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17 CFR Parts 239, 240, 274

Disclosure Regarding Approval of Investment Advisory Contracts By Directors of Investment Companies; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 240, and 274

[Release Nos. 33–8364; 34–49219; IC–26350; File No. S7–08–04]

RIN 3235–AJ10

Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing rule and form amendments under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 to improve the disclosure provided by registered management investment companies about how their boards of directors evaluate and approve, and recommend shareholder approval of, investment advisory contracts. The proposed amendments would require a registered management investment company to provide disclosure in its reports to shareholders regarding the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of advisory contracts during the reporting period. The proposals also are designed to encourage improved disclosure in the registration statements of registered management investment companies regarding the basis for the board's approval of existing advisory contracts, and in proxy statements regarding the basis for the board's recommendation that shareholders approve an advisory contract.

DATES: Comments must be received on or before April 26, 2004.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–08–04; this file number should be included in the subject line if electronic mail is used. All comments received will be posted on the Commission's Internet Web site (http://www.sec.gov) and made available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.[1]

FOR FURTHER INFORMATION CONTACT: Deborah D. Skeens, Senior Counsel, or Paul G. Cellupica, Assistant Director, Office of Disclosure Regulation, Division of Investment Management, (202) 942–0721, at the Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') is proposing for comment amendments to Schedule 14A,[2] the schedule used by registered investment companies and issuers registered under section 12 of the Securities Exchange Act of 1934 (''Exchange Act'')[3] for proxy statements pursuant to section 14(a) of the Exchange Act, and Forms N–1A,[4] N–2,[5] and N–3,[6] registration forms used by management investment companies to register under the Investment Company Act of 1940 (''Investment Company Act'')[7] and to offer their securities under the Securities Act of 1933 (''Securities Act'').[8]

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I. Background

Unlike most business organizations, registered management investment companies (''funds'')[9] are typically organized by an investment adviser that is responsible for the day-to-day operations of the fund. In most cases, the investment adviser is organized as a corporation, whose shareholders may have an interest in the fund that is quite different from the interests of the fund's shareholders. One of the key areas where the interests of fund shareholders and shareholders of the investment adviser diverge is fees. While fund shareholders ordinarily prefer lower fees to achieve greater returns, shareholders of the fund's investment adviser often want to maximize profits through higher fees.

The Investment Company Act relies on fund boards of directors to police conflicts of interest, including conflicts with respect to fees to be received by investment advisers. Section 15(a) makes it unlawful for any person to serve as an investment adviser to a fund, except pursuant to a written contract that has been approved by a majority vote of the fund's shareholders and that continues in effect for not more than two years, unless its continuance is approved at least annually by the board of directors or a majority vote of the shareholders.[10] In addition, Section 15(c) requires that the terms of any advisory contract, and any renewal thereof, be approved by a vote of the majority of the disinterested directors.[11] Section 15(c) also requires a fund's directors to request and evaluate, and an investment adviser to a fund to furnish, such information as may reasonably be necessary to evaluate the terms of any advisory contract.[12] As part of their fiduciary duties with respect to fund fees, boards of directors are required to evaluate the material factors applicable to a decision to approve an investment advisory contract. [13]

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[1] We do not edit personal identifying information, such as names or electronic mail addresses, from hard copy or electronic submissions. You should submit only information that you wish to make available publicly.

[2] 17 CFR 240.14a–101.

[3] 15 U.S.C. 78a *et seq.*

[4] 17 CFR 239.15A and 274.11A.

[5] 17 CFR 239.14 and 274.11a–1.

[6] 17 CFR 239.17a and 274.11b.

[7] 15 U.S.C. 80a–1 *et seq.*

[8] 15 U.S.C. 77a *et seq.*

[9] Management investment companies typically issue shares representing an undivided proportionate interest in a changing pool of securities, and include open-end and closed-end companies. *See* T. Lemke, G. Lins, A. Smith III, Regulation of Investment Companies, Vol. I, ch. 4, § 4.04, at 4–5 (2002). An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer. A closed-end company is any management company other than an open-end company. *See* Section 5 of the Investment Company Act [15 U.S.C. 80a–5]. Open-end companies generally offer and sell new shares to the public on a continuous basis. Closed-end companies generally engage in traditional underwritten offerings of a fixed number of shares and, in most cases, do not offer their shares to the public on a continuous basis.

[10] 15 U.S.C. 80a—15(a).

[11] We refer to directors who are not ''interested persons'' of the fund as ''independent directors'' or ''disinterested directors.'' The term ''interested person'' is defined in Section 2(a)(19) [15 U.S.C. 80a–2(a)(19)] of the Investment Company Act.

[12] 15 U.S.C. 80a–15(c). We recently proposed amendments to rule 31a–2, the fund recordkeeping rule, that would require funds to retain copies of the written materials that directors consider in approving an advisory contract under section 15 of the Investment Company Act. *See* Investment Company Act Release No. 26323 (Jan. 15, 2004) [69 FR 3472, 3477 (Jan. 23, 2004)].

[13] *See, e.g., Burks* v. *Lasker,* 441 U.S. 471, 483 (1979) (''Congress consciously chose to address the conflict-of-interest problem through the [Investment Company] Act's independent-directors section.''); *Brown* v. *Bullock,* 194 F. Supp. 207 (S.D.N.Y.), *aff'd,* 294 F.2d 415 (2nd Cir. 1961) (''By giving the

Since 1994, we have required fund proxy statements seeking approval of an investment advisory contract to include a discussion of the material factors that form the basis of the fund board's recommendation that shareholders approve the contract.[14] In 2001, as part of an initiative intended to enhance the independence and effectiveness of fund boards, we adopted amendments requiring a fund to provide similar disclosure in its Statement of Additional Information (''SAI'') [15] regarding the basis for the board's approval of an existing investment advisory contract.[16] This requirement was intended to provide shareholders with specific information on how directors evaluate and approve investment advisory contracts, including, in particular, the fees paid by the fund to the adviser.

