§ 303.14 [Amended]

2. Section 303.14(a)(1)(i) is amended by removing ''$35,000'' and adding ''$38,650'' in its place.

3. Section 303.14(b)(3) is amended by removing ''$200'' and adding ''$500'' in its place.

4. Section 303.14(d) is revised to read as follows:

§ 303.14 Allocation factors and miscellaneous provisions.

* * * * *

(d) New entrant invitations. Applications from new firms are invited for any unused portion of any territorial share.

* * * * *

5. Section 303.14(e) is amended by removing ''2,640,000'' and adding ''2,240,000'' in its place.

Robert S. LaRussa,

Assistant Secretary for Import Administration.

Allen Stayman,

Director, Office of Insular Affairs.

[FR Doc. 98–20162 Filed 7–27–98; 8:45 am]

BILLING CODE 3510–DS–P 4310–93–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release Nos. IC–23325, IA–1736; File No. S7–22–98]

RIN 3235–AH02

Temporary Exemption for Certain Investment Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for public comment amendments to the rule under the Investment Company Act of 1940 that permits an investment adviser, in certain circumstances, to advise an investment company temporarily under a contract that the investment company's shareholders have not approved. The proposed amendments would expand the exemption provided by the rule to include new advisory contracts entered into as a result of a merger or similar business combination involving the fund's adviser or a controlling person of the adviser, and would lengthen the period during which the adviser may serve under a contract without shareholder approval. The proposed amendments are intended to enable more investment advisers to rely on the rule rather than seek individual exemptions from the Commission, subject to conditions designed to protect the interests of investors pending the shareholder vote.

DATES: Comments must be received on or before September 30, 1998.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Mail Stop 6–9, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–22–98; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Marilyn Mann, Senior Counsel, or Penelope W. Saltzman, Assistant Chief, (202) 942–0690, Office of Regulatory Policy, Division of Investment Management, Mail Stop 5–6, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the ''Commission'') today is requesting public comment on amendments to rule 15a–4 (17 CFR 270.15a–4) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the ''Investment Company Act'' or the ''Act'').

Table of Contents

I. Executive Summary

The Commission is proposing for public comment amendments to rule 15a–4 under the Investment Company Act. Rule 15a–4 permits an investment adviser to an investment company (''fund'') to serve temporarily under a contract that has not been approved by the fund's shareholders. The proposed amendments would extend the rule to new advisory contracts entered into as a result of a merger or similar business combination involving the fund's adviser or a controlling person of the adviser, in connection with which the adviser or a controlling person of the adviser receives a benefit (collectively, ''adviser mergers''). The amendments also would increase the maximum number of days the investment adviser could serve under the rule and clarify the timing of board approval of the fund's advisory contract. The proposed amendments would enable more investment advisers to rely on the rule rather than seek an individual exemption from the Commission, subject to conditions designed to protect the interests of investors pending the shareholder vote.

II. Background

Section 15(a) of the Investment Company Act prohibits a person from serving as an investment adviser to a fund except under a written advisory contract that the fund's shareholders have approved. [1] Section 15(a) also requires that an advisory contract must provide for its automatic termination upon its assignment.[2] An advisory contract that continues in effect for more than two years must be approved annually by either the fund's board of directors or its shareholders. [3]

Section 15(a) is designed to give shareholders a voice in a fund's investment advisory contract and to prevent trafficking in fund advisory contracts.[4] One of section 15(a)'s unintended effects, however, is to leave a fund without an investment adviser if the fund's contract with the adviser is terminated before the fund's shareholders can vote on a new contract.[5] A fund could face this

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[1] 15 U.S.C. 80a–15(a). Section 15(a) requires that a majority of the fund's outstanding voting securities approve the contract. Section 2(a)(42) of the Act (15 U.S.C. 80a–2(a)(42)) defines a vote of a majority of the outstanding voting securities of a fund to mean the vote of shareholders representing (a) 67 percent or more of the voting securities present at the meeting, if the holders of more than 50 percent of the fund's outstanding voting securities are present or represented by proxy, or (b) more than 50 percent of the outstanding voting securities of the fund, whichever is less.

[2] 15 U.S.C. 80a–15(a)(4). An ''assignment'' of an investment advisory contract includes a transfer of the contract to another investment adviser as well as a transfer of a controlling block of the investment adviser's voting securities. 15 U.S.C. 80a–2(a)(4).

[3] 15 U.S.C. 80a–15(a)(2).

[4] *Hearings on S. 3580 Before the Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 253 (1940) (statement of David Schenker).

[5] If an investment advisory contract is terminated by a foreseeable assignment, an investment adviser may be required, under its fiduciary duty, to

Continued

situation, for example, if a controlling shareholder of the fund's adviser suddenly dies and control of the adviser passes to an heir.[6] To prevent funds from being harmed as a result of the loss of advisory services for a period of time, the Commission adopted in 1980 rule 15a–4, which provides a temporary exemption from the requirement that a fund's shareholders approve its advisory contract.[7] The rule permits a fund to be advised under a short-term contract while shareholder approval is obtained for a new advisory contract.

