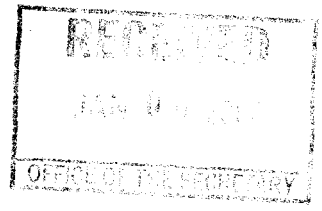
S7-20-03 #2



January 7, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Re: Exemption from Shareholder Approval for Certain Sub-Advisory Contracts (File No. S7-20-03)

Dear Mr. Katz:

SEI Investments Management Corporation ("SIMC") is pleased to provide comments on the Securities and Exchange Commission's proposal to adopt Rule 15a-5 (the "Rule") under the Investment Company Act of 1940, as amended (the "Act"), which would permit, under certain circumstances, the principal investment adviser of an investment company ("fund") to hire a new subadviser or replace an existing subadviser without approval by the shareholders of the fund.[1] SIMC is a leading provider of investment advisory services to funds as a "manager of managers," currently advising over 55 funds representing over $40 billion in assets.[2]

SIMC supports the adoption of the Rule. As discussed in the Proposing Release, the Rule would codify numerous exemptive orders that the Commission has granted in the past permitting manager of manager funds and advisers to enter into and materially amend subadvisory contracts without shareholder approval. SIMC currently operates as a manager of managers pursuant to such an order.[3] As such, we are familiar with the conditions under which such orders have been granted and have a great deal of insight into the day-to-day operation of manager of managers funds pursuant to such an order. The majority of our comments relate to those specific areas in which the Commission solicited comment, and also to certain technical matters regarding the application of certain conditions contained in the Rule designed to prevent conflicts of interest.

---

1 Investment Company Act Release No. 26230 (October 23, 2003), 68 FR 61720 (October 29, 2003) ("Proposing Release").

2 SIMC serves as investment adviser to the various series of SEI Liquid Asset Trust (File No. 811-03231), SEI Tax Exempt Trust (File No. 811-03447), SEI Daily Income Trust (File No. 811-03451), SEI Index Funds (File No. 811-04283), SEI Institutional Managed Trust (File No. 811-04878), SEI Institutional International Trust (File No. 811-05601), SEI Asset Allocation Trust (File No. 811-07445), and SEI Institutional Investments Trust (File No. 811-07257) (collectively, the "SEI Funds").

3 SEI Institutional Managed Trust; et al., Investment Company Act Release Nos. 21863 (April 1, 1996) (notice) and 21921 (April 29, 1996) (order) (the "SEI order").

Conditions of the Rule

1. Terms of the Subadvisory Contracts; Subadvisory Fees.

SIMC believes the conditions set forth in the Proposing Release with respect to aggregate management fee levels and aggregate disclosure of subadvisory fees are appropriate and adequately protect shareholder interests while enabling advisers relying on the Rule to operate manager of manager funds in an efficient and cost effective manner. As set forth in the Proposing Release, the Rule would permit changes to subadvisory fees so long as the new subadvisory contract would not directly or indirectly increase the aggregate management fees paid by the fund.[4] In addition, the Rule would permit manager of manager funds to disclose only the aggregate amount of advisory fees that are paid to subadvisers as a group.[5]

You have requested comment on whether the relief provided by the Rule should be limited to subadvisory contracts that do not increase the portion of the advisory fee retained by the principal adviser. SIMC does not believe that the relief should be limited as such.

- SIMC agrees with the statements made in the Proposing Release that the manager of managers fund's board is in the best position to assess the overall compensation of the principal adviser. Section 15(c) of the Act requires that all investment advisory and distribution agreements, and any renewals thereof, be approved by a majority of the independent directors. Section 15(c) requires the directors to request and evaluate "such information as may reasonably be necessary" to their decision to approve or renew an advisory agreement and the investment adviser must provide such information. Information on the adviser's compensation and profitability is routinely provided to a fund's board to assist in its considerations. The Rule's conditions contemplate the importance of the board's role in this process by requiring any fund seeking to rely on the Rule to have a majority of its board of directors composed of directors that are not interested persons of the fund.

- SIMC believes that the advisory contract renewal process provides the appropriate mechanism for a fund's board to evaluate the reasonableness of the overall compensation of the principal adviser and address any circumstances where reductions in subadvisory fees may merit adjustments in the fees paid to the principal adviser.

- Further, we believe that the scope of relief contemplated in the Proposing Release provides adequate protections to investors in a manner consistent with the intent of

---

[4] Proposed Rule 15a-5(a)(1).