Recently, concerns have been raised regarding the adequacy of review of advisory contracts and management fees by fund boards. In particular, the level of fees charged by investment advisers to mutual fund clients, especially in comparison to those charged by the same advisers to pension plans and other institutional clients, has come under scrutiny.[17] Some have argued that advisory fees charged by investment advisers for equity pension funds are substantially lower than advisory fees charged by investment advisers for equity mutual funds because advisory fees for pension funds are negotiated through arm's-length bargaining.[18] Some have also argued that the process by which fund boards determine to renew advisory contracts is often cursory, at best.[19]

The Commission recently proposed amendments to the fund recordkeeping rule to require that funds retain copies of the written materials that directors considered in approving an advisory contract.[20] This recordkeeping requirement will facilitate our compliance examiners' review of whether directors are obtaining the necessary information to make an informed assessment of the advisory contract. The Commission has also proposed measures to enhance the independence of fund boards of directors by requiring funds that rely on certain exemptive rules to increase the percentage of their independent directors from a majority to 75 percent and requiring that these boards be led by a chairman who is an independent director.[21] A fund board may be more effective when negotiating with the fund adviser over matters such as the advisory fee when the board is composed of a super-majority of independent directors and led by an independent chairman.

Today we are taking steps to encourage fair and reasonable fund fees through increased transparency. Increased transparency with respect to investment advisory contracts, and fees paid for advisory services, will assist investors in making informed choices among funds and encourage fund boards to engage in vigorous and independent oversight of advisory contracts.[22] The Commission is proposing enhanced disclosure regarding the board's basis for approving, or recommending that shareholders approve, investment advisory contracts. These proposals are intended to provide existing fund shareholders with more timely information about the basis for the board's approval of any investment advisory contract. In addition, the proposals are designed to reinforce the existing obligation of a fund to provide meaningful disclosure in the SAI and proxy statements about the basis for the board's approval of the fund's existing advisory contract and any board recommendation that shareholders approve an advisory contract. We have previously reminded funds that ''boilerplate'' disclosure is not appropriate, but we remain concerned that some funds do not provide adequate specificity regarding the board's basis for its decision.[23]

Today's proposal is one step in a larger series of Commission rulemaking initiatives that have sought to improve disclosure to investors concerning fund fees and charges. The Commission is adopting rules that will require mutual funds to include in shareholder reports information regarding the dollar amount of expenses paid by investors on an ongoing basis for investing in the fund. The Commission also recently adopted amendments requiring investment company advertisements to highlight the availability and importance of information on fees and charges found in the prospectus [24] and has proposed amendments to the mutual fund prospectus that would require enhanced disclosure regarding breakpoint discounts on front-end sales loads.[25] In addition, the Commission published a concept release seeking views regarding

directors the right to extend and terminate the [investment advisory] contract, the Act necessarily also imposes upon the directors the fiduciary duty to use these powers intelligently, diligently and solely for the interests of the company and its stockholders.'').

[14] Item 22(c)(11) of Schedule 14A. *See* Investment Company Act Release No. 20614 (Oct. 13, 1994) [59 FR 52689 (Oct. 19, 1994)] (adopting amendments to Schedule 14A).

[15] The SAI is part of a fund's registration statement and contains information about a fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System (''EDGAR'').

[16] Item 13(b)(10) of Form N–1A (registration statement for open-end management investment companies); Item 18.13 of Form N–2 (registration statement for closed-end management investment companies); Item 20(l) of Form N–3 (registration statement for separate accounts organized as management investment companies that offer variable annuity contracts); Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734, 3744 (Jan. 16, 2001)] (adopting requirement for disclosure in SAI of basis for board's approval of advisory contract).

[17] *See, e.g.*, Carla Fried, *Pressure Builds to Cut Fund Fees,* The New York Times, Jan. 11, 2004, at sec. 3, p. 26 (discussing continuing concern among federal and state regulators over level of fund advisory fees); Yuka Hayashi and Tom Lauricella, *Fund Report Disputes Critics' Study—Trade Group Rebuts Figures Cited by New York's Spitzer on High Management Fees,* The Wall Street Journal, Jan. 7, 2004, at D9 (discussing debate over whether mutual fund investors pay significantly higher fees than pension funds and other large investors for similar money-management services). *See also* Testimony of John C. Bogle, *Oversight Hearing on the Mutual Fund and Investment Advisory Industry Before the U.S. Senate Governmental Affairs Committee, Subcommittee on Financial Management,* 108th Cong., 1st. Sess. (November 3, 2003) (''If the management fees that represent the major portion of [fund] costs were subject to arm's length negotiation between funds and their managers, it is true that tens of billions of dollars could be saved and added to investor returns year after year after year.'')

[18] John P. Freeman and Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest,* 26 Iowa Journal of Corporation Law 609, 634 (Spring 2001) (''Freeman/Brown Study''). *But see* Sean Collins, *The Expenses of Defined Benefit Pension Plans and Mutual Funds,* Investment Company Institute Perspective (December 2003), *available at http://www.ici.org/pdf/per12–03.pdf* (arguing that Freeman/Brown Study failed to take into account significant differences in organizational structure and expense structure between mutual funds and equity pension funds).

