SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 240, 270 and 274

[Release Nos. 33–7754; 34–42007; IC–24082; File No. S7–23–99]

RIN 3235–AH75

Role of Independent Directors of Investment Companies

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is publishing for comment proposed amendments to certain exemptive rules under the Investment Company Act of 1940 to require that, for investment companies that rely on those rules: independent directors constitute at least a majority of their board of directors; independent directors select and nominate other independent directors; and any legal counsel for the independent directors be an independent legal counsel. We also are proposing amendments to our rules and forms to improve the disclosure that investment companies provide about their directors. These proposed amendments are designed to enhance the independence and effectiveness of boards of directors of investment companies and to better enable investors to assess the independence of directors.

DATES: Comments must be received on or before January 28, 2000.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0609. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–23–99; 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, N.W., Washington, D.C. 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: For information regarding the proposed substantive rule amendments, contact Jennifer B. McHugh, Attorney, Office of Regulatory Policy, (202) 942–0690, or regarding the disclosure amendments, contact Annette M. Capretta, Senior Counsel, or Heather A. Seidel, Senior Counsel, Office of Disclosure Regulation, (202) 942–0721, at the Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the ''Commission'') today is proposing for public comment new rules 2a19–3 [17 CFR 270.2a19–3], 10e–1 [17 CFR 270.10e–1], and 32a–4 [17 CFR 270.32a–4] and amendments to rules 0–1 [17 CFR 270.0–1], 2a19–1 [17 CFR 270.2a19–1], 10f–3 [17 CFR 270.10f–3], 12b–1 [17 CFR 270.12b–1], 15a–4 [17 CFR 270.15a–4], 17a–7 [17 CFR 270.17a–7], 17a–8 [17 CFR 270.17a–8], 17d–1 [17 CFR 270.17d–1], 17e–1 [17 CFR 270.17e–1], 17g–1 [17 CFR 270.17g–1], 18f–3 [17 CFR 270.18f–3], 23c–3 [17 CFR 270.23c–3], 30d–1 [17 CFR 270.30d–1], 30d–2 [17 CFR 270.30d–2], and 31a–2 [17 CFR 270.31a–2] under the Investment Company Act of 1940 [15 U.S.C. 80a] (''Investment Company Act'' or ''Act''); amendments to Forms N–1A [17 CFR 274.11A], N–2 [17 CFR 274.11a–1], and N–3 [17 CFR 274.11b] under the Investment Company Act and the Securities Act of 1933 [15 U.S.C. 77a–aa] (''Securities Act''); and amendments to Schedule 14A [17 CFR 240.14a–101] under the Securities Exchange Act of 1934 [15 U.S.C. 78a–mm] (''Exchange Act'').

Table of Contents

Executive Summary

The board of directors of an investment company (''fund'') has significant responsibilities to protect investors under state law, the Investment Company Act, and many of our exemptive rules. Independent directors, in particular, serve as ''independent watchdogs,'' guarding investor interests. These interests are paramount, for it is investors who own the funds and for whose benefit they must be operated.

We recently hosted a Roundtable on the Role of Independent Investment Company Directors, which highlighted the significance of those directors in protecting the interests of fund shareholders. After reviewing corporate governance issues and the recommendations of participants at our Roundtable, we are proposing a number of rule and form changes to enhance the independence and effectiveness of fund boards of directors and provide investors with greater information about fund directors.

First, we are proposing to require that, for funds relying on certain exemptive rules:

- Independent directors constitute either a majority or a super-majority (two-thirds) of the fund's board of directors;
- Independent directors select and nominate other independent directors; and
- Any legal counsel for the fund's independent directors be an independent legal counsel.

Second, we are proposing rules and rule amendments that would:

- Prevent qualified individuals from being unnecessarily disqualified from serving as independent directors;
- Protect independent directors from the costs of legal disputes with fund management;
- Permit us to monitor the independence of directors by requiring

funds to keep records of their assessments of director independence;

- Temporarily suspend the independent director minimum percentage requirements if a fund falls below a required percentage due to an independent director's death or resignation; and
- Exempt funds from the requirement that shareholders ratify or reject the directors' selection of an independent public accountant, if the fund establishes an audit committee composed entirely of independent directors.

Finally, we are proposing to require funds to provide better information about directors, including:

- Basic information about the identity and business experience of directors;
- Fund shares owned by directors;
- Information about directors' potential conflicts of interest; and
- The board's role in governing the fund's operations.

In addition, today we are publishing a companion release that sets forth the views of the Commission and the Commission's staff on a number of interpretive matters.[1] This release provides guidance on certain discrete issues related to independent directors.

Together, these initiatives are designed to reaffirm the important role that independent directors play in protecting fund investors, strengthen their hand in dealing with fund management, reinforce their independence, and provide investors with greater information to assess the directors' independence.

I. Background

Today, millions of Americans rely on mutual funds to save and invest for their families' futures.[2] More than 77 million individual investors own shares of mutual funds, which hold over $5.5 trillion in assets—an increase of over 580 percent from ten years ago.[3] Investments in mutual funds are a significant part of retirement plans and college savings plans, as well as many traditional brokerage accounts.[4] Money market funds, which alone have over $1 trillion in assets,[5] often serve as a substitute for checking accounts and provide an important vehicle for cash management for individual investors as well as many institutions and businesses.[6] International and global funds give investors easy access to foreign markets.[7]

Mutual funds are formed as corporations or business trusts under state law and, like other corporations and trusts, must be operated for the benefit of their shareholders.[8] Mutual funds are unique, however, in that they are ''organized and operated by people whose primary loyalty and pecuniary interest lie outside the enterprise.'' [9] As described below, this ''external management'' of virtually all mutual funds presents inherent conflicts of interest and potential for abuses.

An investment adviser typically organizes a mutual fund and is responsible for its day-to-day operations. The adviser generally provides the seed money, officers, employees, and office space, and usually selects the initial board of directors. In many cases, the investment adviser sponsors several funds that share administrative and distribution systems as part of a ''family of funds.'' As a result of this extensive involvement, and the general absence of shareholder activism, investment advisers typically dominate the funds they advise.[10]

Investment advisers to mutual funds are generally organized as corporations, which have their own shareholders. These shareholders may have an interest in the mutual fund that is quite different from the interests of the fund's shareholders. For example, while fund shareholders ordinarily prefer lower fees (to achieve greater returns), shareholders of the fund's investment adviser might want to maximize profits through higher fees. And while fund shareholders might prefer that advisers use brokers that charge the lowest possible commissions, advisers might prefer to use brokers that are affiliates of the adviser. These types of conflicts (and others) resulted in the pervasive abuses that led Congress in 1940 to enact legislation regulating the activities of mutual funds.[11]

The Investment Company Act establishes a comprehensive regulatory scheme designed to protect fund investors by addressing the conflicts of interest between funds and their investment advisers or other affiliated persons. The Act strictly regulates some of the most serious conflicts. For example, the Act prohibits certain transactions between a fund and its affiliates, including the investment adviser, unless approved by the

---

[1] Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. 24083 (Oct. 14, 1999) [''Interpretive Release''].

[2] For simplicity, this release focuses on mutual funds (*i.e.*, open-end funds). Our proposed rule amendments, however, would apply to all management investment companies, except where noted.

[3] *See* Investment Company Institute, Mutual Fund Fact Book 3 (1999) [''1999 Mutual Fund Fact Book'']. Total assets of mutual funds were $5.525 trillion at the end of 1998, compared to $809.4 billion in 1988. In 1998, an estimated 44 percent of U.S. households owned mutual funds, up from 5.7 percent in 1980 and 24.4 percent in 1988. *Id.* at 45. As of December 31, 1998, an estimated 77.3 million individuals owned shares of mutual funds. *Id.* at 41. At the end of 1998, assets of all funds (open-end funds, closed-end funds, and unit investment trusts) totaled $5.778 trillion. *See id.* at 3 (stating that assets of open-end funds totaled $5.525 trillion at the end of 1998); Lipper Inc., Lipper Closed-End Fund Performance Analysis 1–2 (Jan 1999) (stating that assets of closed-end funds totaled $158 billion at the end of 1998); Investment Company Institute, Release No. 99–36 (stating that assets of unit investment trusts totaled $94.54 billion at the end of 1998).

[4] At the end of 1998, assets totaling approximately $1.9 trillion, or 35 percent of all mutual fund assets, were held in retirement accounts, up from $348 billion at the end of 1991. 1999 Mutual Fund Fact Book, *Supra* note 3, at 47–48; *see also* Jennifer Karchmer, *Planning for Retirement Has Given Mutual Fund Assets a Steady Boost,* Bond Buyer, May 24, 1999, at 6.

[5] At the end of 1998, money market fund assets totaled approximately $1.352 trillion. *See* 1999 Mutual Fund Fact Book, *supra* note 3, at 4.

[6] *See generally* Investment Company Institute, Money Market Mutual Funds (1990).

[7] Assets in funds investing primarily in foreign securities totaled over $448.5 billion at the end of 1998. *See* Investment Company Institute, Release No.99–07 (stating that assets of open-end funds investing primarily in foreign securities totaled $416.5 billion at the end of 1998); Lipper Inc., Lipper Closed-End Fund Performance Analysis—Fourth Quarter 1998 Report (stating that assets of closed-end funds investing primarily in foreign securities totaled $32 billion at the end of 1998).

[8] *See generally* James M. Storey & Thomas M. Clyde, Mutual Fund Law Handbook § 7.2 (1998); Allan S Mostoff & Oliver P. Adler, *Organizing an Investment Company—Structural Considerations* § 2.4 *in* The Investment Company Regulation Deskbook (Amy L. Goodman ed., 1997).

[9] Division of Investment Management, SEC, Protecting Investors; A Half Century of Investment Company Regulation 251 (''1992 Protecting Investors Report''); *see also* 1 Tamar Frankel, Regulation of Money Managers 10 (1978).

[10] *See* SEC. Report on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d. Sess. 12 127, 148 (1966) [''Public Policy Report''] (stating that funds generally are formed by their advisers and remain under their control, and that advisers' influence permeates fund activities); Wharton School of Finance and Commerce, a Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess. 463 (1962) [''Wharton Report''] (discussing the dominant position of advisers in the control of funds and the infrequency with which funds have a separate existence from their advisers); *see also* Clarke Randall, *Fiduciary Duties of Investment Company Directors and Management Companies Under the Investment Company Act of 1940,* 31 Okla. L. Rev. 635, 636 (1978) (''The adviser's control and influence over the fund is very nearly total.''); In the Matter of Steadman Security Corporation, Investment Company Act Release No. 9830 [1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,243, at n.81 (Jun. 29, 1977) (''[T]he investment adviser almost always controls the fund.'').

[11] *See* section 1(b)(2) of the Act [15 U.S.C. 80a–1(b)(2)]; SEC, Report on Investment Trusts and Investment Companies, Part III (1939); *see also Storey & Clyde, supra* note 8, at § 2.2 Joseph F,. Krupsky, *The Role of Investment Company Directors,* 32 Bus. Law. 1733, 1737–40 (1977); William J. Nutt, *A Study of Mutual Fund Independent Directors,* 120 U. PA. L. Rev. 179, 181 (1971).

Commission.[12] The Act also relies on fund boards of directors to police conflicts of interest.

Under state law, directors are generally responsible for the oversight of all of the operations of a mutual fund.[13] In addition, the Investment Company Act assigns many specific responsibilities to fund boards. For example, fund boards must evaluate and approve a fund's advisory contract and any assignment of the contract, and may unilaterally terminate the contract.[14] Directors also approve the fund's principal underwriting contract,[15] select the fund's independent accountant,[16] and value certain securities held by the fund.[17] In addition, under the Act and our rules, directors have responsibility for evaluating the reasonableness of advisory and distribution-related fees charged the fund [18] and managing certain operational conflicts. Just recently, for example, we clarified that boards must assume oversight responsibility for personal securities transactions by employees of the fund and its adviser.[19]

The Act requires that independent directors constitute at least 40 percent of a fund's board,[20] and sets the standards for when a person will be disqualified from being an independent director (*i.e.*, will be considered an ''interested person'' under the Act).[21] These independent directors play an important role in representing and guarding the interests of investors. As has been stated many times, Congress intended these directors to be the ''independent watchdogs'' [22] for investors and to ''supply an independent check on management.'' [23]

Many requirements of the Act and our rules that protect investors from conflicts of interest specifically rely on action by these independent directors. The Act, for example, requires independent directors to separately evaluate and approve the fund's contract with an investment adviser or principal underwriter.[24] Our rules have permitted innovative types of funds, more efficient fund operations, and new distribution arrangements by exempting funds from prohibitions related to conflicts of interest. While these rules have provided important flexibility to allow mutual funds to meet the changing needs of investors, they also rely on approval, oversight, and monitoring by independent directors to protect investors.[25]

Earlier this year we held a two-day public Roundtable discussion on the role of independent directors of mutual funds.[26] Participants in the Roundtable included independent directors, investor advocates, executives of fund advisers, academics, corporate governance experts, and experienced legal counsel. They examined the activities and responsibilities of independent directors and reviewed the nature of their independence. Participants also discussed various ways that the Commission might promote greater effectiveness of independent directors.

