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17 CFR Parts 210, et al.

Exemption From Shareholder Approval for Certain Subadvisory Contracts; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 239, 240, 270 and 274

[Release Nos. 33–8312, 34–48683, IC–26230; File No. S7–20–03]

RIN 3235–AH80

Exemption From Shareholder Approval for Certain Subadvisory Contracts

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing a new rule under the Investment Company Act of 1940 that would, under certain conditions, permit an adviser to serve as a subadviser to an investment company (''fund'') without approval by the shareholders of the fund. The rule is designed to reduce burdens on investment companies by eliminating the need to obtain from the Commission exemptive orders that facilitate so-called ''manager of managers'' arrangements, under which one or more subadvisers manage a fund's assets subject to the supervision of an investment adviser whose advisory contract has been approved by fund shareholders.

DATES: Comments must be received on or before January 8, 2004.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only.

Comments in paper format should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments in electronic format may be submitted at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–20–03; if e-mail is used, this file number should be included on the subject line. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (*http://www.sec.gov*).[1]

FOR FURTHER INFORMATION CONTACT: Adam B. Glazer, Attorney, or C. Hunter Jones, Assistant Director, Office of Regulatory Policy, (202) 942–0690, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW., Washington DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Commission today is proposing for public comment new rule 15a–5 [17 CFR 270.15a–5] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the ''Investment Company Act'' or ''Act''); amendments to rule 6–07 [17 CFR 210.6–07] of Regulation S–X [17 CFR part 210] under the Investment Company Act and the Securities Act of 1933 [15 U.S.C. 77a–aa] (the ''Securities Act''); amendments to Form N–1A [17 CFR 274.11A] under the Investment Company Act and the Securities Act; and amendments to Schedule 14A [17 CFR 240.14a–101] under the Securities Exchange Act of 1934 [15 U.S.C. 78a–mm] (the ''Exchange Act'').

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Executive Summary

The Commission is proposing new rule 15a–5 under the Investment Company Act. The rule would permit manager of managers funds to operate without obtaining shareholder approval when the fund's principal investment adviser hires a new subadviser or replaces an existing subadviser. The rule would eliminate the need for a fund to obtain an exemptive order permitting these arrangements. A fund that relied on the proposed rule would be required to inform investors of the identity of the current subadviser(s) managing their portfolio and the ability of the fund to add or replace the subadviser(s) without shareholder approval. The rule also would require that the fund's investment adviser supervise and oversee the fund's subadvisers, and that the hiring of a new or different subadviser not increase the fees charged to the fund.

I. Background

A growing number of investment companies (''funds'')[2] are now offered whose investment advisers do not directly manage a portfolio of securities. Instead, the advisers supervise one or more subadvisers,[3] which are themselves responsible for the day-to-day management of the funds' portfolios. In these ''manager of managers'' funds, the investment adviser seeks to achieve the funds' investment objectives by hiring, supervising and, when appropriate, discharging subadvisers, each of which is responsible for the management of a portion of a fund's portfolio.[4] In many cases, these funds also authorize the adviser to allocate and reallocate fund assets among subadvisers.

Since they were first introduced in the early 1990s, manager of managers funds have grown in popularity. Today more than 100 fund complexes offer these types of funds, which hold more than 400 billion dollars in assets.[5] Many of these funds are sponsored by insurance companies and operate as funding vehicles for separate accounts offering variable annuity and variable

[1] We do not edit personal, identifying information, such as names or e-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

[2] In this Release and proposed rule 15a–5, we use the term ''fund'' to mean a registered open-end management investment company or a separate series of such a company. A series company (or series fund) is a registered open-end investment company which, in accordance with the provisions of section 18(f)(2) of the Act [15 U.S.C. 80a–18(f)(2)], issues two or more classes or series of preferred or special stock each of which is preferred over all other classes or series in respect of assets specifically allocated to that class or series. *See* 17 CFR 270.18f–2(a).

[3] In this Release and proposed rule 15a–5, we use the term ''subadviser'' to mean a party that contracts with a fund's principal adviser to provide investment advisory services to the fund, and the term ''principal adviser'' to mean a party that contracts directly with a fund to provide investment advisory services to the fund. *See* proposed rule 15a–5(b)(2)–(3) (defining ''principal adviser'' and ''subadviser'' by reference to sections 2(a)(20)(A)–(B) of the Act [15 U.S.C. 80a–2(a)(20)(A) ''(B)]).

[4] In the case of a series fund, the adviser seeks to achieve the fund's investment objectives by hiring, supervising and, when appropriate, discharging subadvisers for the management of all or a portion of the portfolio of a series.

[5] Since 1995 we have issued over 100 orders allowing manager of managers funds to retain subadvisers (and materially amend subadvisory contracts) without shareholder approval. *See, e.g.*, Hillview Investment Trust II and Hillview Capital Advisors, LLC, Investment Company Act Release Nos. 24853 (Feb. 6, 2001) [66 FR 10037 (Feb. 13, 2001)] (notice) and 25055 (June 29, 2001) [66 FR 35676 (July 6, 2001)] (order); Sun Capital Advisers Trust and Sun Capital Advisers, Inc., Investment Company Act Release Nos. 24368 (Mar. 27, 2000) [65 FR 17546 (Apr. 3, 2000)] (notice) and 24401 (Apr. 24, 2000) [72 SEC Docket 864 (May 23, 2000)] (order).

life insurance contracts.[6] They represent one of the more recent innovations in managed asset arrangements.

Many sponsors of manager of managers funds have sought and obtained from us orders exempting them from section 15(a) of the Act,[7] which prohibits any person from serving as an investment adviser (or a subadviser) to a fund except under a written contract that the fund's shareholders have approved.[8] The orders permit funds and advisers to enter into and materially amend subadvisory contracts without shareholder approval. Many sponsors of these funds have asserted that without relief from the shareholder voting requirement, the costs and delays associated with obtaining a shareholder vote would prevent advisers from hiring and firing subadvisers and from achieving the funds' investment objectives. They also have asserted that the underlying purpose of section 15(a)—to give shareholders a voice in the fund's investment advisory arrangements [9]—would be satisfied without a shareholder vote on the subadvisory contracts because the principal adviser's contract must still be approved by fund shareholders. Moreover, the principal adviser would act in the shareholders' interests by supervising and overseeing the fund's subadvisers. Sponsors have analogized subadvisers in a manager of managers arrangement to portfolio managers employed by a fund adviser who may be hired and fired without the consent of shareholders.[10]

The Commission is today proposing a new rule, 15a–5, and amendments to Form N–1A, which together would codify the orders we have issued for manager of managers funds, including many of their conditions.[11] The Commission believes that the proposed rule would benefit shareholders by allowing funds to terminate poorly performing subadvisers and hire new subadvisers without the need for a shareholder vote.[12] These amendments are designed to limit the scope of the relief to subadvisers of manager of managers funds, and to assure that investors in manager of managers funds are fully informed of the identity of the current subadviser(s) managing their portfolio, and of the fact that subadvisers could be added or replaced without shareholder approval.

II. Discussion

Section 15(a) of the Investment Company Act was designed to protect the interests and expectations of fund shareholders by requiring that they approve advisory contracts,[13] including subadvisory contracts.[14] The Congress that enacted section 15(a) anticipated subadvisory arrangements, and concluded that shareholders should have a role in the selection of subadvisers. In crafting this rule proposal (and the exemptive orders that have preceded it), we have sought to distinguish subadvisory arrangements in which the subadvisers have resembled portfolio managers from the more traditional subadvisory arrangements that Congress explicitly covered in the shareholder voting requirement of section 15(a). Our proposed rule, therefore, contains several conditions, which we discuss below, that limit the scope of relief to subadvisers of manager of managers funds and that provide other means of protecting fund investor expectations and interests.[15]

Today we are proposing a rule that would eliminate the need for funds to obtain exemptive orders to hire subadvisers that they supervise. We have drafted the rule to preserve, to the extent possible, the important role the Investment Company Act gives shareholders in the governance of their funds while accommodating the special needs of manager of managers funds. The other provisions of section 15 would remain applicable. Under those provisions, the manager of managers fund's principal adviser [16] still must have its contract approved by the fund's board and shareholders,[17] and the board must approve the terms of each subadvisory contract.[18] Thus, the rule would afford shareholders of a manager of managers fund the opportunity, both directly through their consideration of the principal advisory contract and indirectly through their representatives

[6] *See* Gary O. Cohen, *Fitting Variable Annuity Contracts and Variable Life Insurance into the Regulatory Framework of the Investment Company Act of 1940 and Securities Act of 1933,* 813 PLI/Comm 129, 212–13 (2001).

[7] 15 U.S.C. 80a–15(a).

[8] *See supra* note 5.

[9] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 253 (1940) (statement of David Schenker).