[19] *See, e.g., Special Report: Perils in the Savings Pool—Mutual Funds,* The Economist, Nov. 8, 2003, at 65 (arguing that fund boards tend to ''rubber-stamp'' their advisers' contracts without question); Testimony of Gary Gensler, *Hearing before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises,* 108th Cong., 1st Sess. (Mar. 12, 2003) (arguing that ''mutual fund boards fire their advisers with about the same frequency that race horses fire their jockeys'').

[20] *See* Investment Company Act Release No. 26323 (Jan. 15, 2004) [69 FR 3472 (Jan 23, 2004)].

[21] *Id.*

[22] *See Statement of the Commission Regarding the Enforcement Action Against Alliance Capital Management, L.P.,* SEC Press Release 2003–176 (Dec. 18, 2003) *http://www.sec.gov/news/press/2003–176.htm* (stating Commission's view that the best way to ensure fair and reasonable fees ''is a marketplace of vigorous, independent, and diligent mutual fund boards coupled with fully-informed investors who are armed with complete, easy-to-digest disclosure about the fees paid and the services rendered'').

[23] *See* Investment Company Act Release No. 24816, *supra* note, 66 FR at 3744.

[24] *See* Investment Company Act Release No. 26195 (Sept., 29, 2003) [68 FR 57760 (Oct. 6, 2003)].

[25] *See* Investment Company Act Release No. 26298 (Dec. 17, 2003) [68 FR 74732 (Dec. 24, 2003)].

improving disclosure of transaction costs.[26] Finally, the Commission recently proposed new rules that would require broker-dealers to provide their customers with targeted information, at the point of sale and in transaction confirmations, regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares.[27] Together, these initiatives are intended to enhance significantly the information that fund investors receive about fees and charges.

II. Discussion

The Commission is proposing amendments to Forms N–1A, N–2, and N–3 [28] that would require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect thereto that formed the basis for the board of directors' approval of any investment advisory contract.[29] This requirement would apply to shareholder reports of open- and closed-end management investment companies and insurance company managed separate accounts that offer variable annuities. The required disclosure would be similar to disclosure currently required in the SAI and fund proxy statements about the basis for the approval of the fund's existing advisory contract and any board recommendation that shareholders approve an advisory contract. The shareholder reports disclosure would be required for any new investment advisory contract or contract renewal, including subadvisory contracts, approved during the semi-annual period covered by the report, other than a contract that was approved by shareholders.[30] In the case of contracts approved by shareholders, a fund is already required to provide similar disclosure in a proxy statement.[31]

Our proposal is intended to provide existing fund shareholders with more timely disclosure of the reasons for the board's approval of an investment advisory contract. We believe that the visibility of this disclosure, alongside other current information about a fund, such as investment performance and current period dollars and cents expense disclosure,[32] may encourage funds to provide a meaningful explanation of the board's basis for approving an investment advisory contract. This, in turn, may encourage fund boards to consider investment advisory contracts more carefully and investors to consider more carefully the costs and value of the services rendered by the fund's investment adviser.

Our proposals would result in parallel disclosure requirements in fund shareholder reports, the SAI, and fund proxy statements. The proposed disclosure requirement in shareholder reports would provide existing shareholders information about any board approval of an investment advisory contract during the period covered by the report, other than a contract that was approved by shareholders. The existing requirement in proxy statements, which applies to any recommendation that shareholders approve an investment advisory contract, complements this shareholder reports disclosure. Finally, the existing SAI requirement provides prospective investors information about board approval of any existing investment advisory contract.

We are proposing several enhancements to the existing SAI and proxy statement disclosure requirements and are proposing that these same enhancements be included in the new shareholder reports disclosure requirement. These enhancements would clarify and reinforce a fund's obligation under the existing disclosure requirements to discuss the material factors and the conclusions with respect thereto that formed the board's basis for approving, or recommending that the shareholders approve, an advisory contract. They are intended to address our concerns that some funds do not provide adequate specificity regarding the board's basis for its decision. Specifically, our proposal would require a fund to discuss the following in its shareholder reports, in its SAI, and in relevant proxy statements.

Selection of Adviser and Approval of Advisory Fee. The proposed amendments would clarify that the fund's discussion should include factors relating to both the board's selection of the investment adviser, and its approval of the advisory fee and any other amounts to be paid under the advisory contract.[33]

Specific Factors. The fund would be required to include a discussion including, but not limited to, the following: (1) The nature, extent, and quality of the services to be provided by the investment adviser; (2) the investment performance of the fund and the investment adviser; (3) the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund; (4) the extent to which economies of scale would be realized as the fund grows; and (5) whether fee levels reflect these economies of scale for the benefit of fund investors.[34]

Comparison of Fees and Services Provided by Adviser. The fund's discussion would be required to indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other

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[26] *See* Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74820 (Dec. 24, 2003)].

[27] *See* Investment Company Act Release No. 26341 (Jan. 29, 2004) [69 FR 6438 (Feb. 10, 2004)].

[28] Open-end management investment companies use Form N–1A to register under the Investment Company Act and to offer their shares under the Securities Act. Closed-end management investment companies use Form N–2, and insurance company managed separate accounts that offer variable annuities use Form N–3.

[29] Proposed Item 21(d)(6) of Form N–1A; proposed Instruction 6.e. to Item 23 of Form N–2; proposed Instruction 6(v) to Item 27(a) of Form N–3. The proposed amendments to Form N–1A reflect amendments that the Commission is adopting to the requirements for fund shareholder reports that renumber Item 13 (Management) and Item 22 (Financial Statements) of Form N–1A as Items 12 and 21, respectively. The amendments that the Commission is adopting also add Item 21(d) to Form N–1A, Instruction 6 to Item 23 to Form N–2, and Instruction 6(v) to Item 27(a) of Form N–3, containing requirements for annual and semi-annual reports to shareholders for each respective registration form.

