January 8, 2004

BY ELECTRONIC MAIL

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-20-03

Dear Mr. Katz:

On behalf of Fund Democracy,[1] and the Consumer Federation of America,[2] we welcome this opportunity to comment on the Securities and Exchange Commission's proposal to permit an adviser to serve as subadviser to an investment company ("fund") without shareholder approval.[3] This letter incorporates by reference the Memorandum in Support of Hearing Request ("Multi-Manager Memorandum") filed with the Commission on March 5, 2001.[4]

While Fund Democracy and the Consumer Federation of America support the premise underlying proposed Rule 15a-5, we must oppose the proposed rule as written on the ground that it inappropriately strips shareholders of their statutory voting rights, exceeds the Commission's exemptive authority, and permits misleading disclosure by funds and self-dealing by fund advisers.

We strongly support the Commission's proposal to spare shareholders the unnecessary expense of approving subadvisers of funds that employ multiple subadvisers to manage the fund's assets ("multi-manager funds"). When shareholders choose to invest in a *bona fide* multi-manager fund, they are effectively delegating decisions regarding the identity of the entity that manages the fund's portfolio to a primary adviser. Requiring

---

[1] Fund Democracy, a nonprofit membership organization, provides a voice for mutual fund shareholders by publishing information that targets mutual fund practices, policies and rules that are harmful to fund shareholders and by lobbying for mutual fund reform. Fund Democracy appreciates the assistance Milo Mitchel in the preparation of this letter.

[2] The Consumer Federation of America is a nonprofit association of 300 consumer groups, representing more than 50 million Americans, that was established in 1968 to advance the consumer interest through research, education, and advocacy.

[3] Exemption from Shareholder Approval for Certain Subadvisory Contracts, Investment Company Act Rel. No. 26230 (Oct. 23, 2003) (proposing new rule 15a-5) ("Proposing Release").

[4] The Multi-Manager Memorandum is available at: http://www.funddemocracy.com/Supporting%20Memorandum.pdf.

shareholder approval in every instance in which a new subadviser is hired by the primary adviser of a multi-manager fund is inconsistent with shareholders' intent and causes the fund and its shareholders to incur unnecessary costs.

Proposed Rule 15a-5, however, extends far beyond the limited circumstances described immediately above. The rule would permit funds that are not *bona fide* multi-manager funds to circumvent shareholder voting requirements. This aspect of the rule is contrary to shareholders' best interests and exceeds the agency's rulemaking authority. The rule permits self-dealing by a primary adviser by permitting it to increase its fee without shareholder approval. Finally, the rule permits funds to mislead shareholders by using the name of the subadviser in the name of the fund and by failing to require adequate disclosure of the relative roles of the primary adviser and the subadviser.

The most disturbing aspect of the rule is that it would permit any fund – not just funds that have obtained specific exemptions – to engage in the same kinds of abuses that have been permitted under existing multi-manager exemptions for almost a decade. Proposed Rule 15a-5 would permit the same kinds of self-dealing and misleading disclosure by fund advisers that are at the core of the abuses that have been uncovered in the ongoing mutual fund investigations. To respond to the most damaging scandal in the history of the fund industry with a rule that facilitates further abuses suggests a continuing disregard by the Commission for the welfare of mutual fund shareholders.

Such disregard for shareholders' interests is further reflected in the Commission's consideration of prior objections to the conditions under which multi-manager exemptions have been granted. Institutional Shareholder Services ("ISS")[5] and Fund Democracy previously requested that the SEC hold a hearing to address these concerns,[6] but the Commission declined the requests without resolving the substantive issues they raised.[7] When this decision was appealed, the Commission again declined to address the substantive issues raised in the hearing request, choosing instead to seek dismissal on jurisdictional grounds.[8] The Proposing Release nowhere even acknowledges the hearing

[5] The ISS is the world's leading provider of proxy voting and corporate governance services. Its 185-person staff serves more than 950 institutional and corporate clients worldwide. ISS analysts research and recommend votes for 20,000 shareholder meetings each year on behalf of 10,000 U.S. and 12,000 non-U.S. institutional shareholders.

[6] Letters from Mercer Bullard, Founder and CEO, Fund Democracy, LLC to Jonathan Katz, Secretary, Securities and Exchange Commission (Mar. 5, 2001) (Fund Democracy, LLC is the predecessor to Fund Democracy, Inc.), and Erin McNally, Senior Mutual Fund Analyst, Institutional Shareholder Services to Jonathan Katz, Secretary, Securities and Exchange Commission (Mar. 5, 2001).

[7] In the Matter of Hillview Investment Trust, Investment Company Act Rel. No. 25055 (June 29, 2001); see also Statement of Issues, Fund Democracy, LLC v. U.S. Securities and Exchange Commission, File No. 01-1367 (Sep. 21, 2001) (noting inadequate basis of denial of hearing request).

[8] The Commission avoided addressing the substantive issues on appeal to the U.S. Court of Appeals for the District of Columbia by challenging Fund Democracy's Article III standing. See Fund Democracy, LLC v. SEC, 278 F.3d 21 (D.C.Cir. 2001). Subsequent to the Court's decision in that case, Fund Democracy converted to a nonprofit membership organization, the members of which include: the AFL-CIO, Consumer Federation of America, Consumers Union, Financial Planning Association, National Association

requests,[9] and, as discussed in this letter, proposed Rule 15a-5 does not resolve the problems that the hearing requests identified and documented.

These problems are not theoretical; dozens of funds have abused the multi-manager structure for years. As discussed in Part A.1.a, multi-manager funds have routinely employed a single subadviser for years on end, effectively acting as traditional single manager funds where an outside firm, typically an insurance company, has insinuated itself into the advisory relationship in order to claim a share of the fund's management fee. This layering of fees offers no benefits to investors when the primary adviser provides no *bona fide* services other than a more expensive shell through which investors can buy the subadviser's services.

Part A.1.b discusses multi-manager funds that have given greater prominence in fund documents to the subadviser than to the primary adviser, thereby misleading investors as to the true sponsor of the fund in which they are investing. This practice contradicts the conditions under which multi-manager exemptions have been granted, yet the Commission has taken no action to address this abuse.