We endorse the sentiments of the Roundtable participants who favor enhancing the effectiveness and independence of fund boards of directors. While those sentiments can be fully achieved only through amendments to the Investment Company Act, we are impressed by the consensus of the participants concerning the importance of the role of independent directors and the conditions they believe are necessary to enhance the effectiveness of those directors. We therefore are proposing rule amendments designed to reaffirm the important role that independent directors play in protecting fund investors, strengthen their hand in dealing with fund management, reinforce their independence, and provide investors with better information to assess the independence of directors.

II. Discussion

A. Enhancing the Independence of Fund Boards of Directors

Panelists at our recent Roundtable discussed a number of possible ways to enhance the independence and effectiveness of fund boards. Most participants agreed that independent directors can best fulfill their responsibilities when they constitute a substantial majority of the board.

---

[12] Section 17(a) of the Act [15 U.S.C. 80a–17(a)].

[13] *See* Jean Gleason Stromberg, *Governance of Investment Companies*, *in* The Investment Company Regulation Deskbook §§ 4.1–.2 (Amy L. Goodman, ed. 1997).

[14] *See* section 15(a) of the Act [15 U.S.C. 80a–15a)] (requiring annual approval of the advisory contract by the funds's board of directors or shreholders and requiring that the contract empower the board to terminate the contract); section 15(c) of the Act [15 U.S.C. 80a–15(c)] (requiring that a fund's independent directors separately evaluate and approve any advisory contract with the fund).

[15] *See* Section 15(b) of the Act [15 U.S.C. 80a–15(b)] (requiring approval of the principal underwriting contract by the fund's board or shareholders); section 15(c) of the Act (requiring that a fund's independent directors separately evaluate and approve the fund's contract with its principal underwriter).

[16] *See* section 32(a)(1) of the Act [15 U.S.C. 80a–31(a)(1)] (requiring that a fund's independent directors select the fund's independent public accountant).

[17] *See* section 2(a)(41) of the Act [15 U.S.C. 80a–2(a)(41)] (requiring, in effect, that any security for which no market quotation is readily available be valued at fair value as determined in good faith by the board of directors).

[18] *See* sections 15 (a)–(c) of the Act (board review of fees paid to a fund's adviser and principal underwriter); rule 12b–1 under the Act [17 CFR 270.12b–1] (board review of asset-based distribution fees paid pursuant to a ''rule 12b–1 plan'').

[19] *See* Personal Investment Activities of Investment Company Personnel, Investment Company Act Release No. 23958 (Aug. 20, 1999) [64 FR 46821 (Aug. 27, 1999)] (adopting amendments to rule 17j–1 under the Act [17 CFR 270.17j–1]).

[20] Section 10(a) of the Act [15 U.S.C. 80a-10(a)] (prohibiting more than 60 percent of a fund's directors from being interested persons of the fund). We refer to directors who are not ''interested persons'' of the fund as ''independent directors.'' *See also* section 10(b)(2) of the Act [15 U.S.C. 80a-10(b)(2)] (requiring, in effect, that independent directors comprise a majority of a fund's board if the fund's principal underwriter is an affiliate of the fund's investment adviser); section 15(f)(1) of the Act [15 U.S.C. 80a-15(f)(1)] (providing a safe harbor for the sale of an advisory business if directors who are not interested persons of the investment adviser constitute at least 75 percent of a fund's board for at least three years following the assignment of the advisory contract).

[21] Section 2(a)(19) of the Act [15 U.S.C. 80a–2(a)(19)] (defining ''interested person''); *see infra* note 170 (discussing the elements of the definition of ''interested person'').

[22] *See* Burks v. Lasker, 441 U.S. 471, 484 (1979) (quoting Tannenbaum v. Zeller, 552 F.2d 402, 406 (2d Cir. 1977)).

[23] S. Rep. No. 184, 91st Cong., 2d Sess. 31 (1969).

[24] *See* section 15(c) of the Act.

[25] *See, e.g.*, rule 10f-3 [17 CFR 270.10f-3] (permitting funds to purchase securities in a primary offering when an affiliated broker-dealer is a member of the underwriting syndicate if the fund's board, including a majority of its independent directors, (i) approves procedures regulating purchases of these securities and (ii) determines at least quarterly that the purchases complied with the board-approved procedures). In addition, we have eliminated certain rule provisions that arguably required directors to ''micro-manage'' fund operations. *See* Custody of Investment Company Assets Outside the United States, Investment Company Act Release No. 22658 (May 12, 1997) [62 FR 26923 (May 16, 1997)] (amending rule 17f-5 to permit fund directors to delegate certain responsibilities related to foreign custody arrangements and eliminating the requirement that directors annually review those arrangements); Revision of Certain Annual Review Requirements of Investment Company Boards of Directors, Investment Company Act Release No. 19719 (Sept. 17, 1993) [58 FR 49919 (Sept. 24, 1993)] (eliminating certain annual board review requirements of rules 10f-3, 17a-7, 17e-1, 17f-4, and 22c-1). *See also* Investment Company Institute, SEC No-Action Letter (Jun. 15, 1999) (revising the staff's previous position to permit a fund's adviser, rather than the fund's board, to evaluate the creditworthiness of repurchase agreement counterparties and otherwise assume primary responsibility for monitoring and evaluating the fund's use of repurchase agreements).

[26] *See* SEC, Notice of Sunshine Act Meetings (Feb. 18, 1999) [64 FR 8632 (Feb. 22, 1999)]; *see also* Transcripts from the Roundtable on the Role of Independent Investment Company Directors, February 23–24, 1999 [''Roundtable Transcripts'']. The Roundtable Transcripts are available to the public in the Commission's public reference room and the Commission's Louis Loss Library. They also are available on the Commission's Internet web site <http://www.sec.gov/offices/invmgmt/roundtab.htm>.

Participants also recommended that the selection of new independent directors be entrusted to existing independent directors and that independent directors have independent legal counsel.[27] An industry advisory group organized by the Investment Company Institute recently made similar recommendations in a ''best practices'' report (''ICI Advisory Group Report'').[28]

The recommendations of the Roundtable participants have led us to review our exemptive rules that provide funds and advisers relief from various statutory prohibitions designed to prevent the most egregious conflicts of interest. Roundtable participants repeatedly noted that one of the most important functions of independent directors is to oversee conflicts of interest.[29] Although the rules that we have adopted over the years have expanded the responsibilities of boards, the rules generally do not contain conditions designed to enhance the independence and effectiveness of fund boards, with two notable exceptions.[30]

Upon reflection, and in light of the recommendations of the Roundtable participants, we believe that our exemptive rules that rely on fund boards to approve and oversee arrangements or transactions that involve conflicts of interest and are otherwise prohibited by the Act also should contain provisions designed to enhance director independence and effectiveness. We therefore are proposing amendments to certain exemptive rules under the Investment Company Act to enhance the independence of fund directors who are charged with overseeing the fund's activities and transactions covered by those rules. These amendments would require, for funds that rely (or whose affiliated persons rely) on the rules, that: (i) independent directors constitute either a majority or a super-majority (two-thirds) of their boards; (ii) independent directors select and nominate other independent directors; and (iii) any legal counsel for the independent directors be an independent legal counsel.

Our proposals to enhance board independence would amend ten rules under the Investment Company Act. We have selected those rules that (i) exempt funds or their affiliated persons from provisions of the Act, and (ii) have as a condition the approval or oversight of independent directors. For convenience, we will refer to these rules as the ''Exemptive Rules.'' [31] The Exemptive Rules typically relieve funds from statutory prohibitions that preclude certain types of transactions or arrangements that would involve serious conflicts of interest.[32] In one case, a rule permits the board to approve an interim advisory agreement without a shareholder vote that otherwise would be required.[33] Based on these criteria, we propose to amend the following rules:

- Rule 10f–3 (permitting funds to purchase securities in a primary offering when an affiliated broker-dealer is a member of the underwriting syndicate);
- Rule 12b–1 (permitting use of fund assets to pay distribution expenses);
- Rule 15a–4 (permitting fund boards to approve interim advisory contracts without shareholder approval);
- Rule 17a–7 (permitting securities transactions between a fund and another client of the fund's adviser);
- Rule 17a–8 (permitting mergers between certain affiliated funds);
- Rule 17d–1(d)(7) (permitting funds and their affiliates to purchase joint liability insurance policies);
- Rule 17e–1 (specifying conditions under which funds may pay commissions to affiliated brokers in connection with the sale of securities on an exchange);
- Rule 17g–1(j) (permitting funds to maintain joint insured bonds);
- Rule 18f–3 (permitting funds to issue multiple classes of voting stock); and
- Rule 23c–3 (permitting the operation of interval funds by enabling closed-end funds to repurchase their shares from investors).

The Commission requests comment on the criteria that we have used to select these rules. Are there additional rules that we should similarly amend? Conversely, should any of the Exemptive Rules not be amended?

Although the Commission urges all funds to adopt these measures to strengthen the independence of their boards, we are *not* proposing to require all funds to adopt these measures. Funds that do not rely on any of the Exemptive Rules will not be subject to these requirements. They may continue, for example, to have only 40 percent of their boards consist of independent directors.

As discussed above, an advisory group organized by the Investment Company Institute (''ICI Advisory Group'') has issued a report containing a set of ''best practices'' for ''enhancing a culture of independence and effectiveness'' of fund directors.[34] These best practices generally include some of the practices that our proposed rule amendments would require boards to adopt in order to rely on the Exemptive Rules. We applaud the initiative, but, as the report acknowledges, many of the ''best practices'' may be impracticable or unnecessary for all funds to adopt. Moreover, it may not be appropriate for us to address many of the

---

[27] *See infra* notes 41, 63, and 76 (citing testimony of Roundtable participants). We discuss the merits of each of these recommendations below.

[28] Investment Company Institute, Report of the Advisory Group on Best Practices for Fund Directors: Enhancing A Culture of Independence and Effectiveness (June 24, 1999). On July 7, 1999, the Board of Governors of the Investment Company Institute unanimously endorsed the recommended ''best practices.'' *See* ''ICI Board Adopts Resolution Urging Fund Industry to Strengthen Governance,'' at <http://www.ici.org/issues/dtrs__best__prac.htm>.

[29] *See, e.g.*, Roundtable Transcript of Feb. 24, 1999 at 174 (statement of John C. Coffee, Jr.) (stating that the need for activism by independent directors is most evident in the context of conflicts of interest); *id.* at 197 (statement of Richard M. Phillips) (''[T]he focal point of independent directors is conflicts of interest.'').

[30] Rule 12b–1, one of the exceptions, permits the use of fund assets to pay for distribution of fund shares, but only if the fund's independent directors select and nominate other independent directors. *See* rule 12b–1(c) under the Act [17 CFR 270.12b–1(c)]. In adopting this requirement, we stated our view that ''as a general proposition disinterested directors should not be entrusted with a decision on the use of fund assets for distribution without receiving the benefit of measures designed to enhance their ability to act independently.'' Bearing of Distribution Expenses by Mutual Funds, Investment Company Act Release No. 11414 (Oct. 28, 1980) [45 FR 73898 (Nov. 7, 1980)] [''Rule 12b–1 Adopting Release''], at text following n.50. Rule 23c–3, the other exception, permits the creation of so-called ''interval funds'' (i.e., closed-end funds that periodically offer to repurchase their securities from investors), but only if independent directors constitute a majority of the board, and select and nominate other independent directors. Rule 23c-3(b)(8) under the Act [17 CFR 270.23c–3(b)(8)]. These requirements were included in the rule to ''ensure that the board of directors provides independent decisions or scrutiny for actions or decisions that may involve a conflict of interest between the adviser and [the fund's] shareholders.'' Repurchase Offers by Closed-End Management Investment Companies, Investment Company Act Release No. 19399 (Apr. 7, 1993) [58 FR 19330 (Apr. 14, 1993)] [''Rule 23c–3 Adopting Release''], at Section II.D.

[31] A number of the Exemptive Rules exempt fund affiliates, rather than the fund, from certain statutory prohibitions. For ease of reference, this Release generally refers to *funds* that rely on the Exemptive Rules, rather than reiterating that funds or their affiliated persons may be relying on the rules.

[32] These rules also require boards of funds relying on the rules to exercise vigilance in protecting funds and their investors. *See, e.g.*, Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 22775 (July 31, 1997) [62 FR 42401 (Aug. 7, 1997)], at n.52 and accompanying text (the fund's board should be ''vigilant'' not only in reviewing the fund's compliance with the procedures required by rule 10f–3, but also ''in conducting any additional reviews that it determines are needed to protect the interests of investors'').

[33] *See* rule 15a–4 [17 CFR 270.15a–4]. Under section 15(a) of the Act, shareholders generally must approve a fund's contract with its adviser.

[34] ICI Advisory Group Report, *supra* note 28.

recommendations through rulemaking.[35] Thus, we are not at this time proposing to require that funds relying on the Exemptive Rules follow all of these practices. Nonetheless, we believe that fund boards should give serious consideration to the recommendations of the ICI Advisory Group. We request comment whether we should amend the Exemptive Rules, or other rules, to require funds relying on them to follow any of these ''best practices.'' Commenters who favor any of these practices also should address the benefits and burdens of amending the Exemptive Rules in this manner.