[30] The disclosure would be required for approvals of subadvisory contracts where shareholder approval of the contract is not required. *See* Investment Company Act Release No. IC–26230 (Oct. 23, 2003) [68 FR 61720 (Oct. 29, 2003)] (proposing rules that would codify exemptive orders issued for ''manager of manager'' funds that permit such funds to operate without obtaining shareholder approval when the fund's principal investment adviser hires a new subadviser or replaces an existing subadviser).

We are also adding an instruction to the existing disclosure requirements for the SAI, clarifying that these requirements apply to both approvals of new advisory contracts and contract renewals, and to subadvisory contracts. *See* proposed Instruction 1 to Item 12(b)(10) of Form N–1A; proposed Instruction 1 to Item 18.13 of Form N–2; proposed Instruction 1 to Item 20 of Form N–3.

[31] *See* Item 22(c)(11) of Schedule 14A.

[32] The Commission is also publishing a release adopting rules that will require registered open-end management investment companies to include in shareholder reports Management's Discussion of Fund Performance and information regarding the dollar amount of expenses paid by investors on an ongoing basis.

[33] Proposed Items 12(b)(10)(i) and 21(d)(6)(i) of Form N–1A; proposed Item 18.13(a) and proposed Instruction 6.e.(i) to Item 23 of Form N–2; proposed Item 20(l)(i) and proposed Instruction 6(v)(A) to Item 27(a) of Form N–3; proposed Item 22(c)(11)(i) of Schedule 14A.

[34] *Id.* Courts have used similar factors in determining whether directors have met their fiduciary obligations under Section 36(b) of the Investment Company Act [15 U.S.C. 80a–35(b)]. *See, e.g., Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 929 (2nd Cir. 1982) (examining several factors, including ''the adviser-manager's cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager'').

registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, the discussion would be required to describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved.[35]

Evaluation of Factors. The existing proxy and SAI requirements state that conclusory statements or a list of factors will not be considered sufficient disclosure, and that a fund's discussion should relate the factors to the specific circumstances of the fund and the investment advisory contract.[36] We are clarifying this by requiring that the fund's discussion state how the board evaluated each factor. For example, it would not be sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its determination that the contract should be approved.[37]

If we adopt the proposed amendments, we would expect to require all fund reports to shareholders, all registration statements and post-effective amendments that are either annual updates to effective registration statements or that add a new series, and all fund proxy statements filed on or after the effective date of the amendments to comply with the proposed amendments.

III. Request for Comments

The Commission requests comment on the amendments proposed in this release, whether any further changes to our rules or forms are necessary or appropriate to implement the objectives of our proposed amendments, and on other matters that might have an effect on the proposals contained in this release. We request comment specifically on the following issues.

- Would inclusion of the proposed disclosure in reports to shareholders be useful to investors? Should we expand our proposal to require disclosure in shareholder reports with respect to all investment advisory contracts approved by the board during the reporting period, including contracts that were also approved by shareholders? Should disclosure regarding the basis of the board's approval of an advisory contract be required in any additional location (*e.g.*, the prospectus, fund websites)?
- Should disclosure regarding the basis of the board's approval of an existing investment advisory contract continue to be required in the SAI if we adopt the proposed shareholder reports requirement? If we remove the disclosure requirement from the SAI, should we require funds to include a cross-reference in the prospectus or the SAI to the disclosure in shareholder reports?
- Are our proposed enhancements to the existing SAI and proxy statement disclosure requirements, which we are also proposing be included in the new shareholder reports disclosure requirement, appropriate? Will they result in more meaningful disclosure? Will the fact that we have enumerated certain specific matters that should be included in the discussion encourage funds to omit other, equally significant matters from the discussion?
- If a fund's board did not rely upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, should the fund be required to disclose the reasons why the board did not do so?
- Should a fund be required to disclose whether, and if so, how, the board separately assessed amounts to be paid for portfolio management services and amounts to be paid for services other than portfolio management?
- Is there any additional relevant information that we should require funds to disclose? Will any of our proposed disclosure requirements have a chilling effect on boards' consideration of investment advisory contracts?
- What should the compliance date for the amendments be?

IV. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[38] The Commission is submitting the proposed collections of information 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 titles for the collections of information are: (1) ''Rule 30e–1 under the Investment Company Act of 1940, Reports to Stockholders of Management Companies''; (2) ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies''; (3) ''Form N–2—Registration Statement of Closed-End Management Investment Companies''; (4) ''Form N–3—Registration Statement of Separate Accounts Organized as Management Investment Companies''; and (5) ''Rule 20a–1 under the Investment Company Act, Solicitations of Proxies, Consents, and Authorizations.'' 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 OMB control number.

Rule 30e–1 (OMB Control No. 3235–0025) was adopted under section 30(e) of the Investment Company Act.[39] Form N–1A (OMB Control No. 3235–0307), Form N–2 (OMB Control No. 3235–0026), and Form N–3 (OMB Control No. 3235–0316) were adopted pursuant to section 8(a) of the Investment Company Act[40] and section 5 of the Securities Act.[41] Rule 20a–1 (OMB Control No. 3235–0158) was adopted pursuant to section 20(a) of the Investment Company Act.[42]

We are proposing amendments to the requirements for fund shareholder reports in Forms N–1A, N–2, and N–3 that would require funds to provide disclosure regarding the material factors that formed the basis for the board of directors' approval of an investment advisory contract during the relevant reporting period. The additional burden hours imposed by these amendments are reflected in the collection of information requirements for shareholder reports required by rule 30e–1 under the Investment Company Act. In addition, we are proposing amendments to Forms N–1A, N–2, and N–3 that would clarify and reinforce funds' existing obligation to provide disclosure in the SAI of these forms regarding the board's basis for approving any existing investment advisory contract. Finally, we are proposing amendments to Schedule 14A that would clarify and reinforce funds' existing obligation to provide disclosure in proxy statements of the board of directors' basis for a recommendation

[35] Proposed Items 12(b)(10)(i) and 21(d)(6)(i) of Form N–1A; proposed Item 18.13(a) and proposed Instruction 6.e.(i) to Item 23 of Form N–2; proposed Item 20(l)(i) and proposed Instruction 6(v)(A) to Item 27(a) of Form N–3; proposed Item 22(c)(11)(i) of Schedule 14A.

