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May 21, 2004

VIA EMAIL TRANSMISSION

United States Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549
Attn: Jonathan G. Katz
Secretary

Re: Disclosure Regarding Portfolio Managers of Registered Management Investment Companies, (File No. S7-12-04)

Dear Mr. Katz:

USAA Investment Management Company (IMCO) is pleased to provide comments on the Securities and Exchange Commission's (Commission) proposed rulemaking to require certain disclosure regarding portfolio managers of mutual funds. The proposed rule would require prospectus disclosure of the names of any portfolio management team and additional disclosure in the fund's Statement of Additional Information (SAI) regarding the other accounts managed by portfolio managers, their compensation structure and ownership of securities in accounts that they manage or that are managed by control affiliates.

Our comments to the proposed rulemaking are summarized as follows:

- We question the underlying assumption that a portfolio manager's investment in a fund that he or she manages is always an accurate indicator of the portfolio manager's confidence in the investment objective or management of that fund. As such, we believe that such disclosure could be misleading to investors under certain circumstances. For example, the fact that a portfolio manager of a state-specific tax-exempt fund (relating to a state other than the one in which the portfolio manager resides) does not invest in that fund is certainly not a good indicator of that manager's confidence in that fund.
- If the Commission should determine that the disclosure of a portfolio manager's investment in certain funds is necessary, we believe:
    - The disclosure rules should parallel the requirements for disclosure of fund holdings of directors. For example, the disclosure should be limited to investments in the fund complex managed by the primary investment adviser or promoted by the same principal underwriter. Also, the aggregate investment amount should be modeled after the rules governing disclosure of the fund holdings of directors of mutual funds (*i.e.*, any investment over $100,000 should be disclosed merely as over $100,000); and
    - State tax-exempt funds should be excluded from the requirement.

- Finally, we have concerns about the application of some of the proposed disclosure rules regarding portfolio managers employed by unaffiliated advisory firms, as would be required for multi-manager or subadvised funds. The sheer volume of disclosure in manager-of-manager structures could be cumbersome for both funds and their shareholders. Moreover, any disclosure of portfolio holdings by a subadviser in a manager-of-manager structure of holdings in all funds they manage (or that are managed by their firm or control affiliates) will be confusing and potentially misleading. Requiring the proposed disclosure rules to parallel the rules applied to directors' holdings should mitigate this issue.

We discuss these comments in greater detail below.

Background and Analysis

IMCO serves as the investment adviser and distributor of the funds in the USAA family of funds, including thirty-eight (38) retail funds and five (5) funds used as investment options for variable insurance products issued by an affiliated life insurance company (hereafter, the USAA Funds). The USAA Funds and IMCO currently have an exemptive order (USAA Exemptive Order) that permits them to operate manager of manager funds subject to enumerated conditions. The USAA Funds rely on the USAA Exemptive Order to hire unaffiliated subadvisers to manage all but one of its funds that invest all or a portion of their assets in equity securities.

Although we do not object in principle to many of the disclosure requirements in the proposed rule, we have some concerns with the breadth of certain requirements.[1] Also, we have some material concerns with the proposals governing disclosure of a portfolio manager's portfolio holdings in the fund and other accounts, and particularly the application of these rules to funds with an unaffiliated third party subadviser or multiple subadvisory firms. We also have some additional minor comments on other provisions of the proposals, which are all discussed below.

Disclosure of Portfolio Holdings in Fund and Other Accounts

In the proposing release, the Commission noted that some commenters have argued that disclosure of portfolio manager's holdings in the funds and other accounts that they manage would be useful to investors, in that it could "provide a strong signal of his or her alignment with the interest of fund shareholders." The Commission further noted that these advocates argue that portfolio managers with substantial holdings in their funds "may have a greater incentive to keep management fees low and to consider the tax advantages of their trading activity . . .." The Commission noted that these advocates

[1] For example, we do not object to the requirement to identify in the prospectus portfolio management team members, except we note that the identification of this group of persons will affect the volume of disclosure required in the SAI. Also, we do not object to describing the structure of the portfolio manager's compensation but we believe that this should be limited to his or her salary and other benefits that could present a conflict of interest with shareholders (*i.e.*, standard health benefits and qualified retirement benefits should not be required to be disclosed with specificity).