Under rule 15a–4, a person may serve as an adviser to a fund for up to 120 days under a contract that the fund's shareholders have not approved (''interim contract'') [8] when (i) the previous advisory contract has not been renewed, (ii) the fund's directors or shareholders terminate the advisory contract, or (iii) the contract is assigned (and therefore terminates) under circumstances in which the investment adviser, or a controlling person of the adviser, does not receive any money or other benefit. The rule requires the fund's board of directors, including a majority of the directors who are not interested persons of the fund (''independent directors''), to approve the interim contract, [9] and limits the compensation under the interim contract to the amount the adviser could have received under the most recent advisory contract approved by shareholders (''previous contract'').[10]

Based on its experience with the rule since 1980, and in light of developments in the financial services industry, the Commission is proposing three amendments to rule 15a–4. These amendments would (i) clarify the timing of board approval of an interim contract, (ii) expand the rule to permit the fund to operate under an interim contract entered into as a result of an adviser merger, and (iii) lengthen the amount of time a fund can operate under an interim contract from 120 to 150 days. As discussed in more detail below, the amendments would largely codify prior Commission exemptive orders, which effectively permitted advisers or their affiliates to consummate a merger before the fund's shareholders voted on a new advisory contract rather than delay the merger in order to obtain shareholder approval.

Proposed Amendments to Rule 15a–4

A. Board Approval

Under section 15 of the Act and rule 15a–4, the board of directors of a fund must approve an interim contract at or before the time the fund enters into the interim contract. If an assignment results from an unforeseeable event, board approval of the interim contract before the assignment may be impracticable. In addition, with no prior notice of the assignment, members of the board may not be immediately available to meet to approve the interim advisory contract.[11]

The Commission has granted an exemption from the board approval requirement of section 15(c) when death of a controlling shareholder of a fund's investment adviser has resulted in an assignment of the fund's advisory contract.[12] The proposed amendments would provide similar exemptive relief in this type of situation by allowing the board seven calendar days to approve an interim contract in circumstances in which the *current* rule would permit an investment adviser to serve a fund temporarily under a contract without shareholder approval. The proposed amendments also would facilitate a special meeting to approve an interim contract, by permitting the fund's board of directors to participate by telephone or similar means of communication that allows all participants to hear each other at the same time.[13]

The Commission requests comment regarding this proposed amendment. The Commission's rules previously have not provided this grace period for board approval. Have boards been able to meet the requirements of section 15(c) without a grace period when an advisory contract is terminated as a result of an unforeseeable assignment? Does seven days give the board sufficient time to review the interim contract and vote? Should the rule provide a longer period for approval but not provide an exemption from the requirement to vote in person?

B. Adviser Mergers

Since 1980, a growing number of mergers in the financial services industry [14] has led to a growing number of requests for exemptive relief from

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continue providing advisory services to the fund until the shareholders approve a new contract. *See* Exemptions for Certain Investment Advisers and Principal Underwriters of Investment Companies, Investment Company Act Release No. 10809 (Aug. 6, 1979) (44 FR 47100, 47102 (Aug. 10, 1979)) (''1979 Proposing Release'').

[6] *See, e.g.*, American-South African Investment Company Limited, Investment Company Act Release Nos. 6398 (Mar. 22, 1971) (36 FR 5819 (1971)) (notice) and 6456 (Apr. 14, 1971) (order) (investment adviser received exemption from section 15(a) for period between death of indirect owner of 50 percent of outstanding shares of investment adviser and annual meeting of shareholders).

[7] 17 CFR 270.15a–4. *See also* 1979 Proposing Release, *supra* note , at 47101.

[8] The interim contract may terminate at the earlier of the expiration of the 120-day period or the date on which shareholders approve a new contract with the adviser. Alternatively, the fund may enter into a new contract with the adviser which, if approved by shareholders, continues past the 120-day period. In the latter case, the term ''interim contract'' refers to the contract during the time the exemption is in effect.

[9] Rule 15a–4(a) (17 CFR 270.15a–4(a)). Under section 15(c) of the Act, a fund's independent directors must approve the terms of an investment advisory contract before it can go into effect. 15 U.S.C. 80a–15(c). A fund's directors have a duty to request, and the adviser has a duty to furnish, all information reasonably needed to evaluate the terms of the proposed advisory contract. *Id*. In reviewing the advisory contract, the independent directors' role is to represent the interests of shareholders by acting as ''independent watchdogs'' and furnishing an independent check on the fund's management. *See Burks* v. *Lasker*, 441 U.S. 471, 484–85 (1979); *see also* Division of Investment Management, SEC, Protecting Investors: A Half Century of Investment Company Regulation 255–57 (1992) (''Protecting Investors Report'').

[10] Rule 15a–4(b) (17 CFR 270.15a–4(b)).

[11] Section 15(c) of the Act requires the board to vote ''in person'' to approve an investment advisory contract. 15 U.S.C. 80a–15(c). Historically, the Commission has taken the view that the ''in person'' requirement must be satisfied by a meeting at which the directors are physically present. *See* Provisions of Investment Company Amendments Act of 1970 (Pub.L. 91–547) Concerning Approval of Investment Advisory Contracts and Other Matters Which Should Be Considered by Registrants in Connection With Their 1971 Annual Meetings, Investment Company Act Release No. 6336 (Feb. 2, 1971) (36 FR 2867, 2867 & n.3 (Feb. 11, 1971)). Section 15(c) does not by its terms specify that the in person requirement means that board members must be physically present. Under the laws of some states, a similar requirement can be met by a meeting at which directors are present through the means of a conference call or audiovisual conference. *See, e.g.*, Del. Code Ann. tit. 8, § 141(i) (1991); Md. Code Ann., Corps. & Ass'ns § 2–409(d) (1993). The Commission's historic view is based on the legislative history of section 15(c), which indicates that the provision meant directors were required to be ''personally present'' to vote at meetings. H.R. Rep. No. 1382, 91st Cong., 2d Sess. 25–26 (1970); S. Rep. No. 184, 91st Cong., 1st Sess. 39 (1969).

