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January 7, 2004

Via Email and FedEx
Jonathan G. Katz. Secretary
Securities and Exchange Commission
405 Fifth Street NW
Washington, DC 20549

Re: File No. S7-20-03
Proposed Exemption from Shareholder Approval for Certain Subadvisory Contracts
Investment Company Act Release No. 26230

Dear Mr. Katz:

In release No. IC-26230 dated October 23, 2003, ("Proposing Release"), the Securities and Exchange Commission ("Commission") proposed to adopt Rule 15a-5 ("Rule") under the Investment Company Act of 1940 ("1940 Act") and requested comments on the proposal. This letter has been prepared in response to the Commission's request.

Our comments are specifically designed to reflect the perspective of mutual funds that are provided with portfolio management services by two or more subadvisers each under the direct supervision of an investment advisory organization and that have chosen to pay the fees of each such subadviser directly.

Part I: Specific Recommendations with Respect to the Rule.
In concept, we support the adoption of the Rule. We would, however, recommend that the Commission consider making the following specific changes in the Rule prior to its final adoption.[1]

1. The Rule should be clarified to state that the availability of the relief provided by the Rule is dependent on the obligation of the principal adviser to supervise the subadviser and not on whether the principal adviser and subadviser are in privity of contract.[2] Further, we believe that the ability of

[1] We have included in Appendix A to this letter the text of the Rule, as well as excerpts from the other regulations that Commission has proposed to amend, each marked to show those changes that would effect our recommendations. Most of these changes are discussed in this letter; one or two others are self-explanatory.

[2] Privity of contract appears to be required by the language of the Proposing Release (see note 3 and accompanying text) and by the definitions of "subadvisory contract" and "subadviser" set forth in subsections (b)(3) and (b)(4) of the Rule. We believe such a requirement is unnecessary and that the obligation of the principal adviser to monitor and oversee the performance of a fund's subadvisers -- perhaps the most important principle underlying the Rule and the exemptive orders (collectively, "Precedent Orders") that preceded the Rule (see, e.g. Proposing Release at notes 26 to 28 and accompanying text) -- can be included with

the principal adviser to terminate a subadviser should require the approval of the fund's board of directors.[3]

2. The Rule should be clarified to state that the Rule will be available only with respect to subadvisory contracts that do not increase the rate at which investment advisory or management fees paid by the fund are calculated.[4]

3. The Rule and the Proposing Release fail to address the reality that, during periods when the market encourages acquisitions within the financial services sector, changes in the "corporate alignment" of potential subadvisers can be unanticipated. Given the breadth of subsection (a)(2), such realignments would force a principal adviser to choose between the expenses of a proxy solicitation or passing over otherwise qualified subadvisers.[5] Our suggestions for addressing this issue are

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equal effectiveness in the principal adviser's contract with the fund. Supervisory functions and obligations would also be a part of those procedures ("Compliance Procedures") that the fund and the principal adviser are required to adopt pursuant to Rule 38a-1 under the 1940 Act and Rule 206(4)-7 under the Investment Advisers Act of 1940, respectively. Additionally, and as noted later in this letter, we believe a fund's board of directors should consider whether it is appropriate for a fund to be served pursuant to the terms of a Subadvisory contact to which the fund is not a party. See note 9, *infra*. Finally, we believe that the definition of "investment adviser" set forth in Section 2(a)(20) of the 1940 Act (and upon which the definition of both "principal adviser" and "subadviser" as set forth in the Rule depend) was included in the 1940 Act to ensure that persons who provide investment advisory services to a fund even indirectly would be subject to the requirements of the 1940 Act and not to establish a separate category of investment advisory relationships or to mandate a pattern of contractual relationships. Accordingly, we believe that these terms should be defined within the "four corners" of the Rule as finally adopted and that current references to Section 2(a)(20) in these definitions should be omitted. Please note that, in the remainder of this letter, we use the term "principal adviser," to refer to an investment adviser who, pursuant to a contract approved by the fund's shareholders, is obligated to supervise another investment adviser; the term "subadviser" to refer to such other investment adviser (whether or not such other adviser is in privity of contract with the principal adviser), and the term "subadvisory contract" to refer to the contract pursuant to which the subadviser serves the fund, again without regard to whether the principal adviser is a party to such contract.

