 to apply.[11]

Expense allocation decisions by the Independent Directors under the present circumstances do not involve self-dealing and profit motive by persons in a position to take advantage of the Funds. Therefore, we believe they do not represent a Joint Transaction. The abuses that Section 17(d) and Rule 17d-1 were designed to protect against are not present. The function of the Funds of Funds is to gather assets from Mutual of America variable annuity and variable life[12] insurance contract holders for investment in the Underlying Funds and provide them with a convenient way to invest in those Funds. Therefore, shareholders of all the Funds benefit from spreading the fixed costs of non-advisory operating expenses of the Mutual of America fund complex over a larger pool of assets. Further, given the fact that Mutual of America is structured as a mutual insurance company, the Adviser has no incentive to favor one Fund over another Fund. This is because the Adviser is essentially owned by Fund shareholders

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[10] 2 A.L.I. Fed. Sec. Code § 1412 cmt. 3 (1980).

[11] See SEC v. Talley Indus., Inc., 399 F.2d 396, 402-03 (2d Cir. 1968), cert. denied, 393 U.S. 1015 (1969)("The objective of 17(d) of the Investment Company Act is to prevent affiliated persons from injuring the interests of stockholders of registered investment companies by causing the company to participate 'on a basis different from or less advantageous than that of such other participant.'"). In the Adopting Release for Rule 38a-1, the Commission similarly stated that "[t]o prevent self-dealing and overreaching by persons in a position to take advantage of the fund, the Investment Company Act prohibits funds from entering into certain transactions with affiliated persons." This Release cites Section 17(d) and Rule 17d-1 as examples of such provisions created to serve that purpose. Inv. Co. Act Rel. No. 26299 (Dec. 17, 2003), footnote 53 and preceding text.

[12] The variable life contracts invest in some, but not all, of the funds of funds.

and any growth of the Funds simply generates increased advisory fees, which ultimately benefit the Fund shareholders who are the policy holders.

The decision of directors of an investment company in this context should not implicate Section 17(d). As the Staff has observed, "interpreting rule 17d-1 as encompassing [actions within the scope of directors' duties] could impede or in some cases prevent fund directors from taking actions that would be in the best interests of shareholders. Such a broad reading also could be used to prevent fund directors from fulfilling their responsibilities."[13] Thus, the Staff has recognized that decisions of fund directors as directors of the fund in discharging their responsibilities do not implicate Section 17(d). Boards of investment companies and fund families routinely oversee the allocation of expenses, or adopt procedures for the allocation of expenses, incurred by funds in the same complex without receiving exemptive relief from the Commission. If Section 17(d) and Rule 17d-1 were applied literally to these types of expense allocation arrangements, the regulatory scheme for joint transactions might be rendered unworkable from the viewpoint of both the Commission and the industry.

As the Supreme Court has held, "Congress' purpose in structuring the [Investment Company] Act as it did is clear. It was designed to place the unaffiliated directors in the role of 'independent watchdogs.'"[14] As a result of that independence, directors are empowered to make decisions based on their conclusions about the shareholders' best interests, and those decisions are subject to significant deference akin to the Business Judgment Rule.

In its Burks v. Lasker decision, the Supreme Court found that a mutual fund's board of directors was empowered to decline to prosecute a breach of fiduciary duty claim, even though it was not frivolous, where the directors "reasonably believe that the best interests of the shareholders call for a decision not to sue—as, for example, where the costs of litigation to the corporation outweigh any potential recovery."[15] This point is instructive as the Independent Directors' decision on expense allocation would be based on their reasonable belief that the expense of calculating a more precise allocation outweighed the benefit to the shareholders of heightened precision. Such a decision should not be second-guessed as "it would have been paradoxical for Congress to have been willing to rely largely upon 'watchdogs' to protect shareholder interests and yet, where the 'watchdogs' have done precisely that, require that they be totally muzzled."[16] The Supreme Court's willingness to permit the independent "watch dogs" to decide whether to proceed with a derivative suit against their own board of directors, a high-

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[13] See Investment Company Act Rel. 24083 (Oct. 14, 1999).

[14] Burks v. Lasker, 441 U.S. 471, 484, 99 S. Ct. 1831, 1840, 60 L. Ed. 2d 404 (1979) (internal quotations omitted).

[15] Id.

[16] Id. at 485.

stakes decision made amidst accusations of impropriety, strongly suggests that independent directors be permitted to make mundane, non-controversial decisions regarding expense allocation without SEC oversight.