[12] *See, e.g.*, American-South African Investment Company Limited, *supra* note (permitting board approval one week after termination of advisory contract caused by death of controlling shareholder of the investment adviser).

[13] Proposed rule 15a–4(b)(1)(ii).

[14] *See Financial Services Consolidation Hits Mutual Fund Industry in '97*, USA Today, Dec. 18, 1997, at 14E (noting the many mergers in the mutual fund industry in 1997, and predicting that the trend would continue in 1998); Investment Counseling, Inc., Re-Thinking Strategic Activity 1 (1997) (showing the increase in mergers and acquisitions in the money management industry in 1995 and 1996 over 1992–1994); Tim Quinson, *Banks Add More Investment Services With Focus On Fund Firms*, The Dallas Morning News, Dec. 28, 1997, at 9H (many large U.S. banks recently purchased managers of mutual funds); Barry P. Barbash, *Mutual Fund Consolidation and Globalization: Challenges for the Future*, Remarks to the Mutual Fund and Investment Management Conference 1–2 (Mar. 23, 1998) (during the past year, the Commission's Division of Investment Management received from funds and advisory firms an average of one merger-related exemptive application each week) (available on the Internet at <http://www.sec.gov/news/speeches/spch208.htm>).

section 15(a) of the Act.[15] Adviser merger transactions can result in the assignment (and thus the automatic termination) of advisory contracts,[16] but are not covered by rule 15a–4 because the adviser will have received money or other benefits as a result of the transaction.[17]

In response to these requests for relief, the Commission has granted exemptions from section 15(a) in a variety of circumstances in which applicants stated it was necessary to conclude a transaction before a shareholder vote could be held, or when the meeting to hold a shareholder vote on the advisory contract could be combined with another previously scheduled shareholder meeting to occur after the adviser merger.[18] Applicants have represented that it is often impracticable to obtain shareholder approval of an advisory contract prior to an adviser merger without causing a substantial delay in closing the transaction. These delays can result in significant adverse effects, such as the loss of key personnel of the investment adviser, that could be detrimental to fund shareholders.[19]

Rule 15a–4 is designed to deal with unforeseeable assignments of advisory contracts by permitting the board to act on an emergency basis to prevent the fund from being harmed by the absence of advisory services.[20] By contrast, adviser mergers are often foreseeable, will benefit the adviser, and typically occur as a result of a transaction in which the fund is not a participant and in which its interests are not represented.[21] In these cases, fund boards have more opportunity to protect the interests of the fund by, among other things, more closely evaluating the services it will receive under an interim contract (*i.e.,* after the merger or acquisition of the fund's investment adviser or a controlling person of the investment adviser). Therefore, the Commission has granted exemptive relief from section 15(a) in connection with adviser mergers only upon certain additional conditions designed to protect the fund's interests until shareholders have had an opportunity to approve a new advisory contract. The Commission is proposing to codify the relief provided in these orders based on similar conditions, as described below.

1. Terms and Conditions

In considering requests for exemptive relief in connection with adviser mergers, the Commission has required certain actions by the fund's board of directors and certain provisions in the interim contract, which are designed to preserve the quality of advisory and other services that the fund received before the merger until the shareholders vote on a new contract. The Commission is proposing to incorporate these conditions in rule 15a–4. In the case of an adviser merger, the proposed amendments would require that: (i) The interim contract generally contain the same terms and conditions as the previous contract;[22] (ii) the interim contract be approved by the fund's board of directors, including a majority of the independent directors, before the interim contract begins;[23] and (iii) the board, including a majority of independent directors, find that the scope and quality of the advisory services to be provided under the interim contract will be at least equivalent to the scope and quality of the services provided under the previous contract.[24] The Commission requests comment whether the rule should require the board to make specific findings regarding the interim contract. If so, should the rule require any additional findings by the fund's board regarding the interests of investors?

If the quality of the advisory services provided to the fund diminishes during the performance of the interim contract, the board may need to consider whether to terminate the contract and seek to employ another adviser. In order to allow the board to act quickly, the proposed rule would require that the interim contract permit the board to terminate the contract on no more than 10 calendar days' written notice to the adviser.[25]

The Commission requests comment whether the rule should specify actions the directors should take to monitor the adviser's performance during the exemptive period. Should the rule require the adviser to report to the directors regarding changes in personnel

[15] Since rule 15a–4 was adopted in 1980, the Commission has issued over 50 orders temporarily exempting funds and their investment advisers from the shareholder approval requirement in connection with assignments resulting from a merger or acquisition involving the fund's investment adviser. Over half of these orders have been issued since the beginning of 1996.

[16] *See supra* note .

[17] When the Commission adopted rule 15a–4 in 1980, it decided not to extend the rule to cover adviser mergers because they were ''foreseeable.'' *See* Exemptions for Certain Investment Advisers and Principal Underwriters of Investment Companies, Investment Company Act Release No. 11005 (Jan. 2, 1980) (45 FR 1860, 1861 n.2 (Jan. 9, 1980)) (''1980 Adopting Release'').