[3] We recognize that this is a departure from many of the Precedent Orders but we do not believe it would be unduly burdensome. Because the Rule does not suspend the board's obligation with respect to the approval of subadvisory agreements, it is likely that a change in a subadvisory relationship will require the formal involvement of the fund's board. Given this, requiring board approval of a termination should not add to the principal advisers burden in supervising a manager of managers structure. Further, the involvement of the board in the termination of a subadvisory agreement may serve as an additional safeguard against some of the conflicts of interests noted in the Proposing Release. Finally, requiring board approval of a subadviser termination is consistent with the board's contract review responsibilities under Section 15 of the 1940 Act and, we would argue, a board's inherent ability to terminate any agreement pursuant to which a fund is provided with investment advisory services.

[4] As noted in the Proposing Release at note 20, Section 15(a) requires that an investment advisory agreement must "precisely describe the compensation to be paid thereunder" and, thus, effectively requires that the rate of advisory fees paid by a fund be approved by shareholders. The language of subsection (a)(1) of the Rule suggests the Rule would not be available with respect to a subadvisory contract if the contract could result in an increase in the dollar amount of the overall management and advisory fees paid by the fund. Further, this provision would make the Rule unavailable in a case where a principal adviser or a fund's board of directors seeks to replace a subadviser who is compensated under the terms of a performance fee arrangement, even if the terms of the performance fee arrangement are identical to those of the terminated subadvisory contract. While performance fee arrangements in the context of multi-manager funds are not common, they are not unknown. See, Pitcairn Investment Trust, cited at note 26 of the Proposing Release (performance fee is paid by the principal adviser); see also, Investment Company Act Release Nos. 1998, (Nov. 27, 2001)(order); and 1993 (Nov. 1, 2001)(notice), describing a multi-manager arrangement pursuant to which a performance fee is paid directly to a portfolio management firm that is subject to the supervision of an investment adviser.) The provision could similarly call into question the ability of a principal adviser or board of directors to rely upon the Rule in replacing a subadviser that has agreed to waive its fee (either voluntarily or pursuant to a written agreement). Finally, for funds that have chosen to pay their subadvisers directly, the Rule could be deemed unavailable with respect to multi-manager arrangements that contemplate the allocation or reallocation of assets among two or more subadvisers, each of which is compensated under a different fee schedules. In our view, the appropriateness of any such reallocation of assets would depend, among other things, on the adequacy of fee disclosures included in the fund's prospectus.

[5] Many of the Precedent Orders were obtained by mutual fund groups that have only a single manager and/or have only infrequently (if ever) chosen to replace a subadviser. This is in contrast to funds whose principal advisers, selecting from a universe of portfolio management organizations that are unaffiliated with the principal adviser, strive to identify those "portfolio

summarized below. Included among them is a recommendation that the scope of subsection (a)(2) of the Rule be narrowed in cases where the fund and its principal adviser are in compliance with newly adopted Rule 38a-1 under the 1940 Act.

We recommend that subsection (a)(2) of the Rule be modified:

a. to exclude individuals who serve as officers of the fund as part of their duties and in the course of their employment by a fund's administrator or similar service provider and where the service provider has adopted procedures in the manner contemplated in Rule 38a-1 under the 1940 Act.[6]
b. to limit the availability of the Rule as a result of subsection (a)(2) only in the case of knowingly held direct or indirect beneficial ownership in any security issued by the subadviser or a controlling person of the subadviser ("impermissible interest").[7]
c. to permit a fund to rely upon the Rule even if an individual referred to in subsection (a)(2) may hold an impermissible interest as the result of an investment in a mutual fund for which the principal adviser provides investment advisory services, provided that the fund and the principal adviser have implemented procedures in accordance with Rule 38a-1 under the 1940 Act to monitor purchases and redemptions of shares of any such mutual fund by persons within the potentially conflicted class.
d. to permit a fund to rely upon the Rule even though an individual referred to in subsection (a)(2) may hold an impermissible interest as a result of an interest in a private investment vehicle, if investments made on behalf of any such vehicle are committed to the discretion of a person that is not affiliated with the principal adviser or (other than as a result of a subadvisory contract) with the fund.