"also claim that disclosure of fund ownership could provide investors with insight into the level of confidence that a manager has in the investment strategy of the fund." In justifying the proposed disclosure, the Commission stated that the proposed disclosure "could help investors to assess the extent to which the portfolio manager's interests are aligned with theirs, as well as the level of confidence that a manager has in the investment strategy of the fund."

Initially, we question the underlying assumption that a portfolio manager's investment in a fund is always a reliable indicator of the portfolio manager's confidence in the investment objective and management of the fund, and alignment of his or her interest with shareholders. The negative inference of this assumption is that portfolio managers who do not invest in their managed funds do not have confidence in the investment strategy, and do not have interests aligned with those of shareholders. Portfolio managers, like other investors, have retirement accounts and other assets that are invested. A portfolio manager's failure to invest in a particular fund that he or she manages could indicate nothing more than the investment objective is not appropriate for that particular manager (*i.e.*, he or she may have exposure to that investment style in a retirement account). For example, our fixed income portfolio managers manage tax-exempt funds whose investment objective is to produce federal and state-specific tax-exempt income. Portfolio managers who manage state-specific tax-exempt funds that do not reside in the particular state do not have a tax incentive to invest in such funds, as compared to a general federal tax-exempt fund. Moreover, they may not be permitted to invest in a state-specific fund offered only to residents of a state other than the one the portfolio manager resides. Under these circumstances, a portfolio manager's investment or non-investment in such a fund does not carry any message, explicit or implicit, in his or her confidence in the investment objective or management of the fund. Also, the compensation structure applicable to portfolio managers is often the most effective way to align the manager's interest with those of shareholders (*i.e.*, if compensation is tied to the comparative performance of the fund relative to an objective benchmark).

Thus, we do not believe that this disclosure will always assist investors in assessing the confidence that the manager has in the investment strategy of the fund or determining if the portfolio manager's interests are aligned with shareholders. If the Commission determines that such disclosure is necessary or appropriate in some circumstances, we believe it should eliminate this requirement for state-specific tax-exempt funds. We also believe the adopting release should clarify that a manager's investment in a fund is not necessarily indicative of either the manager's confidence in the fund, or whether his or her interests are closely aligned with shareholders.

We also believe that the proposal to require disclosure of the portfolio manager's investment in other accounts managed by the portfolio manager, and in investment companies managed by the adviser or control affiliates of the adviser is overbroad. If the purpose of the proposed disclosure requirements is to help investors "assess the level of confidence that the manager has in the *fund's* investment strategy," we fail to see how requiring disclosure about a portfolio manager's unrelated investments in accounts that may not even be managed by him or her will materially advance an investor's

understanding. Assuming that there is some marginal value in such disclosure, the breadth of this proposal would seriously impinge on the privacy rights of a portfolio manager by providing a more comprehensive picture of a portfolio manager's net worth, and could result in portfolio managers moving their investments to other investments or unaffiliated funds.

This privacy concern is magnified if the Commission adopts the more detailed dollar ranges proposed. Currently, directors of mutual funds must disclose the amount of their investments in the funds they oversee. Under those rules, there are dollar ranges below $100,000, and any investment over $100,000 is disclosed as "over $100,000. Under these proposed rules, a portfolio manager would have to give more detailed disclosure of the nature of his or her investment than would a director. These proposed dollar range categories would give readers much more detailed information about the net worth of a portfolio manager, which could be used for purposes unrelated to the purported justification for the disclosure (*i.e.*, telemarketing and cold calling). These disclosure rules could have the unintended effect of encouraging portfolio managers to invest in other securities or with unaffiliated fund companies.

For all of these reasons, we urge the Commission to limit the disclosure of the portfolio manager's holdings to the fund in question, or to the funds within the complex of funds managed by the primary investment adviser or promoted by the same principal underwriter. We also strongly urge the Commission to adopt the same dollar range reporting standards for portfolio managers that are currently in effect for fund directors.