1. Independent Directors as a Majority of the Board

(a) Proposed Board Composition Requirements. We believe that a fund board that has at least a majority of independent directors is better equipped to perform its responsibilities of monitoring potential conflicts of interests and protecting the fund and its shareholders.[36] By virtue of its independence, and its ability to act without the approval of the investment adviser (whose employees often serve as interested, or ''inside,'' directors on fund boards), such a board is better able to exert a strong and independent influence over fund management.[37] This is particularly important in circumstances where the fund's interests conflict with those of the adviser.[38]

Today most, but not all, mutual funds have boards with at least a simple majority of independent directors.[39] When our Division of Investment Management studied mutual fund governance in 1992 it recommended that, as a requirement for all funds, independent directors constitute at least a majority of a fund's board.[40] Many of the Roundtable participants stated that, based on their experience, a fund board generally is more effective if independent directors represent a substantial majority of the board.[41] Similarly, the ICI Advisory Group Report recently endorsed boards having a ''super-majority'' of independent directors. The Report concluded that a *two-thirds* majority of independent directors on a board ''will be more effective than a simple majority in enhancing the authority of independent directors.''[42]

We take the conclusions of the ICI Report as a serious recommendation reflecting the collective experience and wisdom of the Advisory Group, which consisted of prominent members of the mutual fund industry.[43] Although the Report did not address whether Congress or the Commission should adopt a two-thirds majority as a regulatory requirement, it recommended the standard as a ''best practice'' for all funds to consider.[44] It is unclear, however, why a super-majority standard as a ''best practice'' would be appropriate for some fund boards and not others.

A simple majority requirement would permit, under state law, the independent directors to control the ''corporate machinery,'' *i.e.*, to elect officers of the fund, call meetings, solicit proxies, and take other actions without the consent of the adviser. Such a provision would require few funds to change the current composition of their boards, but would bring those that must change into conformity with the better practice. A two-thirds requirement, on the other hand, could change the dynamics of board decision-making in favor of the interests of investors, but may require many funds to change the composition of their boards.

In light of the potential benefits to funds, their boards, and shareholders, we are proposing to amend the Exemptive Rules to require funds relying on them to have boards with *at*

---

[35] In addition, because our rules apply to all funds (or, in the case of the Exemptive Rules, all funds that rely on those rules), we have designed our amendments by considering, among other things, the costs, benefits, and paperwork burdens for funds and investors (including small entities) that may result from the changes. *See, e.g., infra* Section III (cost-benefit analysis); Section IV (Paperwork Reduction Act analysis); Section V (Regulatory Flexibility Act analysis). In each area of consideration, we have requested comment on the costs, benefits, and burdens of the proposed rule amendments.

[36] *See* 1992 Protecting Investors Report, *supra* note 9, at 267 (''[A]n increased measure of independence is necessary to allow independent directors to perform these responsibilities appropriately.''). In the context of business development companies, Congress has recognized that having a majority of independent directors is particularly important ''where board approval is made expressly a substitute for Commission review or for a per se restriction.'' H.R. Rep. No. 1341, 96th Cong., 2d Sess. 25 (1980). *See also* S. Rep. No. 75, 94th Cong., 1st Sess. 71 (1975) (stating that the requirement in section 15(f) that 75 percent of a fund's board consist of directors who are not interested persons of the adviser for three years following the sale of an advisory contract is a ''safeguard [ ] to protect the investment company and its shareholders'').

[37] The original Senate bill that culminated in the Investment Company Act would have required a majority of a fund's directors to be independent from management. *See* S. 3580, 76th Cong., 3d Sess. § 10(a) (1940). That requirement was changed to 40 percent out of concern that a board with an independent majority would repudiate the recommendations of the investment adviser, depriving fund shareholders of those recommendations. *See Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before the House Subcomm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 109–10 (1940) (statement of David Schenker). Experience has shown that this concern was unfounded. *See* 1992 Protecting Investors Report, *supra* note 9, at 267. Rather, we believe that an independent majority enhances board oversight without unnecessarily impeding fund operations or significantly increasing costs.

[38] We expressly recognized this when we adopted rule 23c–3. We included the requirements that independent directors constitute a majority of the board and select and nominate their successors to ''ensure that the board of directors provides independent decisions or scrutiny for actions or decisions that may involve a conflict of interest between the adviser and [fund] shareholders.'' Rule 23c–3 Adopting Release, *supra* note 30; *cf.* Peter Tufano & Matthew Sevick, *Board Structure and Fee-setting in the U.S. Mutual Fund Industry*, J. FIN. ECON. 321, 350 (1997) (''[T]he salutary benefits of * * * a higher fraction of independent directors [on a fund's board] should be *most visible* when management's and shareholders' interests are most at odds.'').

[39] *See* ICI Advisory Group Report, *supra* note 28, at 5 (''The vast majority of fund boards today consist of a majority of independent directors.''); Investment Company Institute, Understanding the Role of Mutual Fund Directors 5 (1998) (noting that most fund boards have a majority of independent directors). In some cases, fund boards have an independent majority in order to comply with certain requirements of the Act and our rules. *See, e.g.*, section 10(b)(2) (requiring, in effect, that independent directors comprise a majority of a fund's board if the fund's principal underwriter is an affiliate of the fund's investment adviser); section 15(f)(1) (providing a safe harbor for the sale of an advisory business if directors independent of the adviser constitute at least 75 percent of a fund's board for at least three years following the assignment of the advisory contract); rule 6e–3(T)(b)(15) [17 CFR 270.6e–3(T)(b)(15)] (exempting certain funds underlying insurance products from various Investment Company Act provisions provided that independent directors constitute a majority of the boards of those funds); rule 23c–3(b)(8) (permitting the operation of interval funds if, among other conditions, independent directors comprise a majority of the board).

[40] *See* 1992 Protecting Investors Report, *supra* note 9, at 267 (Division recommended that Investment Company Act be amended to require that independent directors constitute more than 50 percent of a fund's board); *see also* Wharton Report, *supra* note 10, at 35 (increasing the proportion of unaffiliated directors may enhance the value of those directors as a check on management).

[41] *See* Roundtable Transcript of Feb. 24, 1999 at 241 (statement of Aulana L. Peters) (''My experience * * * dictates that for a board to have a chance of operating truly independently * * * there should be at least two independent [ ] [directors] to one [inside director].''); *id.* at 265 (statement of Gerald C. McDonough) (recommending that fund boards be required to have ''a certain majority, 60, 66 percent, * * * certainly a clear majority of truly independent [directors]''); Roundtable Transcript of Feb. 23, 1999 at 136 (statement of Faith Colish) (endorsing a ''substantial majority'' of independent directors as a positive corporate governance feature for fund boards). *See also* Tufano & Sevick, *supra* note 38 (using empirical analysis to suggest that funds with boards that have a larger fraction of independent directors tend to have lower fees).

[42] *See* ICI Advisory Group Report, *supra* note 28, at 11.

[43] As noted above, the Board of Governors of the ICI also unanimously endorsed the recommendations of the ICI Advisory Group Report. *See supra* note 28.

[44] The Report also noted that, while many funds already have a two-thirds majority of independent directors, the practice is ''far from universal.'' ICI Advisory Group Report, *supra* note 28, at 11.

least a majority of independent directors. Comment is requested on whether we should adopt a simple majority requirement, as the staff recommended in 1992, or the two-thirds super-majority requirement recommended by the ICI Advisory Group Report. We also request comment whether we should adopt an even higher percentage requirement (*e.g.*, 75 percent or 100 percent).[45]

We note that the charters [46] of some funds may contain provisions that require the approval of greater than a majority of a fund's board for some matters, and, in light of our proposed amendments, other funds may amend their charters to provide that a board may act only upon the vote of greater than a simple (or two-thirds) majority of its members. Would the existence of these super-majority voting provisions in fund charters undercut the effectiveness of a board with a majority of independent directors by requiring the consent of the ''inside'' directors and thus, in many cases, give the adviser a veto over board votes? We request comment regarding the prevalence and potential effect of these voting provisions in fund charters.

If we adopt the proposed amendments, we expect to delay the compliance date for one year to allow funds to bring their boards into compliance with the majority independence condition to the Exemptive Rules.[47] As of the compliance date, any fund relying on an Exemptive Rule would be required to have a board with the requisite percentage of independent directors. We request comment on this transition period.

(b) Suspension of Board Composition Requirements. If the death, disqualification, or bona fide resignation of an independent director causes the representation of independent directors on the board to fall below that required under the Investment Company Act, section 10(e) of the Act suspends the percentage requirement for a short time to allow the vacancy to be filled.[48] Under section 10(e), the relevant percentage requirement is suspended for 30 days if the board may fill the vacancy,[49] or for 60 days if the vacancy must be filled by a shareholder vote.[50] Section 10(e) also authorizes the Commission to set a longer period for filling a board vacancy in these circumstances.[51]

In our experience, the time provided by section 10(e) is insufficient for most funds to select and nominate qualified independent director candidates, and, if necessary, hold a shareholder election. Many funds address this problem by avoiding the need to rely on the section—they have a greater percentage of independent directors than is required by the Act. This approach may become more difficult if, as we propose, funds relying on the Exemptive Rules must have a majority or a super-majority of independent directors.[52] Moreover, the consequence of a fund falling below the minimum required percentage of independent directors would be more severe and more immediate because the fund would lose the availability of the Exemptive Rules.[53]

The Commission is proposing new rule 10e–1 to address these concerns. Proposed rule 10e–1 would suspend the board composition requirements of the Act, and of the rules under the Act, for 60 days if the board of directors may fill the vacancy or 150 days if a shareholder vote is required.[54] We believe these longer time periods are appropriate in light of the need to select, nominate, and elect qualified candidates for service as independent directors.[55]

We request comment whether the proposed 60-day and 150-day periods are adequate to provide funds and their independent directors with the time needed to approve new independent directors. Commenters who believe that a longer or shorter period is appropriate should explain why, and specify the number of days they believe would be adequate.

2. Selection and Nomination of Independent Directors

Independent directors who are truly independent are more effective in their roles as ''watchdogs'' for fund shareholders. While the Investment Company Act precludes independent directors from having certain affiliations or relationships with the fund's adviser or principal underwriter,[56] no law can

[45] *See, e.g.*, section 15(f)(1) of the Act (providing a safe harbor for the sale of an advisory business if directors who are independent of the adviser constitute at least 75 percent of a fund's board for at least three years following the assignment of the advisory contract). The ICI Advisory Group Report discussed, but did not recommend at a best practice, having fund boards comprised exclusively of independent directors. *See* ICI Advisory Group Report, *supra* note 28, at 11–12. As a result of the Glass-Steagall Act, most bank-sponsored funds have boards comprised entirely of independent directors. *See* section 32 of the Glass Steagall Act [12 U.S.C. 78] (prohibiting directors of any entity issuing securities, such as a fund, from simultaneously serving as an officer, director, or employee of a national bank); *see also* Roundtable Transcript of Feb. 24, 1999 at 111 (statement of Richard J. Herring, independent director of a family of bank-related mutual funds and business school professor of international banking) (noting that a bank-related fund board comprised entirely on independent directors ''works quite well'').

[46] We use the term ''charters'' generally to include the organizational documents of a fund—typically articles of incorporation or declarations of trust, and corporate by-laws.

[47] There are several methods by which funds could affect the transition to majority independent representation on their boards. For instance, funds could (i) increase the size of their boards and elect new independent board members; (ii) decrease the size of their boards and allow some inside directors to resign; or (ii) allow some inside directors to resign and replace them with independent board members. A fund's ability to alter the composition of its board without holding a shareholder vote will be determined by state law and by section 16(a) of the Act [15 U.S.C. 89a–16(a)], which states that a fund's board may fill a board vacancy without a shareholder vote if, after the new director takes officer, at least two-thirds of the board has been elected by shareholders. Section 16(a) further requires a shareholder meeting to elect directors if the number of shareholder-elected board members decreases to less than half of the board. Newly organized funds could begin operations during the one-year transition period without a majority of independent directors and still rely on the Exemptive Rules, but they, like other funds, would be required to have boards with a majority of independent directors if they rely on any of the Exemptive Rules after the compliance date for the amendments.

[48] Various provisions of the Investment Company Act require a particular percentage or minimum number of independent directors. *See* sections 10(a), 10(b)(2), 10(d) [15 U.S.C. 80a–10(d)], and 15(f)(1); *see also supra* notes 20, 39, and 45 (discussing sections 10(a), 10(b)(2), and 15(f)(1) and their percentage requirements). Section 10(e) [15 U.S.C. 80a–10(e)] similarly suspends the board composition requirements of sections 10(d)(1), 10(b)(3), and 10(c) [15 U.S.C. 80a–10(b)(1), –10(b)(3), and –10(c)]. For convenience, we refer to all of the above requirements as ''percentage requirements.''

[49] *See* section 16(a) of the Act (permitting directors to fill a board vacancy if, after the new director takes officer, at least two-thirds of the board has been elected by shareholders, but requiring a shareholder meeting to elect directors if the number of shareholder-elected board members decreases to less then half of the board).

[50] Section 10(e)(1) and (2) [15 U.S.C. 80a–10(e)(1) and (2)].

[51] Section 10(e)(3) [15 U.S.C. 80a–10(e)(3)].

[52] *See supra* Section II.A.1.a.

[53] Currently, the loss of an independent director that causes a fund to fall below a statutorily required percentage of independent directors does not result in immediate consequences for a fund. Issues arise only when the fund's next board vote is required. Under the proposed amendments to the Exemptive Rules, however, the fund would be unable, for example, to offer multiple classes of shares, pay distribution fees under rule 12b–1, engage in securities transactions with fund affiliates, or participate in a joint liability insurance policy from the date of the loss of the independent director until the fund replaces the independent director.