[36] *See* Instruction to Item 13(b)(10) of Form N–1A; Instruction to Item 18.13 of Form N–2; Instruction to Item 20(l) of Form N–3; Instruction to Item 22(c)(11) of Schedule 14A.

[37] Proposed Instruction 2 to Item 12(b)(10) and proposed Instruction 2 to Item 21(d)(6) of Form N–1A; proposed Instruction 2 to Item 18.13 and proposed Instruction 6.f. to Item 23 of Form N–2; proposed Instruction 2 to Item 20(l) and proposed Instruction 6(vi) to Item 27(a) of Form N–3; proposed Instruction to Item 22(c)(11) of Schedule 14A.

[38] 44 U.S.C. 3501, *et seq.*

[39] 15 U.S.C. 80a–29(e).

[40] 15 U.S.C. 80a–8(a).

[41] 15 U.S.C. 77e.

[42] 15 U.S.C. 80a–20(a).

that shareholders approve an investment advisory contract.

Shareholder Reports

Rule 30e–1, which requires funds to include in the shareholder reports the information that is required by the fund's registration statement form including the proposed amendments, contains collection of information requirements.[43] The respondents to this collection of information requirement are funds registered on Forms N–1A, N–2, and N–3. Compliance with the disclosure requirements of rule 30e–1 is mandatory. Responses to the disclosure requirements will not be kept confidential.

We estimate that there are approximately 3,800 funds subject to rule 30e–1. The current approved hour burden for preparing and filing semi-annual or annual shareholder reports in compliance with rule 30e–1 is 143.3 hours per report per fund, or a total of 1,088,984 annual burden hours (143.3 hours per report x 2 reports x 3,800 funds).

We currently estimate that the 3,800 funds filing annual and semi-annual shareholder reports pursuant to rule 30e–1 include 9,706 portfolios, including 8,938 portfolios of open-end management investment companies (''mutual funds'') registered on Form N–1A, 733 closed-end funds registered on Form N–2, and 35 sub-accounts of managed separate accounts registered on Form N–3.[44] We estimate that the proposed amendments will increase the estimated burden hours for complying with rule 30e–1 by 2 hours per portfolio annually. Accordingly, if the proposed amendments were adopted, we estimate the total annual hour burden for all funds for complying with rule 30e–1 would be 1,108,396 hours (1,088,984 hours + (9,706 portfolios x 2 hours)).

Forms N–1A, N–2, and N–3

The purpose of Forms N–1A, N–2, and N–3 is to meet the registration and disclosure requirements of the Securities Act and the Investment Company Act and to provide investors with information necessary to evaluate an investment in a fund. Forms N–1A, N–2, and N–3 contain collection of information requirements. The likely respondents to the information collection in Form N–1A are open-end funds registering with the Commission. The likely respondents to the information collection in Form N–2 are closed-end funds registering with the Commission on Form N–2. The likely respondents to the information collection in Form N–3 are separate accounts, organized as management investment companies and offering variable annuities, registering with the Commission on Form N–3. Compliance with the disclosure requirements of Forms N–1A, N–2, and N–3 is mandatory. Responses to the disclosure requirements are not confidential.

The proposed amendments to Forms N–1A, N–2, and N–3 would clarify and reinforce funds' existing obligation to provide disclosure in these forms regarding the board's basis for approving any existing investment advisory contract. Because funds are already required to provide disclosure in appropriate detail regarding the material factors and the conclusions with respect thereto that formed the board's basis for approving an existing investment advisory contract, we estimate that the proposed amendments will not increase the hour burden for filing registration statements on these forms.

Proxy Statements

Rule 20a–1, including the proposed amendments to Schedule 14A, contains collection of information requirements.[45] The respondents to this collection of information requirement include funds registered on Forms N–1A, N–2, and N–3. Compliance with the disclosure requirements of rule 20a–1 is mandatory. Responses to the disclosure requirements are not confidential.

The proposed amendments to Schedule 14A would clarify and reinforce funds' existing obligation to provide disclosure in proxy statements regarding the board's basis for recommending that shareholders approve an investment advisory contract. Because funds are already required to provide disclosure in appropriate detail regarding the material factors and the conclusions with respect thereto that formed the board's basis for recommending shareholder approval of an investment advisory contract, we estimate that the proposed amendments will not increase the hour burden for complying with the requirements of rule 20a–1.

Request for Comments

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

Persons submitting comments on the collection of information requirements should direct the comments 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. S7–08–04. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7–08–04, and be submitted to the Securities and Exchange Commission, Office of Filing and Information Services, 450 Fifth Street, NW., Washington, DC 20549–0609. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release.

V. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. Our proposals would require funds to improve the disclosure that they provide regarding the fund board's basis for approving, or recommending that shareholders approve, an investment

[43] The amendments are to the shareholder reports requirements in Forms N–1A, N–2, and N–3. Rule 30e–1(a) under the Investment Company Act [17 CFR 270.30e–1(a)] requires funds to include in the shareholder reports the information that is required by the fund's registration statement form.