[10] *See, e.g.,* TIFF Investment Program, Inc. and Foundation Advisers, Inc., Investment Company Act Release Nos. 21268 (Aug. 3, 1995) [60 FR 40875 (Aug. 10, 1995)] (notice) and 21328 (Aug. 30, 1995) [60 SEC Docket 316 (Sept. 26, 1995)] (order), in which the applicant had represented that the employment of a new subadviser was ''closely analogous to the decision by a money management firm to hire another portfolio manager or analyst.'' *See id.,* Investment Company Act Release No. 21268, at text following n.1. Our disclosure rules require that a change in portfolio managers be disclosed to investors through a prospectus ''sticker.'' *See* Disclosure of Mutual Fund Performance and Portfolio Managers, Investment Company Act Release No. 19382 (Apr. 6, 1993) [58 FR 19050 (Apr. 12, 1993)], at text accompanying nn.9–11. A fund also must disclose in its prospectus the identity of the fund's subadvisers. *See* Item 6(a)(1) of Form N–1A.

[11] As discussed below, we also are proposing related amendments to Regulation S–X under the Act and the Securities Act and to Schedule 14A under the Securities Exchange Act. We are not, however, proposing amendments to rule 18f–2 [17 CFR 270.18f–2] even though we have provided relief, in response to requests, from rule 18f–2 in a number of our manager of managers exemptive orders. Rule 18f–2, among other things, describes how the shareholder voting requirement of section 15(a) applies in the case of a fund with multiple series or multiple classes. Because the relief we are proposing today would provide exemptive relief from the requirements of section 15(a), we believe that relief from rule 18f–2 is unnecessary.

[12] The inability of a fund adviser to hire a subadviser without obtaining shareholder approval can inhibit a fund manager from terminating a poorly performing subadviser and thus managing the fund in the best interests of shareholders. An investment adviser has a fiduciary duty to act in the best interests of a fund it advises. *See Rosenfeld* v. *Black,* 445 F.2d 1337 (2d Cir. 1971); *Brown* v. *Bullock,* 194 F.Supp. 207, 229, 234 (S.D.N.Y.), *aff'd,* 294 F.2d 415 (2d Cir. 1961). *See also* In the Matter of Provident Management Corp., Securities Act Release No. 5115 (Dec. 1, 1970) at n.12 and accompanying text.

[13] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 253 (1940) (statement of David Schenker) (section 15 recognizes that a ''management contract is personal, that it cannot be assigned, and that you cannot turn over the management of other people's money to someone else'').

[14] Section 15(a) of the Investment Company Act prohibits a person from serving as an investment adviser to a fund except under a written contract, *whether with the fund or with an investment adviser of the fund,* that has been approved by the vote of a majority of the fund's outstanding voting securities. Thus, the shareholder voting requirement applies not only to an advisory contract between a fund and an adviser, but also to a subadvisory contract between a fund's adviser and a subadviser. *See* 15 U.S.C. 80a–2(a)(20) (defining investment adviser). *See also* Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan 2, 2001) [66 FR 3734 (Jan. 16, 2001)] at n.53 (''The Act does not distinguish an adviser from a sub-adviser.'') (citing section 2(a)(20)). Section 15(c) also requires that a majority of the fund's independent directors approve contracts with all investment adisers, including subadvisers. 15 U.S.C. 80a–15(c).

[15] Section 6(c) of the Act [15 U.S.C. 80a–6(c)] permits the Commission, conditionally or unconditionally, to exempt any person, security, or transaction (or classes of persons, securities, or transactions) from any provision of the Act ''if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions'' of the Act.

[16] We use the term ''principal adviser'' to mean a party that contracts directly with a fund to provide investment advisory services to the fund. *See supra* note 3.

[17] *See* 15 U.S.C. 80a–15(a). Although the proposed rule does not exempt a fund's advisory contract with a principal adviser from the shareholder approval requirement of section 15(a), rule 15a–4 under the Act [17 CFR 270.15a–4] allows for the possibility that a principal adviser to the fund is temporarily serving the fund without shareholder approval of its advisory contract.

[18] *See* 15 U.S.C. 80a–15(c).

on the board of directors, to influence the terms of the advisory contracts under which their fund is managed.

A. Conditions of the Proposed Rule

1. Terms of the Subadvisory Contracts; Subadvisory Fees

The proposed amendments would largely rely on the principal adviser, negotiating with each subadviser on an arm's length basis and subject to the approval of the fund's board, to determine the terms of the subadvisory contract, including the amount of the subadviser's fee. As a condition to the rule, however, we would preclude a new or modified subadvisory contract from directly or indirectly increasing the management fees charged to the fund or its shareholders.[19] As a result, the rule would preserve the statutory requirement that increases in the rate of advisory fees paid by the fund be approved by shareholders.[20]

In most cases, subadvisers are compensated by the fund's principal adviser, which negotiates the amount of the subadvisers' compensation. Consequently, a principal adviser is free to bargain for lower subadvisory fees, which will benefit the fund to the extent that lower subadvisory fees are passed on through lower advisory fees. Sponsors of manager of managers funds have represented that they are able to negotiate lower fees with subadvisers if they do not have to disclose those fees separately, and in our orders we have provided them relief from our disclosure requirements.[21] We are proposing to codify this relief, which permits a manager of managers fund to disclose only the *aggregate* amount of advisory fees that it pays to subadvisers as a group.[22]

We recognize that permitting aggregate disclosure of subadvisory fees will not permit investors to understand the benefits obtained by a principal adviser that negotiates lower subadvisory fees. We note, however, that the Act compels a fund board to take into consideration subadvisory fees when establishing the amount of the principal adviser's compensation,[23] and imposes significant liabilities on the principal adviser itself with respect to that compensation.[24] The board is in the best position to assess the overall compensation of the principal adviser when, for example, some subadvisory fees have increased and some have decreased. Moreover, the reduction of an individual subadvisory fee would be reflected in lower aggregate fees that would be disclosed under the proposed amendments.

We request comment on the proposal.

- Should the Commission permit fund directors to enter into subadvisory contracts that increase advisory fees without the consent of shareholders?
- Should the Commission limit relief to subadvisory contracts that do not increase the portion of the advisory fee retained by the principal adviser in order to assure that subadvisers are selected based on ability and performance?
- Do shareholders need information about the amount of compensation paid to each subadviser?
- We also request comment on whether any amendments are required to the fee table items of Forms N–4 and N–6, the registration forms used by insurance company separate accounts registered under the Act as unit investment trusts.[25]

2. Obligation To Supervise

An important aspect of any manager of managers arrangement is the responsibility assumed by the principal adviser to supervise, *i.e.*, monitor and oversee, the subadvisers in the performance of their duties for the fund.[26] We propose to require that any principal advisory contract under the rule obligate the principal adviser to supervise the subadviser.[27] In addition,

[19] Proposed rule 15a–5(a)(1). It's a new subadvisory contract were to increase those fees, the subadviser entering into the contract would not qualify for relief under the rule, and the contract would need to be submitted to shareholders for their approval. A subadvisory fee could be increased under the rule, however, as long as the total amount of the advisory fees paid by the fund does not exceed the total amount provided by advisory contracts that shareholders have approved. For instance, a subadvisory contract would still be eligible for relief under the proposed rule even though it increases a fund's subadvisory fees, if the increase is deducted from the principal adviser's fee. *See* Republic Funds, Investment Company Act Release Nos. 24292 (Feb. 16, 2000) [65 FR 10132 (Feb. 25, 2000)] (notice) and 24338 (Mar. 14, 2000) [71 SEC Docket 2701 (Apr. 11, 2000)] (order) (granting exemption from sharehold approval for subadvisory contracts where the fund directly pays subadvisory fees and deducts the subadvisory fees from the fee paid to the principal adviser).

[20] *See* 15 U.S.C. 80a–15(a)(1) (requesting any investment advisory contract to *precisely* describe all compensation to be paid thereunder).

[21] *See, e.g.,* Endeavor Series Trust, Investment Company Act Release Nos. 24054 (Sept. 27, 1999) [64 FR 53428 (Oct. 1, 1999)] (notice) and 24108 (Oct. 22, 1999) [70 SEC Docket 3081 (Nov. 23, 1999)] (order); Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (June 25, 1995)] (order).

[22] The individual fee paid to an unaffiliated subadviser of the principal adviser would not have to be disclosed, but the individual fee paid to each wholly-owned subadviser (defined below in Section II.A.3) would have to be disclosed. Under our proposal, a fund would disclose in its statement of Additional Information on Form N–1A, in lieu of the individual fee paid to each subadviser, (i) the individual fees paid to the principal adviser and to each subadviser that is an affiliated person of the principal adviser (including a wholly-owned subadviser whose contract has not been approved by shareholders on reliance on the proposed rule), (ii) the net advisory fee retained by the principal adviser after payment of fees to all subadvisers, and (iii) the aggregate fees paid to all of the fund's subadvisers that are not affiliated persons of the principal adviser. Proposed Instruction 5 to Item 15(a)(3) of Form N–1A. We also are proposing conforming amendments to rule 6–07 of Regulation S–X and the Instructions to Item 22(c) of Schedule 14A.