Part II: Request for Clarification.
In addition, we suggest that, in any release that accompanies the adoption of the Rule, the Commission clarify the following points:

1. A subadviser that provides investment advisory services to one series ("subadvised portfolio") of a mutual fund will be permitted to rely upon the Rule in entering into a subadvisory contract relating to

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managers" that are, at a particular point in time, best suited to achieve the objectives of the fund, given their relative performance, other portfolio management organizations serving the fund, then current market conditions, and related factors. It is the shareholders of these funds who are most likely to benefit from the cost savings and other efficiencies that will result from the Rule. The principal advisers of these funds would be most likely to be handicapped, with little appreciable increase in shareholder protection, if subsection (a)(2) of the Rule is adopted as proposed.

[6] This change would recognize the point that, in many small mutual fund organizations, employees of non-advisory, third party service providers serve as mutual fund officers, and in some cases, as executive officers. While such individuals are often subject to express fiduciary duties under various regulatory provisions and serve important functions in the day-to-day administration of the mutual funds they serve, these individuals are not in the service of the principal adviser and are unlikely to benefit as a result of the hiring or firing of a particular subadviser. We believe the continuing duty of inquiry would impose a burden on funds that have "active" multi-manager structures. See note 5, *supra*.

[7] Subsection (a)(2)(i) of the Rule appears to address the conflict of interest that may arise as a result of securities ownership. We base this conclusion on the use of the phrase "owns any material interest" and that fact that the provision does not, under most circumstances, extend to interests resulting from ownership of a pooled investment vehicle. Assuming this view is correct, the Rule, as finally adopted, should employ the "beneficial ownership" formula that is used elsewhere in the Federal securities laws (including Section 2(a)(19) of the 1940 Act) and upon which existing compliance and "due diligence" procedures (e.g. Rule 17j-1 of the 1940 Act; directors and officers questionnaires designed to ensure accurate prospectus disclosure, and compliance with Section 10(a) of the 1940 Act) are traditionally based.

another series of that mutual fund or of any other mutual fund that is under common control with the subadvised portfolio.[8]

2. The Proposing Release identifies the investment performance achieved by a subadviser as the appropriate basis for decisions to terminate an investment advisory contract. Other factors may be equally significant, however, in a decision to terminate (or retain) a subadviser. By way of example, a fund's principal adviser or board of directors may believe that a change in the fund's advisory arrangements is warranted based on changes (or anticipated changes) in the executive personnel of the service provider; its corporate structure or governance/compliance practices; the identity or perceived influence of its the service provider's affiliated companies; or changes in the economy or other market developments that are believed to favor the investment style, emphasis or research disciplines of another subadviser.

3. Call to the attention of mutual fund boards of directors that a subadvisory contract may provide for its termination in the event that the agreement between the fund and the principal adviser terminates. Note that such a provision may make it more difficult for a board of directors to replace the principal adviser, even in cases where a fund is a party to the subadvisory contract because termination of the contract with the principal adviser may effectively terminate all of the fund's portfolio management arrangements.[9]

Part III. Response to Certain Specific Commission Inquires.

The Commission specifically requested comment on whether it should permit fund directors to enter into subadvisory contracts that increase advisory fees without the consent of shareholders. As indicated above, we believe that the important factor is whether there is an increase in the rate at which advisory fees are calculated, as disclosed in the fund's prospectus and relevant advisory and subadvisory contracts. If, for example, a subadvisory contract that provided for the payment of a performance fee is terminated, shareholder approval should not be required for a "successor" subadvisory contract that includes the same performance fee arrangement, even if the new subadviser subsequently is entitled to a higher fee due to relatively better performance than the terminated subadviser.[10]

The Commission also requested comment on whether it should limit relief to subadvisory contracts that do not increase the portion of the advisory fee retained by the principal adviser in order to assure that subadvisers are selected based on ability and performance. We do not believe such a limitation is

[8] We believe that this is consistent with the rule, as proposed and the definition included in subsection (b)(1) of the Rule. This clarification will ensure that those mutual fund families that consist of separate registered open-end investment companies will not be disadvantaged as a result of their structure.

[9] This practical impediment to board action with respect to a fund's agreement with its principal adviser necessarily exists in any case where the agreement between a principal adviser and a subadviser is bilateral. This reality underlies our recommendation that the Rule be modified to remove the implication that a subadviser must be in privity of contract with the principal adviser. In different context, the Commission has seen fit to minimize obstacles to board action with respect to advisory contracts. See, e.g. Rule 15a-4(b)(2) of the 1940 Act and Investment Company Act Release No. IC-24816 (Jan. 2, 2001) (Role of Independent Directors of Investment Companies) at note 19. In response to commenters who noted that the directors of funds that do not comply with the new governance conditions could be constrained from terminating an adviser because they are unable to enter into an interim advisory contract without obtaining an exemptive order, the Commission determined to apply such governance conditions only with respect the paragraph of Rule 15a-4 that permits interim advisory contracts in foreseeable circumstances.