Multi-manager funds have frequently exacerbated misleading fund disclosure by including the name of the subadviser in the name of the fund, as discussed in Part A.1.b. This practice strongly suggests that the subadviser is the sponsor of the fund. Also including the name of the primary adviser in the name of the fund, as suggested by the Commission, does nothing to mitigate the inevitable impression that the subadviser is at least a co-sponsor of the fund. This is a false, misleading impression that is designed to use the subadviser's name to attract investors to a fund over which the subadviser has no authority and that is actually sponsored by another entity.

Finally, primary advisers have used the multi-manager structure to engage in self-dealing through unauthorized fee increases. In a conventional structure, an adviser cannot increase its fee without shareholder approval. The need for this constraint on an adviser's authority to raise its fee is self-evident, as demonstrated by specific instances described in Part A.1.c in which a primary adviser exploited the multi-manager structure to benefit itself at the expense of fund shareholders. Such self-dealing lies at the heart of the current mutual fund scandal and is further facilitated by proposed Rule 15a-5.

---

of Investors Corporation, National Association of Personal Financial Advisors, U.S. Public Interest Research Group and Zero Alpha Group.

[9] Nor does it appear that the staff considered the administrative history of the multi-manager exemption, or consulted any shareholder representatives, in developing the present proposal. For example, the proposing release's discussion of the costs and benefits of the new rule references discussions with fund representatives, yet there does not appear to have been any discussions with ISS or any other shareholder representatives, notwithstanding that the most significant "costs" associated with this proposal is the abrogation of the shareholder's right to approve a fund's subadviser and the increased fees paid by shareholders resulting from primary advisers' pocketing savings from reduced subadvisory fees. Proposing Release at n.79 (citing discussions with fund representatives regarding costs of disclosure associated with proposal's disclosure requirements).

In general, the Commission has for years permitted multi-manager funds that are "multi-manager" only in name. Many multi-manager funds have served primarily as a means whereby a firm that specializes in packaging and distribution, but has no advisory expertise, can, in the words of one attorney, get its "mouth under the spigot" of the stream of advisory fees. Proposed Rule 15a-5 would enable a primary adviser to engage in a classic bait-and-switch, whereby a prominent subadviser's reputation is used to attract assets, and then an inferior subadviser is hired at a lower fee, with the primary adviser keeping the profit without providing any additional services. Rather than proposing a rule that will substantially expand the number of fund advisers permitted to engage in longstanding multi-manager abuses, the Commission should use this rulemaking to reform the conditions under which multi-manager exemptions historically have been granted.

These are the same principal issues that were raised in connection with ISS's and Fund Democracy's hearing requests two years ago, but which have been left unaddressed by the Commission. Fund Democracy and the Consumer Federation of America urge the Commission to carefully consider and respond fully to these issues before taking final action on proposed Rule 15a-5.

A. Background

Section 15(a) of the Investment Company Act (the "Act") provides that no person may serve as the investment adviser to a registered investment company except pursuant to a written contract that has been approved by a vote of the majority of the outstanding voting securities of such registered investment company. Shareholder voting rights are triggered both by new advisory contracts and by advisory contracts the terms of which have changed materially, such as by a material increase in the fees paid under the contract.

Proposed Rule 15a-5 would exempt a fund from the requirement to approve a new or amended contract with a subadviser. The rule generally codifies the terms of numerous exemptions granted to funds since 1995.[10]

The first funds to obtain a multi-manager exemption,[11] Frank Russell Investment Company and the Russell Insurance Funds (the "Frank Russell Funds"), were *bona fide* multi-manager funds, all of which employed multiple subadvisers and frequently fired subadvisers and hired replacements. Shareholders who invest in these funds intend that the funds' manager make these decisions. The requirement to obtain shareholder approval of each new subadvisory agreement therefore would impose unnecessary costs

[10] The Commission previously granted multi-manager relief to the Vanguard funds in 1993. The basis for the Vanguard relief was its structure as an internally managed fund complex. This structure avoids the conflicts that arise when a fund is managed by an external investment adviser. See generally, The Vanguard Group, Investment Company Act Release No. 19411, 1993 WL 128766 (Apr. 16, 1993).

[11] For a discussion of the Frank Russell application, see Frank Russell Investment Company, Investment Company Act Release No. 21108, 1995 WL 358131 (June 2, 1995).

and would be inconsistent with shareholders' intent. See Multi-Manager Memorandum at Part A.1.

The exemptions granted to the Frank Russell Funds and subsequent applicants were based on two primary principles. First, the exemptions were conditioned on the applicant's employing a *bona fide* multi-manager structure in which multiple subadvisers were used and the primary adviser actively evaluated the subadvisers on a regular basis. Second, the exemptions were conditioned on the applicant funds being held out as multi-manager funds to ensure that investors understood the respective roles played by the primary manager and the subadvisers, and, in particular, that the subadvisers could be replaced without shareholder approval. See Multi-Manager Memorandum at Part A.2.

1. The Corruption of the Multi-Manager Exemption

Over time, however, the SEC staff abandoned these guiding principles. The staff granted exemptions, on its own authority, to numerous applicants that were not *bona fide* multi-manager funds. These funds virtually never employed more than a single subadviser and rarely changed the subadviser. They also have not held themselves out as *bona fide* multi-manager funds. The primary advisers have engaged in self-dealing by increasing their fees without shareholder approval and without providing any additional services.

a. Multi-manager Funds Have Operated as Single-Manager Funds

A comparison of the operating history of the Frank Russell Funds and 111 other multi-manager funds operated by Equitable and American Skandia illustrates the corruption of the multi-manager exemption.[12]

As shown in Tables 1, 2 & 3 at Attachment A, 108 of the 111 Equitable and American Skandia funds reviewed, or 97%, never had more than one subadviser. The EQ Advisors Trust offers 45 funds, only 3 of which has ever had more than one subadviser. The American Skandia Advisor Funds offers 25 funds, none of which has ever had more than one subadviser. The American Skandia Trust offers 41 funds, none of which has ever had more than one subadviser.