Under the conditions of the manager of managers orders allowing a fund to disclose the aggregate fees paid to all of the fund's unaffiliated subadvisers, the principal adviser is required to provide the board, no less frequently than quarterly, with information about its profitability for each fund that is relying on the order. In addition, the principal adviser is required to provide the board with information showing the expected impact on the principal adviser's profitablity whenever a subadviser is hired or terminated. We have not included these conditions in the proposed rule. However, information must still be provided to the board pursuant to section 15(c) of the Act, which requires fund directors to request and evaluate, and an investment adviser to the fund to furnish, any information that may be necessary to evaluate the terms of any investment advisory contract with the fund.

[23] Section 15(c) of the Act requires fund directors to request and evaluate, and an investment adviser to the fund to furnish, any information that may be necessary to evaluate the terms of any investment advisory contract with the fund. Therefore, the board must request, and the principal adviser must provide, information regarding the fees paid to the principal adviser's subadvisers in order for the board to evaluate properly the terms of the principal adviser's contract with the fund.

[24] Section 36(b) of the Act [15 U.S.C. 80a–35(b)] imposes a fiduciary duty on an investment adviser with respect to its receipt of compensation from the fund for services, and allows an action to be brought by the Commission or a shareholder for a breach of this duty. *See Daily Income Fund, Inc.* v. *Fox,* 464 U.S. 523, 541–42 (1984) (discussing fund shareholders' right to initiate legal proceedings against the fund's adviser for breach of the adviser's fiduciary duty with regard to its receipt of compensation under section 36(b) of the Act, without first making a demand on the board to initiate such action).

[25] 17 CFR 239.17b–c, 274.11c–d.

[26] *See, e.g.*, Pitcairn Funds and Pitcairn Trust Company, Investment Company Act Release Nos. 25106 (Aug. 9, 2001) [66 FR 42901 (Aug. 15, 2001)] (notice) and 25150 (Sept. 5, 2001) [75 SEC Docket 2214 (Oct. 2, 2001)] (order); Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order). A typical subadvisory agreement stipulates that the subadviser, in carrying out its investment management duties under the agreement, is subject to the supervision and/or oversight of the board of directors and the principal adviser.

[27] Proposed rule 15a–5(a)(4). *See* Western Asset Management Co. and Legg Mason Fund Adviser, Inc., Investment Advisers Act Release No. 1980 (Sept. 28, 2001) (the Commission found that the principal adviser failed to adequately supervise an employee of its affiliated subadviser). Although the manager of managers orders do not require the principal advisory contract to contain a provision requiring the principal adviser to supervise all of the subadvisers it retains to provide services to the fund, the orders do require the principal adviser to supervise its subadvisers. *See, e.g.*, Hillview

because the principal adviser must be able to discharge a subadviser in order to effectively supervise the subadviser, our proposed rule includes a condition requiring that the subadvisory contracts be terminable at any time by the principal adviser, on no more than 60 days written notice, without payment of penalty.[28]

3. Arm's Length Relationship Between Principal Adviser and Subadvisers

We are proposing two related conditions designed to limit the rule to arrangements in which the principal adviser is in a position to hire and supervise (and, if necessary, discharge) subadvisers on the basis of the subadviser's performance, rather than on the basis of other business relationships the principal adviser may have with the subadviser. First, we would preclude subadvisers relying on the rule from being affiliated persons of the principal adviser with which they contract or of the fund (other than by reason of serving as investment advisers to the fund) (''affiliated subadviser'').[29] Second, we would preclude any director or officer of the fund and the principal adviser or any director or officer of the principal adviser with which the subadviser has contracted from owning, directly or indirectly, any material interest in the subadviser other than through a pooled investment vehicle that is not controlled by such person or entity.[30] A principal adviser may not be in a position to discharge, for example, a parent corporation or a sister corporation, or a person that controls the principal adviser. It may have substantial economic incentives to hire and refrain from discharging a subsidiary or other types of affiliated persons. These conditions have been a key element of our exemptive orders in order to protect against the conflict of interest and potential for self-dealing that are inherent when a principal adviser hires an affiliated subadviser.[31]

The Commission, however, has issued an order expanding the traditional relief to allow wholly-owned subsidiaries of the principal adviser to replace other wholly-owned subsidiaries of the principal adviser as subadvisers (''wholly-owned subadvisers'') to the manager of managers fund and to allow the principal adviser to materially amend a wholly-owned subsidiary's subadvisory contract without shareholder approval.[32] The applicants asserted that no impermissible conflict of interest would be present when replacing one wholly-owned subadviser with another wholly-owned subadviser.[33]

In light of the absence of an economic incentive for the principal adviser to replace one wholly-owned subadviser with another (other than to increase the fund's return on its investments),[34] we are including wholly-owned subadvisers within the scope of the proposed rule.[35] We are, however, limiting relief to allow the principal adviser to replace only a wholly-owned subadviser with another wholly-owned subadviser and to allow the principal adviser to materially amend a wholly-owned subsidiary's subadvisory contract without shareholder approval.[36] The rule would not permit a principal adviser to replace any other type of subadviser with a wholly-owned subadviser, because the principal adviser would have an economic incentive in such a situation by virtue of its total (or near total) ownership interest in the wholly-owned subadviser, as compared to no ownership or a smaller ownership interest in the subadviser being replaced.

- We request comment on whether the scope of the proposed rule should be expanded to include wholly-owned subadvisers replacing other affiliated subadvisers.
- Should the scope of the rule be expanded to include other affiliated subadvisers? Should all subadvisory contracts be exempt from the Act's shareholder voting requirement? If so, should the Commission expand the proposed rule to include all subadvisers?

4. Board Oversight

Under the Investment Company Act, a fund's board plays an important role in the selection and oversight of the fund's subadvisers.[37] Because the rule would permit a fund board to approve subadvisory contracts without the shareholder vote that the statute otherwise requires, we propose to require that the fund adopt certain governance practices that strengthen the role of the independent directors. As part of our initiative to improve fund governance practices, in 2001 we made similar amendments to a number of our exemptive rules, including rule 15a–4, which permits boards of directors to approve interim advisory contracts

Investment Trust II and Hillview Capital Advisors, LLC, Investment Company Act Release Nos. 24853 (Feb. 6, 2001) [66 FR 10037 (Feb. 13, 2001)] (notice) and 25055 (June 29, 2001) [66 FR 35676 (July 6, 2001)] (order); Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order).

[28] Proposed rule 15a–5(b)(4). The manager of managers exemptive orders typically do not require that the principal adviser be able to terminate a subadvisory contract. Most subadvisory contracts for manager of managers funds operating under an exemptive order, however, are terminable by the principal adviser. This termination provision often is found in the same section of the contract that provides, as required by section 15(a)(3) of the Act [15 U.S.C. 80a–15(a)(3)], that the advisory contract is terminable by the fund's board or shareholders.

[29] Proposed rule 15a–5(a)(2)(i).

[30] Proposed rule 15a–5(a)(2)(i).

[31] *See, e.g.*, Pitcairn Funds and Pitcairn Trust Company, Investment Company Act Release Nos. 25106 (Aug. 9, 2001) [66 FR 42901 (Aug. 15, 2001)] (notice) and 25150 (Sept. 5, 2001) [75 SEC Docket 2214 (Oct. 2, 2001)] (order); Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order).

[32] *See* PIMCO Funds: Multi-Manager Series and PIMCO Advisors L.P., Investment Company Act Release Nos. 24558 (July 17, 2000) [65 FR 45632 (July 24, 2000)] (notice) and 24597 (Aug. 14, 2000) [73 SEC Docket 176 (Sept. 12, 2000)] (order) (''PIMCO''). A ''wholly-owned subsidiary'' is defined in section 2(a)(43) of the Act [15 U.S.C. 80a–2(a)(43)].

[33] *See* PIMCO, *supra* note. That order contains all of the other conditions contained in a typical manager of managers order, including the condition that prohibits a new subadvisory contract from increasing the management fees. The principal adviser would be unlikely to have a direct economic incentive to replace one wholly-owned subadviser with another, because its overall compensation would not increase by virtue of its ownership interest in both entities.

[34] Replacing one wholly-owned subadviser with another is no different than the principal adviser terminating a wholly-owned subadviser and directly managing the assets of the fund formerly managed by the wholly-owned subadviser. In either situation, the principal adviser's advisory fee (and the portion of the fee that it retains after paying all unaffiliated subadvisers) remains the same.

[35] Proposed rule 15a–5(a)(2)(ii).

[36] Proposed rule 15a–5(a)(2)(ii). The first wholly-owned subadviser hired by the fund would not qualify for relief under the proposed rule, and its subadvisory contract would have to be approved by shareholders. A wholly-owned subadviser that replaces the original wholly-owned subadviser (and any wholly-owned subadvisers thereafter that replace other wholly-owned subadvisers) would then be eligible for exemptive relief under the proposed rule.