The Supreme Court, in its Burks v. Lasker decision, also cited the reasoning of the Second Circuit's decision in Tannenbaum v. Zeller. In that case, the Second Circuit considered the power of an independent board to make decisions regarding recapture of brokerage commissions, and found that "nothing in the structure or legislative history of the Investment Company Act [] indicates that Congress meant to remove the question...from the informed discretion of the independent members of a mutual fund's board of directors."[17] Likewise, there is no indication in the Investment Company Act that Congress expected expense allocations to be determined by the SEC through the exemptive process instead of by an investment company's independent directors unless there was potential for overreaching by a party in a position to place its interests over the interest of the funds.

In fact, Congress, in drafting Section 36(b) of the Act, which provides a private right of action for improper adviser fees, instructs courts that "approval by the board of directors of such investment company of such compensation or payments, . . . and ratification or approval of such compensation or payments, . . . by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances."[18] It is reasonable to consider the "circumstances" to which Congress refers relate to whether independent directors adhere to their duties of care and loyalty, for "independent directors can perform their function under the Act only when they exercise informed discretion. . . . This responsibility is particularly pressing when the matter in question is one on which the interests of the management and the mutual fund may be at odds."[19] In this case, where the Independent Directors would be fully educated regarding the decision they were making, as well as inarguably independent, their informed discretion should be given the utmost consideration and deference.

This deference to the decisions of independent directors has been applied by the Commission in the precise context of Section 17(d). In Investment Company Act Rel. 24083,[20] the Staff clarified that it:

[17] Tannenbaum v. Zeller, 552 F.2d 402, 417 (2d Cir. 1977).

[18] 15 U.S. Code § 80a–35(b)(2).

[19] Tannenbaum v. Zeller, 552 F.2d 402, 417–18 (2d Cir. 1977)

[20] (Oct. 14, 1999).

"believes that, when a fund's directors are acting on behalf of the fund in their capacities as fund directors, the requisite element of 'combination' is not present. Indeed, in order for the requisite element of 'combination' to be present, the staff generally believes that the joint arrangement must involve activities that are beyond the scope of the directors' duties to the fund."

In its reasoning, the Staff observed that "interpreting rule 17d-1 as encompassing [actions within the scope of directors' duties] could impede or in some cases prevent fund directors from taking actions that would be in the best interests of shareholders. Such a broad reading also could be used to prevent fund directors from fulfilling their responsibilities." Thus, the Commission Staff has recognized that decisions of fund directors do not implicate Section 17(d) when they act within the Business Judgment Rule in discharging their responsibilities.

There is no precedent in which the allocations of expenses among funds in a fund complex, including those between funds-of-funds and underlying funds, has been found to violate Rule 17d-1. This is not surprising as these types of expense determinations are done by all fund complexes, and few, if any, seek exemptive orders from the SEC, as the Commission and its Staff are well aware. The boards of funds and fund families routinely oversee the allocation of expenses, or prescribe procedures for the allocation of expenses, incurred by affiliated funds. Fund boards have long taken this action without receiving any exemptive relief from the SEC. The possible arrangement is identical to these situations in many ways, including the types of service arrangements at issue here,[21] such as: (a) fees for services of a common board of directors; (b) fees for administrative, custody and audit services under a shared services agreement with a common fee schedule; (c) expenses for the preparation and printing of combined documents, such as prospectuses and shareholder reports; and (d) fees and expenses for legal and compliance support. The methodology of allocating the expenses of a fund

[21] In a number of no-action letters, the Staff has taken the position that service arrangements with an affiliated person (or an affiliated person of an affiliated person) and shared among registered investment companies that are affiliated persons of each other (e.g., because they are under common control) do not require relief under Rule 17d-1. See <u>Federated Securities Corp.</u>, SEC No-Act (pub. avail. Oct. 21, 1983) ("[b]ecause section 17 comprehensively regulates sales and purchases of property, loans, joint transactions, and agency services for the purchase and sale of property by investment companies, the omission therefore of any general prohibition against service contracts suggests that Congress did not intend to prohibit them"). See also <u>Flex-Fund</u>, SEC No-Act (pub. avail. Nov. 22, 1985) ("[a]s the staff stated in <u>Federated Securities Corp.</u> (pub avail Oct. 21, 1983), [the staff believes] that, as a general matter, a service arrangement does not constitute a 'joint enterprise or other joint arrangement or profit-sharing plan' within the meaning of Section 17(d) and Rule 17d-l."). In <u>Flex-Fund</u>, the Staff confirmed that it would not take the position that Section 17(d) or Rule 17d-1 was violated by an arrangement among five registered investment companies pursuant to which the affiliated investment companies retained for compensation a single affiliated service provider to provide administrative and accounting services. The five registered investment companies in Flex-Fund had a common investment adviser and were, as a result, presumably affiliated persons of each other in the view of the Staff.

complex in proportion to the assets of each fund is common in the industry. The Independent Directors' decision to permit the allocation of the expenses of the Funds of Funds in accordance with the assets of each Underlying Fund, and allowing the Funds of Funds to pick up their proportionate share through their investment in the Underlying Funds, would be neither unusual nor impermissible.