Among these 111 funds, some of which were more than 8 years old when this data was collected, there were only 26 new subadviser hirings and 22 subadviser firings. Ninety-two, or 83 %, of these funds had never changed subadvisers.

The SEC staff has stated that whether an applicant uses a bona fide multi-manager strategy is indicated in part by "the number of sub-advisors employed for each portfolio."

[12] This data was collected as of Fund Democracy's and ISS's initial hearing request on March 5, 2001. See Multi-Manager Memorandum at Part B.

Yet only 3 of the 111 funds had more than 1 subadviser.[13] Only 1 ever had more than 2 subadvisers.

The operating history of these funds could not be more different from that of the Frank Russell Funds. A review of the operating history of 24 Frank Russell Funds, each a series of the Frank Russell Investment Company or the Russell Insurance Fund, as shown in Tables 1 and 2 at Attachment B, evidences a consistent pattern of employing multiple subadvisers and frequently replacing advisers.

The 24 multi-manager funds employ 109 subadvisers. All but 3 of the funds (all money market funds) had at least 2 subadvisers since their inception, and 7 of the 24 funds had 7 or more subadvisers. The funds hired 65 new subadvisers and fired 36 subadvisers from 1996 to 2001. A total of 17 funds, or 71%, changed subadvisers at least once.

As illustrated in the table immediately below, the Equitable and American Skandia funds have made a mockery of the requirement that applicants for multi-manager voting exemptions demonstrate that they have used and will use a *bona fide* multi-manager strategy. Both before and after the funds obtained exemptions, they operated as single-manager funds, with a single, unchanging subadviser making all investment selections.

	Equitable and American Skandia Funds	Frank Russell Funds
Number of Funds	111	24
Funds With More Than One Subadviser At Any Time Since Inception (% of total funds)	19 (3%)	21 (88%)
Average Number of Subadvisers/Fund	1.07	4.54
Average Number of New Subadvisers Hired Per Fund	0.23	2.71
Average Number of Subadvisers Fired Per Fund	0.20	1.46

The retention of a single subadviser year after year is inconsistent with the condition of the multi-manager exemption that requires that the primary adviser "provide general

[13] In the case of one of the three funds, EQ Advisor Trust's Calvert Socially Responsible fund, it is unclear whether the second subadviser actually acts as a subadviser to the fund, rather than merely as a consultant.

management services to each portfolio, . . . and, subject to review and approval by the Board, . . . (ii) select Advisers, (iii) when appropriate, recommend to the Board, the allocation and reallocation of a Portfolio's assets among multiple Advisers, [and] (iv) monitor and evaluate the investment performance of the Advisers."[14]

Indeed, the SEC staff voiced this very suspicion in comments on the Equitable funds' request for multi-manager relief. The Equitable application suggested that the manager might waive its management fee. The staff asked Equitable why it would so if the funds were "receiving economic benefits from the services performed by" Equitable, and expressed concern that Equitable's "willingness [to waive its fee] creates the impression that it is not performing meaningful services for the" fund.[15] The staff's concern has been borne out by the Equitable funds' static, single-subadviser structure.

b. Multi-manager Funds Have Not Held Themselves Out To The Public As Multi-manager Funds

Multi-manager funds also have disregarded the requirement they hold themselves out as multi-manager funds, as demonstrated by a review of the Equitable and American Skandia filings at the time of Fund Democracy's and ISS's hearing request.[16]

For example, the prospectuses for funds offered by the EQ Advisors Trust give far greater prominence to the subadvisers than to Equitable, the funds' purported manager. The Trust's subadvisers are discussed in the prospectus's description of each fund, beginning on page 19, whereas there is no discussion of Equitable's management role, investment strategy, or personnel anywhere in the prospectus.

The discussion of Equitable as the fund manager, which does not appear until page 94 of the prospectus, merely (1) states that Equitable is a subsidiary of AXA Financial, Inc., (2) explains that the voting exemption gives it the authority to hire and enter into agreements with subadvisers without shareholder approval, and (3) describes Equitable's role as follows:

> The Manager also monitors each Adviser's investment program and results, reviews brokerage matters, and carries out the directives of the Board of Trustees. The Manager also supervises the provision of services by third parties such as the Trust's custodian.

In contrast, the description of the subadvisers, placed much earlier in the prospectus from pages 19 to 87, typically provides a description of the subadviser's experience in

[14] EQ Advisors Trust and EQ Financial Consultants, Inc., Investment Company Act Release No. 23093 (Mar. 30, 1998) (condition number 7).

[15] Letter from Brian Hourihan to Jane Kanter (Mar. 7, 1997).

[16] Supra note 6.

investment management, the amount of its assets under management, and the names and professional experience of the individual portfolio managers.

The American Skandia funds give even greater prominence to the funds' subadvisers. In the first 15 pages of the prospectus, the "principal investment strategies" of each fund are described. These descriptions typically include a discussion of the subadviser's investment strategy. They include no discussion of American Skandia. American Skandia's management role, investment strategy, and personnel are not described anywhere in the prospectus.

In fact, the discussion of American Skandia's role and the multi-manager exemption are buried deep in the prospectus, and provides only the following:

> The Investment Manager is responsible for monitoring the activities of the Sub-advisors it engages to manage the Non-Feeder Funds and Portfolios and reporting on such activities to the Directors of the Company or the Trustees of the Trust. The Investment Manager must also provide, or obtain and supervise, the executive, administrative, accounting, custody, transfer agent and shareholder servicing services that are deemed advisable by the Directors or the Trustees.

In contrast, the description of the subadvisers that immediately follows the description of Skandia's role typically includes the subadviser's experience in investment management, the amount of its assets under management, and the name and experience of the individual portfolio managers.

Not only are the Equitable and American prospectuses inconsistent with the multi-manager operating structure, they also may violate the conditions of their exemptive orders.

The American Skandia prospectuses do not refer to the manager's responsibility for hiring and negotiating contracts with subadvisers until deep into the document, notwithstanding the exemptive order condition requiring that this be disclosed "prominently."