[37] Section 15 of the Act requires that a majority of the board's independent directors approve the fund's advisory contracts (including subadvisory contracts), and that the board (or shareholders) annually approve any advisory contract that continues more than two years. 15 U.S.C. 80–15(a), 15(c). The directors also must request and evaluate information reasonably necessary for them to evaluate the terms of an advisory contract. 15 U.S.C. 80a–15(c). The board in carrying out its obligations under the Act should consider any material business arrangements between the adviser or principal underwriter and the subadviser, including the involvement of the subadviser in the distribution of the fund's shares. The board when approving a wholly-owned subadviser's contract also should consider the effect that the affiliation between the principal adviser and wholly-owned subadviser had on the decision of the principal adviser to replace a wholly-owned subadviser with another wholly-owned subadviser (as opposed to replacing with an unaffiliated subadviser).

without a shareholder vote.[38] Thus, manager of managers funds relying on the rule would be required to have a board of directors whose independent directors (i) constitute a majority of directors, (ii) are selected and nominated by independent directors, and (iii) if represented by legal counsel, are represented by ''independent legal counsel.'' [39]

5. Expectation of Investors

We also are proposing four requirements designed to assure that investors understand that they are investing in a manager of managers fund, and to require that they receive information about who the subadvisers are and that the subadvisers could be changed at any time without shareholder approval. First, the rule would require that, except in the case of a newly offered fund, shareholders approve the fund's operation as a manager of managers fund, by authorizing the adviser (with the approval of the fund's board of directors) to enter into subadvisory contracts without shareholder approval.[40] Second, we would amend Form N–1A to require that the fund disclose in its prospectus the principal adviser's ability, subject to the approval of the fund's board of directors, to retain and discharge subadvisers without shareholder approval.[41]

Third, proposed rule 15a–5 would prohibit a fund from having a name that contains the subadviser's name unless the name of the principal adviser precedes the subadviser's name. This limitation is designed to prevent confusion about the relative roles of the adviser and subadviser. A fund name that includes the name of a subadviser might serve to invite investors to invest in the fund to obtain the advisory services of the subadviser rather than the adviser, which is arguably inconsistent with the basis upon which we have granted relief from the shareholder voting requirement for manager of managers funds. Use of such a name also suggests that the principal adviser is unlikely to be in a position to terminate the advisory contract without upsetting the investors who have invested for the purpose of seeking the advisory services of the subadviser. On the other hand, use of a subadviser's name may merely identify one investment option among many in a series fund.

Fourth, we are proposing to require that when the principal adviser enters into a subadvisory contract or makes a material change to a wholly-owned subadviser's contract, the fund furnish shareholders with (and file with the Commission) an information statement that describes the subadvisory agreement, and contains other information that would have been provided in a proxy statement had a vote been held.[42] This condition has been included in our exemptive orders.

- We request comment on whether the proposed requirements are adequate to assure that investors understand they are investing in a manager of managers fund. If they are not adequate, what additional requirements should be included? Should the rule simply prohibit the use of the subadviser's name in a manager of managers fund to assure that investors are investing in a fund based on the principal adviser's reputation for selecting and supervising subadvisers?
- We are considering whether to adopt substantially similar amendments to Form N–3, the registration form for insurance company ''managed separate accounts.'' [43] Should we amend Form N–3, and if so should the amendments differ from the proposed Form N–1A amendments?

6. Number of Subadvisers

Many manager of managers funds employ multiple subadvisers. Our exemptive orders, however, do not require the retention of a minimum number of subadvisers,[44] and some funds operating under our orders use only one subadviser for the fund, or for each series of the fund.[45]

The conditions contained in our exemptive orders provide the same protections for funds with single subadvisers and those with multiple subadvisers.[46] In each case, the conditions limit relief to funds in which the subadviser is analogous to a portfolio manager and in which shareholders were informed of the principal adviser's ability to retain new subadvisers without shareholder approval. Moreover, the principal adviser's ability to hire and fire subadvisers without shareholder approval benefits shareholders by allowing funds to terminate poorly performing subadvisers, while avoiding having to operate for a significant period of time without a subadviser providing investment management services.[47] Also, subadviser changes are not infrequent for funds advised by single subadvisers.[48] Therefore, the Commission has issued orders to funds with a single subadviser, and our proposed rule would not require that each fund or portfolio engage a certain minimum number of subadvisers.[49]

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[38] *See* Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734 (Jan. 16, 2001)].

[39] Proposed rule 15a–5(a)(7). *See* 17 CFR 270.0–1(a)(6)(i) (defining ''independent legal counsel''). The manager of managers exemptive orders have typically included these board composition and nomination requirements. The manager of managers orders that also include relief from our disclosure rules *require* independent directors to retain independent counsel. Consistent with the amendments to exemptive rules in 2001, the proposed rule would require that the independent directors have independent counsel only if they choose to retain counsel. *See* Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734 (Jan. 16, 2001)].

[40] Proposed rule 15a–5(a)(3). If the fund has not publicly offered securities or sold securities to non-affiliates or promoters (or their affiliates), the rule would require that the board of directors approve the fund's operation as a manager of managers fund by authorizing the adviser to enter into subadvisory contracts without shareholder approval. *Id.* This condition also has been included as a condition to our orders.

[41] Proposed Instruction 3 to Item 4(b)(1) and proposed amendments to Item 6(a)(1)(i) of Form N–1A. The amendments to Form N–1A also would require the fund to disclose in its prospectus, in the discussion of principal investment strategies, the fund's use of (or reservation of its right to use) subadvisers that may be changed at any time. Proposed Instruction 3 to Item 4(b)(1). A fund also would have to disclose in its summary of principal investment strategies, required by Item 2(b) of Form N–1A, that the fund uses (or reserves the right to use) the services of one or more subadvisers without shareholder approval. *See* Item 2(b) of Form N–1A (Item 2(b) of the prospectus must identify, based on the information given in response to Item 4(b), the fund's principal investment strategies).

[42] Proposed rule 15a–5(a)(5). The information would have to be provided to shareholders within 90 days of entering into a subadvisory contract or materially amending a wholly-owned subadviser's contract.

[43] 17 CFR 239.17a, 274.11b.

[44] *See, e.g.*, Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order).

[45] *See, e.g.*, Managed Accounts Services Portfolio Trust and Mitchell Hutchins Asset Management, Inc., Investment Company Act Release Nos. 21590 (Dec. 11, 1995) [60 FR 64461 (Dec. 15, 1995)] (notice) and 21666 (Jan. 11, 1996) [61 SEC Docket 142 (Feb. 6, 1996)] (order) (order granted to fund in which each series of the fund was advised initially by a single subadviser).

[46] For example, the compensation received by subadvisers to single subadviser funds is fully disclosed to investors. *See supra* Section II.A.1.

[47] Absent the impediment of operating without a subadviser, it is more likely that poorly performing subadvisers would be terminated.

[48] For example, between August 1999 and October 2000, 6 of 27 American Skandia portfolios that employed only one subadviser replaced the subadviser. Between October 1999 and September 2000, 3 of 11 Paine Webber PACE Select Advisors Trust portfolios that employed only one subadviser (as of October 1999) replaced the subadviser.

[49] Some have argued that the conditions of the Commission's exemptive orders were designed for funds in which a principal adviser selects and supervises multiple subadvisers, and that the costs and delays associated with a shareholder vote for a fund with one subadviser do not warrant

- We request comment on whether the circumstances involving single subadvisers are sufficiently similar to those involving multiple subadvisers, to justify similar treatment under the proposed amendments.
- Should the proposed rule include as a condition that the principal adviser engage multiple subadvisers for each fund, or each series of the fund? Should any of the conditions in the rule be modified in the case of single subadviser funds?

B. Rescission of Previously Issued Exemptive Orders

As discussed above, we have issued over 100 orders permitting manager of managers funds to operate without the need for shareholder approval of new subadvisory contracts. Our rule proposal today is designed largely to codify the relief we have provided by order. However, the conditions in some of the orders vary slightly from others.[50] We are concerned that, if we permit the continued operation of funds under the orders we have issued in the past, funds will be operating under different sets of conditions, which might have an adverse effect on competition.[51] We therefore anticipate rescinding those orders upon adoption of the proposed rule.

- We request comment on the possible effects caused by the rescission of the orders. If the Commission does not rescind the orders, how would competition be affected?

III. General Request for Comment

The Commission requests comment on the proposed rule, rule amendments, and form amendments proposed in this Release. The Commission also requests suggestions for additional changes to existing rules or forms, and comments on other matters that might have an effect on the proposals contained in this Release. Commenters are requested to provide empirical data to support their views.

IV. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. As discussed above, proposed rule 15a–5 and the proposed amendments to Form N–1A would essentially codify existing exemptive orders that allow manager of managers funds and their principal advisers to enter into subadvisory contracts without shareholder approval. Therefore this analysis examines the costs and benefits to funds, advisers, and investors that would result from reliance on the exemptive relief under the proposed amendments, in comparison to the costs and benefits associated with obtaining an exemptive order from the Commission.

A. Benefits

We anticipate that funds, their advisers, and their shareholders would benefit from the proposed rule and amendments.[52] Funds and advisers that rely on the rule would be able to enter into subadvisory contracts without obtaining exemptive relief from the Act's shareholder approval requirement, which relief can be costly to funds and their shareholders.[53] Obtaining an exemptive order also can entail delays for the fund that applies for relief, although these applications for relief are typically processed expeditiously.[54]

Some of the conditions included in the proposed rule and amendments differ from the conditions or representations typically included in a manager of managers exemptive order. We anticipate that these differences will not yield significant costs or benefits. For example, an exemptive order for a fund that intends to provide only aggregate fee disclosure concerning subadvisers typically requires that the fund's independent directors retain independent legal counsel.[55] The proposed rule would not require independent directors to retain legal counsel.