[54] *See* proposed rule 10e–1.

[55] *See infra* Section II.A.2 (discussing the selection and nomination of independent directors by other independent directors); *cf.* Temporary Exemption for Certain Investment Advisers, Investment Company Act Release No. 23325 (July 22, 1998) [63 FR 40231 (July 28, 1998)] (proposing amendments to rule 15a–4 in part to extend, from 120 days to 150 days, the period of time funds are permitted to operate with an interim advisory contract that has not been approved by shareholders to allow funds more time to seek shareholder approval of an advisory contract).

[56] *See* section 2(a)(19)(B) [15 U.S.C. 80a–2(a)(19)(B)] (outlining the types of affiliations and

Continued

guarantee that an independent director will be vigilant in protecting fund shareholders. Fund shareholders therefore must depend on the character, ability, and diligence of persons who serve as fund directors to protect their interests.[57]

One recognized method of enhancing the independence of directors is to commit the selection and nomination of new independent directors to the incumbent independent directors.[58] Independent directors who are selected and nominated by other independent directors, rather than by the fund's adviser, are more likely to have their primary loyalty to shareholders rather than the adviser.[59] In addition, when independent directors are self-selecting and self-nominating, they are less likely to feel beholden to the adviser. Thus, they may be more willing to challenge the adviser's recommendations when the adviser's interests conflict with those of the shareholders.[60]

Two comprehensive studies that addressed mutual fund governance recognized that the selection and nomination of independent directors by other independent directors could enhance their independence.[61] In its guidebook for fund directors, the American Bar Association's Section of Business Law has endorsed this practice,[62] as did several participants at our Roundtable.[63] The recent ICI Advisory Group report also recommended the self-selection and self-nomination of independent directors.[64] As noted above, two of our rules currently require funds to have self-selecting and self-nominating independent directors,[65] and many fund groups have adopted this practice.[66]

We are proposing to amend each of the Exemptive Rules to require that funds relying on those rules have boards whose independent directors select and nominate any other independent directors.[67] Funds that have adopted distribution plans under rule 12b–1, which already contains this requirement, would be unaffected by the proposal.[68] Funds whose independent directors were not nominated in this manner would not immediately lose their ability to rely on the Exemptive Rules. Rather, if we adopt the proposed amendments, these funds would be required to adopt the practice before the compliance date for the amendments, and the fund's incumbent independent directors subsequently would select and nominate all independent directors of the fund.[69]

We understand that committing the selection and nomination of independent directors to a board committee composed entirely of independent directors might, in some cases, conflict with applicable state law.[70] We believe that a fund could comply with our proposed amendments in those circumstances if the fund's independent directors choose the candidates and then present their recommendations to the full board. We

relationships that render a director an ''interested person'' of a fund's adviser or principal underwriter).

[57] *See* Bearing of Distribution Expenses by Mutual Funds, Investment Company Act Release No. 10862 (Sept. 7, 1979) [44 FR 54014 (Sept. 17, 1979)] (proposing rule 12b–1) (''[P]roper fulfillment of directors' duties depends primarily on the character, ability, and diligence of directors.''); William G. Bowen, Inside the Boardroom: Governance by Directors and Trustees 47 (1994) (''Effective governance by any board surely depends, most of all, on having an outstanding group of members.''); Roundtable Transcript of Feb. 23, 1999 at 14–15 (statement of Arthur Levitt, Chairman, SEC) (''[B]oard independence does not come from a specific legal structure * * * I believe passionately in boards made up of men and women of good, sound independent judgment. Board independence comes from directors who do their jobs aggressively.'').

[58] Selection and nomination refers to the process by which board candidates are researched, recruited, considered, and formally named. Some funds establish a nominating committee of the board that is comprised entirely of independent directors to select and nominate directors.

[59] *See* ICI Advisory Group Report, *supra* note 28, at 14 (''[I]ndependent directors are uniquely qualified to evaluate whether a present or prospective director is likely to contribute to the continuing independence and effectiveness of the independent directors as a group.'').

[60] *See* ICI Advisory Group Report, *supra* note 28, at 14 (''[C]ontrol of the nominating process by the independent directors helps dispel any notion that the directors are 'hand picked' by the adviser and therefore not in a position to function in a true spirit of independence.'')

[61] *See* 1992 Protecting Investors Report, *supra* note 9, at 266–67 (recommending that the Act be amended to require that independent directors be self-nominating); Wharton Report, *supra* note 10, at 465–66 (noting that the selection of unaffiliated directors by management limits those directors' independence).

[62] *See* A.B.A., Section of Business Law, Fund Director's Guidebook 27 (1996) [''Fund Director's Guidebook''] (''The independence of a fund's independent directors is enhanced by providing that persons nominated by the board for election as independent directors be nominated by a committee of the fund's incumbent independent directors.'').

[63] *See* Roundtable Transcript of Feb. 24, 1999 at 182 (statement of John C. Coffee, Jr.) (''[W]e should have'' independent nominating committees.); Roundtable Transcript of Feb. 23, 1999 at 136 (statement of Faith Colish) (''a very good idea''); Roundtable Transcript of Feb. 24, 1999 at 63 (statement of Dawn-Marie Driscoll) (''I'm a great believer in independent directors choosing other independent directors who the adviser does not know. * * * The more ways you can ensure independence, the better the process will be.''); *id.* at 148 (statement of Ronald J. Gilson) (''A nominating committee made up of independent directors makes an enormous amount of sense.''); *id.* at 215 (statement of John R. Haire) (''[Self-selection and self-nomination are] very helpful in the process of seeing that * * * independent directors * * * bring to the board a diversity of skills that are useful * * * in the role of overseeing management.''); *id.* at 243 (statement of Aulana L. Peters) (''[I]t is not a good idea to have the adviser or the CEO of the adviser * * * be the sole decisionmaker on who should serve as a disinterested member of the board.''). *But see id.* at 245 (statement of Aulana L. Peters) (stating that the involvement of a fund's adviser in the selection and nomination of independent directors may facilitate increasing diversity on a fund's board).

[64] *See* ICI Advisory Group Report, *supra* note 28, at 14–16.

[65] Rule 12b–1 permits the use of fund assets to pay for distribution of fund shares, but only if the fund's independent directors select and nominate other independent directors. *See supra* note 30 (discussing rule 12b–1). In discussing our decision to include this condition in the rule, we noted that ''the likelihood that a decision will be in the best interests of a fund and its shareholders will be increased if the disinterested directors are genuinely independent of management,'' and that ''formal independence will breed an atmosphere in which actual independence will develop.'' Rule 12b–1 Adopting Release, *supra* note 30, at discussion of ''Independence of Directors.'' See also *supra note* 30 (discussing rule 23c–3, which permits the operation of interval funds if independent directors are self-selecting, self-nominating, and comprise a majority of the board). The Act also requires independent directors to select and nominate individuals to fill independent director vacancies for a period of three years following the sale of an investment advisory contract. Section 16(b) [15 U.S.C. 80a–16(b)].

[66] *See* ICI Advisory Group Report, *supra* note 28, at 15 (noting that funds with rule 12b–1 plans, which are required to have self-selecting and self-nominating independent directors, represent a majority of all mutual funds and that many funds without rule 12b–1 plans also assign to independent directors the selection and nomination of other independent directors); Joel H. Goldberg & Gregory N. Bressler, *Revisiting Rule 12b–1 Under the Investment Company Act*, 31 Rev. Sec. & Commodities Reg. 147, 147 (1998) (since the adoption of rule 12b–1 in 1980, over 7,000 mutual funds have adopted rule 12b–1 plans).

[67] *See* proposed rules 10f–3(b)(11)(i); 15a–4(c)(1); 17a–7(f)(1); 17a–8(c)(1); 17d–1(d)(7)(v)(A); 17e–1(c)(1); 17g–1(j)(3)(i); 18f–3(e)(1). In addition, we are proposing to amend rules 12b–1 and 23c–3 to conform their current language regarding the self-selection and self-nomination of independent directors to the language of the proposed amendments. Proposed rules 12b–1(c)(1) and 23c–3(b)(8)(i).

[68] Our proposals to amend rules 12b–1 and 23c–3 to conform their language regarding self-selection and self-nomination to the language of our proposed amendments are not intended to have any substantive effect on the operation of those rules. *See* proposed rules 12b–1(c)(1), 23c–3(b)(8)(i).

[69] Our proposed amendments would have no impact on the initial selection of an organizing fund's directors because, at the time of organization, the fund would not yet be registered under the Investment Company Act and therefore would not be relying on our Exemptive Rules. Any organizing fund that intends to rely on the Exemptive Rules, however, should adopt a self-selection and self-nomination practice, and once the fund begins operations, independent directors should select and nominate other independent directors as board vacancies occur.

[70] *See, e.g.*, ICI Advisory Group Report, *supra* note 28, at n.28 (discussing Md. Code Ann., Corps. & Ass'ns § 2–411(a)(2), which prohibits the bylaws of a Maryland corporation from authorizing the board to delegate to a committee the power to recommend to stockholders any action that requires stockholder approval). Section 2–411(a)(2) may have a greater effect on closed-end funds, which, unlike mutual funds, generally must hold annual meetings of shareholders at which shareholders elect directors.

request comment whether this approach adequately addresses any potential conflicts between state law and our proposed amendments regarding self-selection and self-nomination of independent directors.

Moreover, our proposals regarding the self-selection and self-nomination of independent directors are not intended to limit the abilities of public shareholders to nominate independent directors. To the extent permitted under state law, shareholders may participate in the nomination process.[71]

We request comment whether we should further amend the Exemptive Rules to require that independent directors, rather than the entire board, elect other independent directors in those instances when a shareholder vote is not required.[72] Commenters should discuss the effect state law would have on a fund board's ability to delegate its authority to elect directors to a subset of the board.

3. Independent Legal Counsel

Another recognized method of enhancing the independence and effectiveness of independent directors is to provide them with independent counsel.[73] Because mutual funds are highly regulated and their boards frequently are called upon to protect fund shareholders from conflicts of interest, independent counsel can be particularly helpful to independent directors of funds.[74] Experienced counsel can help to identify potential conflicts of interest and other compliance issues. They can assist directors in ''marshal[ling] arguments to balance those presented by management in matters involving conflicts of interest,'' and evaluating legal issues with an independent and critical eye.[75] Often, independent counsel can draw on their experience and knowledge to identify best practices of other funds that might be appropriate for directors to adopt for their fund.

We believe counsel who does not also represent the fund's adviser can best provide zealous representation of independent directors. Several of our Roundtable participants made this point,[76] as have many legal commentators over the years.[77] The recent ICI Advisory Group Report recommended that independent directors have qualified counsel who is independent from the fund's adviser and other service providers.[78] Courts too have recognized that independent legal counsel improves the deliberative process of fund independent directors.[79] As a result, independent directors of many funds retain legal counsel who does not also represent the adviser and, in some cases, does not represent the fund.

We are aware, however, that in some cases counsel has regularly represented the fund, the fund's adviser, and the independent directors. We have no doubt that such representation has been in conformity with applicable codes of legal ethics, which permit a lawyer to represent clients with conflicting interests after full disclosure and client consent.[80] We nevertheless are troubled by such conflicts and how they affect the ability of independent directors to carry out their responsibilities under the Act and the Exemptive Rules. We are particularly concerned when lawyers represent both the independent directors and management organizations in the negotiation of the advisory contract, distribution arrangements (*e.g.*, 12b–1 plans), and other matters of fundamental importance to a fund and its shareholders. Lawyers representing

[71] *See* Item 7(e)(2) of Schedule 14A (requiring that any proxy sent to shareholders for the purpose of electing directors state whether a registrant's nominating committee will consider nominees recommended by shareholders and describe the procedures to be followed by shareholders submitting nominee recommendations); *see also infra* note 224 and accompanying text.

[72] The ICI Advisory Group Report recommends that, to the extent permitted by state law, fund boards delegate to a fund's incumbent independent directors the authority to elect independent directors in the absence of a shareholder vote. *See* Advisory Group Report, *supra* note 28, at 15–16; *see also supra* note 47 (discussing section 16(a) of the Act and the circumstances under which fund directors may elect a board member without holding a shareholders vote).

[73] *See generally* Grover C. Brown, Michael J. Maimone, and Joseph C. Schoell, *Director and Advisor Disinterestedness and Independence Under Delaware Law*, 23 Del. J. Corp. L. 1157 (1998).

[74] *See* ICI Advisory Group Report, *supra* note 28, at 18 (''[Independent] counsel can help to ensure that the directors understand their responsibilities, ask the pertinent questions, and receive the information necessary to carry out those responsibilities.''); *What's the Job of Your Fund Counsel?*, Fund Directions, Nov. 1995, at 4, 5 (Independent directors ''look to their lawyer for assistance in resolving and acting upon any matters where the adviser potentially has a conflict of interest with the shareholders.' '') (quoting Edward T. O'Dell, partner, Goodwin, Procter & Hoar LLP).

[75] Joel H. Goldberg, *Disinterested Directors, Independent Directors and the Investment Company Act of 1940*, 9 Loy. U. Chi. L.J. 565, 585 (1978).