The Equitable and American Skandia prospectuses also fail to "hold [the funds] out to the public as employing the management structure described in the application." They give greater prominence to the subadviser's role than to their own, and provide no discussion of their multi-manager philosophy.

The disclosure in the Equitable and American Skandia prospectuses exposes the funds for what they are: conventional single-manager funds operating under the protection of an SEC multi-manager voting exemption. The funds are, in fact, nothing more than conventional single-manager funds where an insurance company has interposed itself between the fund and its true investment adviser. The subadvisers are the entities to

which shareholders should look for the funds' performance -- not Equitable or American Skandia.

Furthermore, Equitable and American Skandia have flouted the "holding out" requirement by offering at least 107 funds that include the full name of the subadviser in the name of the fund, notwithstanding the SEC staff's once-held view that this practice is "inconsistent with the fundamental concept on which multi-manager applications have been premised."[17]

Most of the Equitable fund names include no reference to Equitable; others include the appellation "EQ." Similarly, the American Skandia funds include the oblique "ASAF" and "AST" tags.

The use of a subadviser's name in the name of a multi-manager is misleading to investors. This practice strongly suggests that, as with any single-manager fund, investors will have the right to choose a replacement for the subadviser. Rather, this right has been usurped by entities enigmatically identified as in the funds' names as "EQ," "ASAF," and "AST."

The Frank Russell prospectus sends exactly the opposite message from that trumpeted by the Equitable and American Skandia prospectuses: shareholders should look to the manager -- Frank Russell -- as the entity responsible for the funds' performance. The Frank Russell prospectuses includes extensive discussions of Frank Russell's multi-manager philosophy and management role, and provides the names and experience of individual Frank Russell managers. The subadvisers are listed only on the last page of the prospectus, and only their names and addresses are provided. Naturally, no Frank Russell fund uses the name of a subadviser in the name of any Frank Russell fund.

c. Multi-manager Funds Have Used the Exemption to Increase Their Fees

An unappreciated, but significant effect of the multi-manager voting exemption is that it permits managers to increase their fees without shareholder approval. A multi-manager's manager can approve subadviser contracts, including reductions in subadviser fees, and pocket the savings, despite the fact that the change in the subadviser may have no effect on the manager's responsibilities.

A fund manager that pays subadvisers' fees out of its own pocket has a conflict of interest regarding the negotiation of the subadviser's fee. The manager has an incentive to negotiate the lowest possible fee, even if the result may be lower quality or fewer services provided by the subadviser, because the manager retains any excess compensation. In the absence of the multi-manager voting exemption, the manager would have to obtain shareholder approval of such an increase in its own fee.

[17] Supra note 15.

American Skandia exploited this loophole when it replaced subadvisers for eight multi-manager funds in 2000. As a result, Skandia stood to collect, on a net basis, $342,000 more annually as a result of changes in subadviser fees, based on the funds' asset sizes on the date the new fees went into effect and assuming no growth in fund assets.

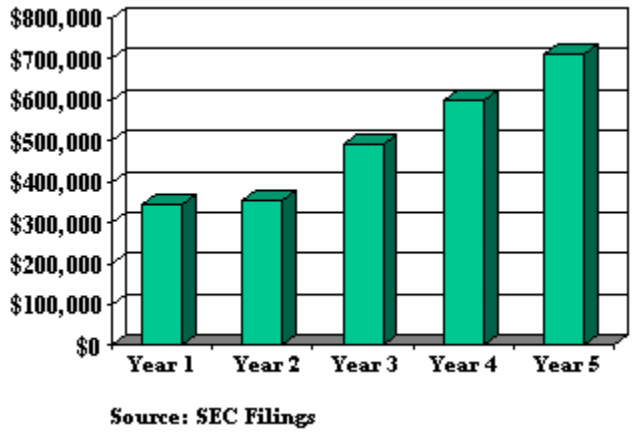
When American Skandia replaced Lord Abbett with Alliance Capital as the subadviser to the ASAF Alliance Growth and Income and AST Growth and Income funds, it reduced the subadviser's fee from 0.50% of fund assets to 0.30% of fund assets. As a result, Skandia saved itself approximately $377,000 annually that it would have paid Lord Abbett.

When American Skandia replaced T. Rowe Price with American Century as the subadviser of the ASAF American Century International Growth Fund and the AST American Century Growth Fund, it also reduced the subadviser's fee, resulting in annual savings for Skandia – but not the funds' shareholders – of approximately $93,000.

For four other funds, fees paid to subadviser replacements increased, which in the aggregate reduced American Skandia's take by approximately $128,000. But one of these reductions will turn into an increase for Skandia as the fund grows.

As a result of American Skandia's replacement of Bankers Trust with Sanford Bernstein as the subadviser of the ASAF Index 500 and AST Index 500 funds, Skandia must pay $66,000 more to Bernstein. But if the funds' assets grow to a combined $300 million, Skandia will pay about $50,000 less annually to Bernstein than it would have paid to Bankers Trust. When the funds' assets reach $1 billion, Skandia will pay Bernstein about $260,000 less annually.

If one assumes similar increases in all eight funds over five years, the net gain to American Skandia will be approximately $2.5 million over that period. The annual net fee increase for Skandia is shown in the chart below.



Source: SEC Filings

American Skandia has argued that it needs to be able to increase or reduce its share of the fund's advisory fee to reflect changes in the allocation of responsibilities between the manager and the subadviser.[18]

This argument fails for two reasons.

First, under a *bona fide* multi-manager structure, shifts in responsibilities that warrant a reallocation of fees between the manager and the funds' subadvisers are unlikely. Under a *bona fide* multi-manager structure, such as the structure used by Frank Russell, a fund would typically employ three or more subadvisers. In this situation, the manager would not allocate its responsibilities differently depending on its contract with each subadviser. Rather, the subadviser would assume a standard set of responsibilities, and be paid a fee according to those duties. Minor changes in the scope of these duties should not necessitate an increase in its advisory fee.