[18] *See, e.g.,* Cash Reserve Management, Inc., Investment Company Act Release Nos. 16172 (Dec. 11, 1987) [52 FR 47985 (Dec. 17, 1987)] (notice) and 16202 (Jan. 5, 1988) [39 SEC Docket 1602 (Jan. 19, 1988)] (order) (acquisition of investment adviser through tender offer); Mutual Fund Group, Investment Company Act Release Nos. 21629 (Dec. 28, 1995) [61 FR 365 (Jan. 4, 1996)] (notice) and 21696 (Jan. 23, 1996) [61 SEC Docket 555 (Feb. 20, 1996)] (order) (meetings to be held after the assignment to vote on fund mergers); *see also* Kenneth S. Gerstein, *Acquisitions of Mutual Fund Advisors: Some Practical Issues Under the Investment Company Act,* Investment Law., Apr. 1994, at 12, 13.

[19] *See, e.g.,* General Securities, Inc., Investment Company Act Release Nos. 18884 (Aug. 7, 1992) [57 FR 37020 (Aug. 17, 1992)] (notice) and 18927 (Sept. 3, 1992) (52 SEC Docket 1776 (Sept. 22, 1992)) (order) (delaying the closing of the merger could cause defections of investment adviser's registered representatives, possibly threatening adviser's viability and diminishing the services provided to the fund); Kidder, Peabody Investment Trust, Investment Company Act Release Nos. 20818 (Jan. 4, 1995) [60 FR 2803 (Jan. 11, 1995)] (notice) and 20865 (Jan. 27, 1995) [58 SEC Docket 2092 (Feb. 28, 1995)] (order) (delaying the closing of the transaction until shareholders could vote on new advisory contracts would result in substantial defections by portfolio managers, advisory employees, and supervisory personnel).

[20] *See* 1980 Adopting Release, *supra* note 17, at n.2; *see also* 1979 Proposing Release, *supra* note , at 47102. The 1979 Proposing Release stated that the Commission intended the rule to cover assignments of advisory contracts that were not reasonably foreseeable, such as assignments resulting from the death of a controlling shareholder of the adviser. *Id.* at 47101–02. When an investment adviser assigns a contract under reasonably foreseeable circumstances, such as pursuant to a merger, ''the investor protection concerns expressed by Congress with respect to section 15(a) are better fulfilled when investment company shareholders are provided the opportunity to approve any successor investment advisory contract prior to the successor adviser's serving the company.'' *Id.* at 47102. The 1979 Proposing Release also noted that the rule would not extend the period during which an investment company must comply with section 15(a) requirements regarding annual continuance of investment advisory contracts. *Id.* at n.8.

[21] *See* Stephanie A. Djinis, *Acquisition of a Mutual Fund Adviser: The Role of Fund Directors,* 29 Sec. & Commodities Reg. 135, 135–36 (June 19, 1996) (adviser may inform fund's board about merger plans after negotiating the transaction, and the board is not in a position to reject the merger); Gerstein, *supra* note 18, at 12 (neither a fund, nor its shareholders, are parties to the acquisition of the fund's adviser).

[22] Proposed rule 15a–4(b)(2)(v). The requirement concerning the terms and conditions of the interim contract is designed to ensure that the contract does not vary from the previous contract with respect to important matters such as indemnification, the adviser's standard of care, and the allocation of expenses between the adviser and the fund. The interim contract would, however, have effective and termination dates that are different from the dates of the previous contract and could contain other differences that the fund's board of directors determines are immaterial.

[23] Proposed rule 15a–4(b)(2)(ii).

[24] Proposed rule 15a–4(b)(2)(iii). Thus, the interim contract could provide for lower advisory fees, but not a lower level of service. The Commission anticipates that the information needed to make this additional finding generally would be similar to the information the independent directors examine in fulfilling their responsibilities under section 15(c) and could include information on the services to be provided under the interim contract, such as the quality of the investment adviser's personnel (especially in light of any personnel changes) and the investment adviser's past performance and compliance records.

[25] Proposed rule 15a–4(b)(2)(iv).

or other matters?[26] The Commission also requests comment on the maximum 10-day notice the interim contract may require before termination of the interim contract. Is this type of provision necessary? If it is, should the rule provide a shorter or longer maximum notice period (*e.g.*, 5 or 20 days)? Commenters who believe that a shorter or longer notice period is needed should explain why, and specify the number of days they believe would be appropriate.

2. Placement of Advisory Fees in Escrow

Orders for exemptive relief from section 15(a) have been conditioned on placing advisory fees earned during the interim period in an escrow account payable to the adviser only when and if the fund's shareholders approve a new contract with the adviser. The escrow requirement was designed to allow shareholders, in effect, to subsequently ratify the investment adviser's compensation under the interim contract.

The proposed amendments would include a modified escrow requirement. The provision would require that advisory fees earned under the interim contract be held in an interest-bearing escrow account with a bank or the fund's custodian.[27] If the shareholders approve the new advisory contract, the escrowed fees would be paid to the investment adviser in accordance with the interim contract.[28] If the shareholders do not approve the new contract, however, the adviser would be compensated out of the escrowed fees for the actual costs of performing the interim contract, so long as the costs do not exceed the total compensation the adviser would have received under the interim contract.[29] Any remaining escrowed fees would be returned to the fund.

Most of the prior exemptive orders required all the escrowed fees to be returned to the fund if shareholders did not approve a new contract with the investment adviser. The proposed change from the condition in prior exemptive orders is intended to allow shareholders to withhold an adviser's profits if the shareholders do not approve a new contract with that adviser, while providing for compensation for services rendered by the adviser.[30]

The Commission requests comment on the proposed escrow requirement. Do the escrow arrangements encourage investment advisers to obtain shareholder approval prior to the adviser merger? Does this approach create economic burdens for investment advisers, especially smaller or less capitalized advisers?

