

without a shareholder vote.³⁸ Thus, manager of managers funds relying on the rule would be required to have a board of directors whose independent directors (i) constitute a majority of directors, (ii) are selected and nominated by independent directors, and (iii) if represented by legal counsel, are represented by "independent legal counsel."³⁹

5. Expectation of Investors

We also are proposing four requirements designed to assure that investors understand that they are investing in a manager of managers fund, and to require that they receive information about who the subadvisers are and that the subadvisers could be changed at any time without shareholder approval. First, the rule would require that, except in the case of a newly offered fund, shareholders approve the fund's operation as a manager of managers fund, by authorizing the adviser (with the approval of the fund's board of directors) to enter into subadvisory contracts without shareholder approval.⁴⁰ Second, we would amend Form N-1A to require that the fund disclose in its prospectus the principal adviser's ability, subject to the approval of the fund's board of directors, to retain and discharge subadvisers without shareholder approval.⁴¹

³⁸ See Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734 (Jan. 16, 2001)].

³⁹ Proposed rule 15a-5(a)(7). See 17 CFR 270.0-1(a)(6)(i) (defining "independent legal counsel"). The manager of managers exemptive orders have typically included these board composition and nomination requirements. The manager of managers orders that also include relief from our disclosure rules require independent directors to retain independent counsel. Consistent with the amendments to exemptive rules in 2001, the proposed rule would require that the independent directors have independent counsel only if they choose to retain counsel. See Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3734 (Jan. 16, 2001)].

⁴⁰ Proposed rule 15a-5(a)(3). If the fund has not publicly offered securities or sold securities to non-affiliates or promoters (or their affiliates), the rule would require that the board of directors approve the fund's operation as a manager of managers fund by authorizing the adviser to enter into subadvisory contracts without shareholder approval. *Id.* This condition also has been included as a condition to our orders.

⁴¹ Proposed Instruction 3 to Item 4(b)(1) and proposed amendments to Item 6(a)(1)(i) of Form N-1A. The amendments to Form N-1A also would require the fund to disclose in its prospectus, in the discussion of principal investment strategies, the fund's use of (or reservation of its right to use) subadvisers that may be changed at any time. Proposed Instruction 3 to Item 4(b)(1). A fund also would have to disclose in its summary of principal investment strategies, required by Item 2(b) of Form N-1A, that the fund uses (or reserves the right to

Third, proposed rule 15a-5 would prohibit a fund from having a name that contains the subadviser's name unless the name of the principal adviser precedes the subadviser's name. This limitation is designed to prevent confusion about the relative roles of the adviser and subadviser. A fund name that includes the name of a subadviser might serve to invite investors to invest in the fund to obtain the advisory services of the subadviser rather than the adviser, which is arguably inconsistent with the basis upon which we have granted relief from the shareholder voting requirement for manager of managers funds. Use of such a name also suggests that the principal adviser is unlikely to be in a position to terminate the advisory contract without upsetting the investors who have invested for the purpose of seeking the advisory services of the subadviser. On the other hand, use of a subadviser's name may merely identify one investment option among many in a series fund.

Fourth, we are proposing to require that when the principal adviser enters into a subadvisory contract or makes a material change to a wholly-owned subadviser's contract, the fund furnish shareholders with (and file with the Commission) an information statement that describes the subadvisory agreement, and contains other information that would have been provided in a proxy statement had a vote been held.⁴² This condition has been included in our exemptive orders.

- We request comment on whether the proposed requirements are adequate to assure that investors understand they are investing in a manager of managers fund. If they are not adequate, what additional requirements should be included? Should the rule simply prohibit the use of the subadviser's name in a manager of managers fund to assure that investors are investing in a fund based on the principal adviser's reputation for selecting and supervising subadvisers?

- We are considering whether to adopt substantially similar amendments to Form N-3, the registration form for insurance company "managed separate accounts."⁴³ Should we amend Form

use) the services of one or more subadvisers without shareholder approval. See Item 2(b) of Form N-1A (Item 2(b) of the prospectus must identify, based on the information given in response to Item 4(b), the fund's principal investment strategies).

⁴² Proposed rule 15a-5(a)(5). The information would have to be provided to shareholders within 90 days of entering into a subadvisory contract or materially amending a wholly-owned subadviser's contract.

⁴³ 17 CFR 239.17a, 274.11b.

N-3, and if so should the amendments differ from the proposed Form N-1A amendments?

6. Number of Subadvisers

Many manager of managers funds employ multiple subadvisers. Our exemptive orders, however, do not require the retention of a minimum number of subadvisers,⁴⁴ and some funds operating under our orders use only one subadviser for the fund, or for each series of the fund.⁴⁵

The conditions contained in our exemptive orders provide the same protections for funds with single subadvisers and those with multiple subadvisers.⁴⁶ In each case, the conditions limit relief to funds in which the subadviser is analogous to a portfolio manager and in which shareholders were informed of the principal adviser's ability to retain new subadvisers without shareholder approval. Moreover, the principal adviser's ability to hire and fire subadvisers without shareholder approval benefits shareholders by allowing funds to terminate poorly performing subadvisers, while avoiding having to operate for a significant period of time without a subadviser providing investment management services.⁴⁷ Also, subadviser changes are not infrequent for funds advised by single subadvisers.⁴⁸ Therefore, the Commission has issued orders to funds with a single subadviser, and our proposed rule would not require that each fund or portfolio engage a certain minimum number of subadvisers.⁴⁹

⁴⁴ See, e.g., Frank Russell Investment Company, Investment Company Act Release Nos. 21108 (June 2, 1995) [60 FR 30321 (June 8, 1995)] (notice) and 21169 (June 28, 1995) [59 SEC Docket 2105 (July 25, 1995)] (order).

⁴⁵ See, e.g., Managed Accounts Services Portfolio Trust and Mitchell Hutchins Asset Management, Inc., Investment Company Act Release Nos. 21590 (Dec. 11, 1995) [60 FR 64461 (Dec. 15, 1995)] (notice) and 21666 (Jan. 11, 1996) [61 SEC Docket 142 (Feb. 6, 1996)] (order) (order granted to fund in which each series of the fund was advised initially by a single subadviser).

⁴⁶ For example, the compensation received by subadvisers to single subadviser funds is fully disclosed to investors. See *supra* Section II.A.1.

⁴⁷ Absent the impediment of operating without a subadviser, it is more likely that poorly performing subadvisers would be terminated.

⁴⁸ For example, between August 1999 and October 2000, 6 of 27 American Skandia portfolios that employed only one subadviser replaced the subadviser. Between October 1999 and September 2000, 3 of 11 Paine Webber PACE Select Advisors Trust portfolios that employed only one subadviser (as of October 1999) replaced the subadviser.

⁴⁹ Some have argued that the conditions of the Commission's exemptive orders were designed for funds in which a principal adviser selects and supervises multiple subadvisers, and that the costs and delays associated with a shareholder vote for a fund with one subadviser do not warrant