ICAA

April 27, 2004

Via Electronic Filing

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W. Mailstop 6-9
Washington, DC 20549

Re: Proposed Rule: Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies; Release Nos. 33-8364; 34-49219; IC-26350; File No. S7-08-04

Dear Mr. Katz:

The Investment Counsel Association of America[1] appreciates the opportunity to submit comments regarding the Commission's proposed rule amendments to require mutual funds to provide additional disclosure to shareholders regarding the material factors and the conclusions with respect to those factors that formed the basis for their board of directors' approval of advisory contracts.[2]

Specifically, the proposed disclosure must discuss factors relating to the board's selection of the adviser and approval of the advisory fee and any other amounts to be paid by the fund under the contract. These factors would include: (1) the nature, extent, and quality of the services to be provided by the adviser; (2) the investment performance of the fund and adviser; (3) the costs of the services to be provided and profits to be realized by the adviser and its affiliates from the relationship with the fund; (4) the extent to which economies of

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[1] The ICAA is a not-for-profit association that exclusively represents the interests of SEC-registered investment advisers. Founded in 1937, the Association's membership today consists of more than 300 investment advisory firms that collectively manage approximately $4 trillion for a wide variety of institutional and individual clients. For additional information, please consult our web site at www.icaa.org.

[2] *Proposed Rule: Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies*, SEC Release Nos. 33-8364; 34-49219; IC-26350; File No. S7-08-04 (Feb. 11, 2004). The rule would amend Schedule 14A, the schedule used by registered investment companies and issuers registered under section 12 of the Securities Exchange Act of 1934 for proxy statements pursuant to section 14(a) of the Exchange Act, and Forms N-1A, N-2, and N-3, the registration forms used by management investment companies to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933.

scale would be realized as the fund grows; and (5) whether fee levels reflect these economies of scale. The fund would also be required to indicate whether the board relied on comparisons of the services rendered and fees paid with those under other investment advisory contracts, and, if so, how these comparisons assisted the board in deciding to approve the contract.

The SEC states that the proposal is intended to provide fund shareholders with more timely disclosure of the reasons for the board's approval of an investment advisory contract. The Commission believes that this increased disclosure "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."[3] We commend the Commission for seeking to improve fund oversight by directors, to increase fund directors' accountability to fund shareholders, and to assist directors with satisfying their statutory duties under section 15(c) of the Investment Company Act when they recommend approval of an investment advisory contract. We write simply to discuss the appropriate type of fund disclosure regarding the costs and profits of the adviser.

This proposed disclosure item raises several issues. First, there are different methods of calculating costs and estimating profitability. The determination of the costs of the services provided and the profit realized is subjective and involves many different factors and elements. The advisory fee for mutual funds (also referred to as the management fee) often includes compensation for portfolio management services, administrative fees, and various other services. An adviser's costs may also include costs of operations and services applicable to many funds and other clients. Different advisers may not attribute costs among their advised funds uniformly. The process of ascertaining various components of costs attributable to services provided to a particular fund involves an adviser's judgment and is not easily standardized or comparable from adviser to adviser. Similarly, the elements of profitability may not be comparable across funds. Because costs and profits may be subjective and non-uniform among funds, the process by which the board evaluates these various elements is the most important information to provide to investors.[4]

Second, cost and profit information is proprietary information. Disclosure of such information could have a harmful competitive effect on investment advisers. For example, many advisers would not want their competitors to know the details of their cost structure.[5] We respectfully submit that other substantial information that the adviser provides to the board provides a more than adequate basis for disclosure. For example, under the proposal, the fund will be required to discuss how the board considered economies of scale. This factor will necessarily incorporate costs, expenses and profits of an adviser to some extent. Moreover, the reasonableness of an advisory fee depends on several factors, many of which

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[3] *Id.* at 4.

[4] This type of disclosure is consistent with the Commission's intent "to promote insightful disclosure of the board review process." *See* Speech by Paul F. Roye, Director of Division of Investment Management, "Integrity and Accountability: The New Imperatives for the Mutual Fund Industry" (Mar. 22, 2004).

[5] Similarly, specific information about an adviser's advisory agreements with other clients is proprietary and confidential information, the disclosure of which may be anti-competitive or violate the adviser's duty of confidentiality to its clients.

are unrelated to the adviser's internal operating costs and profit structures, such as investment style and strategy, the experience and expertise of the firm's portfolio management team, the type and size of the fund managed, the fund's expense ratio and turnover, and the fund's performance.

Third, current laws and rules already impose significant obligations on fund directors and advisers with respect to investment advisory compensation and contracts. Directors are required under section 15(c) to satisfy their duty "to request and evaluate . . . such information as may reasonably be necessary to evaluate the terms of any [advisory] contract." In addition, advisers are required by section 15 to furnish such information to the fund board. Further, section 36(b) of the Investment Company Act imposes on an adviser to a registered investment company "a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser." Finally, advisers under the Investment Advisers Act owe a fiduciary duty to their clients, including mutual funds whose interests are represented by the fund's board of directors, to act in their clients' best interests.

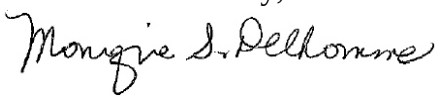
Accordingly, fund directors have a statutory obligation to review the appropriateness of the advisory contract for fund shareholders. It is the responsibility of the board to evaluate information and make inquiries necessary to ensure the protection of fund investors. Regardless of disclosure requirements, directors are entitled to request any information they deem relevant to the analysis of whether an advisory fee bears a reasonable relationship to the services the adviser is providing. Directors are also entitled to consider the adequacy of the information provided by the adviser in analyzing fees. Advisers and fund directors are able to discuss and negotiate the type of information provided. For example, advisers may agree to provide certain types of cost and profit information on a confidential basis to the board. We submit that such agreements should not be vitiated by disclosure requirements to the contrary.

For all of these reasons, we respectfully request that the Commission confirm that the fund is required to include a discussion of the process by which the board analyzed the costs and profits of the adviser with respect to the fund, without identifying specific proprietary and confidential operating cost and profit information.[6]

[6] Similarly, with respect to any comparisons to contracts with other clients of the investment adviser, the fund should be permitted to discuss consideration of the factor, rather than disclose specific information regarding the adviser's other contracts. General information regarding the adviser's fee schedule is already disclosed in Item 1.D of Form ADV, Part II, which all registered advisers must provide to clients.

We appreciate the opportunity to comment on the potential effects of the proposed rule on investment advisers. Please do not hesitate to contact the undersigned or ICAA General Counsel Karen Barr to discuss any questions the Commission or its staff may have with respect to our comments.

Sincerely,



Monique S. Delhomme
ICAA Counsel

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