3. Costs of Shareholder Solicitation

In most investment adviser business combinations, the advisers bear the expenses of the transaction.[31] Applicants have stated in requests for exemptive relief that funds would not pay any of the costs of soliciting shareholder approval of the new advisory contract after an adviser merger, and the orders have included this representation as a condition for relief.[32] The Commission is not proposing to include this condition in the rule because it does not appear to be relevant to the question of whether relief should be granted from the shareholder approval requirement of section 15(a). If an advisory contract is terminated as a result of an adviser's action (such as an adviser merger) that benefits the adviser, however, issues may arise under other sections of the Investment Company Act if the fund pays the costs of soliciting shareholder approval of a new contract.[33] The Commission requests comment whether, in light of these issues, rule 15a–4 should require that the parties to an adviser merger, rather than the fund, pay the costs associated with the transaction.

The Commission also requests comment generally on the proposed amendment to rule 15a–4 to exempt advisory contracts temporarily from the shareholder approval requirement in the context of adviser mergers. Do the proposed conditions adequately protect fund shareholders against overreaching by the investment adviser?

C. Length of Exemptive Period

Rule 15a–4 currently exempts an investment adviser from the shareholder approval requirement for 120 days. This time period was adopted to provide a fund adequate time to solicit proxies and obtain a quorum of voting shareholders.[34] Today, however, the 120-day period in many cases may be insufficient time for obtaining shareholder approval of the new advisory contract.[35] Funds have found it difficult to obtain a quorum of shareholders necessary to vote on an advisory contract.[36] In addition, funds that hold annual shareholders' meetings often must call a special meeting to approve the advisory contract within

[26] Prior exemptive orders have required that the investment adviser report to the fund's board during the exemptive period any material changes in the adviser's personnel, in order to permit the directors to monitor the scope and quality of services provided to the fund. *See, e.g.*, Nations Fund Portfolios, Inc., Investment Company Act Release Nos. 21801 (Mar. 4, 1996) [61 FR 9511 (Mar. 8, 1996)] (notice) and 21854 (Mar. 25, 1996) (61 SEC Docket 1821 (Apr. 23, 1996)) (order).

[27] Proposed rule 15a–4(b)(2)(vi)(A).

[28] Proposed rule 15a–4(b)(2)(vi)(B).

[29] Proposed rule 15a–4(b)(2)(vi)(C). This procedure is similar to that permitted by rule 18f–2(c)(2) (17 CFR 270.18f–2(c)(2)), which allows an investment adviser to continue to advise a series fund without approval from the series shareholders pending approval of a new contract as long as the adviser's compensation is limited to the lesser of actual costs or the amount it would have received under the advisory contract.

[30] Placing the fees in escrow until the shareholders vote on the new contract also may encourage the investment adviser to obtain the shareholder vote as soon as possible.

[31] *See* 1 Thomas P. Lemke et al., Regulation of Investment Companies § 24.02[1][c] (1997).

[32] *See, e.g.*, Merrill Lynch & Co., Inc., Investment Company Act Release Nos. 22947 (Dec. 19, 1997) (62 FR 67420 (Dec. 24, 1997)) (notice) and 22997 (Jan. 12, 1998) (66 SEC Docket 981 (Feb. 10, 1998)) (order); USLIFE Income Fund, Inc., Investment Company Act Release Nos. 22664 (May 16, 1997) (62 FR 28079 (May 22, 1997)) (notice) and 22701 (June 11, 1997) (64 SEC Docket 2011 (July 8, 1997)) (order).

[33] *See* 1979 Proposing Release, *supra* note 5, at n.13 (if a fund were to bear any of the costs caused by an adviser merger, including costs associated with conducting a special shareholders' meeting, payment of those costs might constitute compensation to the investment adviser and might raise questions regarding the availability of section 15(f) (15 U.S.C. 80a–15(f)) (creating safe harbor under which investment advisers may receive a benefit in connection with a sale of securities of, or a sale of any other interest in, an investment adviser that results in an assignment of an investment advisory contract, if certain conditions are met), section 15(a)(1) (15 U.S.C. 80a–15(a)(1)) (advisory contract must precisely describe all compensation to be paid under the contract) and section 36(b) (15 U.S.C. 80a–35(b)) (investment adviser's fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by the fund or its shareholders)). *But see* Travelers Group Inc., et al., Investment Company Act Release Nos. 22873 (Nov. 3, 1997) (62 FR 60540 (Nov. 10, 1997)) (notice) and 22911 (Nov. 26, 1997) (65 SEC Docket 2962 (Dec. 23, 1997)) (order) (adviser to pay costs of soliciting shareholder approval of new advisory contract, except that if solicitation is in conjunction with fund's annual meeting at which other matters are to be discussed, fund may pay portion of costs).

[34] *See* 1980 Adopting Release, *supra* note 17.

[35] The Commission has issued several orders temporarily exempting fund advisers from the shareholder approval requirement of section 15(a) when the fund was unable to obtain a quorum within the time period allowed by rule 15a–4, or when the fund wished to postpone the shareholder vote until its next annual or special meeting. *See, e.g.*, The Emerging Germany Fund Inc., Investment Company Act Release Nos. 18323 (Sept. 18, 1991) (56 FR 48265 (Sept. 24, 1991)) (notice) and 18492 (Oct. 16, 1991) (50 SEC Docket 1432 (Feb. 4, 1992)) (order). The Commission staff also has taken the position in a number of no-action letters that an adviser may temporarily (pending shareholder approval of the advisory contract) provide services to the fund at the lower of the cost to the adviser of providing the services or the compensation the adviser would have received under the previous contract. *See, e.g.*, NPG Growth Fund, Inc., SEC No-Action Letter (July 6, 1975).