[44] The estimates of the number of mutual fund portfolios registered on Form N–1A and the number of closed-end funds registered on Form N–2 are based on the Commission staff's analysis of reports filed on Form N–SAR in 2003. The estimate of the number of sub-accounts of managed separate accounts registered on Form N–3 is based on the staff's analysis of reports filed on Form N–SAR in 2003.

[45] The proposed amendments are to Item 22 of Schedule 14A. Rule 20a–1 requires funds to comply with Regulation 14A, Schedule 14A, and all other rules and regulations adopted pursuant to section 14(a) of the Exchange Act that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to section 12 of the Exchange Act. The annual responses to rule 20a–1 reflect the number of proxy and information statements that are filed by funds.

advisory contract. Specifically, the proposals would:

- Require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of an advisory contract during the reporting period;
- Enhance the existing requirement for a fund to provide disclosure in its SAI about the board's basis for approving any investment advisory contract; and
- Enhance the existing requirement for a fund to provide disclosure in a proxy statement seeking approval of an investment advisory contract about the board's basis for its recommendation that shareholders approve the contract.

A. Benefits

The Commission's proposals would improve the disclosure provided by funds about how their boards of directors evaluate and approve, and recommend shareholder approval of, investment advisory contracts. First, the proposals would provide existing fund shareholders with more timely information about the basis for the board's approval of investment advisory contracts. The increased visibility of this disclosure resulting from its inclusion in shareholder reports may encourage funds to provide a meaningful explanation of the board's basis for approving an investment advisory contract. This, in turn, may benefit investors by encouraging them to consider more carefully the costs and value of the services rendered by the fund's investment adviser, and by enabling them to make more informed choices among funds.

In addition, the increased visibility of the proposed disclosure in shareholder reports may encourage fund boards to engage in more vigorous and independent oversight of investment advisory contracts. This increased oversight by fund boards would also benefit investors.

The proposals would also amend the current disclosure requirements in proxy statements and in a fund's SAI. These proposed amendments would clarify and reinforce funds' obligation under the existing disclosure requirements in the SAI and proxy statements to discuss the material factors and the conclusions with respect thereto that formed the basis for the board's approval of the fund's existing advisory contract, or its recommendation that shareholders approve an investment advisory contract. This improved disclosure in proxy statements and in the SAI would also benefit investors.

We seek comment on the benefits of the proposed amendments (and any alternatives suggested by commenters) as well as any data quantifying those benefits.

B. Costs

The proposals would impose new requirements on funds to provide disclosure in their shareholder reports regarding the fund board's basis for approving an investment advisory contract. We estimate that complying with the proposed new disclosure requirements would entail a relatively small financial burden. Funds currently are required to provide similar disclosure in their SAIs and in relevant proxy statements, and the required information regarding a fund board's evaluation of each advisory contract should be readily available to management and to the fund board. Therefore, we expect that the cost of compiling this information should be minimal, and the primary costs attributable to the proposed amendments would be those of reporting this information. These costs may include both internal costs (for attorneys and non-legal staff to prepare and review the required disclosure) and external costs (for printing, and typesetting, and mailing of the disclosure).

For purposes of the Paperwork Reduction Act, we have estimated that the proposed new disclosure requirements would increase the annual hour burden for completing a shareholder report in compliance with rule 30e–1 under the Investment Company Act by 19,412 hours. We estimate that this additional burden would equal total internal costs of $1,523,454 annually, or approximately $401 per fund.[46] We have estimated that the proposed amendments to Forms N–1A, N–2, and N–3 will have no impact on the hour burden for filing registration statements on these forms. In addition, we have estimated that the proposed amendments to Schedule 14A will have no impact on the hour burden for complying with rule 20a–1 under the Investment Company Act.

The external costs of providing the enhanced disclosure in fund shareholder reports regarding the process by which a fund board reviews and approves an investment advisory contract are expected to be limited, but would depend on the individual circumstances of each fund and its contractual relationships with its advisers and sub-advisers, and the nature of the process by which the board determines whether to approve the fund's advisory contract. We estimate that the additional disclosure that would be required in shareholder reports may add one additional page to a fund's annual or semi-annual report, at a cost of $0.02 per page.[47] We estimate that there are approximately 257 million fund shareholder accounts which would send out 231 million reports to shareholders annually that would include the required disclosure.[48] Therefore, we estimate that the additional disclosure in shareholder reports will cost approximately $4,620,000 ((231 million shareholder reports x $0.02 per page) in external costs for funds annually.

We request comment on the nature and magnitude of our estimates of the costs of the additional disclosure that would be required if our proposals were adopted.

C. Request for Comments

We request comments on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of, or suggested alternatives to,

[46] These internal cost estimates are based on a Commission estimate that approximately 3,800 investment companies would be subject to the proposed amendments and an estimated hourly wage rate of $78.48. This estimated wage rate is a blended rate, based on published hourly wage rates for compliance attorneys ($74.22) and programmers ($42.05) in New York City, and the estimate that professional and non-professional staff will divide time equally on compliance with the disclosure requirements, yielding a weighted wage rate of $58.135 (($74.22 × .50) + ($42.05 × .50)) = $58.135). *See* Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2001* (Oct. 2001) (for most current rate for compliance attorneys in New York City); Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2002* (Sep. 2002) (for most current rate for programmers in New York City). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of $78.48 ($58.135 × 1.35 = $78.48).

[47] This cost per page is based on an estimate that the typical shareholder report is approximately 25 pages long and costs $.52 to print and deliver. *See* Securities Act Release No. 33–7766 (Nov. 4, 1999) [64 FR 62540, 62543 (Nov. 16, 1999)].