B. Costs

Funds that choose to rely on the proposed amendments, as well as their advisers, would incur certain costs in complying with the rules.[56] As discussed above, proposed rule 15a–5 includes a condition requiring the contract between a manager of managers fund and its principal adviser to provide that the adviser will supervise and monitor the performance of its subadvisers.[57] If the Commission rescinds the previous exemptive orders granted for manager of managers funds, a fund that already has an exemptive order would need to modify its advisory contract to include that provision. Similarly, if an existing fund were to choose to operate as a manager of managers fund under the proposed amendments, it would need to modify its advisory contract.[58]

The modification of advisory contracts in response to the proposed rule would impose one-time costs. The Commission anticipates providing a sufficiently long compliance period for the proposed amendments, so that the contract modifications could be made when the fund's board next approves a new advisory contract. Therefore we believe the costs involved in making the modifications would be minor.[59]

There are no new costs associated with any of the remaining conditions of the proposed rule and amendments. First, the proposed rule would require that the fund provide shareholders,

exemptive relief. *See* Hillview Investment Trust II and Hillview Capital Advisors, LLC, Investment Company Act Release No. 25055 (June 29, 2001) [66 FR 35676 (July 6, 2001)].

[50] It is not unusual for the conditions in our orders to evolve as we and our staff gain experience with the operation of a type of a fund under an exemptive order.

[51] The rescission of the orders would not affect existing subadvisory contracts entered into under an order prior to the adoption of the proposed rule. However, new or renewed subadvisory contracts entered into after adoption of the proposed rule would have to comply with the proposed rule's requirements.

[52] Our staff estimates that approximately 2,798 portfolios (comprising portions of 631 open-end funds) have at least one subadviser and as such could benefit from the proposed rule and amendments. The staff's estimates are based on an examination of the information reported on Form N–SAR from July through December 2002.

[53] Based on discussions with fund representatives, the Commission estimates that obtaining an exemptive order for a manager of managers fund costs approximately $35,000.

[54] Our staff estimates, based upon orders issued in the past, that the exemptive application process (from initial filing to issuance of order) takes about eight months. During that time, Commission staff review and comment on applications, applicants submit responses to comments, the completed application is summarized in a notice to the public, and public comments are received and evaluated.

[55] *See, e.g.,* Pitcairn Funds and Pitcairn Trust Company, Investment Company Act Release Nos. 25106 (Aug. 9, 2001) [66 FR 42901 (Aug. 15, 2001)] (notice) and 25150 (Sept. 5, 2001) [75 SEC Docket 2214 (Oct. 2, 2001)] (order).

[56] Because the proposed rule is an exemptive rule, funds can choose whether or not to rely on it. Only those funds that choose to rely on the proposed rule would incur costs in complying with the rule.

[57] *See supra* Section II.A.2.

[58] Under our proposal, contracts between the principal adviser and subadvisers also would be required to authorize the principal adviser to terminate the subadvisory contract at any time without penalty. However, most if not all subadvisory contracts already contain such a provision, and therefore this condition would not impose a new cost on funds.

[59] For purposes of the Paperwork Reduction Act, the Commission staff has estimated that it would take a total of 5 hours and $1,287.77 per fund to comply with the condition of proposed rule 15a–5 related to the supervision of subadvisers. During the first year after adoption of the rule, it is estimated that all funds that currently rely on exemptive orders (plus existing funds that would choose to rely on the proposed rule during the first year) would spend a total of 600 hours and $154,719 to comply with the supervision requirement. After the first year, the staff estimates that ten funds per year, whose securities have already been publicly offered, would seek to rely on the proposed rule and therefore would need to modify their advisory contracts with principal advisers. The Commission staff estimates that, after the first year, those ten funds together would annually spend 50 hours and $12,877 to comply with the supervision requirement.

within 90 days of the entry into a subadvisory contract or a material change to a wholly-owned subadviser's contract, with an information statement that contains the information that would have been provided to shareholders in a proxy statement if a shareholder vote had been held.[60] Second, the proposed rule would require funds to obtain shareholder authorization for a principal adviser to enter into subadvisory contracts without shareholder approval.[61] Third, the proposed rule would require that disinterested directors comprise a majority of the fund board, and that the disinterested directors select and nominate any other disinterested directors.[62] Fourth, the proposed rule would require independent directors, if they hire legal counsel, to hire an independent legal counsel.[63] All of these conditions (or their substantial equivalent) are typically included in manager of managers exemptive orders, and therefore would not result in any new costs to funds, their advisers, or investors.[64]

Although the proposed rule would alter the relationship between the principal adviser and shareholders (by allowing the principal adviser to hire and terminate subadvisers without shareholder approval) and the principal adviser and its subadvisers, the effects of such alterations would be minimal because shareholders have the right to terminate subadvisers [65] and principal advisers have a contractual duty to supervise their subadvisers.[66]

C. Request for Comment

The Commission requests comment on the potential costs and benefits of the proposed rule and amendments and any suggested alternatives to the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding any additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Act of 1996,[67] the Commission also requests information regarding the potential impact of the proposals on the U.S. economy on an annual basis. Commenters are requested to provide data to support their views.

V. Consideration of Promotion of Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and section 3(f) of the Exchange Act require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.[68] The Commission anticipates that the proposed amendments would not adversely affect efficiency, competition, or capital formation.

The proposed amendments are intended to allow funds to enter into subadvisory contracts without shareholder approval, which would eliminate the need for funds to hold a shareholder meeting or obtain specific exemptive relief, either of which can be costly and time consuming. We anticipate that the proposed amendments would enhance efficiency by significantly reducing the time period needed for selecting subadvisers, while also reducing the fund's costs associated with the hiring of a new subadviser.[69] Adoption of the proposed rule and rescission of the exemptive orders would subject all funds and advisers to the same conditions, and enable them to compete under more uniform conditions. The Commission does not expect the proposed amendments to have a material effect on competition or capital formation.[70]

The Commission requests comments on whether the proposed rule and proposed form and rule amendments, if adopted, would promote efficiency, competition, and capital formation. Comments will be considered by the Commission in satisfying its responsibilities under section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and sections 3(f) and 23(a)(2) of the Exchange Act.

VI. Paperwork Reduction Act

Certain provisions of proposed rule 15a–5 and certain provisions of the proposed amendments to Form N–1A would result in new ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[71] The Commission is submitting these proposals to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information associated with the proposed rule is ''Rule 15a–5 under the Investment Company Act of 1940, 'Exemption from shareholder approval for certain subadvisory contracts.' '' The title for the collection of information associated with the proposed amendments is ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, 'Registration Statement of Open-End Management Investment Companies.' '' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The approved collection of information associated with Form N–1A, which would be revised by the proposed amendments, displays control number 3235–0307.

Proposed rule 15a–5 and the proposed amendments to Form N–1A would permit manager of managers funds to operate without obtaining shareholder approval when the fund's principal adviser hires a new subadviser or replaces an existing subadviser subject to certain conditions. The rule and amendments would largely codify numerous exemptive orders issued by the Commission. We believe that the information collection requirements of the proposed rule and amendments ensure that only manager of managers funds are eligible for relief, that shareholders are provided with information on the identity of the fund's subadvisers, and that shareholders are aware of a fund's and a principal adviser's ability to hire and fire subadvisers without shareholder approval. The provision of information in accordance with the proposed rule and amendments would be voluntary,

[60] Proposed rule 15a–5(a)(5).

[61] Proposed rule 15a–5(a)(3).

[62] Proposed rule 15a–5(a)(7)(i).

[63] Proposed rule 15a–5(a)(7)(ii).

[64] The manager of managers orders that also include relief from our disclosure rules *require* independent directors to retain independent counsel. The proposed rule would require that the independent directors have independent counsel only if they choose to retain counsel. Moreover, the amendments we made to a number of exemptive rules in January 2001, *see supra* notes 38–39 and accompanying text, make it likely that most funds that would use the exemptive relief provided by the proposed rule would already have independent counsel or would not retain legal counsel.

[65] Section 15(a)(3) of the Act [15 U.S.C. 80a–15(a)(3)] provides that any advisory contract must be terminable at any time by vote of a majority of the outstanding voting securities of the fund.

[66] The proposed rule would require the principal adviser's contract with the fund to include a provision requiring the principal adviser to supervise its subadvisers. *See* proposed rule 15a–5(a)(4).

[67] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

[68] 15 U.S.C. 80a–2(c), 15 U.S.C. 77b(b), and 15 U.S.C. 78c(f). Section 23(a)(2) of the Exchange Act also requires the Commission, in adopting rules under the Exchange Act, to consider the anticompetitive effects of any rule it adopts. 15 U.S.C. 78w(a)(2).