Second, to the extent that major changes in the manager's duties occur, they should be, as Congress intended, subject to a shareholder vote. A fund manager has a strong incentive to reduce subadviser fees, thereby giving itself a raise in return for no or merely nominal additional work. Congress required shareholder approval of advisory contracts to mitigate exactly this conflict of interest.

B. Discussion

We oppose Rule 15a-5 because it strips shareholders of their statutory right to vote on the fund's subadvisory contracts regardless of whether the funds have: (1) ever employed more than one subadviser or hired a new subadviser, (2) properly disclosed the relative roles of the primary adviser and the subadvisers, (3) included the name of the subadviser in the name of the fund, (4) used the rule to facilitate self-dealing in the form of unauthorized increases in the primary adviser's fee. Each of these issues is addressed separately below.

1. Rule 15a-5 Should be Limited to *Bona Fide* Multi-Manager Funds

Rule 15a-5 should be available only to *bona fide* multi-manager funds. The purpose of the rule is to relieve multi-manager funds of the cost of approving new subadvisory contracts.[19] If a fund never has more than one subadviser and never or rarely changes the subadviser, the small risk that the cost of a proxy vote will be incurred is not a sufficient basis for stripping shareholders of their statutory voting rights. See Multi-Manager Memorandum at Part C.1.a. Indeed, such a fund effectively functions as a traditional

[18] Conversation between Mercer Bullard and Christian Thwaites, Senior Vice President, American Skandia, on February 6, 2001.

[19] The argument that Rule 15a-5 is needed to avoid delays in replacing subadvisers is unfounded. Rule 15a-4 under the Investment Company Act provides that a new adviser or subadviser to a fund generally may serve under an interim contract for up to 150 days without shareholder approval. This permits a primary adviser to hire a new subadviser with no delay. The 150-day period then provides ample time to obtain shareholder approval of the new subadviser. See Multi-Manager Memorandum at Part C.1.b.

fund where one adviser – the subadviser – makes all of the investment decisions year after year, with shareholders looking to the subadviser as the party ultimately responsible for the fund's performance. The discussion in Part A.2.a above provides specific examples of this problem, and these examples are by no means limited to Equitable and American Skandia funds.

Further, Rule 15a-5 exceeds the Commission's exemptive authority, as it effectively repeals the provision – Section 15(a) – to which the exemption applies. See Multi-Manager Memorandum at Part C.2.b. Section 15(a) expressly requires that a contract with an "investment adviser of a registered investment company" be approved by shareholders. The definition of "investment adviser of a registered investment company" in Section 2(a)(20) of the Act has two parts. Part (A) refers to a person who "regularly furnishes advice" to the fund pursuant to a contract with the fund. Id. Part (B) refers to a person who "regularly performs substantially all of the duties undertaken by" a person described in Part (A) pursuant to a contract with that person. Id. Thus, Congress separately identified subadvisers – persons who manage fund assets pursuant to a contract with the fund's primary adviser – as persons whose contracts required shareholder approval.

Rule 15a-5, however, undermines Congress's intent by effectively repealing Section 15(a) as applied to subadvisers. If any fund, the investments of which are selected by a single subadviser, can qualify for the exemption, then there is no circumstance in which Section 15(a)'s shareholder vote requirement as applied to subadvisers remains inviolate. While Congress's grant of exemptive authority is broad, Congress could not have intended to authorize the Commission permit to effectively repeal section 15(a) as applied to subadvisory contracts.

The Commission should revise proposed rule 15a-5 to require that multi-manager funds use at least two subadvisers. If only two subadvisers are used and one or both are terminated, the fund should have a grace period of three or six months during which it can have fewer than two subadvisers provided that it is actively seeking replacements. Otherwise, shareholders should have the right to approve the subadviser.

2. Rule 15a-5 Should Require Appropriate Disclosure of the Roles of the Primary Adviser and Subadvisers

Proposed Rule 15a-5 provides insufficient assurances that funds will adequately disclose the relative roles of the primary adviser and subadvisers. The Commission has required as a condition of multi-manager exemptions that:

> Each portfolio will disclose in its prospectus the existence, substance, and effect on the order. In addition, each portfolio will hold itself out to the public as employing the management structure described in the application. The prospectus will prominently disclose that the manager has ultimate responsibility to oversee

> [subadvisers] and recommend their hiring, termination, and replacement.[20]

In contrast, proposed Rule 15a-5 and the accompanying amendments to the instructions to Form N-1A would require only that subadvisers may be retained without shareholder approval, and that this structure be treated as a principal investment strategy.

These requirements are inadequate because they fail to address the way in which the roles of the primary adviser and subadvisers are presented in the fund's prospectus.[21] Existing multi-manager funds have routinely given as great or greater prominence to the subadviser(s) than to the primary adviser. See Multi-Manager Memorandum at Part B.2. This practice is inherently misleading and inconsistent with the multi-manager structure, which is premised on shareholders' looking to the primary adviser as the party ultimately responsible for the fund's investments. The discussion in Part A.1a above provides concrete examples of how investors are misled by disclosures permitted under multi-manager exemptions.

The Commission should require that the primary adviser be given greater prominence than the subadvisers. This could be partly accomplished by requiring that the prospectus describe the process whereby the primary adviser evaluates subadvisers and the basis on which it recommends their hiring or termination. At a minimum, descriptions of the subadvisers should be presented in a format that makes it clear that their role is secondary to that of the primary adviser. The Commission should consider requiring that most information about subadvisers be moved in the Statement of Additional Information.

3. Rule 15a-5 Should Prohibit Multi-Manager Funds From Using Misleading Names

Proposed Rule 15a-5 would prohibit a fund from using a subadviser's name in the name of the fund unless the primary adviser's name was also included in the name of the fund. As argued in the Multi-Manager Memorandum, including the name of subadviser in the name of a fund is inherently misleading and inconsistent with the basis for the exemption. See Parts A.1, B.2 & C.2.a.i. This is no less true when the primary adviser's name is also included in the name of the fund.

