

MEMO# 17380

April 13, 2004

DRAFT ICI COMMENT LETTER ON SEC PROPOSAL REGARDING BOARD APPROVAL OF ADVISORY CONTRACTS; CONFERENCE CALL APRIL 16TH

[17380] April 13, 2004 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 16-04 SEC RULES COMMITTEE No. 32-04 SMALL FUNDS COMMITTEE No. 22-04 RE: DRAFT ICI COMMENT LETTER ON SEC PROPOSAL REGARDING BOARD APPROVAL OF ADVISORY CONTRACTS; CONFERENCE CALL APRIL 16TH As we previously informed you, the Securities and Exchange Commission has proposed rule and form amendments that would call for disclosure in fund shareholder reports regarding the reasons for a fund board's approval of an investment advisory contract.¹ The proposed requirements would apply to all registered management investment companies. The Institute has prepared a draft comment letter on the proposal, which is attached and summarized below. Comments on the proposal must be filed with the SEC by Monday, April 26th. The Institute will hold a conference call on Friday, April 16, 2004 at 2:30 p.m. Eastern time to discuss the draft letter. The dial-in number for the call is 877-352-5208 and the pass code is 14111. If you plan to participate on the call, please send an e-mail to Monica Carter-Johnson at mcarter@ici.org. If you are unable to participate on the call, please provide me your comments before the call, if possible, by phone (202-218-3563), fax (202-326-5827), or email (ddonohue@ici.org). The draft letter generally supports the Commission's proposal, noting that making this information more readily available to shareholders may help them better understand one of the most important responsibilities of fund directors. It expresses concern, however, with the negative implications of certain statements in the proposing release relating to (1) the level of mutual fund fees and (2) board oversight of advisory contracts. The letter requests that the Commission address these concerns in its adopting release, noting that it is important for the administrative record supporting Commission rulemaking to reflect accurately the context in which new regulatory requirements are being considered. With respect to the implication that fund fees are excessive, the draft letter points to studies showing that the overall costs of investing in mutual funds has declined over time, the highly competitive nature of the fund industry, and regulatory protections against excessive 1 See Memorandum to Closed-End Investment Company Committee No. 8-04; SEC Rules Committee No. 17-04; and Small Funds Committee No. 13-04 [17109], dated February 17, 2004. The proposal also would enhance current requirements for such disclosure in fund statements of additional information and proxy statements. 2 fund fees. The draft letter also addresses the inaccurate claim cited in the proposing release that pension fund advisory fees are substantially lower than mutual fund advisory fees. With respect to board oversight of advisory fees, the draft letter explains why it is inappropriate to measure the

diligence of fund boards and their effectiveness in serving the interests of fund shareholders by reference to the frequency with which they fire fund investment advisers. On a related point, the draft letter recommends that the Commission revise the proposal by deleting references to the board's "selection" of the investment adviser, to avoid unintentionally perpetuating a misconception of the board's role and possibly confusing funds seeking to comply with the new requirements. In addition, the draft letter makes the following recommendations.

Subadvisory Contracts. The draft letter states that disclosure should not be required with respect to contracts with unaffiliated subadvisers, given that these contracts are negotiated at arms-length. It suggests that if the Commission nevertheless determines to require such disclosure, consideration should be given to adopting a streamlined disclosure requirement for these arrangements. We request members' views on whether the Institute should make a more specific recommendation for streamlined disclosure regarding approval of contracts with unaffiliated subadvisers and, if so, what it should be.

Location of Disclosure. The draft letter comments that it is not necessary to require the same disclosure in shareholder reports and SAIs; the SAI disclosure requirement should be eliminated because shareholder reports provide a more appropriate context for the disclosure. The letter further recommends that the proposed disclosure be required in annual reports to shareholders, but not in semi-annual reports to shareholders (to avoid the possibility that a fund would have to make the same disclosure twice within a given year).

Compliance with Disclosure Obligation. The draft letter notes that it is important that funds understand their disclosure obligation so that they will be in a position to comply with the new and enhanced disclosure requirements. It includes as an appendix sample disclosure that the Institute believes would satisfy the proposed requirements in order to assist funds in this regard. The letter also urges the Commission and its staff, in administering the new requirements, to bear in mind that the desire to maximize transparency must be carefully balanced against the need to support directors' continued candid and rigorous execution of their contract review responsibilities. We have attached to the draft letter sample disclosure that is based on one fund group's current disclosure. We are interested in your views regarding whether we should include any such disclosure with our final comment letter. We also would be interested in reviewing, and possibly providing as additional sample disclosure, any other disclosure regarding board review of advisory contracts that has not drawn negative comments from the SEC staff. Accordingly, if your fund group has such disclosure, please send it to me by fax (202-326-5827) or email (ddonohue@ici.org). Also, we request your views on whether the Institute should recommend that the Commission include disclosure examples in its adopting release.

3 Compliance Date. The draft letter recommends that the Commission establish an effective date 60 days from publication of the final requirements in the Federal Register, and that compliance with the new requirements be mandatory in the next annual report (or any proxy statement) filed with the Commission following the effective date.

Dorothy M. Donohue Associate Counsel Attachment (in .pdf format)