[76] *See* Roundtable Transcript of Feb. 24, 1999 at 178 (statement of John C. Coffee, Jr.) (''[T]he central lesson from corporate governance generally is that independent directors can function well as a committee if an probably only if they have the effective assistance of a truly independent legal counsel who does not generally represent the investment adviser and who does not have any other conflict.''); *id.* at 190–97 (statement of Leslie L. Ogg) (discussing the important role of service providers, including separate counsel, to fund independent directors); *id.* at 52 (statement of David M. Butowsky) (stating that independent directors should be counseled by someone ''who is completely independent of any affiliation with management when reviewing found reorganizations following the acquisition of an adviser); *id.* at 67 (statement of Joseph Hankin) (noting that retaining counsel separate from fund management is ''absolutely a prudent step'' when reviewing fund mergers and advisory contracts); *see also id.* at 222–23 (statement of David A. Sturms) (reviewing various structures of legal representation of a fund, its independent directors, and its adviser).

[77] *See, e.g.*, Martin Lipton, *Directors of Mutual Funds: Special Problems*, 31 BUS. LAW. 1259, 1262 (1976) (''[M]utual funds should have separate counsel. Either the independent directors of a fund should have separate counsel or the fund itself should have separate counsel. That is, separate counsel from counsel for the management company. Independent counsel plays a very important role.''); Goldberg, *supra* note 75, at 585 (''[T]he value of [independent] counsel in helping to ensure independent consideration of issues by disinterested directors is beyond dispute * * *.''); Jean W. Gleason, Mutual Fund Governance: Independent Directors—Their Role and Incentives and Tools for Fulfilling It, VI–A–9, VI–A–16 (1994) (material prepared for the 1994 Mutual Funds and Investment Management Conference) (''Access to, and use of, outside experts [such as independent legal counsel] can provide increased independence and allow for informed judgments [by independent directors] * * *.''). *See also* Public Policy Report, *supra* note 10, at 130–31 (listing the absence of separate legal counsel as one of the factors contributing to the relative ineffectiveness of unaffiliated directors).

[78] *See* ICI Advisory Group Report, *supra* note 28, at 18–20. The Advisory Group concluded that ''[c]ounsel to the independent directors must be independent from the adviser and other fund service providers in order to render objective advice on areas of potential conflict between the fund and its service providers.'' *Id.* at 18. *See also* Fund Director's Guidebook, *supra* note 62, at 23 (''[G]enerally it is important that the independent directors have ready access to counsel who views the board and the fund, not the adviser, as the client.'').

[79] *See* Tannenbaum v. Zeller, 552 F.2d 402, 428 (2d Cir. 1977) (stating that it would have been preferable if the fund's independent directors received advise from an independent counsel, rather than counsel who also represented the fund, the fund's adviser, and the fund's distributor); Fogel v. Chestnutt, 533 F.2d 731, 750 (2d Cir. 1975) (''It would have been * * * better to have the investigation of recapture methods and their legal consequences performed by disinterested counsel furnished to the independent directors.''); Schuyt v. Rowe Price Prime Reserve Fund, Inc., 663 F. Supp. 962, 965, 982, 986 (S.D.N.Y.) (noting that ''[d]uring all relevant times, the independent directors * * * had their own counsel'' who was an ''important resource'' and who advice ''the record indicates the directors made every effort to keep in mind as they deliberated''), *aff'd*, 835 F.2d 45 (2d Cir. 1987); Cartenberg v. Merill Lynch Asset Management, Inc., 528 F. Supp. 1038, 1064 (S.D.N.Y. 1981) (noting that the ''non-interested Trustees were represented by their own independent counsel * * * who acted to give them conscientious and competent advice''), *aff'd, 694 F.2d 923 (2d Cir. 1982). See also* Palilsky v. Berndt, [1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,627, 15 90,133 (S.D.N.Y. June 24, 1976) (noting that a law firm, in advising both a fund and the fund's adviser, ''was counseling people with contrary interests. * * * The effect of the inadequate advice was to discourage any independent inquiry by * * * [the] Board.'').

[80] *See* American Bar Association, Center for Professional Responsibility, Model Rules of Professional Conduct [''ABA Model Rules''], Rule 1.7 (1998); *see also* Del. Prof. Cond. R. 1.7 (1998); MASS. SUP. JUD. CT.R. 3:07, R.P.C. 1.7 (1999); Md. Rule 1.7 (1998).

fund management may not suggest courses of action to independent directors that are opposed by their management clients. Thus, we are proposing to amend the Exemptive Rules to require that counsel for a fund's independent directors not also act as counsel to the fund's adviser, principal underwriter, or administrator (or their control persons).[81]

We are not, however, proposing at this time to *require* independent directors to retain legal counsel. Although we believe that independent directors are in the best position to fulfill the roles assigned to them by the Exemptive Rules if they have the assistance of independent counsel, the services of counsel do not come without cost.[82] We are hesitant to propose a rule that might result in the engagement of legal counsel simply to fulfill a legal requirement. Moreover, we believe that a likely result of our proposed amendments would be that fund directors will seek independent counsel. Comment is requested whether we should amend the Exemptive Rules to require independent directors of funds relying on those rules to retain independent legal counsel. Would this requirement impose substantial costs on small fund groups? If we adopt this condition to the Exemptive Rules, should we provide for an exception for smaller fund groups? If so, what factors should determine which fund groups are small?

Under the proposed amendments, reliance on each of the Exemptive Rules would be conditioned on any legal counsel for a fund's independent directors being an ''independent legal counsel.'' [83] A person would be an ''independent legal counsel'' if the fund reasonably believes the person and his law firm, partners, and associates [84] have not acted as legal counsel for the fund's investment adviser, principal underwriter, administrator [85] (collectively, ''management organizations''), or any of their control persons [86] at any time since the beginning of the fund's last two completed fiscal years.[87] The independent directors could make an exception and permit a person to serve as independent legal counsel even if the person has a remote or minor conflict of interest because the person has provided legal advice to management organizations or their control persons.[88]

(a) Independent of Fund Management Organizations. The proposed amendments would treat as fund management organizations, fund advisers (including sub-advisers), principal underwriters, and fund administrators.[89] We are proposing to include fund administrators because, in some fund complexes, an administrator performs many of the management functions traditionally performed by a fund's adviser, and thus may have the same types of conflicts as an investment adviser sponsoring a fund.[90] The limitations on dual representation also would extend to *control persons* of fund management organizations: persons who directly or indirectly control, are controlled by, or are under common control with the adviser, principal underwriter, or fund administrator.[91] Counsel to both a parent company of the fund's adviser and a fund's independent directors, for example, may face the same conflicts as those faced by counsel to the fund's adviser and the fund's independent directors.[92] We request comment whether the amendments should extend to other types of service providers in addition to management organizations,[93] and to persons other than control persons (*e.g.*, affiliated persons of a management organization).

Under the proposed amendments, a person could be an independent legal counsel to a fund's independent directors regardless of the nature and amount of legal services he or she provides to the fund itself. A person acting as both fund counsel and independent director counsel ordinarily should not have the types of conflicts of interest that would diminish the counsel's ability to provide zealous

[81] Our proposals are not intended to regulate the practice of law, but rather to delimit the ability of independent fund directors to waive certain conflicts of interest. In other contexts, fiduciaries have been similarly restricted in their ability to waive conflicts. *See, e.g.*, section 327 of the U.S. Bankruptcy Code [11 U.S.C. 327] (bankruptcy trustee generally cannot employ a counsel who represents an interest adverse to the estate in bankruptcy, and any counsel employed by the trustee must be a disinterested person); Md. Regs. Code tit. 13 § 105 (attorney to a receiver or assignee in bankruptcy must meet prescribed independence standards, including that the attorney does not represent an interest adverse to the estate). *See also* rule 116.5 of the Bureau of Indian Affairs [25 CFR 116.5] (no person with a personal, financial, or business connection to a trustee of restricted Indian property may act as an appraiser of that property in connection with loans made from the trust).

[82] In the 1992 Protecting Investors Report, the staff of the Division of Investment Management considered, but did not recommend, requiring funds to provide independent directors with their own counsel. While the staff recognized the benefits of separate counsel for independent directors, it was concerned about the costs associated with requiring separate counsel in all cases. *See* 1992 Protecting Investors Report, *supra* note 9, at 268.

[83] *See* proposed rules 10f–3(b)(11)(ii); 12b–1(c)(2); 15a–4(c)(2); 17a–7(f)(2); 17a–8(c)(2); 17d–1(d)(7)(v)(B); 17e–1(c)(2); 17g–1(j)(3)(ii); 18f–3(e)(2); 23c–3(b)(8)(ii).

[84] The proposed definition of an independent legal counsel would apply to a ''person.'' *See* proposed rule 0–1(a)(6)(i). The term ''person'' would have the same meaning as in section 2(a)(28) of the Act [15 U.S.C. 80a–2(a)(28)] and, in addition, would include a partner, co-member, or employee of any person. *See* proposed rule 0–1(a)(6)(ii)(A). The term ''co-member'' is intended to address law firms organized as limited liability companies. The interest-holders of limited liability companies generally are called ''members.''

[85] *See infra* note 89.

[86] *See infra* note 91 and accompanying text.

[87] *See* proposed rule 0–1(a)(6)(i)(A). We intend that the phrase ''act as legal counsel'' as used in the proposed definition of ''independent legal counsel'' will have the same meaning that it has for purposes of section 2(a)(19)(B)(iv) [15 U.S.C. 80a–2(a)(19)(B)(iv)]. The staff has interpreted the phrase ''acts as legal counsel'' broadly. *See* 399 Fund, SEC No-Action Letter (Sept. 2, 1973) (fund directors would be an ''interested person'' because his firm had entered an appearance on behalf of certain officers and directors of the fund's adviser in litigation unrelated to the fund); Alpha Investors Fund, Inc., SEC No-Action Letter (Jan. 9, 1972) (fund director would be an ''interested person'' because his firm had performed two small legal projects for a company that owned a 50 percent share of an adviser to a fund).

In some cases, ethics rules permit counsel to accept payment for legal services from a non-client third party. *See* ABA Model Rules, *supra* note 79, rule 1.8(f) (1998) (counsel may accept compensation from a third party if (i) the client consents after consultation, (ii) there is no interference with counsel's independence of professional judgment or with the attorney-client relationship, and (iii) counsel maintains client confidentiality); *see also id.* Rule 1.7 cmt. 10 (''Interest of Person Paying for a Lawyer's Service''). Under our proposed amendments, we would not view a lawyer as ''acting as legal counsel'' to a fund's investment adviser merely because the lawyer accepts payment of fees from the adviser for legal services performed on behalf of the fund or its independent directors as permitted by relevant professional ethics rules.

[88] *See infra* Section 11.A.3(d) ''Exception''; proposed rule 0–1(a)(6)(i)(B).

[89] We are proposing to define ''administrator'' as any person who provides significant administrative or business affairs management services to a fund. Proposed rule 0–1(a)(5). This definition is substantially similar to, and has the same meaning as, the definition of administrator contained in Item 22(a)(1)(i) of Schedule 14A and Item 15(h)(1) of Form N–1A.

[90] Funds are increasingly turning to third-party fund administrators to provide an array of services, including shareholder servicing, recordkeeping, accounting, and fund distribution. *See* Jackie Cohen, *Priming the Pump for Better Mutual Fund Sales*, Bank Tech. News, June 1998, at 43; Katharine Fraser, *Fund Administrators Vie for Megabank Pacts*, Am. Banker, May 27, 1998, at 10. As of December 31, 1998, third-party fund administrators had approximately $527 billion in assets under administration. *See generally* Lipper Inc., Lipper Directors' Analytical Data: Executive Summary (1st ed. 1999) (providing estimates of fund assets administered by entities other than funds, from which estimates of fund assets administered by entities unaffiliated with the fund may be derived).

[91] The definition of ''control person'' would exclude funds. This exclusion enables the same counsel to represent a fund and its independent directors. *See* proposed rule 0–1(a)(6)(ii)(B); *see also infra* note 94 and accompanying text.

[92] This could be the case even if the legal work performed for the control person is unrelated to the fund or its operations.

[93] *See* ICI Advisory Group Report, *supra* note 28, at 19 (recommending counsel for the independent directors who is independent from all of the fund's service providers).

representation of independent directors.[94] Similarly, our proposal would not preclude counsel from representing the independent directors of multiple funds affiliated with the same management organization. We request comment on this provision.

(b) Two-Year Period. Section 2(a)(19) of the Act prevents any person who has acted as legal counsel to a fund's adviser or principal underwriter during the last two years from serving as an independent director of the fund.[95] This section reflects Congress's belief that acting as counsel to fund management organizations creates conflicts that may affect a person's ability to represent shareholder interests. Based upon similar considerations, the proposed amendments would (subject to the exception discussed below) preclude a person from acting as counsel for independent directors for two years after having acted as legal counsel to a fund management organization or its control person. As in section 2(a)(19), the disqualification would apply to any partner or employee of a person who acted as legal counsel to the management organization or its control person.[96]

(c) Reasonable Belief. The proposed amendments would require the fund to have a ''reasonable belief'' that counsel to the independent directors meets the requirements of the independent legal counsel definition. If, despite the fund's reasonable belief, counsel does not actually meet the requirements, the fund would not lose the ability to rely on any of the Exemptive Rules. A fund could form a reasonable belief based on a representation from counsel. If the fund relies on counsel's representation, the fund also should obtain an undertaking that the counsel will inform the fund and the independent directors if it begins to act as legal counsel to the fund management organizations or any of their control persons.