[48] Investment Company Institute, Mutual Fund Fact Book 65 (43rd ed. 2003), at 63 (estimating approximately 251 million shareholder accounts associated with mutual funds). In addition, we estimate that there are approximately 2 million shareholder accounts associated with closed-end funds registered on Form N–2 and approximately 4 million shareholder accounts associated with managed separate accounts registered on Form N–3. These figures are based on the Commission staff's analysis of reports filed on Form N–SAR in 2003. We estimated the number of shareholder reports by reducing the number of accounts by 10% to reflect an estimated 10% savings in the number of reports that must be delivered to shareholders due to householding rules.

the proposed amendments. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. Consideration of Burden on Competition; Promotion of Efficiency Competition, and Capital Formation

Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) also prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[49] In addition, section 2(c) of the Investment Company Act,[50] section 2(b) of the Securities Act,[51] and section 3(f) of the Exchange Act [52] 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, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The proposed amendments are designed to encourage better, more visible, and more timely disclosure to fund shareholders about the material factors, and the conclusions with respect to those factors, that formed the basis for the decision of a fund's board of directors to approve or renew an investment advisory contract, or to recommend approval of an investment advisory contract. These amendments may thereby improve efficiency. By increasing transparency with respect to advisory fees, the proposed amendments may assist investors in making informed choices among funds and encourage fund boards to engage in vigorous and independent oversight of advisory contracts, which may promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. These proposals may also improve competition, as enhanced transparency regarding the board's basis for approving an investment advisory contract may encourage investors to consider more carefully the costs and value of the services rendered by the fund's investment adviser. Finally, the proposed amendments have no effect on capital formation.

As noted above, we believe that the proposed amendments would benefit investors. We note that funds currently are required to provide similar disclosure in their SAIs and in relevant proxy statements. We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. We also request comment on any anti-competitive effects of the proposed amendments. Commenters are requested to provide empirical data and other factual support for their views if possible.

VII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis (''Analysis'') has been prepared in accordance with section 3(a) of the Regulatory Flexibility Act.[53] It relates to the Commission's proposed rule and form amendments to Schedule 14A under the Exchange Act and to Forms N–1A, N–2, and N–3 under the Investment Company Act.

A. Reasons for, and Objectives of, Proposed Amendments

Section I of this Release describes the background and reasons for the proposed form amendments. Section II of this Release discusses the objectives of the proposed form amendments. As we discuss in detail above, these proposals are designed to increase the transparency of the information that a fund provides regarding the board's basis for approving an investment advisory contract, or recommending that shareholders approve an investment advisory contract.

B. Legal Basis

The Commission is proposing amendments to Schedule 14A pursuant to authority set forth in sections 14 and 23(a)(1) of the Exchange Act [54] and sections 20(a) and 38 of the Investment Company Act.[55] The Commission is proposing amendments to Forms N–1A, N–2, and N–3 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act [56] and sections 8, 15, 24(a), 30, and 38 of the Investment Company Act.[57]

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies 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.[58] Approximately 145 investment companies registered on Form N–1A meet this definition, and approximately 70 investment companies registered on Form N–2 meet this definition.[59] We estimate that few, if any, registered separate accounts registered on Form N–3 are small entities.[60]

D. Reporting, Recordkeeping, and Other Compliance Requirements

As described above, the proposals would:

- Require fund shareholder reports to discuss, in reasonable detail, the material factors and the conclusions with respect to these factors that formed the basis for the board's approval of an advisory contract during the relevant reporting period;
- Enhance the existing requirements for a fund to provide disclosure in its SAI about the board's basis for approving any existing investment advisory contract; and
- Enhance the existing requirements for a fund to provide disclosure in a proxy statement seeking approval of an investment advisory contract about the board's basis for its recommendation that shareholders approve the contract.

The Commission estimates some one-time formatting and ongoing costs and burdens that would be imposed on all funds, including funds that are small entities. These include the costs related to providing this disclosure in shareholder reports. These costs also could include expenses for legal fees. We note, with respect to the proposed amendments to the disclosure requirements in the SAI and proxy statements, that these proposals would clarify and reinforce funds' obligation under the existing disclosure requirements to discuss the board's basis for approving, or recommending shareholder approval of, any existing investment advisory contract. Therefore, we expect that the cost of compliance with the proposed amendments to the existing disclosure requirements in the SAI and proxy statements should be minimal. We believe the benefits that will result to shareholders through

[49] 15 U.S.C. 78w(a)(2).

[50] 15 U.S.C. 80a–2(c).

[51] 15 U.S.C. 77(b).

[52] 15 U.S.C. 78c(f).

[53] 5 U.S.C. 603.

[54] 15 U.S.C. 78n and 78w(a)(1).

[55] 15 U.S.C. 80a–20, 80a–37.

[56] 15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a).

[57] 15 U.S.C. 80a–8, 80a–15, 80a–24(a), 80a–29, and 80a–37.

[58] 17 CFR 270.0–10.

[59] This estimate is based on an analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers, including Morningstar, Inc. and Lipper.

[60] This estimate is based on figures compiled by Division of Investment Management staff regarding separate accounts registered on Form N–3. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Rule 0–10(b) under the Investment Company Act [17 CFR 270.0–10(b)].

better information with respect to their fund board's evaluation of such advisory contracts justify these potential costs.

The Commission solicits comment on the effect the proposed amendments would have on small entities.

E. Duplicative, Overlapping or Conflicting Federal Rules

There are no rules that duplicate, overlap, or conflict with the proposed amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small registrants. In connection with the proposed amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The proposed amendments would provide shareholders with greater transparency regarding the fund board's basis for approving an investment advisory contract, or recommending that shareholders approve an investment advisory contract. Different disclosure requirements for funds that are small entities may create the risk that the shareholders in these funds would be less able to consider the costs and value of the services rendered by the fund's investment adviser, and less able to make informed choices among funds. We believe it is important for the disclosure that would be required by the proposed amendments to be provided to shareholders by all funds, not just funds that are not considered small entities.