[36] *See* Protecting Investors Report, *supra* note 9, at 272 n.82; Lori Pizzani, *Avoiding Proxy Voting Bumps*, Mutual Fund Market News, Apr. 28, 1997, at 1.

the 120-day period, which results in additional costs for the fund.

The Commission proposes to increase the period permitted by the rule to 150 days, to allow funds more time to seek shareholder approval of the new advisory contract.[37] Commenters who believe that a longer period is needed should explain why, and specify the number of days they believe would be appropriate. Should the rule allow funds that hold annual shareholder meetings to postpone the shareholder vote on the advisory contract until the next annual meeting?[38]

D. Availability of Exemption After Shareholder Vote

The Commission's proposal to extend the exemptive period is intended to provide sufficient time to obtain shareholder approval of a new advisory contract. Consistent with current rule 15a–4, if the shareholders do not approve the new contract before the exemptive period expires, the rule would not be available for an additional period of time. Thus, for example, if a contract terminates and shareholders subsequently vote to terminate the interim contract, the adviser will not be able to serve the fund under another interim contract under rule 15a–4.[39]

E. General Request for Comment

The Commission requests comment on the proposed rule amendments that are the subject of this release, suggestions for additional provisions or changes to the rule, and comments on other matters that might have an effect on the proposals contained in this release. The Commission requests comment whether the proposals, if adopted, would promote efficiency, competition, and capital formation. Comments will be considered by the Commission in satisfying its responsibilities under section 2(c) of the Investment Company Act.[40] The Commission encourages commenters to provide data to support their views.

IV. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The proposed amendments are likely to result in cost savings for investment advisers[41] by removing the need to seek exemptive relief in the case of adviser mergers. Based on orders issued in 1997, the Commission estimates that the total annual cost savings for investment advisers resulting from the proposed amendments would be approximately $260,000, and possibly more. In 1997, the Commission issued 13 orders granting exemptive relief in connection with adviser mergers at an estimated cost to the applicants of $20,000 for each application. The Commission expects that cost savings could be greater in the future because the steady increase in orders issued in connection with adviser mergers over the past three years appears likely to continue in 1998.[42] The requirements of the rule with respect to director findings should not be burdensome in view of the fact that section 15(c) already requires the fund's independent directors to review and approve the new advisory contract. In addition, cost savings could be realized by funds and advisers not governed by paragraph (b)(2) of the rule in that directors may participate in the meeting to approve the advisory contract ''by any means of communication that allows all directors participating to hear each other simultaneously during the meeting.'' This provision could result in savings in time and travel costs.

Unlike most prior exemptive orders, the proposed amendments would not prohibit funds from paying costs associated with soliciting shareholder approval of a new advisory contract after an adviser merger. Thus, the proposed amendments could result in increased costs if funds bear those expenses in the future. In most investment adviser business combinations, however, the advisers bear the costs of the transaction.[43] In addition, applicants have represented that advisers will bear the costs of soliciting shareholder approval of a new advisory contract after an adviser merger. While the Commission cannot predict what will happen if the proposed amendments are adopted, we believe that advisers are likely to continue to pay these costs and, therefore, the proposed amendments are not likely to result in increased shareholder solicitation costs for funds.

The Commission requests comment on the potential costs and benefits of the rule and of the proposed amendments or any suggested alternatives to the proposed amendments. Data is requested concerning these costs and benefits.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[44] the Commission also requests information regarding the potential impact of the proposed rule on the economy on an annual basis. Commenters are requested again to provide data to support their views.

V. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA'') in accordance with 5 U.S.C. 603 regarding the proposed amendments to rule 15a–4. The following summarizes the IRFA.

Existing rule 15a–4 provides a temporary exemption in certain circumstances from the requirement that shareholders approve an investment advisory contract. The rule does not, however, cover interim contracts entered into as a result of adviser mergers. Due to the growing number of acquisitions and mergers in the financial services industry, the Commission has received a growing number of applications for exemption from the shareholder approval requirement in connection with adviser mergers. In addition, funds have advised the Commission that the 120-day exemptive period in rule 15a–4 is too short to obtain shareholder approval of an advisory contract.

The proposed amendments would extend rule 15a–4 to adviser mergers, extend the length of the exemptive period to 150 days, and clarify the timing of board approval of the fund's advisory contract. The proposed amendments would significantly reduce the need to file exemptive applications, resulting in cost and time savings for funds and investment advisers.

The Commission is proposing to amend rule 15a–4 pursuant to the authority set forth in sections 6(c) and

[37] Proposed rule 15a–4(a)(2).

[38] A provision related to annual shareholder meetings would, as a practical matter, principally affect closed-end funds. The Act does not require that shareholders annually elect directors. Investment Company Act section 16(a) (15 U.S.C. 80a–16(a)); John Nuveen & Co. Inc., SEC No-Action Letter (Nov. 18, 1986). Most open-end funds are organized in states that do not require annual shareholders' meetings. *See, e.g.,* Del. Code Ann. tit. 12, § 3806(b)(5) (1995); Md. Code Ann., Corps. & Ass'ns § 2–501(b) (1993). *See generally* Protecting Investors Report, *supra* note 9, at 275. Most closed-end funds, however, list their shares on stock exchanges and are required to hold annual meetings under stock exchange rules. *See, e.g.,* New York Stock Exchange Listed Company Manual ¶ 302.00 (1995).