(d) Exception. As discussed above, these proposed amendments are intended to assure that independent directors have the benefit of counsel who is free from the types of conflicts that may affect the advice provided to independent directors. The scope of the proposed limitation, described above, is broad and covers direct and indirect conflicts. As a result, the proposed amendments might preclude a person from serving as counsel to a fund's independent directors because of a remote or minor conflict involving, for example, a law-firm partner who represented an affiliate of the fund's adviser in a minor real estate transaction. Therefore, the proposed definition of ''independent legal counsel'' includes an exception that would permit the independent directors to retain the counsel if they determine that the counsel's representation was ''so limited that it would not adversely affect the counsel's ability to provide impartial, objective, and unbiased legal counsel to the [independent] directors.'' [97]

The exception would not permit waivers in all instances, but only in circumstances where the nature or extent of the conflict is minor. We would expect that the independent directors, in making a determination under the exception, would consider all relevant factors. These factors could include whether the representation presented a direct and ongoing conflict with the fund, the amount of legal fees generated by the representation, and the nature and the extent of the affiliation between a control person and a fund management organization. The basis for any determination under this provision also must be recorded in board meeting minutes.[98]

We request comment on the approach we have taken. Should independent directors who engage legal counsel under the exception to the general rule be required to make findings different from those proposed? For example, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees recommended that a director who does not meet proposed independence standards be allowed to serve as a member of a company's audit committee if the board, under exceptional and limited circumstances, determines that membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual proxy statement, the reasons why the director does not meet the independence standards and the reasons for the board's determination.[99] Should we also require public disclosure of the independent directors' determination regarding their counsel's conflict and the nature of that conflict? If so, in what document should the disclosure be made?

(e) Transition Period. If we adopt the proposals after the comment period, counsel for the independent directors of funds relying on any of the Exemptive Rules would not be required to be ''independent legal counsel'' until the compliance date established in the adopting release. We believe that independent directors of most fund groups would not be required to seek new counsel. In some cases, however, they may. Comment is requested on the transition time that independent directors would need to hire new counsel.

B. Limits on Coverage of Directors Under Joint Insurance Policies

The oversight responsibilities that the Act assigns to independent directors [100] may create tensions between those directors and the fund's adviser [101] that can lead to disputes.[102] A dispute among these parties that escalates to the level of a lawsuit can result in significant legal expenses for the independent directors.[103]

Funds typically purchase ''errors and omissions'' insurance policies (''D&O/E&O policies'') [104] to cover expenses

---

[94] *See id.* at 18–19 (''The Adisory Group believes that counsel for the independent directors also may serve as fund counsel because, in virtually every situation except possibly litigation, the interests of the fund and its directors are aligned.''). *But see* Roundtable Transcript of Feb. 24, 1999 at 179 (statement of John C. Coffee, Jr.) (noting that counsel to a fund invariably works closely with, and generally receives work requests from, personnel of the adviser who manages the fund, and that the close association with the adviser that results from representing the fund could influence the counsel's representation of the independent directors).

[95] Section 2(a)(19)(B)(vi). Section 2(a)(19)(A)(iv) of the Act [15 U.S.C. 80a–2(a)(19)(A)(iv)] also precludes a person who has acted as *fund* counsel from serving as an independent director of that fund for at least two years. As discussed above, our proposal would not preclude counsel to a fund from serving as counsel to a fund's independent directors. *See supra* note 94 and accompanying text.

[96] *See* proposed rule 0–1(a)(6)(ii)(A); *see also supra* note 84.

[97] *See* proposed rule 0–1(a)(6)(i)(B).

[98] *See id.*

[99] *See* Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees 11 (1999) [''Blue Ribbon Committee Report''].

[100] *See supra* notes 12–24 and accompanying text; *see also* section 36(a) of the Act [15 U.S.C. 80a–35(a)] (enabling federal lawsuits to be brought against fund directors for breaches of fiduciary duty involving personal misconduct).

[101] *See* Roundtable Transcript of Feb. 24, 1999 at 234 (statement of Gerald C. McDonough) (''The adversarial role * * * of independent [directors] and fund advisers is a healthy and desirable one.'').

[102] *See* David A. Sturms, The Debate: The System is Broken—Fix It or Scrap It vs. The System Works—Don't Fix What Isn't Broken 4–7 (materials prepared for SEC Roundtable on the Role of Independent Investment Company Directors, Feb. 23–24, 1999) (discussing recent disputes between independent directors of funds and the funds' advisers).

[103] *See* ICI Advisory Group Report, *supra* note 28, at 26 (''[L]itigation [involving independent directors] can be extremely expensive and may even carry with it a potential for personal financial ruin.'').

[104] D&O/E&O policies generally insure directors and officers of an insured entity (*e.g.*, a fund) for claims made against them for their designated acts, errors, or omissions. *See generally* Spiro K. Bantis, ''What Mutual Fund D&O/E&O Policies Don't Cover''; Ellen Metzger, Mutual Fund D&O/E&O Insurance: Considerations in Selecting and

Continued

incurred by directors and officers in the event of litigation.[105] Often these policies are joint policies that cover numerous funds within a fund family as well as the adviser and principal underwriter of those funds. Although the Investment Company Act and our rules generally prohibit joint transactions and other joint arrangements involving a fund and its affiliates,[106] rule 17d–1(d)(7) permits the purchase of joint D&O/E&O policies.[107]

Joint D&O/E&O policies historically have excluded claims in which the parties under the policy sue each other.[108] A policy that insures both a fund's investment adviser and its independent directors therefore may not cover the independent directors' expenses of litigation with the fund's adviser. Without this coverage, independent directors face substantial personal legal expenses in the event of a lawsuit.[109]

The exclusion of coverage under joint policies creates a potential threat to directors' personal assets, which can hamper directors' willingness to question management and weaken their resolve to protect fund shareholders in the event of a conflict with the adviser. Because we are concerned about the effect that these exclusions may have on the ability of independent directors to carry out their statutory responsibilities, we propose to amend rule 17d–1(d)(7) to make the rule available only for joint liability insurance policies that do not exclude coverage for litigation between the independent directors and the fund's adviser.[110] These proposals are intended to allow independent directors to engage in the good faith performance of their statutory responsibilities without concern for their personal financial security.[111]

We request comment on the proposed amendments to rule 17d-1(d)(7) concerning the purchase of joint D&O/E&O policies. The ICI Advisory Group Report recommended more broadly that fund boards should consider obtaining D&O/E&O insurance policies and/or indemnification from the fund ''that is adequate to ensure the independence and effectiveness of independent directors.'' [112] The proposed amendments do not require that funds obtain insurance coverage or indemnification for independent directors, so that funds will have the latitude to determine which arrangements are appropriate for their circumstances. We request comment whether we should further amend rule 17d-1(d)(7) to require that joint insurance polices purchased under the rule be in an amount adequate to ensure that independent directors can perform their duties in an independent and effective manner, and what that amount might be.

C. Exemption From Ratification of Independent Public Accountant Requirement for Funds With Independent Audit Committees

The Investment Company Act requires that a fund's independent directors select the fund's independent public accountant.[113] The Act further requires that the selection of the fund's independent public accountant be submitted to shareholders for ratification or rejection at their next annual meeting.[114]

We have observed that shareholders rarely contest votes over the ratification of the selection of a fund's independent accountant. Many believe shareholder ratification has become perfunctory. This may have occurred because of the growth of funds,[115] their organization into large complexes, the increased complexity of accounting issues, or the consolidation of accounting firms, which have made it impracticable for shareholders to evaluate the qualifications and independence of fund auditors. We are proposing, therefore, to exempt funds from the shareholder ratification requirement if the auditor is subject to the oversight and direction of an audit committee consisting entirely of independent directors.

Today, in many corporations and fund complexes, audit committees play an important and growing role in assuring the integrity of financial statements.[116] The current listing

---

Maintaining a Policy; Natalie Shirley, Claims—What to Do When the Unthinkable Happens; Daniel T. Steiner, Selected Issues Regarding Basic Policy Forms (collected materials from 1995 Mutual Funds and Investment Management Conference, Mutual Fund D&O/E&O Insurance 101).

[105] Under the Act, a fund's organizational documents cannot contain any provision protecting a director or officer of the fund from any liability to the fund or its shareholders to which he is subject by reason of willful misfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of his office. *See* section 17(h) of the Act [15 U.S.C. 80a–17(h)]; *see also* Interpretive Release, *supra* note 1, Section II.C (discussing section 17(h) and providing guidance regarding when a fund may pay an advance of legal fees to its directors).

[106] *See* section 17(d) [15 U.S.C. 80a–17(d)] (prohibiting an affiliated person of a fund from effecting a joint transaction with the fund in contravention of Commission rules); rule 17d–1 [17 CFR 270.17d–1] (prohibiting a fund affiliate from participating in any joint enterprise, joint arrangement, or profit-sharing plan with a fund without first obtaining a Commission order, except in certain designated circumstances); *see also* Interpretive Release, *supra* note 1, Section II.B (discussing section 17(d) and rule 17d–1 and explaining the view of the staff that actions taken by fund directors within the scope of their duties for the fund generally would not be joint transactions under section 17(d) and rule 17d–1).

[107] 17 CFR 270.17d–1(d)(7). Reliance on rule 17d–1(d)(7) currently is conditioned on a fund's board, and a majority of its independent directors, annually determining that the joint policy is in the best interests of the fund and that the proportion of the policy's premium allocated to the fund is fair and reasonable.

[108] *See* ICA Advisory Group Report, *supra* 28, at 26. The general purpose of these standard ''insured versus insured'' exclusions is to prevent collusion among insureds.

[109] *See* Paul H. Dykstra and Paulita Pike-Bokhari, *The Yacktman Battle: Manager Bites the Watchdogs*, Investment Law., Nov./Dec. 1998, at 1, 9–10 (discussing the effect of an ''insured versus insured'' exclusion of insurance coverage on independent directors of the Yacktman Fund).

[110] Proposed rule 17d–1(d)(7)(iii). The proposed amendments would prohibit exclusions for bonafide (*i.e.*, non-collusive) claims made against any independent director by another person insured under the joint insurance policy. The proposed amendments also would prohibit exclusion of coverage for the fund if it is a co-defendant with an independent director in a claim brought by a co-insured. We believe that the ability of fund directors to perform their duties may be further impaired if an adviser's lawsuit poses a threat to fund assets as well as to director's personal assets.

[111] Earlier this year, Chairman Levitt expressed concern about standard ''insured versus insured'' exclusions. *See* Arthur Levitt, Keeping Faith with the Shareholder Interest: Strengthening the role of Independent Directors of Mutual Funds (remarks at the Mutual Funds and Investment Management Conference, Palm Springs, CA, Mar. 22, 1999), available at <http://www.sec.gov/news/speeches/spch259.htm>. In response, the ICI Mutual Insurance Company (''ICI Mutual''), which insures funds representing approximately 70 percent of all mutual fund assets, recently announced that it has revised its D&O/E&O policies to clarify that these types of claims are covered under its standard insurance policy. *See* Aaron Lucchetti, *Direct and Protect*, Wall St. J., April 2, 1999, at C23. ICI Mutual now makes available a standard policy endorsement that permits independent directors to recover defense costs, settlements, and judgments in ''insured versus insured'' claims otherwise covered under the policy. This change by ICI Mutual is a significant step toward ensuring the ability of independent directors to vigorously fulfill their duties under the Act without concerns of personal liability. We believe, however, that all independent directors who serve on funds that obtain joint liability insurance policies should have the benefit of protections similar to those provided by ICI Mutual.

ICI Advisory Group Report, *supra* note 28, at 26. the Report also noted that independent directors may need to be covered by insurance after their service on the board has ended for claims involving their service as directors. *Id.* at 26–27.

[113] Section 32(a)(1).

[114] Section 32(a)(2) [15 U.S.C. 80a–31(a)(2)].

[115] *See supra* note 3 and accompanying test.

[116] *See generally* A.B.A., Section of Business Law, Corporate Director's Guidebook 27–32 (2d ed. 1994) [''1994 Corporate Director's Guidebook'']; *See also* Investment Company Institute, Understanding the Role of Mutual Fund Directors 7 (1998) (noting that although not required by law, it is common practice for mutual funds to have an audit committee oversee the financial reporting and internal controls of the fund and stating that the results of a 1998 survey conducted by Management Practice Inc. indicated that 100 percent of fund boards surveyed had an audit committee); Fund Director's Guidebook, *supra* note 62, at 26 (stating that the audit committees of many funds are comprised of all of the fund's independent directors).

requirements of the primary U.S. securities exchanges require publicly traded companies to have audit committees,[117] and many commentators have recognized the value of independent audit committees and the significance of their function in a corporate governance structure.[118] Recently, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees emphasized the important role of audit committees and recommended enhanced responsibilities, membership standards, and methods of operation designed to strengthen their oversight function.[119] The ICI Advisory Group Report, furthermore, recommended that fund boards establish audit committees comprised entirely of independent directors.[120]

We believe that the ongoing oversight provided by an independent audit committee can provide greater protection to shareholders than the current requirement for shareholder ratification of a fund's independent auditors. We therefore are proposing a rule that would exempt a fund from the Act's requirement that shareholders ratify or reject the selection of the fund's independent public accountant if the fund has an audit committee comprised wholly of independent directors.[121] In order for a fund to rely on the proposed exemption, (i) the audit committee must be responsible for overseeing the fund's accounting and auditing processes,[122] (ii) the fund's board of directors must adopt an audit committee charter setting forth the committee's structure, duties, powers, and methods of operation,[123] and (iii) the fund must maintain a copy of the charter.[124]

We request comment regarding the conditions of the proposed rule. Should the exemption require that the charter set forth certain specific responsibilities and methods of operation? Should funds relying on the exemption be required to provide a copy of their audit committee charter as an exhibit to their registration statement, and should the board be required to review the charter on an annual basis? Should the exemption require fund audit committees to obtain an annual representation from the fund's independent public accountant certifying its independence, as the ICI Advisory Group suggested?[125] Should the exemption include other conditions that are similar to the recommendations of the ICI Advisory Group and Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees?