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

section 15(a) of the Act, while maintaining flexibility to deal with changing market and business conditions. Limiting the relief provided by the Rule to subadvisory contracts that do not increase the portion of the advisory fee retained by the principal adviser may have the potential to create certain conflicts of interest if a principal adviser was unable to offset, at least over time, an increase in subadvisory fees paid to one subadviser with a decrease in fees paid to another. We believe that this may, in turn, increase the likelihood that an adviser would consider factors other than ability and performance in selecting subadvisers. Such constraints on the relief could inadvertently foster an environment in which advisers may have economic incentives to refrain from recommending the termination of a less-expensive subadviser in favor of a more-expensive subadviser, even if such change may be in the best interests of the fund from an investment perspective.

- We also observe that a traditional investment adviser is permitted to terminate a portfolio manager employed by that adviser and replace him or her with another at a significantly lower salary, and thereby increase the adviser's profitability without shareholder approval. We believe that an adviser that operates as a manager-of-managers should have the same ability with respect to making changes in subadvisers.

You have requested comment on whether shareholders of a manager of managers fund need information about the amount of compensation paid to each subadviser. SIMC does not believe that such information would be useful to shareholders.

- SIMC agrees with the Commission's proposal to codify past exemptive relief by revising the requirements of Form N-1A, as well as other disclosure requirements, to permit manager of manager funds to disclose only aggregate subadvisory fees. By investing in a manager of managers fund, shareholders essentially hire the principal adviser to manage assets by using its investment sub-adviser selection and monitoring process for an advisory fee that is fully disclosed and determined by the board to be reasonable. Disclosure of the fees that a principal adviser pays to each subadviser does not serve any meaningful purpose since investors pay the principal adviser to retain and compensate the subadvisers.

- Based on our experience, the ability to disclose only aggregate advisory fees under the terms of the SEI order has had the positive effect of facilitating lower overall investment advisory fees for the SEI Funds. As acknowledged in the Proposing Release, many subadvisers charge their customers for the full range of advisory services according to a "posted" fee schedule. However, subadvisers may be willing to negotiate fees lower than those posted in the schedule where they are providing less than the full range of services. In our experience, we have been able to negotiate subadvisory fees that are lower than a subadviser's posted fee schedule in part because the subadviser's lower fee will not be

disclosed in public documents that would be available to other prospective or existing customers of that subadviser.

- We believe that requiring manager of manager funds to disclose the fees paid to each subadviser would likely have a chilling effect on the willingness of such subadvisers to negotiate lower fees and, in turn, would increase the likelihood of higher overall advisory fees for manager of manager funds to compensate for these higher subadvisory fees. SIMC believes that the potential benefits to manager of manager fund shareholders of lower negotiated subadvisory fees clearly outweighs the benefit, if any, such shareholders would derive from access to this information. As recognized in the Proposing Release, we believe that the manager of managers fund's board is in the best position to assess the overall compensation of the principal adviser, consistent with its fiduciary duty to shareholders.

2. Arm's Length Relationship between Principal Adviser and Subadvisers.

SIMC supports the inclusion of conditions to the Rule designed to prohibit conflicting relationships.[6] These conditions would preclude affiliated or other "materially related" subadvisers from relying on the Rule. We agree that in situations where subadvisers may be affiliates of the principal adviser, the business relationships between the parties give rise to actual or apparent conflicts of interest that may compromise the adviser's ability to engage and terminate a subadviser on the basis of its skill and performance.

However, we wish to raise one technical point with respect to the application of certain of the prohibitions currently contained in the Rule. In addition to a ban on affiliated persons of the principal adviser, the Rule would require that:

> . . . 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).[7] [emphasis added]

In articulating similar prohibitions on conflicting relationships, past exemptive orders permitted manager of manager funds to rely on the relief where a director or officer of the fund, or principal adviser or director or officer of the principal adviser with which the subadviser has contracted, directly or indirectly owned *less than a 1% interest* in the subadviser other than an interest

---

6 Proposed Rule 15a-5(a)(2).

7 Proposed Rule 15a-5(a)(2)(i).

through ownership of shares of a pooled investment vehicle that is not controlled by such person (or entity).[8]

We recognize that this shift from the objective standard of "less than a 1% interest" to the subjective standard "any material interest" may allow for additional flexibility in the application of the Rule, and arguably expands on the past relief provided in the exemptive orders. For example, a manager of manager fund's board may, nonetheless, determine that that an ownership interest of more than 1% does not create substantial economic incentives to hire and refrain from discharging a particular subadviser.[9] However, this subjective materiality standard would also presumably require a fund's board to make a materiality determination with respect to any ownership interest in a potential subadviser by a director or officer, even with respect to ownership of a single share of stock.