[10] Please refer to notes 4 and 5, *supra*.

necessary. Although "fee transparency" is a much discussed issue at the present time, we believe that the primary interest of most shareholders is (i) the reputation of the investment advisory organizations responsible for managing the fund and/or selecting investments; and (ii) the "net performance" of their investment, as shown in the Expense Table and accompanying Example required by Form N-1A to be included in a fund's prospectus. We note, however, that the benefit realized by a principal adviser if a subadviser is willing to accept a lower fee is a conflict of interest that does not arise where the subadviser is paid directly by the fund pursuant to subadvisory contracts that name the fund as a contracting party. Accordingly, we believe that direct payment of subadvisory fees by a fund may be desirable in order to secure the benefit of fee reductions for a fund's shareholders. Such arrangements also carry the corollary benefit -- if fee transparency is a desired result -- of ensuring that the fees paid by a fund, directly or indirectly, are disclosed in the expense table required to be included in the fund's prospectus (See, Item 3 of Form N-1A).[11]

Finally, we offer the following thoughts on the difference between the circumstances of funds served by a single subadviser and those served by multiple subadvisers. While there are business and administrative challenges faced by multi-manager funds, particularly those whose subadvisers are "actively" managed by their principal advisers, we do not believe that the Rule needs to be specially crafted for either investment structure. By the same token, however, we do not believe that the Rule should require a principal adviser to engage multiple subadvisers. While we believe that the manager of manager structure was originally conceived to accommodate active management of subadvisers, the concept has evolved in a way that, at its best, permits principal advisers to seek out portfolio management services that complement those available within the principal adviser's organization in a way that preserves continuity of management, supervision and shareholder services.

We appreciate the opportunity to comment on the Commission's proposals. If we can provide any further information, we would welcome the opportunity to speak with members of the Commission's staff with respect to this matter.

Very truly yours,

Laura Anne Corsell, Esq.
Corsell Law Group, Ltd.

cc: William H. Donaldson, Chairman
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
Cynthia A. Glassman, Commissioner
Harvey J. Goldschmid, Commissioner
Paul F. Roye, Director, Division of Investment Management

[11] We note that, because subadvisory contracts are "material contracts" as that term is used in Part C of Form N-1A, and thus required to be filed with the Commission, information about subadvisory fees is generally available to the public via the EDGAR system.

Cynthia M. Fornelli, Senior Adviser to the Director, Division of Investment Management
Robert E. Plaze, Associate Director, Division of Investment Management
C. Hunter Jones, Assistant Director, Office of Regulatory Policy
Adam B. Glazer, Attorney, Division of Investment Management

APPENDIX A

The following material reflects the text of each of the several amendments proposed in Investment Company Act Release No. 26230 (October 23, 2003), including the text of proposed Rule 15a-5. Each is marked to show changes that we believe would implement the recommendations discussed in the accompanying letter.

1. **Proposed changes to Regulation S-X (§ 210.6-07 Statements of operations).**

2. Expenses.

(d) If a registered investment company or separate series of a registered investment company ("Fund") or a principal adviser (as defined in § 270.15a-5(b)(2) of this chapter) of the Fund, in reliance on § 270.15a-5 of this chapter, has entered into a contract or contracts with a subadviser (as that term is defined in § 270.15a-5(b)(3) of this chapter) of the Fund without approval by a vote of the securities of the Fund and~~.~~ if the fee payable to the subadviser is paid by the principal adviser and not by the Fund,[12] the investment advisory fee paid to any subadviser that is not an affiliated person (as defined in 15 U.S.C. 80a-2(a)(3)) of the principal adviser ~~with which it has contracted~~ or of the Fund (other than by reason of serving as an investment adviser to the Fund) need not be disclosed as a separate expense item in response to paragraphs 2.(a), (b), or (c) of this section.

2. **Proposed changes to Schedule 14A (Item 22. Information required in a proxy statement)**

Instructions to paragraph (c). 1.