The proposed rule assumes that the appropriate form for the instrument governing an audit committee is a charter. Should the rule explicitly recognize that the audit committee provisions could be included in a document other than the charter, such as the fund's by-laws, articles of incorporation, or declaration of trust?

D. Qualification as an Independent Director

In addition to the amendments to enhance the independence of fund boards, we are proposing amendments to prevent qualified individuals from being unnecessarily disqualified from serving as independent directors. The Investment Company Act sets standards for who may be considered an independent director.[126] While these standards are meant to exclude individuals with affiliations or business interests that can impair their independence, there are circumstances in which the standards may cause certain individuals to be unnecessarily disqualified from serving as an independent director. For this reason, Congress directed the Commission to apply the standards ''in a flexible manner'' and adopt appropriate exemptions.[127] Today we are proposing (i) to amend the rule that permits directors to be considered independent directors even if they are affiliated with a broker-dealer, and (ii) a new rule that would prevent directors from being disqualified as independent directors solely because they own shares of index funds that hold limited interests in their fund's adviser or principal underwriter.

1. Affiliation With a Broker-Dealer

Section 2(a)(19) of the Act provides that no person can be an independent director if he is, or is affiliated with, a registered broker-dealer.[128] This provision is designed to prevent independent directors from being influenced by a business relationship with broker-dealers.[129] Rule 2a19–1 under the Act provides relief from this provision under certain conditions, but only if no more than a minority of a

---

[117] *See e.g.*, New York Stock Exchange Listed Company Manual ¶ 303.00.

[118] *See, e.g.*, Roundtable Transcript of Feb. 23, 1999 at 236 (statement of Manuel H. Johnson) (noting that an audit committee comprised entirely of independent directors serves as a check and balance); 1994 Corporate Director's Guidebook, *supra* note 116, 27 (''The Audit Committee should be composed solely of independent directors.''); Fund Director's Guidebook, *supra* note 62, at 25–26 (noting that the boards of many public companies, including funds, have established audit committees at the urging of many governmental and non-governmental institutions that have determined that audit committees can play a meaningful role in ensuring corporate accountability), *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation: Statement of the Business Roundtable*, 33 Bus. Law. 2083, 2108, 2109 (1978) (''[W]e believe it highly desirable * * * that the board be served by an Audit Committee.'' THe audit committee should be ''composed entirely of non management directors.'') Report of the National Commission on Fraudulent Financial Reporting 12 (Oct. 1987) [''Treadway Report''] (''The audit committee on the board of directors plays a role critical to the integrity of the company's financial reporting. [We] recommend[] that all public companies be required to have audit committees composed entirely of independent directors.''); Advisory Panel on Auditor Independence, Strengthening the Professionalism of the Independent Auditor 14 (Sep. 13, 1994) (Special Report to the Oversight Board of the SEC Practice Section, AICPA [''Kirk Panel Report''] (noting that it is important that companies have audit committees of independent directors).

[119] Blue Ribbon Committee Report, *supra* note 99. With respect to independence of audit committee members, the Blue Ribbon Committee Report states:

[I]t is widely recognized that each member of the audit committee should be an independent director. Several recent studies have produced a correlation between audit committee independence and two desirable outcomes: a higher degree of active oversight and a lower incident of financial statement fraud. In addition, common sense dictates that a director without any financial, family, or other material personal ties to management is more likely to be able to evaluate objectively the propriety of management's accounting internal control and reporting practices.

Id. at 22.

[120] ICI Advisory Group Report, *supra* note 28, at 22–23.

[121] *See* proposed rule 32a–4(b). A closed-end fund listed on a stock exchange also is subject to the exchange's listing requirements regarding audit committees. *See, e.g., Supra* note 117 and accompanying text.

[122] Proposed rule 32a–4(a).

[123] Proposed rule 32a–4(c).

[124] Proposed rule 32a–4(d). Under the current requirements of rule 31a–1(b)(4) [17 CFR 270.31a–1(b)(4)], funds also would be required to maintain minute books of the audit committee's meetings.

[125] *See* ICI Advisory Group Report, *supra* note 28, at 22–23. *Cf.* Independence Standards Board Standard No. 1: Independence Discussions with Audit Committees (Jan. 1999) (requiring, for all funds with fiscal years ending after July 19, 1999, that a fund's auditor provide an annual representation of the auditor's independence).

[126] For example, the Act provides that no person can be an independent director to a fund if he is affiliated with the fund itself, or with the fund's investment adviser or principal underwriter. Section 2(a)(19)(A)(i), (A)(iii), (B)(i) [15 U.S.C. 80a–2(a)(19)(A)(i), (A)(iii), (B)(i)]. *See generally infra* note 170.

[127] *See* H.R. Rep. No. 1382, 91st Cong., 2d Sess. 15 (1970).

[128] Section 2(a)(19)(A)(v), (B)(v) [15 U.S.C. 80a–2(a)(19)(A)(v), (b) (v)].

[129] *See* The First Australia Fund, Inc., SEC No-Action Letter, at n.8 and accompanying text (Oct. 8, 1987) (''The broad scope of section 2(a)(19) with respect to brokers and dealers appears to have been prompted by the many subtle relationships that exist between persons who are active in the securities markets.'') (citing Public Policy Report, *supra* note 10, at 162–88). Congress also may have adopted this broad prohibition reaction to the nature of fund brokerage arrangements when fixed commission rates were prevalent. *See* Certain Persons Not Deemed Interested Persons; Definition of Regular Broker or Dealer, Investment Company Act Release No. 13920 (May 2, 1984) [49 FR 19519 (May 8, 1984)] at n.1 [''Rule 2a19–1 Proposing Release''].

fund's independent directors are broker-dealers or affiliated with broker-dealers.[130] When we proposed this condition in 1984, we explained that allowing all of the fund's independent directors to be affiliated with broker-dealers would be inconsistent with Congress's intent to separate independent directors from the brokerage industry.[131]

In recent years, some directors have been unable to qualify as independent directors due to the condition that no more than a minority of a fund's independent directors may be affiliated with a broker-dealer. This condition has been especially troublesome for funds with small boards of directors. For example, if a three-member board has only two independent directors, neither director can rely on rule 2a19–1 because it would result in more than a minority of the independent directors relying on the rule. In these types of circumstances, the Commission has granted exemptions from this condition of the rule.[132]

We are proposing to amend rule 2a19–1 to provide that no more than *one-half* of a fund's independent directors may be broker-dealers or their affiliates.[133] This condition should make the rule more flexible for funds with small boards of directors, while continuing to ensure that not all of a fund's independent directors are broker-dealers or their affiliates.[134] We seek comment on whether rule 2a19–1 should be expanded further.

2. Ownership of Index Fund Securities

Section 2(a)(19) disqualifies an individual from being considered an independent director if he knowingly has any direct or indirect beneficial interest in a security issued by the fund's investment adviser or principal underwriter, or by a controlling person of the adviser or underwriter.[135] A fund director, for example, who owns securities issued by the fund's adviser (or its parent company) could not be an independent director. This provision was designed to ensure that an independent director does not have a financial interest in the organizations that are closely associated with the fund or that would benefit from payments that the independent director is charged with scrutinizing.[136]

If a director owns securities of an index fund [137] that seeks to replicate a securities market index that includes securities of the fund's adviser (or principal underwriter or a controlling person of the adviser or principal underwriter), an issue could arise whether the director knowingly has an indirect beneficial interest in the securities of the adviser (or principal underwriter or controlling person).[138] We believe that this attenuated interest in the adviser's or underwriter's securities is not the type of interest Congress intended to prohibit independent directors from owning when it adopted section 2(a)(19). An index fund's investment decision-making process is dictated by the goal of mirroring the performance of a market index, and thus is largely mechanical.[139] Because index fund portfolios typically are spread among a large number of issuers, ownership of their shares is unlikely to have a material effect on the independent judgment of a fund director.

In order to resolve concerns that may have arisen about the status of independent directors who own index funds, we are proposing a new rule that would conditionally exempt an individual from being disqualified as an independent director merely because he owns shares of an index fund that invests in the adviser or underwriter of the fund, or their controlling persons.[140] The exemption would be available if the value of securities issued by the adviser or underwriter (or controlling person) does not exceed five percent of the value of any index tracked by the index fund.[141] The purpose of this condition is to assure that an independent director's indirect interest in the adviser's securities will not be substantial enough to impair his independence and create a conflict of interest.

The proposed rule would define an ''index fund'' as a fund with an investment objective to replicate the performance of a securities index or indices.[142] We request comment on the proposed definition of index fund. Does it encompass the types of funds for which relief is appropriate? Should other types of investment vehicles be included in the proposed rule? We also request comment on the proposed limit on the percentage of the value of securities of the adviser or principal underwriter (or their controlling persons) represented in any index tracked by the fund. Should the rule allow an independent director to own index fund shares when the value of the securities issued by the adviser or underwriter (or their controlling persons) in the index constitutes more than five percent of the value of any index tracked by the fund? Should the limit be less than five percent?

---

[130] Rule 2a19–1(a)(3) [17 CFR 270.2a19–1(a)(3]. Rule 2a19–1 also requires that the broker-dealer not execute any portfolio transactions for, engage in any principal transactions with, or distribute shares for, the fund's ''complex,'' and that the board determine that the fund and its shareholders will not be adversely affected if the broker-dealer does not perform those functions for the fund. Rule 2a19–1(a)(1), (2) [17 CFR 270.2a19–1(a)(1), (2)]. The rule defines ''complex'' to the fund on whose board the director serves, its investment adviser and principal underwriter, and other funds having the same adviser or principal underwriter. Rule 2a19–1(b) [17 CFR 270.2a19–1(b).

[131] *See* Rule 2a19–1 Proposing, *supra* note 129, at n.36 and accompanying text.

[132] *See* Bergstrom, Capital Corporation, Investment Company Act Release Nos. 23629 (Dec. 31, 1998) [64 FR 1035 (Jan. 7, 1999)] (notice) and 23666 (Jan. 26, 1999) [68 SEC Docket 3501 (Feb. 23 1999)] (order); Counsellors Tandem Securities Fund, Inc. and Warburg, Pincus Counsellors, Inc., Investment Company Act Release Nos. 15636 (Mar. 24, 1987) [52 FR 10278 (Mar. 31, 1987)] (notice) and 15697 and 15697 (Apr. 22, 1987) [38 SEC Docket 318 (May 5, 1987)] (order).

[133] Proposed amendment to rule 2a19–1(a)(3).

[134] We also are proposing to amend the title of rule 2a19–1 to refer specifically to broker-dealers, the subject of the rule.

[135] Section 2(a)(19)(B)(iii) [15 U.S.C. 80a–2(a)(19)(B)(iii)].

[136] *See* H.R. Rep. No. 1382, 91st Cong., 2d Sess. 13–14 (1970) (expressing policy concerns about the use of ''affiliated person'' in the Act because, among other things, it permitted a director to be classified as ''unaffiliated'' even though he had substantial business relationships with the fund, its adviser, or its underwriter); Public Policy Report, *supra* note 10, at 332–34 (same); *see also* section 15(c) of the Act (requiring independent directors to scrutinize and approve the fund's contracts with investment advisers and principal underwriters).

[137] An index fund is a type of fund that selects the securities in its portfolio in an effort to replicate the investment performance of the securities in a market index. Nearly 20 percent of the index funds registered with the Commission track the performance of the Standard & Poor's 500 Composite Stock Price Index.® For a discussion of other types of indexes, *see* John Waggoner, *Index Funds Race Into New Venues; Investors Can Track Europe or Racing Firms,* USA Today, Nov. 27, 1998, at 3B.

[138] *Cf.* The Massachusetts Company, SEC No-Action Letter (Jan. 29, 1972) (fund director who serves as a trustee of an irrevocable trust that holds shares of a controlling person of the fund's adviser and underwriter would be an interested person of the fund under section 2(a)(19)(B)(iii)).

[139] *Cf., e.g.,* The Victory Stock Index Fund, SEC No-Action Letter (Feb. 7, 1995) (staff would not recommend enforcement action under section 12(d)(3) or rule 12d3–1 when an index fund purchased securities of an affiliated person of the fund's adviser or principal underwriter, because, among other things, the ''non-volitional nature of the index fund's purchases'' made it unlikely that the fund's portfolio securities would be selected in the interest of the fund's adviser or principal underwriter, rather than the fund's shareholders).

[140] The proposed rule would not address an independent director's ownership of securities of an *actively* managed fund. The holdings of this type of fund can vary from day to day without the knowledge of the fund's shareholders, and periodic disclosure of fund holdings may be out of date by the time an investor receives them. We therefore believe it is clear that an independent director who owns shares of an actively managed fund ordinarily would not ''knowingly'' have an indirect beneficial interest in the issuers of securities the fund holds.