SIMC generally supports the Commission in its efforts to provide for additional flexibility in the application of the relief afforded by the Rule. We respectfully request, however, that the Commission consider creating a "safe harbor" whereby an ownership interest of less than 1% shall be presumed to be not material for purposes of satisfying the conditions contained in the Rule. Under a subjective materiality standard, reasonable boards could come to different conclusions regarding the materiality of a given ownership interest. We believe that, absent such a safe harbor or other guidance, such determinations could contribute to a lack of uniformity in the application of the rule and the satisfaction of its conditions.

3. *Number of Subadvisers.*

SIMC supports the Commission's proposal to permit manager of manager funds using only one subadviser to rely on the Rule. We believe that the circumstances involving single subadvisers are sufficiently similar to those involving multiple subadvisers, and do not merit modification of any of the conditions contained in the Rule.

- SIMC agrees with the Commission's view, as stated in the Proposing Release, that the conditions contained in its exemptive orders provide the same protections for funds with single subadvisers and those with multiple subadvisers. Similar to funds using more than one subadviser, funds using a single subadviser would be subject to the Rule's conditions prohibiting fee increases and conflicts of interest and requiring shareholder approval of the manager of managers advisory approach, supervision by the principal adviser and disclosure to shareholders.

---

8 *See supra* note 3.

9 However, we recognize that an ownership interest of 5% or more may make the subadviser an affiliated person of the fund pursuant to section 2(a)(3) of the Act.

- The Rule, as proposed, would additionally require any fund that identifies the subadviser as part of the fund's name or title, to also clearly identify in its name or title the name of the principal adviser.[10] As a practical matter, we believe that the funds most likely to engage in such a practice would be those using a single subadviser, affording an additional degree of protection for shareholders of such funds.

- Further, the Rule proposes that the investment advisory contract between the fund and the principal adviser must provide that the principal adviser is required to supervise and oversee the activities of the subadviser under the subadvisory contract.[11] We believe that this requirement, along with board oversight and the principal adviser's fiduciary obligations to the fund, provides adequate assurance that the adviser is responsible for the general performance of the subadviser or subadvisers. The principal adviser's compliance obligations with respect to this requirement would be no different for a fund utilizing a single subadviser than it would be for a fund using more than one.

- In addition we believe that there are circumstances where the principal adviser could reasonably determine, consistent with its fiduciary duties, that the use of more than one subadviser would not be in the best interests of the fund. For example, the principal adviser could make such a determination where fund assets levels are below a certain level, or the particular asset class or investment objective is less conducive to management by multiple subadvisers (e.g., certain money market funds).

Conclusion

SIMC supports the Commission's proposals. The Rule would codify a number of exemptive orders that the Commission has issued providing an exemption from shareholder approval for certain subadvisory contracts, while simplify the conditions required for reliance on such relief. In addition, the Rule would benefit funds and their shareholders by providing manager of manager funds with additional flexibility to enter into subadvisory contracts by eliminating the cost and time involved in obtaining shareholder approval, and provide for potential cost savings to shareholders through lower negotiated subadvisory fees. Finally, the proposals would relieve the burden on Commission staff in processing similar exemptive applications.

We also respectfully request that the Commission adopt provisions to provide a safe harbor providing that ownership of less than 1% of the outstanding shares of a sub-adviser or its corporate affiliate would be deemed immaterial for purposes of proposed Rule 15a-5(a)(2)(i). We believe that such *de minimis* ownership interests would not create substantial economic

---

[10] Proposed Rule 15a-5(a)(6).

[11] Proposed Rule 15a-5(a)(4).

incentives to hire and refrain from discharging a particular subadviser and, consequently, little opportunity for abusive practices.

We also generally support, but have not provided comments on, other provisions contained in the proposing release as they pertain to allowing greater flexibility in the operation of manager of manager funds.

* * * * * * * * * * * * *

Thank you for the opportunity to provide comments on this proposal. If you have any questions regarding our comments, please do not hesitate to contact me at (610) 676-1933 or Tim Barto at 610-676-2533.

Sincerely,

Edward Loughlin
Executive Vice President
SEI Investments Management Corporation