[39] *See* 1979 Proposing Release, *supra* note 5, at n.12.

[40] Section 2(c) requires the Commission, when it engages in rulemaking and is required to consider whether an action is consistent with the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. 15 U.S.C. 80a–2(c).

[41] One of the standard conditions to the adviser merger orders is that the costs of the exemptive application will be paid by the adviser or advisers.

[42] The Commission issued 6, 11, and 13 orders granting exemptive relief in connection with adviser mergers in 1995, 1996, and 1997, respectively. The Commission already has received five applications in the first quarter of 1998.

[43] *See* 1 Lemke, *supra* note 31, at § 24.02(1)(c).

[44] Pub. L. 104–121, Title II, 110 Stat. 857 (1996).

38(a) of the Act. Rule 15a–4 applies to funds (including business development companies (''BDCs'')) and their investment advisers.[45] The rule does not affect funds that do not have an external investment adviser[46] (*i.e.*, unit investment trusts or other funds that are internally managed).

An investment adviser is a small entity if it (1) manages less than $25 million in assets, (2) has total assets of less than $5 million on the last day of its most recent fiscal year, and (3) does not control, is not controlled by, and is not under common control with another investment adviser that manages $25 million or more in assets, or any person (other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year.[47] The Commission estimates that there are approximately 820 investment advisers that advise funds, approximately 180 of which are small entities. A fund is a small entity if it, together with other funds in the same group of related funds, has net assets of $50 million or less as of the end of its most recent fiscal year.[48] There are approximately 2,600 active open-end funds, approximately 210 of which are small entities. There are approximately 545 active closed-end funds, approximately 42 of which are small entities. There are approximately 63 BDCs, approximately 33 of which are small entities.

The Commission believes that the proposed amendments would decrease the burdens on small funds and small investment advisers by making it unnecessary for them to seek an exemptive order from the Commission in order to delay the shareholder vote required by section 15(a). The requirements of the rule, as explained above in section III, are designed to protect the interests of investment companies, including small funds and their shareholders, and therefore an exemption from any of those requirements for small entities would not be consistent with the protection of investors. The Commission believes that the burden these requirements place on small advisers is minimal because the requirements generally are intended to maintain the status quo until the shareholder vote can be held.

The Commission is proposing escrow arrangements under the proposed rule amendments that differ from the escrow arrangements required under most exemptive orders issued to date to funds seeking relief similar to that provided by the proposed amendments. The proposed amendments would require the advisory fee to be paid under the interim contract to be placed in escrow, but would allow an investment adviser to recover its costs of performing the interim contract if a fund's shareholders do not approve a new advisory contract. Most of the prior exemptive orders required that all the escrowed fees be returned to the fund if shareholders did not approve a new contract with the investment adviser. The proposed changes from conditions imposed under prior exemptive orders are designed to allow shareholders to withhold profits under an interim contract when the shareholders reject a new contract with that adviser, while providing for compensation for services provided by the adviser. This provision may be of particular benefit to small advisers.

The Commission has not identified any overlapping or conflicting federal rules. The Commission has considered alternatives to the proposed rule amendment that would accomplish the objective of the rule and minimize the impact on small entities. These alternatives include: (i) Establishing different compliance requirements that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

The Commission believes that further clarification, consolidation, or simplification of the compliance requirements is not necessary. Standards contained in the proposed amendment are performance, rather than design, standards.[49] An exemption from coverage of the rule for small advisers or small funds would prevent those entities from benefiting from rule 15a–4 and would not be consistent with the protection of investors.

The Commission encourages the submission of comments on matters discussed in the IRFA. Comment specifically is requested on the number of small entities that would be affected by the proposed rule amendments. Comment also is requested on the effect of the rule amendments on investment advisers and funds that are small entities. Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect. These comments will be placed in the same public file as comments on the proposed rule amendments.

A copy of the IRFA may be obtained by contacting Marilyn Mann, Mail Stop 5–6, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549.

VI. Statutory Authority

The Commission is proposing to amend rule 15a–4 pursuant to the authority set forth in sections 6(c) and 38(a) (15 U.S.C. 80a–6(c) and 80a–37(a)) of the Investment Company Act.

List of Subjects in 17 CFR Part 270

Investment companies, Securities.

Text of Proposed Rule

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–34(d), 80a–37, 80a–39 unless otherwise noted;

* * * * *

2. Section 270.15a–4 is revised to read as follows:

§ 270.15a–4 Temporary exemption for certain investment advisers.

(a) *Definitions.* For purposes of this section:

(1) *Fund* means an investment company;

(2) *Interim contract* means a written contract for a period no greater than 150 days that has not been approved by a majority of the fund's outstanding voting securities; and

(3) *Previous contract* means an investment advisory contract that has been approved by a majority of the fund's outstanding voting securities and has been terminated.

(b) Notwithstanding section 15(a) of the Act (15 U.S.C. 80a–15(a)), a person may act as investment adviser for a fund under an interim contract after the termination of a previous contract as

[45] Section 59 of the Act (15 U.S.C. 80a–58) provides, among other things, that sections 15(a) and 15(c) of the Act apply to a BDC to the same extent as if it were a registered closed-end investment company.

[46] The vast majority of open-end and closed-end funds are externally managed. All face-amount certificate companies currently in existence are externally managed. The Commission does not keep statistics on how many BDCs are externally managed.