The Commission itself has recognized that including a subadviser's name in the name of a multi-manager fund is inconsistent with the multi-manager exemption. The staff has reasoned that including the subadviser's name in the fund's name:

---

[20] EQ Advisors Trust and EQ Financial Consultants, Inc., Investment Company Act Release No. 23093 (Mar. 30, 1998).

[21] For example, the Proposing Release states that the proposed disclosure requirements "will not permit investors to understand the benefits obtained by a principal adviser that negotiates lower subadvisory fees." Part A.1. It seems self-evident that disclosure that "will not permit" understanding by investors is not adequate disclosure.

> suggests that investors should not rely on the manager, but rather on the [subadviser] whose name is part of the [fund's] name. This is inconsistent with the fundamental concept on which multi-manager applications have been premised. The Division is unwilling to support the requested relief if a [subadviser's] name is included in the name of the [fund].[22]

The staff even stated that it would require that the fund amend its prospectus and remove the name of the subadviser from the fund's name before the fund relied on the exemptive order.[23]

Authorizing multi-manager funds to include the name of the subadviser in the name of the fund is inherently misleading. A shareholder who invests in a fund that includes a subadviser's name is likely to believe that the fund is part of that subadviser's family. The Commission concedes that a "fund name that includes the name of the subadviser might serve to invite investors to invest in the fund to obtain the advisory services of the subadviser." Proposing Release at Part A.5. Nonetheless, as discussed above in Part A.1.b, the SEC staff has permitted dozens of multi-manager funds to include the name of the subadviser in the name of the fund.

There is no reason to believe that including the primary adviser's name in the fund's name will allay investors' likely confusion.[24] Rather, investors will logically conclude – as intended by the primary manager[25] -- that the fund is being run by both entities, when in fact the primary adviser's control is predominant and exclusive, albeit obscured.

---

[22] Letter from Brian Hourihan to Jane Kanter (Mar. 7, 1997); see Letter from Christine Greenlees to Robert Zakem (Oct. 9, 1996). The staff noted that "[m]ulti-manager applications have been premised on the fact that the relevant fund is designed so that investors look to the principal adviser, rather than the subadvisers, as the primarily responsible for the fund's investment performance." Id., see also Letters from Mary Kay Frech to Gregg Shulklapper (June 9, 1995); Marc Duffy to William Vastardis (June 9, 1995); Deepak Pai to Karen Balisteri (Dec. 13, 1995); and Kathleen Knisely to Jeremiah Garvey (Feb. 7, 1997).

[23] Supra note 15.

[24] The Commission's only argument in favor of its position is that the "use of a subadviser's name may merely identify one investment option among many in a series fund." Proposing Release at Part A.4. This argument is counterintuitive, as it is premised on the idea that the name of the subadviser may appropriately used not only to name, or identify, a fund, but also to be the characteristic that distinguishes it from other funds. The fact that a subadviser's name may be used to distinguish one multi-manager fund from another militates ***against*** permitting the subadviser's name to be used in the fund's name, as it relies for its effect on the very confusion – an overemphasis on the subadviser's role -- that the Commission seeks to avoid.

[25] There is empirical evidence that fund managers use fund names to manipulate investors and that investors are susceptible to such manipulation. For example, a recent study found that fund managers have routinely changed fund names specifically to generate sales of fund shares. See Michael Cooper, Huseyin Gulen and P. Raghavendra Rau, "Changing Names with Style: Mutual Fund Name Changes and their Effects on Fund Flows (Aug. 2003) at www.mgmt.purdue.edu/faculty/mcooper/ (finding that a year after name changes funds earned average cumulative excess flows of 30%, regardless of whether the fund's style matched that suggested by its name, that could not be attributed to improved performance and suggested that investors respond irrationally to cosmetic changes).

The proposed rule's attempt to mitigate the misleading effect of permitting the subadviser's name in the fund's name is an ill-advised and conceptually indefensible compromise. Either the name of the subadviser will lead investors to believe that they are buying a fund sponsored or co-sponsored by that subadviser, or it won't. Splitting the difference will not make the fund's name any less misleading. **Proposed Rule 15a-5 should prohibit the use of the subadviser's name in the name of the fund.**

4. Rule 15a-5 Should Prohibit Self-Dealing by Primary Advisers Through Unauthorized Fee Increases

Proposed Rule 15a-5 would permit an unaffiliated subadviser to increase or decrease its fee without shareholder approval. As noted above, Section 15(a)'s contract approval requirement is triggered both by the hiring of a new fund adviser and by any increase in the adviser's fee.

Fund Democracy agrees that shareholder approval of increases in subadvisory fees is not necessary when the increase does not affect the aggregate fee paid by shareholders and the subadviser is not affiliated with the primary adviser. When the primary adviser has no direct economic interest in the fee paid to the subadviser, it does not have a conflict of interest with respect to that fee.

In contrast, the primary adviser has a substantial conflict of interest when it reduces a subadviser's fee or hires a replacement subadviser at a lower fee. By negotiating a lower subadvisory fee, the primary adviser can increase its own fee by pocketing the savings. The primary adviser may increase its fee without any concomitant increase in the services it provides, and shareholders may be saddled with an inferior subadviser. Part A.1.c documents a number of examples of a primary adviser exploiting this loophole by raising its at the expense of shareholders.

There is nothing in the nature of a multi-manager fund that necessitates permitting the primary adviser to pocket savings realized from reductions in subadvisory fees. If a primary adviser is able to negotiate a lower subadvisory fee, then the difference should accrue to the shareholders. At a minimum, a primary adviser should be allowed to increase its own fee only after approval by fund shareholders, as Congress required in Section 15(a),

Nor is it consistent with shareholders' intent to exempt a primary adviser's fee increase from shareholder approval. While shareholders of multi-manager funds may intend to delegate to the primary adviser the selection of subadvisers, it does not follow that they intend to delegate to the primary adviser the authority to cut corners and enrich itself by reducing the subadviser's fee.[26]

---

[26] Proposing Release at Part A.1 (conceding that disclosure under the Commission's proposal "will not permit investors to understand the benefits obtained by a principal adviser that negotiates lower subadvisory fees").