A decision regarding expense allocation by Independent Directors, under which the Underlying Funds would pay certain immaterial expenses that could have been directly allocated to the Funds of Funds, would be a rational business decision intended to benefit the shareholders of the Underlying Funds in two ways: first, the cost of more precise allocation would outweigh its benefit to the shareholders and, second, shareholders would benefit from paying for distribution, an admitted function of the Funds of Funds, as the SEC and the industry as a whole have repeatedly noted.

The Commission has never used Section 17(d) to displace the well-established tenets of trust law that provide that a fiduciary may only incur expenses that "are reasonable in amount and appropriate to the purposes and circumstances of the trust."[22] Implicit in a trustee's duties is a duty to be cost-conscious.[23] This obligation has been restated as "a trustee may only incur costs that are appropriate and reasonable in relation to the trust assets, the purposes of the trust and the skills of the trustee."[24]

Moreover, in 1980, the SEC adopted Rule 12b-1, which "permits a fund to use fund assets to pay broker-dealers and others for providing services that are primarily intended to result in the sale of the fund's shares."[25] Although the SEC did so at the urging of market participants who noted that payment of distribution fees would "benefit fund shareholders by increasing economies of scale and reducing fund expense ratios,"[26] the SEC remained concerned about the potential conflict of interest such fees raised. In order to permit mutual funds to access these potential benefits, while at the same time countering the potential conflicts, the SEC's final rule "required the fund's board of directors, and in particular its independent directors, to play a key role."[27]

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[22] Restatement of Trusts (Third), § 88.

[23] Id. comment a.

[24] Uniform Prudent Investor Act § 7. The comment accompanying this section states, "Wasting beneficiaries' money is imprudent."

[25] SEC Release Nos. 33-9128; 34-62544; IC-29367; File No. S7-15-10 [https://www.sec.gov/rules/proposed/2010/33-9128.pdf] at 10

[26] Id. at 10.

[27] Id. at 13.

The SEC did not include specific limits or restrictions on the fund boards charged with making the fee decisions, but instead "requires directors (including a majority of the independent directors) to conclude, in exercising their reasonable business judgment and in light of their fiduciary duties, that there is a reasonable likelihood that the plan will benefit both the fund and its shareholders."[28] By charging independent directors to use their business judgment to make decisions regarding the propriety and amount of such expenses, the SEC also intended to entrust the allocation of such expenses to the independent directors as well, especially as the SEC notes "[t]he rule was intended to allow fund boards some latitude to exercise their reasonable business judgment to authorize the distribution arrangements."[29] Such latitude would reasonably extend to allow the independent directors to use their reasonable business judgment in allocating expenses among the funds entrusted to their oversight.

Prior no-action letters also support the interpretation that 17(d) and Rule 17d-1 should not apply to arrangements such as the possible expense allocation where an investment adviser or other party is not in a position to take advantage of the fund or does not participate in a significant way in a transaction with a third party. A "joint arrangement" under Rule 17d-1 requires some element of combination between the fund and its affiliate. In Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (pub. avail. Jul 28, 2000), the Staff indicated that, in the context of a negotiated private transaction, a conflict under Rule 17d-1 exists only where the fund's adviser has a material pecuniary interest in the transaction. Such conflict does not exist in the situation where there is a decision by independent directors to allocate an immaterial amount of expenses among funds that have no conflicting interests.

MassMutual involved the joint purchase of private placements by funds with the same adviser. The funds were deemed to be affiliates of each other by virtue of their common management by the same adviser. Their collective action in purchasing a block position in a private placement and then allocating that position among the participating funds constituted a joint arrangement. At first, the Staff permitted the practice as long as the funds only collectively negotiated to purchase the block at the lowest possible price. When pressed for clarification from the industry, however, the Staff stated that the funds could collectively negotiate all of the terms of the joint investment as long as the adviser, or an account in which it held a large position, was not participating in the block. The reason for this clarification was that the funds themselves, although technically affiliated with each other, had no conflicts with each other. This is exactly analogous to the situation in the possible arrangement, where the allocation of expenses would be among funds that had no conflicting interests.

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[28] Id. at 14.

[29] Id. at 15.

Conclusion

Based on the foregoing, we respectfully request that the Staff advise us that it would not recommend enforcement action to the Commission if the Adviser proceeds with the proposed expense allocation described above. Should you have any further questions, please contact me at 212-940-8765.

Very truly yours,

Richard D. Marshall

Richard D. Marshall