[47] Definitions of ''Small Business'' or ''Small Organization'' Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933, Securities Act Release No. 7548 (June 24, 1998) (63 FR 35508 (June 30, 1998)) (''Small Entity Release'').

[48] *Id.*

[49] Proposed rule 15a–4(b)(2)(iii), (v).

provided in paragraphs (b)(1) and (b)(2) of this section:

(1) In the case of a previous contract terminated by an event described in section 15(a)(3) of the Act (15 U.S.C. 80a–15(a)(3)), by the failure to renew the previous contract, or by an assignment (other than an assignment by an investment adviser or a controlling person of the investment adviser in connection with which assignment the investment adviser or a controlling person directly or indirectly receives money or other benefit):

(i) The compensation to be received under the interim contract is no greater than the compensation the adviser would have received under the previous contract; and

(ii) The fund's board of directors, including a majority of the directors who are not interested persons of the fund, has approved the interim contract within seven calendar days after the termination, at a meeting in which directors may participate by any means of communication that allows all directors participating to hear each other simultaneously during the meeting.

(2) In the case of a previous contract terminated by an assignment by an investment adviser or a controlling person of the investment adviser in connection with which assignment the investment adviser or a controlling person directly or indirectly receives money or other benefit:

(i) The compensation to be received under the interim contract is no greater than the compensation the adviser would have received under the previous contract;

(ii) The board of directors, including a majority of the directors who are not interested persons of the fund, has voted in person to approve the interim contract before the previous contract is terminated;

(iii) The board of directors, including a majority of the directors who are not interested persons of the fund, determines that the scope and quality of services to be provided to the fund under the interim contract will be at least equivalent to the scope and quality of services provided under the previous contract;

(iv) The interim contract provides that the fund's board of directors or a majority of the fund's outstanding voting securities may terminate the contract at any time, without the payment of any penalty, on not more than 10 calendar days' written notice to the investment adviser;

(v) The interim contract contains the same terms and conditions as the previous contract, with the exception of its effective and termination dates, provisions governed by paragraphs (b)(2)(i), (b)(2)(iv), and (b)(2)(vi) of this section, and any other differences in terms and conditions that the board of directors, including a majority of the directors who are not interested persons of the fund, finds to be immaterial; and

(vi) The interim contract contains the following provisions:

(A) The compensation earned under the contract will be held in an interest-bearing escrow account with the fund's custodian or a bank.

(B) If a majority of the fund's outstanding voting securities approve a contract with the investment adviser by the end of the 150–day period, the amount in the escrow account (including interest earned) will be paid to the investment adviser.

(C) If a majority of the fund's outstanding voting securities do not approve a contract with the investment adviser, the investment adviser will be paid, out of the escrow account, the lesser of:

(*1*) Any costs incurred in performing the interim contract (plus interest earned on that amount while in escrow); or

(*2*) The total amount in the escrow account (plus interest earned).

Dated: July 22, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–20088 Filed 7–27–98; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 938

[PA–121–FOR]

Pennsylvania Abandoned Mine Land Reclamation Program

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

ACTION: Proposed rule; reopening of comment period.

SUMMARY: OSM is reopening the public comment period on a proposed amendment to the Pennsylvania Abandoned Mine Land Reclamation (AMLR) Plan (hereinafter referred to as the Pennsylvania Program) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA), 30 U.S.C. 1201 *et seq.*, as amended. The proposed amendment adds a new section ''F'' entitled Government Financed Construction Contracts (GFCC) to authorize the incidental removal of coal at AML sites that would not otherwise be mined and reclaimed under the Title V program. The proposed amendment also includes the Program Requirements and Monitoring Requirements related to the use of GFCC for that purpose. The proposed amendment is intended to improve the efficiency of the Pennsylvania program by allowing the Government-financed construction exemption in Section 528 of SMCRA to be applied in cases involving less than 50% government financing only in the limited situation where the construction constitutes a government approved and administered abandoned mine land reclamation project under Title IV of SMCRA.

DATES: Written comments must be received by 4:00 p.m., [E.D.T.] August 12, 1998.

ADDRESSES: Written comments should be mailed or hand delivered to Robert Biggi, Field Office Director, at the address listed below. Copies of the Pennsylvania program, the proposed amendment, and all written comments received in response to this document will be available for public review at the addresses listed below during normal business hours, Monday through Friday, excluding holidays. Each requester may receive one free copy of the proposed amendment by contacting OSM's Harrisburg Field Office: Mr. Robert J. Biggi, Director, Harrisburg Field Office, Third Floor, Suite 3C, Harrisburg Transportation Center (Amtrack), 415 Market Street, Harrisburg, Pennsylvania 17101. Telephone: (717) 782–4036.

FOR FURTHER INFORMATION CONTACT:

Mr. Robert J. Biggi, Director, Harrisburg Field Office, Third Floor, Suite 3C, Harrisburg Transportation Center (Amtrack) 415 Market Street, Harrisburg, Pennsylvania 17101. Telephone: (717) 782–4036.

SUPPLEMENTARY INFORMATION:

I. Background on the Pennsylvania Program

On July 30, 1982, the Secretary of the Interior conditionally approved the Pennsylvania program. Background on the Pennsylvania program, including the Secretary's findings and the disposition of comments, can be found in the July 30, 1982 **Federal Register** (47 FR 33079). Subsequent actions concerning the AMLR program amendments are identified at 30 CFR 938.20 and 938.25.