[69] The proposed amendments permitting a fund to disclose only the aggregate fees paid to all of the fund's unaffiliated subadvisers also could enhance efficiency by allowing funds to negotiate fees lower than the subadviser's usual fee. *See supra* Section II.A.1.

[70] Similarly, the Commission does not expect the adoption of the proposed rule and amendments to have any anticompetitive effects. *See supra* note 68.

[71] 44 U.S.C. 3501.

because rule 15a–5 is an exemptive rule and, therefore, funds may choose whether to rely on it. Because the information provided to the Commission on Form N–1A is available to the public, this analysis does not address the confidentiality of responses under the proposed rule.

The proposed rule would require that a fund's contract with each principal adviser that retains the services of one or more subadvisers contain a provision obligating the principal adviser to supervise and oversee the activities of its subadvisers.[72] The proposed rule also would require all contracts with subadvisers that are retained without shareholder approval to provide that the principal adviser may terminate the subadviser at any time without penalty.[73]

During the first year after adoption of the rule, the Commission staff estimates that requiring funds to modify their existing contracts with principal advisers so that each principal adviser is required to supervise and oversee the activities of its subadvisers would create an initial one-time burden of 5 hours per fund (4 hours by in-house counsel, .5 hours by fund directors, .5 hours by support staff) [74] or about 600 burden hours.[75] The Commission staff estimates that after the first year, approximately 10 registered open-end investment companies [76] would spend, on average, 5 hours annually (4 hours by in-house counsel, .5 hours by fund directors, .5 hours by support staff) to modify their contracts regarding supervision, for a total of 50 burden hours.

Rule 15a–5 also would require funds to provide shareholders (and file with the Commission), within 90 days of entering into a subadvisory contract or materially amending a wholly-owned subsidiary's subadvisory contract, with an information statement describing the agreement and containing all of the information shareholders would have received in a proxy statement had a shareholder vote been held.[77] During the first 3 years after adoption of the proposed rule, the Commission staff estimates that 150 registered open-end investment companies [78] would each spend 20 hours [79] annually in preparing and distributing information statements. The total annual burden estimate for complying with the reporting requirement of rule 15a–5 would be 3,000 hours annually.

The proposed amendments also would result in new information collection requirements. The proposed amendments to Form N–1A would require any fund that is authorized to hire one or more subadvisers without shareholder approval pursuant to proposed rule 15a–5, to disclose this information in its prospectus.[80] The Commission believes that the added information collection burdens would be negligible and would be mostly offset by other disclosure amendments that would permit funds that comply with the requirements of proposed rule 15a–5 to disclose the aggregate fees paid to all unaffiliated subadvisers of the principal adviser, in lieu of the individual fee paid to each subadviser.[81]

To arrive at the total information collection burden, a weighted average of the first year burden and the annual burden after the first year was calculated. Using a three-year period, the weighted average information collection burden is 3,232 hours.[82]

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed rule and amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609, with reference to File No. S7–20–03. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–20–03, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services.

VII. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis

[72] Proposed rule 15a–5(a)(4).

[73] Proposed rule 15a–5(b)(4). Most subadvisory contracts already contain terms that allow the principal adviser to terminate the contract at any time. We therefore estimate that there would be no costs imposed on funds by this requirement.

[74] These estimates are based on discussions with fund representatives.

[75] The Commission staff estimates that 120 funds would have to modify their advisory contracts with their principal advisers to comply with the proposed rule. These 120 funds include 101 funds that currently rely on exemptive orders, 9 funds that have filed an application for an exemptive order and, as explained *infra* note 76, 10 additional funds that would choose to rely on the proposed rule during the first year. The total number of burden hours for the first year is 120 funds × 5 hours = 600 hours.

[76] Based on the number of manager of managers applications submitted since 1995, the staff estimates that 20 additional funds per year would seek to rely on the proposed rule. Approximately 10 of those funds would be funds whose securities have already been publicly offered, and therefore would need to modify their advisory contracts with principal advisers.

[77] Proposed rule 15a–5(a)(5).

[78] Commission staff estimates that 130 funds (including 101 funds that currently rely on exemptive orders, 9 funds that have filed an application for an exemptive order, and 20 additional funds that would have filed for exemptive relief during the first year after the rule's adoption) would rely on the proposed rule during the first year after its adoption. After the first year, the staff estimates that each year 20 additional funds would rely on the proposed rule.

[79] Based on discussions with fund representatives, the Commission estimates that on average each fund would hire two new subadvisers per year. Therefore, funds would be required to send to shareholders two information statements per year. Based on discussions with fund representatives, the Commission estimates that each fund would spend 10 hours to prepare and mail each information statement.

[80] Proposed Instruction 3 to Item 4(b)(1) of Form N–1A would require a fund to disclose if it is authorized to use the services of subadvisers without shareholder approval. Proposed Item 6(a)(1)(i) of Form N–1A would require a fund in its identification and description of its investment advisers to explain for each subadviser that serves the fund without shareholder approval that such adviser may be replaced, and additional subadvisers may be retained, without shareholder approval.

[81] Proposed Instruction 5 to Item 15(a)(3) of Form N–1A would allow funds to disclose the aggregate fees paid to all unaffiliated subadvisers of the principal adviser in lieu of the individual fee paid to each such subadviser.

[82] The first year burden of 3,600 hours (600 hours to modify existing contracts + 3,000 hours to comply with the reporting requirement) is weighted (1 year / 3 years = 33 percent) as 1,188 hours. The burden after the first year of 3,050 hours (50 hours to modify contracts + 3,000 hours to comply with the reporting requirement) is weighted (2 years / 3 years = 67 percent) as 2,044 hours. The total weighted information collection burden hours for the proposed amendments are 1,188 + 2,044 = 3,232 hours.

(''IRFA'') in accordance with 5 U.S.C. 603 regarding proposed rule 15a–5 under the Investment Company Act and proposed amendments to rule 6–07 of Regulation S–X under the Investment Company Act and the Securities Act, Form N–1A under the Investment Company Act and the Securities Act, and Schedule 14A under the Exchange Act. The following summarizes the IRFA.

The IRFA summarizes the background of the proposed rule and amendments. The IRFA also discusses the reasons for the proposed rule and amendments and the objectives of, and legal basis for, the rule and amendments. Those items are discussed above in this Release.

The IRFA discusses the effect of the proposed rule and amendments on small entities. A small business or small organization (collectively, ''small entity'') for purposes of the Regulatory Flexibility Act is a fund that, together with other funds in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[83] Of approximately 2,200 registered open-end investment companies (consisting of about 9,000 portfolios), approximately 157 are small entities.[84] Approximately 2,798 portfolios (comprising portions of 631 registered open-end investment companies) currently retain one or more subadvisers. Approximately 13 of the 631 registered open-end companies (containing 35 of the 2,798 portfolios) are small entities.[85] Funds that are small entities, like other funds, may rely on the rule if they satisfy its conditions. The rule is an exemptive rule and therefore funds may choose not to rely on it.

The Commission staff estimates that only two of the approximately one hundred exemptive orders issued by the Commission involved small entities. The staff anticipates that the number of funds seeking exemptive relief will continue to rise, but that the proportion of small funds to total funds will remain relatively stable in the future.[86]

The Commission staff expects the proposed rule and amendments to have little impact on small entities. Like other funds, small entities will be affected by the proposed rule and amendments only if they enter into a subadvisory contract with an unaffiliated or wholly-owned subadviser. Because the proposed rule is voluntary in nature, only small entities that choose to rely on the rule will be subject to its conditions.[87] Moreover, the burdens imposed by the proposed rule and amendments should be more than offset by the fact that the proposed rule and amendments would enable funds, including small entities, to enter into subadvisory contracts without incurring the expenses associated with a shareholder vote or the filing of an application for exemption under section 6(c) of the Act.

The IRFA discusses the reporting, recordkeeping, and compliance requirements associated with the proposed rule and amendments. It notes that the proposed rule would require funds to provide an information statement to its shareholders (and file it with the Commission) within 90 days of the entry into a subadvisory contract or a material change to a wholly-owned subadviser's contract as a substitute for the proxy statement that the fund would have had to provide to each shareholder if a shareholder vote had been held.[88]

The IRFA also explains that the proposed rule would impose compliance requirements. For funds relying on the proposed rule, the rule would require that: (i) the subadvisory contract: (a) does not directly or indirectly increase the management and advisory fees charged to the fund or its shareholders,[89] and (b) provides that it may be terminated at any time, on no more than 60 days written notice, without penalty, by the principal adviser;[90] (ii) the subadviser is not an affiliated person of the fund or the principal adviser with which it has contracted (other than by reason of serving as an investment adviser to the fund);[91] (iii) no director or officer of the fund, and no principal adviser or director or officer of the principal adviser with which the subadviser has contracted, directly or indirectly owns any material interest in the subadviser other than an interest through ownership of shares of a pooled investment vehicle that is not controlled by such person or entity;[92] (iv) shareholders of the fund have authorized a principal adviser, subject to approval by the board of directors, to enter into subadvisory contracts without shareholder approval or, if the fund's securities have not been publicly offered or sold to persons who are not promoters or affiliated persons of the fund, the directors have authorized the principal adviser to enter into such contracts;[93] (v) the contract between the fund and a principal adviser provides that the principal adviser must supervise and oversee the activities of its subadvisers on behalf of the fund;[94] (vi) if the fund identifies the subadviser as part of the fund's name or title, it also clearly identifies the principal adviser with which the subadviser has contracted, before the name of the subadviser;[95] (vii) a majority of the directors of the fund are not interested persons of the fund, and those directors select and nominate any other disinterested directors;[96] and (viii) any person who acts as legal counsel for the disinterested directors is an independent legal counsel.[97]

The IRFA explains that the proposed rule would benefit funds by allowing them to enter into subadvisory contracts without shareholder approval, and thereby avoid incurring the costs and delay associated with the exemptive application process or with obtaining shareholder approval. The IRFA also notes that while the proposed rule would require funds to comply with numerous conditions, many of the compliance requirements do not involve any new costs on funds and those that

[83] 17 CFR 270.0–10.