The Proposing Release suggests that the Act may protect shareholders against self-dealing by the primary adviser. The Release states that Section 15(c)[27] of the "Act compels a fund board" to protect shareholders, and Section 36(b)[28] of the Act "imposes significant liabilities" on fund boards and advisers, with respect to an adviser's advisory fees. Yet the Commission has never brought an enforcement action under Section 15(c) or targeted a fund's fees in an action under Section 36(b).[29] Further, if these provisions are sufficient to protect shareholders with respect to fee increases resulting from subadvisory fee reductions, then they logically would be just as effective in protecting against increases in the adviser's fee in a non-multi-manager context.[30] The argument that shareholders can rely on fund directors seems particularly inappropriate in the context of the worst scandal in the history of the fund industry and fund directors' stunning failure to protect shareholders against abuses even more egregious than the new abuses that proposed Rule 15a-5 would permit.[31]

If Congress believed that board review provided adequate protection with respect to advisory fees, then it would not also have required that fee increases also be approved by shareholders. **As Congress recognized, an adviser has a conflict of interest when its decision about the amount of a subadviser's fee may increase its own fee. Proposed Rule 15a-5 should be amended to leave intact the current prohibition on such self-dealing by a primary adviser.**

C. Conclusion

As discussed above, Fund Democracy and the Consumer Federation of America support the adoption of a rule that would exempt *bona fide* multi-manager funds from the requirement that shareholders approve subadvisers. We must oppose proposed Rule 15a-5, however, on the grounds that it is overbroad and does not adequately protect investors.

---

[27] Proposing Release at Part A.1. Section 15(c) requires a fund's board to request and evaluate, and the adviser to provide, all information that may be necessary to evaluate the advisory contract.

[28] Proposing Release at Part A.1. Section 36(b) imposes a fiduciary duty on a fund's board and its adviser with respect to fees received by the adviser and authorizes the Commission to bring an action for a violation of this duty).

[29] Section 36(b) also creates a private right of action, but there has never been a case decided in favor of plaintiffs under that provision.

[30] Although the latter case would also involve an increase in the aggregate costs of the fund, it is not Sections 15(c) and 36(b) (or shareholder approval requirements, for that matter) were intended solely to address absolute fund costs, but also the conflict of interest that exists when an adviser has substantial influence over, if not effective control of, the fund and its board, and sets its own fee.

[31] See generally, Patrick McGeehan, Guard Dogs Without Teeth (Nov. 9, 2003) (describing fund directors' failure to uncover frauds underlying mutual fund scandal).

As documented in this letter, multi-manager exemptions have been abused for years, yet Proposed Rule 15a-5 does nothing to address these problems. The parallels to the current mutual fund scandal are disturbing. The frauds underlying the scandal developed partly because the Commission did not take action against known problems in the fund industry.[32] The history of multi-manager funds again demonstrates a history of abuse that has been actively ignored by the Commission, as illustrated by the Commission's dismissive response to Fund Democracy's and ISS's original hearing request, and the Proposing Release's omission of any reference to those requests or to the substantial data and analysis collected and presented to the Commission in connection with those requests. Permitting the kinds of abuses that would be facilitated by proposed Rule 15a-5 sends a message to the fund industry that abusive practices will continue to be tolerated. If the Commission does not stop multi-manager abuses now, this structure and the abuse of shareholders will continue to expand until more drastic action becomes necessary.

The proposed rule's permissive position on unauthorized fee increases and misleading fund names is of particular concern. The unauthorized fee increases that proposed Rule 15a-5 would facilitate represent precisely the kind of self-dealing that the Investment Company Act was enacted to address. The use of a subadviser's name in the name of a multi-manager is inherently misleading and cannot be reconciled with the basis for the exemption. Proposed Rule 15a-5 will only serve to make these abuses more common by obviating the need for funds wishing to exploit the multi-manager structure to obtain an individual exemption. At a time when state and federal investigations are exposing a stunning variety of fraudulent practices throughout the fund industry, the Commission should be focusing its energies on protecting shareholders, not facilitating abusive practices.

We strongly urge the Commission to amend proposed Rule 15a-5 to prohibit these practices.

* * * * * * * * * *

[32] Mercer Bullard, Investors Deserve an Intolerant SEC, TheStreet.com (Sep. 8, 2003). The Commission has testified that it did not even inspect funds for late trading or market timing. Testimony of William H. Donaldson before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (Nov. 18, 2003) (oral statements).

Respectfully submitted,

Mercer Bullard
Founder & President
Fund Democracy

Barbara Roper
Director of Investor Protection
Consumer Federation of America

cc (U.S. mail only):

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, Esq.
Robert E. Plaze, Esq.
Susan Nash, Esq.

ATTACHMENT A
TABLE 1
EQ ADVISORS TRUST

EQ Advisors Trust: Fund Names	Number of Subadviser Changes Since Inception of Fund	Highest Number of Subadvisers Since Inception of Fund
T. Rowe Price International Stock	0	1
T. Rowe Price Equity Income	0	1
EQ/Putnam Growth & Income Value	0	1
EQ/Putnam International Equity	0	1
EQ/Putnam Investors Growth	0	1
EQ/Putnam Balanced	0	1
MFS Research	0	1
MFS Emerging Growth Companies	0	1
MFS Growth with Income	0	1
Morgan Stanley Emerging Markets Equity	0	1
Warburg Pincus Small Company Value	0	1
Mercury World Strategy	0	1
Mercury Basic Value Equity	0	1
Lazard Small Cap Value	0	1
Lazard Large Cap Value	0	1
JP Morgan Core Bond	0	1
BT Small Company Index	0	1
BT International Equity Index	0	1
BT Equity 500 Index	0	1
EQ/Evergreen Foundation	0	1
EQ/Evergreen	0	1
Calvert Socially Responsible	0	2
Capital Guardian Research	0	1
Capital Guardian U.S. Equity	0	1
Capital Guardian International	0	1
EQ/AXP New Dimensions	0	1
EQ/AXP Strategy Aggressive	0	1
EQ/Janus Large Cap Growth	0	1
Alliance Common Stock	0	1
Alliance Conservative Investors	0	1
Alliance Equity Index	0	1
EQ/Mid Cap	0	1
Alliance Global	0	1
Alliance Growth and Income	0	1
Alliance Growth Investors	0	1
Alliance High Yield	0	1
Alliance Intermediate Government Securities	0	1
Alliance International	0	1
Alliance Money Market	0	1
Alliance Quality Bond	0	1
Alliance Small Cap Growth	0	1
EQ/Aggressive Stock	1	2
EQ/Balanced	3	4
EQ/Alliance Premier Growth	0	1
EQ/Alliance Technology	0	1