Disclosure of Information Regarding Portfolio Managers of Unaffiliated SubAdvisers

We believe that our concerns are magnified when a fund is managed by one or multiple subadvisers unaffiliated with the investment adviser or principal underwriter of a fund because a fund could be required to disclose numerous portfolio manager's investments in numerous fund families depending on the firm's team composition, and corporate structure and activities of control affiliates. For example, the USAA Funds employ certain subadvisers that manage the day-to-day activities of most of the equity funds in the USAA Funds family. These subadvisers are not affiliated with USAA or IMCO in any way, although as subadvisers they are considered affiliates of the funds that they manage. Under the proposed rules, the USAA Funds would have to disclose the investments of a portfolio manager of an external subadviser in the USAA Funds, any accounts managed by the portfolio manager at the external subadviser, and any other funds managed or subadvised by that external subadviser or its control affiliates. We believe that such disclosure will be burdensome to the disclosing fund companies to collect and update, and will provide investors little useful information. It also will put fund companies in the unenviable position of having to disclose competitor funds in its SAI, and facing registration statement liability for the accuracy of such information. We strongly urge that the Commission either limit all such disclosure to the portfolio manager's investment in the fund managed, or exclude from the disclosure requirement

any investment in funds and accounts managed by an external subadviser that is not otherwise affiliated with the fund's investment adviser or principal underwriter.

We also note that in response to concerns raised by the recent industry issues of market timing by portfolio managers, some advisory firms are actually restricting the ability of their portfolio managers to invest in the external fund they manage as subadvisers. In those cases, a fund would have no investment in its fund to disclose but would have to disclose any other investment made by the portfolio manager in funds managed by the external subadviser or its control affiliates.

Other Issues

We do not object to the proposed requirement to disclose the structure of compensation of portfolio managers, even portfolio managers employed by unaffiliated advisory firms. We also do not object to the proposed requirement to disclose the aggregate number of accounts and net assets managed by the portfolio manager broken down into categories. We note, however, that there is insufficient distinction between the categories for "other investment companies" and "other pooled investment vehicles." For example, are funds that are excepted from the definition of an "investment company" under Section 3 of the Investment Company Act of 1940 to be classified as "other investment companies" or "other pooled investment vehicles?" If the former, we are unsure about what accounts would fall within the term "other pooled investment vehicles. We suggest that the Commission either combine these two categories or provide additional clarification regarding the dividing line between the two proposed categories.

The proposed rules also would require funds to disclose *any* conflict of interest that *may* arise in connection with the portfolio manager's management of the fund's investments and the investments in other accounts, and a description of the policies and procedures used by the fund to address these conflicts. We believe that the disclosure standard should be any *material* conflict of interest arising because of the management of the different accounts. We oppose the requirement to disclose the fund's policies and procedures to address conflicts of interest raised by the management of different accounts. We believe that satisfying this requirement would basically amount to duplicating large portions of Part II of an adviser's Form ADV in the SAI, which runs counter to the goal of simplifying and shortening registration statements. We also are aware that commenters support attaching copies of the fund's policies and procedures to address portfolio manager conflicts of interest to the SAI. We note that such policies and procedures can be lengthy and located in numerous policies and procedures related to trading practices, codes of ethics, personal transactions and reporting requirements, and trade allocation. Similar to duplicating Part II of Form ADV, we believe that attaching these documents to the SAI would merely increase the length and amount of disclosure without providing investors more meaningful information. Finally, because fund boards must review and approve such policies under the new compliance program rule, we believe that an alternative could be to disclose that funds have policies designed to address such conflicts that are reviewed and approved by the board of directors.

In conclusion, although we recognize the reasons behind the Commission's rule proposals, we remain concerned that the aggregate effect of the proposed rules and definitions could be overly invasive to the privacy of portfolio managers while burying the investor in a sea of new disclosure and policies and procedures. We believe that unnecessarily increasing disclosure in one area can obstruct more critical information. This concern is particularly magnified in the context of funds with more than one portfolio manager and one or more unaffiliated subadvisers, whereby funds could be disclosing the investment holdings of employees of unaffiliated companies in investment accounts not managed by the primary investment adviser of the fund in which an investor has invested.

We appreciate the opportunity to provide comments on this rule proposal. If you have any questions regarding our comments, or would like additional information, please contact me at (210) 498-8696 or Eileen Smiley at (210) 498-4103.

Sincerely,

Mark S. Howard
Senior Vice President, Secretary & Counsel
USAA Investment Management Company