[84] Some or all of these entities may contain multiple series or portfolios. If a registered investment company is a small entity, the portfolios or series it contains are also small entities.

[85] These estimates are based on data reported on Form N–SAR filed with the Commission between July and December 2002.

[86] The Commission believes that small funds are unlikely to retain multiple subadvisers to manage fund assets because it would not be practical for subadvisers to manage a portion of a small fund's assets. A subadviser receives as a fee a percentage of the value of the assets under its management. Therefore, providing management services to a portion of a small fund's assets would not provide a large enough fee to justify the subadviser's time or effort. Because it is unlikely that a small fund would retain more than one subadviser, small funds rarely have reason to seek exemptive relief.

[87] As noted above, to date only two small funds have obtained an exemptive order allowing them to enter into subadvisory contracts without shareholder approval. The Commission does not believe that the number of small funds seeking such relief will increase in the future. *See supra* note 86 and accompanying text.

[88] Proposed rule 15a–5(a)(5). The exemptive orders that have been issued by the Commission require that shareholders be provided with an information statement in place of the proxy statement.

[89] Proposed rule 15a–5(a)(1).

[90] Proposed rule 15a–5(b)(4).

[91] Proposed rule 15a–5(a)(2)(i).

[92] Proposed rule 15a–5(a)(2)(i). The proposed rule would allow a wholly-owned subadviser to qualify for relief from section 15(a) of the Act even though it is an affiliate of the principal adviser and the principal adviser has an ownership interest in the subadviser, if the wholly-owned subadviser meets all of the other conditions of the proposed rule and the wholly-owned subadviser is replacing another wholly-owned subadviser or its contract has been materially amended. Proposed rule 15a–5(a)(2)(ii).

[93] Proposed rule 15a–5(a)(3).

[94] Proposed rule 15a–5(a)(4).

[95] Proposed rule 15a–5(a)(6).

[96] Proposed rule 15a–5(a)(7)(i).

[97] Proposed rule 15a–5(a)(7)(ii).

do would not result in a significant burden being placed on the funds.[98]

The IRFA explains that the proposed amendments would impose reporting requirements on funds, but would not impose recordkeeping or compliance requirements. The proposed amendments would require any fund that is authorized to hire one or more subadvisers without shareholder approval pursuant to proposed rule 15a–5, to disclose this ability in its prospectus.[99] Compliance with these amendments would require little time, involve no extra costs to funds, and should not impose a significant burden, if any, on funds, including small entities. Shareholders of funds would benefit by being fully informed of the fund's ability to replace subadvisers without shareholder approval.

The proposed amendments also would allow a fund that complies with the requirements of proposed rule 15a–5 to decide not to disclose the individual fee paid to each unaffiliated subadviser of the principal adviser.[100] For purposes of fee disclosure in the fund's Statement of Additional Information, the fund would be required to disclose in place of the individual fee paid to each subadviser (both as a dollar amount and as a percentage of its net assets) (i) the individual fees paid to the principal adviser and to each of its affiliated subadvisers (including its wholly-owned subadvisers), (ii) the net advisory fee retained by the principal adviser after payment of fees to all subadvisers, and (iii) the aggregate fees paid to all subadvisers that are not affiliated persons of the principal adviser.[101] These amendments would benefit funds, including small entities, by reducing the disclosure burden on funds that qualify for relief under the proposed rule and by allowing the principal adviser to negotiate a lower advisory fee with each unaffiliated subadviser than the fee normally charged by each such subadviser.[102]

The IRFA explains that the Commission has considered significant alternatives to the proposed rule and amendments that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. The Commission believes that no alternative could carry out these objectives as effectively as the proposed rule and amendments.

The Commission encourages the submission of comments on matters discussed in the IRFA. Specifically, comment is requested on the effects the proposed rule and amendments would have on small entities, and the number of small entities that would be affected. Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect. These comments will be placed in the same public file as comments on the proposed rule and amendments themselves. A copy of the IRFA may be obtained by contacting Adam B. Glazer, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0506.

VIII. Statutory Authority

The Commission is proposing to adopt new rule 15a–5 pursuant to the authority set forth in sections 6(c) and 38(a) [15 U.S.C. 80a–6(c) and 80a–37(a)] of the Investment Company Act. The Commission is proposing amendments to rule 6–07 of Regulation S–X pursuant to authority set forth in section 7 of the Securities Act [15 U.S.C. 77g] and sections 8 and 38(a) of the Investment Company Act [15 U.S.C. 80a–8, 80a–37(a)]. We are proposing amendments to Schedule 14A pursuant to authority set forth in sections 14 and 23(a)(1) of the Exchange Act [15 U.S.C. 78n, 78w(a)(1)] and sections 20(a) and 38 of the Investment Company Act [15 U.S.C. 80a–20(a), 80a–37]. We are proposing amendments to Form N–1A pursuant to authority set forth in sections 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77f, 77g, 77j, 77s(a)] and sections 8, 24(a), and 30 of the Investment Company Act [15 U.S.C. 80a–8, 80a–24(a), and 80a–29].

List of Subjects

17 CFR Part 210

Accounting, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 239 and 240

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules and Form Amendments

For reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for part 210 continues to read as follows:

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[98] The requirements regarding prohibited relationships between the subadviser and the fund or principal adviser (or their affiliates) do not involve any costs or burdens. The requirements regarding board composition and the selection and nomination of independent directors would not impose any new costs or burdens. Under our current manager of managers orders, funds are required to comply with the same board composition and selection and nomination requirements. The independent legal counsel requirement does not require independent directors to retain legal counsel, but those who are represented by counsel that does not meet the definition of "independent legal counsel" would be required to retain different counsel if their fund chooses to rely on the proposed rule. The manager of managers orders that also include relief from our disclosure rules *require* independent directors to retain independent counsel. Moreover, the amendments we made to a number of exemptive rules in January 2001, *see supra* notes 38 and 39 and accompanying text, make it likely that most funds that would use the exemptive relief provided by the proposed rule would already have independent counsel or would not retain legal counsel.

Requiring funds to furnish shareholders with an information statement (and file such statement with the Commission) following the retention of a new subadviser or a change in the fee paid to a wholly-owned subadviser would not impose any new costs on funds. Currently, funds either have to provide shareholders with a proxy statement in connection with seeking shareholder approval of the subadvisory contract or, if operating under a manager of managers exemptive order, have to provide shareholders with an information statement (and file such statement with the Commission). In the absence of the proposed rule, therefore, the fund still would be required to provide shareholders with the same information. Similarly, requiring the shareholders or the board of the fund to authorize the principal advisers to enter into subadvisory contracts without shareholder approval would not impose any new costs on the fund. Currently, a fund either has to receive shareholder approval of all subadvisory contracts or, if operating under a manager of managers exemptive order, obtain shareholder authorization for entering into subadvisory contracts without shareholder approval. In the absence of the proposed rule, therefore, the fund would still incur the same or greater costs in obtaining shareholder approval or operating under an order.

[99] Proposed Instruction 3 to Item 4(b)(1) of Form N–1A would require a fund to disclose if it is authorized to use the services of subadvisers without shareholder approval. Proposed Item 6(a)(1)(i) of Form N–1A would require a fund in its identification and description of its investment advisers to explain for each subadviser that serves the fund without shareholder approval that such subadviser may be replaced, and additional subadvisers may be retained, without shareholder approval.

[100] Proposed rule 6–07(2)(d) of Regulation S–X, proposed Instruction 2 to Item 22(c) of Schedule 14A, and proposed Instruction 5 to Item 15(a)(3) of Form N–1A. In the absence of these amendments, funds would be required to disclose the individual fee paid to each subadviser.

[101] Proposed Instruction 5 to Item 15(a)(3) of Form N–1A.

[102] By allowing funds to disclose only the aggregate fee paid to all unaffiliated subadvisers, each unaffiliated subadviser would be more likely to accept a lower fee than the fee it charges to its other clients, because a subadviser's other clients would not be aware of the exact fee paid to each subadviser.