ATTACHMENT A
TABLE 2
AMERICAN SKANDIA ADVISOR FUNDS

American Skandia Advisor Funds	Number of Subadviser Changes Since Inception of Fund	Highest Number of Subadvisers Since Inception of Fund
ASAF Founders International Small Capitalization Fund	0	1
ASAF American Century International Growth Fund	1	1
ASAF Janus Small-Cap Growth Fund	1	1
ASAF T. Rowe Price Small Company Value Fund	0	1
ASAF Janus Capital Growth Fund	0	1
ASAF Invesco Equity Income Fund	0	1
ASAF American Century Strategic Balanced Fund	0	1
ASAF Federated High Yield Bond Fund	0	1
ASAF Pimco Total Return Bond Fund	0	1
ASAF JPM Money Market Fund	0	1
ASAF Janus Overseas Growth Fund	0	1
ASAF Alliance Growth and Income Fund	1	1
ASAF Neuberger & Berman Mid-Cap Growth Fund	0	1
ASAF Neuberger & Berman Mid-Cap Value Fund	0	1
ASAF Marsico Capital Growth Fund	0	1
ASAF AIM International Equity Fund	0	1
ASAF Sanford Bernstein Managed Index 500 Fund	1	1
ASAF MFS Growth With Income Fund	0	1
ASAF Alliance Growth Fund	2	1
ASAF Kemper Small-Cap Growth Fund	0	1
ASAF Janus Mid-Cap Growth Fund	0	1
ASAF Alger All-Cap Growth Fund	0	1
ASAF Gabelli All-Cap Value Fund	0	1
ASAF Invesco Technology Fund	0	1
ASAF Rydex Managed OTC Fund	0	1

ATTACHMENT A
TABLE 3
AMERICAN SKANDIA TRUST

American Skandia Trust	Number of Subadviser Changes Since Inception of Fund	Highest Number of Subadvisers Since Inception of Fund
AST Founders Passport Portfolio	2	1
AST Scudder Japan Portfolio	0	1
AST AIM International Equity Portfolio	2	1
AST Janus Overseas Growth Portfolio	0	1
AST American Century International Growth Portfolio	0	1
AST American Century International Growth Portfolio II	1	1
AST MFS Global Equity Portfolio	0	1
AST Janus Small-Cap Growth Portfolio	1	1
AST Kemper Small-Cap Growth Portfolio	0	1
AST Federated Aggressive Growth Portfolio	0	1
AST Lord Abbett Small Cap Value Portfolio	0	1
AST Gabelli Small-Cap Value Portfolio	1	1
AST Janus Mid-Cap Growth Portfolio	0	1
AST Alger Mid-Cap Growth Portfolio	0	1
AST Neuberger Berman Mid-Cap Growth Portfolio	0	1
AST Neuberger Berman Mid-Cap Value Portfolio	1	1
AST Alger All-Cap Growth Portfolio	0	1
AST Gabelli All-Cap Value Portfolio	0	1
AST Kinetics Internet Portfolio	0	1
AST T. Rowe Price Natural Resources Portfolio	0	1
AST Alliance Growth Portfolio	2	1
AST MFS Growth Portfolio	0	1
AST Alger Growth Portfolio	0	1
AST Marsico Capital Growth Portfolio	0	1
AST JanCap Growth Portfolio	0	1
AST Janus Strategic Value Portfolio	0	1
AST Cohen & Steers Realty Portfolio	0	1
AST Sanford Bernstein Managed Index 500 Portfolio	1	1
AST American Century Income & Growth Portfolio	1	1
AST Alliance Growth and Income Portfolio	1	1
AST MFS Growth with Income Portfolio	0	1
AST INVESCO Equity Income Portfolio	0	1
AST AIM Balanced Portfolio	2	1
AST American Century Strategic Balanced Portfolio	0	1
AST T. Rowe Price Asset Allocation Portfolio	0	1
AST T. Rowe Price Global Bond Portfolio	1	1
AST Federated High Yield Portfolio	0	1
AST Lord Abbett Bond-Debenture Portfolio	0	1
AST PIMCO Total Return Bond Portfolio	0	1
AST PIMCO Limited Maturity Bond Portfolio	0	1
AST Money Market Portfolio	0	1

ATTACHMENT B
TABLE 1
RUSSELL INSURANCE FUND

Russell Insurance Fund	Number of Subadviser Changes Since Inception of Fund	Highest Number of Subadvisers Since Inception of Fund
Multi-Style Equity	7	7
Aggressive Equity	4	4
Non-U.S.	1	4
Core Bond	0	2
Real Estate Securities	3	3

ATTACHMENT B
TABLE 2
FRANK RUSSELL INVESTMENT COMPANY

Frank Russell Investment Company	Number of Subadviser Changes Since Inception of Fund	Highest Number of Subadvisers Since Inception of Fund
Equity I	9	11
Equity II	2	7
Equity III	2	3
Equity Q	1	4
International Fund	6	8
Fixed Income I	0	3
Fixed Income III	3	4
Money Market	0	1
Diversified Equity	9	11
Special Growth	2	7
Equity Income	2	3
Quantitative Equity	1	4
International Securities	6	8
Real Estate Securities	2	3
Diversified Bond	0	3
Short Term Bond	0	3
Multistrategy Bond	3	4
U.S. Government Money Market	0	1
Tax Free Money Market	0	1