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

3. **Proposed Rule 15a-5: § 270.15a-5 Exemption from shareholder approval for certain Subadvisory contracts.**

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

(1) No increase in fees. The subadvisory contract does not ~~directly or indirectly~~ increase the rate at which the management fee paid to the principal adviser or the~~and~~ subadvisory fees charged to the fund or its shareholders and described in the manner contemplated by Section 15(a)(i) of the Act (15 U.S.C. 80a-15(a)) in investment advisory contracts pursuant to which the fund is provided with investment advisory services, are computed.

(2) Conflicting relationships prohibited.

(i)(a) The subadviser is not an affiliated person of the principal adviser ~~with which it has contracted~~ or of the fund (other than by reason of serving as an investment adviser to the fund), and no director or officer of the fund (other than officers of the fund who serve in such capacity within the scope of their employment by the fund's administrator as that terms is defined in [cite to 38a-1(?)] and in accordance with procedures adopted in the manner contemplated by rule 38a-1 under the Act., and (b) no principal adviser or director or officer of the principal adviser ~~with which the subadviser has contracted~~, knowingly has a beneficial

[12] This change reflects the "direct payment" of subadvisory fees by the fund but preserves the itemization that we understand it currently required.

interest, directly or indirectly, in any securityowns any material interest issued by inthe subadviser or any person who controls the subadviser other than an interest through ownership of shares of (A) a pooled investment vehicle (other than a registered investment company) if investments made on behalf of such vehicle are committed to the discretion of a person that is not affiliated with the principal adviser or (other than as a result of a subadvisory contract) the fund; or (B) shares of a registered investment company for which the principal adviser provides investment advisory services, provided that the fund and the principal adviser have implemented procedures in accordance with rule 38a-1 under the Act and Rule 206(4)-7 under the Investment Advisers Act of 1940 to monitor purchases and redemptions of shares of any such mutual fund by the officers and directors of the fund and of officers and employees of the principal adviser that is not controlled by such person (or entity); or

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

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

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

(5) Disclosure to shareholders. Within 90 days after entry into a new subadvisory contract or after makinga material change to a wholly-owned subsidiary's existing subadvisory contract is approved by the fund's directors in the manner contemplated by Section 15(c) of the Act, the fund furnishes its shareholders with an information statement, which must be filed with the Commission in accordance with the requirements of § 240.14c-5(b) of this chapter, that describes the new agreement, and contains the information specified in Regulation 14C (17 CFR 240.14c-1 through 240.14c-7), Schedule 14C (17 CFR 240.14c-101), and Item 22 of Schedule 14A (17 CFR 240.14a-101) under the Securities Exchange Act of 1934 (15 U.S.C. 78a - mm).

(6) Fund name. If the fund identifies the subadviser as a part of the fund's name or title, it also clearly identifies in its name or title the principal adviser that is obligated to supervise and oversee the activities of with which the subadviser has contracted, before the name of the subadviser.

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

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

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

(b) Definitions.

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

(2) Principal Adviser means an investment adviser as defined in section 2(a)(20)(A) of the Act (15 U.S.C. 80a-2(a)(20)(A)) that is obligated under an investment advisory agreement with the fund, which agreement has been approved by the shareholders of the fund in the manner contemplated by Section 15(a) of the Act, to supervise and oversee the activities of a subadviser that provides investment advice to the fund pursuant to a subadvisory contract.

(3) Subadviser means an investment adviser as defined in section 2(a)(20)~~(B)~~ of the Act (15 U.S.C. 80a-2(a)(20)~~(B)~~) that provides investment advice to the fund pursuant to the terms of a subadvisory contract.

(4) Subadvisory contract means a contract between a principal adviser and/or a fund and subadviser to a fund, ~~under~~pursuant to the terms of which contract (i) the subadviser agrees to perform investment advisory services on behalf of the fund; (ii) the subadviser is expressly subject to the supervision and oversight of the principal adviser;~~,~~ and (iii)~~which~~ the subadviser may be terminated ~~is terminable~~at any time by the principal adviser with the approval of the fund's board of directors, on no more than 60 days written notice, without payment of penalty.

4. **Proposed Amendments to Form N-1A**

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

Instructions. * * *

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

Item 6. Management, Organization, and Capital Structure

(a) * * *

(1) Investment Adviser.

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

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

Item 15. Investment Advisory and Other Services

Instructions.

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

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

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

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