We have endeavored through the proposed amendments to minimize the regulatory burden on all funds, including small entities, while meeting our regulatory objectives. Small entities should benefit from the Commission's reasoned approach to the proposed amendments to the same degree as other investment companies. Further clarification, consolidation, or simplification of the proposals for funds that are small entities would be inconsistent with the Commission's concern for investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context. Based on our past experience, we believe the proposed disclosure would be more useful to investors if there were enumerated informational requirements.

G. Solicitation of Comments

The Commission encourages the submission of written comments with respect to any aspect of this Analysis. Comment is specifically requested on the number of small entities that would be affected by the proposed amendments and the likely impact of the proposals on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–08–04; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549–0102, and also will be posted on the Commission's Internet Web site (*http://www.sec.gov*).[61]

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Enforcement Fairness Act of 1996,[62] a rule is ''major'' if it results or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

The Commission requests comment on the potential impact of the proposed amendments on the U.S. economy on an annual basis. Commenters are requested to provide empirical data to support their views.

IX. Statutory Authority

The Commission is proposing amendments to Schedule 14A pursuant to authority set forth in sections 14 and 23(a)(1) of the Exchange Act[63] and sections 20(a) and 38 of the Investment Company Act.[64] The Commission is proposing amendments to Forms N–1A, N–2, and N–3 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act[65] and sections 8, 15, 24(a), 30, and 38 of the Investment Company Act.[66]

List of Subjects

17 CFR Parts 239 and 240

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule and Form Amendments

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

1. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 78c, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 77sss, 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

2. The general authority citation for Part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n,

[61] We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

[62] Pub. L. 104–21, Title II, 110 Stat. 857 (1996).

[63] 15 U.S.C. 78n and 78w(a)(1).

[64] 15 U.S.C. 80a–20, 80a–37.

[65] 15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a).

[66] 15 U.S.C. 80a–8, 80a–15, 80a–24(a), 80a–29, and 80a–37.

78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

3. Section 240.14a–101 is amended by revising paragraph (c)(11) of Item 22 to read as follows:

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

* * * * *

Item 22. Information required in investment company proxy statement.

* * * * *

(c) * * *

(11) Discuss in reasonable detail the material factors and the conclusions with respect thereto that form the basis for the recommendation of the board of directors that the shareholders approve an investment advisory contract. The discussion should include:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in determining to recommend that the shareholders approve the advisory contract; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instruction. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Fund and the investment advisory contract for which approval is sought and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its determination to recommend approval of the contract.

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

4. 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.

* * * * *

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

a. Revising Item 12(b)(10); and

b. Adding new Item 21(d)(6).

The revision and addition 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 12. Management of the Fund

* * * * *

(b) * * *

(10) Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of directors approving any existing investment advisory contract. The discussion should include:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions

1. Board approvals covered by this item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Fund and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

Item 21. Financial Statements

* * * * *

(d) * * *

(6) *Statement Regarding Basis for Approval of Investment Advisory Contract.* If the board of directors approved any investment advisory contract during the period covered by the report, other than a contract that was approved by shareholders during the period, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. The discussion should include:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the

investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions

1. Board approvals covered by this item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Fund and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

* * * * *

6. Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by:

a. Revising Item 18.13; and

b. Adding new Instructions 6.e and 6.f to Item 23.

The revision and additions read as follows:

Note: The text of Form N–2 does not and this amendment will not appear in the Code of Federal Regulations.

Form N–2

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Item 18. Management

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13. Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of directors approving any existing investment advisory contract. The discussion should include:

(a) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(b) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage.

Instructions

1. Board approvals covered by this item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

* * * * *

Item 23. Financial Statements

* * * * *

Instructions

* * * * *

6. * * *

e. If the Registrant's board of directors approved any investment advisory contract during the period covered by the report, other than a contract that was approved by shareholders during the period, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. The discussion should include:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide

research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage.

f. board approvals covered by Instruction 6.e. to this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by Instruction 6.e. include subadvisory contracts. Conclusory statements or a list of factors will not be considered sufficient disclosure under Instruction 6.e. The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

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7. Form N–3 (referenced in §§ 239.17 and 274.11b) is amended by:

a. Revising Item 20(l).

b. Adding new Instructions 6(v) and 6(vi) to Item 27(a).

The revision and additions read as follows:

Note: The text of Form N–3 does not and this amendment will not appear in the Code of Federal Regulations.

Item 20. Management

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(l) Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of managers approving any existing investment advisory contract. The discussion should include:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage.

Instructions

1. Board approvals covered by this item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

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Item 27. Financial Statements

(a) * * *

Instructions

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6. * * *

(v) If the Registrant's board of managers approved any investment advisory contract during the period covered by the report, other than a contract that was approved by shareholders during the period, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. The discussion should include:

(A) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Registrant under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Registrant and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Registrant; the extent to which economies of scale would be realized as the Registrant grows; and whether fee levels reflect these economies of scale for the benefit of the Registrant's investors. The discussion should also indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.,* pension funds and other institutional investors). If the board relied upon such comparisons, the discussion should describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(B) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating the Registrant's brokerage.

(vi) Board approvals covered by Instruction 6(v) to this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by Instruction 6(v) include subadvisory contracts. Conclusory statements or a list of factors will not be considered sufficient disclosure under Instruction 6(v). The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

Dated: February 11, 2004.

By the Commission.

J. Lynn Taylor,

Assistant Secretary.

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