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 78c, 78j–1, 78*l*, 78m, 78n, 78o(d), 78q, 78u–5, 78w(a), 78*ll*, 78mm, 79e(b), 79j(a), 79n, 79t(a), 80a–8, 80a–20, 80a–29, 80a–30, 80a–31, 80a–37(a), 80b–3, 80b–11, 7202 and 7262, unless otherwise noted.

2. Section 210.6–07 is amended by:

a. Redesignating paragraphs 2.(d), (e), (f), and (g) as paragraphs 2.(e), (f), (g), and (h); and

b. Adding new paragraph 2.(d) to read as follows:

§ 210.6–07 Statements of operations.

* * * * *

2. *Expenses.* * * *

(d) If a registered investment company or separate series of a registered investment company (''Fund'') or a principal adviser (as defined in § 270.15a–5(b)(2) of this chapter) of the Fund, in reliance on § 270.15a–5 of this chapter, has entered into a contract or contracts with a subadviser (as that term is defined in § 270.15a–5(b)(3) of this chapter) of the Fund without approval by a vote of the securities of the Fund, the investment advisory fee paid to any subadviser that is not an affiliated person (as defined in 15 U.S.C. 80a–2(a)(3)) of the principal adviser with which it has contracted or of the Fund (other than by reason of serving as an investment adviser to the Fund) need not be disclosed as a separate expense item in response to paragraphs 2.(a), (b), or (c) of this section.

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

3. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 80a–8, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7202, 7241, 7262, and 7263; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

5. Section 240.14a–101, Item 22, is amended by:

a. Designating the Instruction before paragraph (c)(1) as Instruction 1 and adding Instruction 2; and

b. Designating the Instruction after paragraph (c)(10) as Instruction 1 and adding Instruction 2.

These additions and revisions read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 22. Information required in investment company proxy statement.

* * * * *

(c) * * *

Instructions to paragraph (c). 1.* * *

2. Where information is furnished in response to this item in order to comply with the requirements of § 270.15a–5(a)(5) of this chapter, the rate of compensation and the aggregate amount of the fee paid to the subadviser (as that term is defined in § 270.15a–5(b)(3) of this chapter) need not be disclosed in response to any paragraph of this item, and the information required by paragraph (c)(9) of this item need not be disclosed, unless such subadviser is a wholly-owned subsidiary (as defined in 15 U.S.C. 80a–2(a)(43)) of the principal adviser (as that term is defined in § 270.15a–5(b)(2) of this chapter) with which it has contracted.

* * * * *

(10) * * *

Instructions to paragraph (c)(10). 1. * * *

2. Where information is furnished in response to this item in order to comply with the requirements of § 270.15a–5(a)(5) of this chapter, the compensation information required by this paragraph (c)(10) need not be disclosed, unless the information pertains to a subadviser (as that term is defined in § 270.15a–5(b)(3) of this chapter) that is a wholly-owned subsidiary (as defined in 15 U.S.C. 80a–2(a)(43)) of the principal adviser (as that term is defined in § 270.15a–5(b)(2) of this chapter) with which it has contracted.

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

6. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

* * * * *

7. Section 270.15a–5 is added to read as follows:

§ 270.15a–5 Exemption from shareholder approval for certain subadvisory contracts.

(a) *Exemption from shareholder approval.* Notwithstanding section 15(a) of the Act (15 U.S.C. 80a–15(a)), a subadvisory contract need not be approved by a vote of a majority of the outstanding voting securities of a fund, if the following conditions are met:

(1) *No increase in fees.* The subadvisory contract does not directly or indirectly increase the management and advisory fees charged to the fund or its shareholders.

(2) *Conflicting relationships prohibited.*

(i) The subadviser is not an affiliated person of the principal adviser with which it has contracted or of the fund (other than by reason of serving as an investment adviser to the fund), and no director or officer of the fund, and no principal adviser or director or officer of the principal adviser with which the subadviser has contracted, directly or indirectly owns any material interest in the subadviser other than an interest through ownership of shares of a pooled investment vehicle that is not controlled by such person (or entity); or

(ii) The subadviser is a wholly-owned subsidiary (as defined in section 2(a)(43) of the Act (15 U.S.C. 80a–2(a)(43)) of the principal adviser, and the wholly-owned subsidiary has been hired as a subadviser to replace another wholly-owned subsidiary that has been terminated as a subadviser to the fund, or the subadvisory contract of a wholly-owned subsidiary has been materially amended.

(3) *Shareholder authorization.* Shareholders of the fund have authorized a principal adviser, subject to approval by the board of directors, to enter into contracts with subadvisers without approval by a vote of the outstanding voting securities of the fund or, if the fund's securities have not been publicly offered or sold to persons who are not promoters or affiliated persons of the fund, the directors of the fund have authorized the principal adviser to enter into such contracts.

(4) *Supervision of subadvisers.* A contract between the fund and a principal adviser provides that the principal adviser must supervise and oversee the activities of the subadviser under the subadvisory contract on behalf of the fund.

(5) *Disclosure to shareholders.* Within 90 days after entry into a new subadvisory contract or after making a material change to a wholly-owned subsidiary's existing subadvisory contract, the fund furnishes its shareholders with an information statement, which must be filed with the

Commission in accordance with the requirements of § 240.14c–5(b) of this chapter, that describes the new agreement, and contains the information specified in Regulation 14C (17 CFR 240.14c–1 through 240.14c–7), Schedule 14C (17 CFR 240.14c–101), and Item 22 of Schedule 14A (17 CFR 240.14a–101) under the Securities Exchange Act of 1934 (15 U.S.C. 78a–mm).

(6) *Fund name.* If the fund identifies the subadviser as a part of the fund's name or title, it also clearly identifies in its name or title the principal adviser with which the subadviser has contracted, before the name of the subadviser.

(7) *Board of directors composition, selection, and representation.*

(i) A majority of the directors of the fund are not interested persons of the fund, and those directors select and nominate any other disinterested directors; and

(ii) Any person who acts as legal counsel for the disinterested directors is an independent legal counsel.

(b) *Definitions.*

(1) *Fund* means a registered open-end management investment company, or separate series of a registered open-end management investment company.

(2) *Principal adviser* means an investment adviser as defined in section 2(a)(20)(A) of the Act (15 U.S.C. 80a–2(a)(20)(A)).

(3) *Subadviser* means an investment adviser as defined in section 2(a)(20)(B) of the Act (15 U.S.C. 80a–2(a)(20)(B)).

(4) *Subadvisory contract* means a contract between a principal adviser and subadviser to a fund, under which contract the subadviser agrees to perform investment advisory services on behalf of the fund, and which is terminable at any time by the principal adviser, on no more than 60 days written notice, without payment of penalty.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

9. Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by:

a. In Item 4(b)(1) by redesignating Instructions 3, 4, 5, 6, and 7 as Instructions 4, 5, 6, 7, and 8 and adding new Instruction 3;

b. In Item 6 adding a sentence to the end of paragraph (a)(1)(i) and a Note; and

c. In Item 15 adding Instruction 5 before paragraph (b).

These additions and revisions read as follows:

Note: The text of Form N–1A does not and these amendments will not appear in the *Code of Federal Regulations.*

Form N–1A

* * * * *

Item 4. Investment Objectives, Principal Investment Strategies, and Related Risks

* * * * *

(b) * * *

(1) * * *

Instructions. * * *

3. A Fund that uses (or reserves the right to use) the services of any other investment adviser to implement the investment objectives, strategies, and policies of the Fund, without shareholder approval of those advisers' contracts in reliance on § 270.15a–5, should regard such use (or reservation to use) as a principal investment strategy.

* * * * *

Item 6. Management, Organization, and Capital Structure

(a) * * *

(1) *Investment Adviser.*

(i) * * * If the investment adviser is a subadviser whose contract has not been approved by shareholders in reliance on § 270.15a–5, explain that the subadviser may be replaced, and that additional subadvisers may be retained, without shareholder approval.

Note: If the Fund uses the services of more than one subadviser whose contracts have not been approved by shareholders in reliance on § 270.15a–5, then the Fund may include a general statement, appropriately located, explaining that any of the subadvisers may be replaced, and that additional subadvisers may be retained, without shareholder approval.

* * * * *

Item 15. Investment Advisory and Other Services

(a) * * *

(3) * * *

Instructions. * * *

5. If the Fund and an investment adviser comply with the conditions of § 270.15a–5(a)(1)–(7) and (b)(4) (which permits a subadviser to advise the Fund without shareholder approval), the Fund may elect not to disclose separately the fees paid to each subadviser that is not an affiliated person of the principal adviser with which it has contracted, if the Fund instead discloses, both as a dollar amount and as a percentage of its net assets:

(a) The individual fees paid to the principal adviser of the Fund and to each subadviser that is an affiliated person of the principal adviser with which it has contracted;

(b) The net advisory fee retained by the principal adviser after payment of fees to all subadvisers; and

(c) The aggregate fees paid to all subadvisers of the Fund that are not affiliated persons of the principal adviser with which they have contracted.

* * * * *

By the Commission.

Dated: October 23, 2003.

Jill M. Peterson,

Assistant Secretary.

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