[141] Proposed rule 2a19–3.

[142] *Id.*

E. Disclosure of Information About Fund Directors

Participants at the Roundtable agreed that independent directors can vigilantly represent the interests of mutual fund shareholders only when they are truly independent of those who operate and manage the fund.[143] We agree with the Roundtable participants and believe that the effectiveness of fund boards of directors is enhanced by a high degree of independence of each independent director.

We believe that shareholders have a significant interest in knowing who the independent directors are, whether the independent directors' interests are aligned with shareholders' interests, whether the independent directors have any conflicts of interest, and how the directors govern the fund. This information helps a mutual fund shareholder to evaluate whether the independent directors can, in fact, act as an independent, vigorous, and effective force in overseeing fund operations.

The Commission has long recognized the importance of providing mutual fund shareholders with relevant information about fund directors and has required funds to provide shareholders with certain information about fund directors. Currently, information about directors is available in fund registration statements and proxy statements for the election of directors. Generally, funds are required to provide basic information about directors in the statement of additional information (''SAI'') and proxy statements, including name and age; positions with the fund; principal occupations during the past five years; and compensation from the fund and fund complex.[144] Moreover, funds are required to disclose in proxy statements for the election of directors a director's positions with, interests in, and transactions with, the fund and certain persons related to the fund.[145]

For some time, however, we have been concerned that mutual fund investors do not in all cases have access to significant information about fund directors when they need it. When we adopted our recent comprehensive revisions to the mutual fund prospectus, we noted that mandating more information about fund directors than is available under our existing rules may be appropriate in light of independent directors' role as ''watchdogs'' for fund shareholders.[146] Critics have charged that shareholders do not know the very people who are entrusted with safeguarding their interests.[147] Some have complained that fund shareholders do not know whether the interests of independent directors are aligned with shareholders or with fund management.[148]

We have reevaluated our disclosure requirements in light of these criticisms and have concluded that, while our fundamental approach is sound, there are several gaps in the information that shareholders currently receive about directors. Historically, the primary vehicle for providing information about mutual fund directors was the proxy statement prepared in connection with shareholder meetings. In recent years, the proxy statement has become an ineffective vehicle for communicating information to fund shareholders on a regular basis because funds generally are no longer required to hold annual meetings.[149]

In addition, although mutual funds are required to disclose certain information that bears on a director's potential conflicts, the SAI requirements and proxy rules do not require disclosure of other circumstances that could raise similar conflict of interest concerns, such as those involving a director's immediate family members. The current rules also do not require disclosure of information that may show

[143] *See, e.g.*, statement of Bruce K. MacLaury, Roundtable Transcript of Feb. 23, 1999, at 42 (''It should be apparent that boards work best when the possibilities for conflict of interest are minimized so that truly independent directors can exercise their best judgment on behalf of the interest of the shareholders.''); statement of Dawn-Marie Driscoll, Roundtable Transcript of Feb. 24, 1999, at 63 (''[I]ndependence is one of the most important characteristics of an independent director. The more ways that you can ensure independence the better the process will be.''); statement of Thomas R. Smith, Jr., Roundtable Transcript of Feb. 24, 1999, at 253 (''There is something beyond what is in the statute that you consider when you pick new directors. You've got to look at material business relationships, and, quite frequently, in the selection process you will rule somebody out, although technically they are independent, because of relationships.'').

[144] Items 13(b) and (d) of Form N–1A; Items 18.1 and 18.4 of Form N–2; Items 20(a) and (c) of Form N–3; Items 401(a) and (e) of Regulation S–K, through Item 22(b)(4) of Schedule 14A.

Funds also are required to disclose for each director the positions held with affiliated persons or principal underwriters of the fund. Item 13(c) of Form N–1A; Item 18.2 of Form N–2; Item 20(b) of Form N–3. Funds also must provide the percentage of the fund's equity securities owned as a group by all officers, directors, and advisory board members. Item 14(c) of Form N–1A and Item 19.3 of Form N–2. *See also* Items 23(f) and 25 of Form N–1A; Items 24.2.i and 29 of Form N–2; Items 21(a)(ii) and (f)(ii), 28(b)(10), and 32 of Form N–3.

[145] *See* Item 22(b)(1) of Schedule 14A (requiring disclosure of director's positions with the investment adviser and a director's securities holdings or material interest in the investment adviser and any person controlling, controlled by, or under common control with the investment adviser); Item 401 of Regulation S–K, through Item 22(b)(4) of Schedule 14A (requiring disclosure of director's positions with the fund); Item 22(b)(2) of Schedule 14A (requiring disclosure of any material interests of a director in the fund's principal underwriter or administrator); Item 22(b)(3) of Schedule 14A (requiring disclosure of any material interests of a director in any material transactions with the fund, the investment adviser, the principal underwriter, or the administrator, and any person controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator); Item 404(a) of Regulation S–K, through Item 22(b)(4) of Schedule 14A (requiring disclosure of a director's material interests in transactions with the fund involving amounts over $60,000). Funds also must disclose in proxy statements a director's holdings in the fund. Item 403(b) of Regulation S–K, through Item 6(d) of Schedule 14A. *See also* Items 5, 7(e), (f), and (g), and 22(b)(5) and (b)(6) of Schedule 14A (requiring other information about directors).

[146] Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916, 13931 (Mar. 23, 1998)] (''1998 Form N–1A Release'').

[147] John Markese, president of the American Association of Individual Investors, discussed his view that there is a ''disconnect'' between shareholders and the independent directors at our recent Roundtable. Roundtable Transcript of Feb. 23, 1999, at 48–49. *See also* Paul J. Lim, *Despite Plan to Fortify Independent Directors, Shareholders Must be Their Own Watchdogs*, L.A. Times, Mar . 28, 1999, at C3; Russ Wiles, ''Fund Directors Losing Clout,'' The Arizona Republic D1 (Mar. 28, 1999).

[148] *See, e.g.*, Edward Wyatt, *Empty Suits In the Board Room; Under Fire, Mutual Fund Directors Seem Increasingly Hamstrung*, N.Y. Times, June 7, 1998, at C1; Steven D. Kaye, *Whose board is it?*, U.S. News & World Rep., Feb. 2, 1998, at 64; Jason Zweig, *How Funds Can Do Better*, MONEY, Feb. 1998, at 42.

[149] *See* John Nuveen & Co., Inc. SEC No-Action Letter (Nov. 18, 1986) (''Nuveen Letter'') (annual meetings to elect directors not required by Investment Company Act). The Nuveen Letter took the position that annual meeting requirements generally are a question of state law.

For historical and other reasons, most funds are organized under the laws of Massachusetts or Maryland. The organizational and operational requirements of Massachusetts business trusts are not specified by statute, and a fund's essential structure is contained in the trust agreement, which generally includes a provision eliminating the need for annual shareholder meetings to elect directors. *See generally* Jones, Moret and Storey, *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421 (1988). Under Maryland corporate law, fund charters or by-laws are not required to provide that annual meetings be held in any year in which election of directors is not required by the Investment Company Act. MD. CODE ANN., CORPS. & ASS'NS Code § 2–501(b) (1999). In addition, Delaware, Minnesota, and California also have business trust or special corporate law structures that have the effect of not requiring shareholder meetings other than those required by the Investment Company Act. DEL. CODE ANN. tit. 12, § 3806 (1999); Minn. Stat. § 302A.431 (1999); CAL. CORP. CODE § 600(b) (West 1999).

Closed-end funds registered on national securities exchanges, however, are required to hold an annual meeting to elect directors under the rules of the exchanges. *See, e.g.*, American Stock Exchange Listing Standards, Policies, and Requirements § 704; New York Stock Exchange Listed Company Manual § 302.00. Closed-end fund shareholders therefore generally would receive annual proxy statements.

that a director's interests are aligned with shareholder interests, including a director's securities holdings in funds in the fund complex.

Therefore, we are proposing amendments to our disclosure rules to close these gaps. Our proposals would require mutual funds to:

- Provide basic information about directors to shareholders annually so that shareholders will know the identity and experience of their representatives;
- Disclose to shareholders fund shares owned by directors to help shareholders evaluate whether directors' interests are aligned with their own;
- Disclose to shareholders information about directors that may raise conflict of interest concerns; and
- Provide information to shareholders on the board's role in governing the fund.

These proposals would supplement the information that currently is available in the mutual fund SAI and in proxy statements. For ease of reference, we have attached as Appendix A a table cross-referencing the proposed disclosure requirements in the proxy rules and the SAI of Form N–1A with existing requirements.[150]

1. Basic Information About Directors

(a) Location of Information. The Commission is proposing to require mutual funds to disclose basic information about directors in an easy-to-read tabular format.[151] We are proposing to combine in one table certain information currently required for directors in the SAI and proxy statements.[152] This new table would be required in three places: the fund's annual report to shareholders, SAI, and proxy statement for the election of directors. This would ensure that the information is available to prospective investors upon request. It also would ensure that mutual fund shareholders receive basic information about the identity and experience of their directors both annually and whenever they are asked to vote to elect directors.

We are not proposing to require that basic information about directors be included in the prospectus. We considered, and rejected, this idea during our recent top-to-bottom overhaul of the mutual fund prospectus.[153] At the time of our prospectus overhaul, however, we directed the Division of Investment Management to consider whether information about directors should be included in fund annual reports, and we have now concluded that it should.[154]

Our proposals would, for the first time, require that basic information about mutual fund directors be included in the annual report to shareholders.[155] Because the proxy statement is no longer received by most fund shareholders annually, we are proposing to include basic information about directors in the annual report to ensure that shareholders will receive it regularly. We also are proposing to require funds to include in the annual report a statement that the SAI includes additional information about fund directors and is available without charge upon request.[156] The statement must include a toll-free (or collect) telephone number for shareholders to call for additional information.

We request comment on the appropriate location for basic information about mutual fund directors. Please address whether basic information should be included in the prospectus, SAI, annual report, and/or proxy statement. Should we, for example, reconsider our decision not to include any of the basic information about directors in the prospectus?

(b) Required Information. The proposed table would require for each director: (1) Name, address, and age; (2) current positions held with the fund; (3) term of office and length of time served; (4) principal occupations during the past five years; (5) number of portfolios overseen within the fund complex; and (6) other directorships held outside of the fund complex.[157] The table also would require for each ''interested'' director, as defined in section 2(a)(19) of the Act, a description of the relationship, events, or transactions by reason of which the director is an interested person.[158]

Currently, mutual funds must disclose the number of other registered investment companies in the fund complex that a director oversees.[159] The Commission now is proposing to require disclosure of the total number of portfolios, rather than registered investment companies, that a director oversees.[160] In today's environment, where a complex may choose between organizing a single series company with multiple portfolios or multiple investment companies each with a single portfolio, we believe that requiring disclosure of the number of portfolios that a director oversees would provide a more accurate picture of the director's responsibilities.

The Commission seeks comment on whether the proposed basic information would provide shareholders with sufficient information about the directors who are charged with protecting shareholder interests. If the disclosure would not achieve this purpose, is there other basic information about directors that should be required? If proposed disclosure of any item is not necessary or useful to investors, please explain the reason why. Should the same basic information be included in the SAI, annual report, and proxy statement?

2. Ownership of Equity Securities in Fund Complex

As discussed above, some have complained that shareholders do not know whether directors' interests are

---

[150] Form N–1A is the registration form used by open-end management investment companies to register under the Investment Company Act and to offer their shares under the Securities Act. We also are proposing parallel changes to Forms N–2 (closed-end funds) and N–3 (managed separate accounts offering variable annuity contracts).

[151] Proposed Item 22(b)(1) of Schedule 14A; proposed Items 13(a)(1) and 22(b)(5) of Form N–1A; proposed Item 18.1 and Instruction 4.e. to Item 23 of Form N–2; proposed Item 20(a) and Instruction 4(v) to Item 27 of Form N–3. For convenience in discussing the proposed requirements, we are not specifically referring to nominees for election as directors. The proposed requirements, however, would be applicable to nominees in proxy solicitations for the election of directors. The disclosure requirements in Item 22 of Schedule 14A also are applicable to information statements prepared in accordance with Regulation 14C and Schedule 14C [17 CFR 240.14c–101].

[152] *See* Item 13(b) of Form N–1A; Item 18.1 to Form N–2; Item 20(a) of Form N–3; Items 401(a) and (e) of Regulation S–K, through Item 22(b)(4) of Schedule 14A. As currently required, funds would continue to include in the table information about officers and advisory board members of the fund, as well as directors. *See* Items 13(b) of Form N–1A; Item 18.1 of Form N–2; Item 20(a) of Form N–3; Items 401(b) and (e) of Regulation S–K, through Item 22(b)(4) of Schedule 14A.

[153] *See* 1998 Form N–1A Release, *supra* note 146, at 13930–13931.

[154] *See Id.*

[155] Proposed Item 22(b)(5) of Form N–1A; proposed Instruction 4.e. to Item 23 of Form N–2; proposed Instruction 4(v) to Item 27 of Form N–3.

[156] Proposed Item 22(b)(6) of Form N–1A; proposed Instruction 4.e. to Item 23 of Form N–2; proposed Instruction 4(vi) to Item 27 of Form N–3.

[157] As is currently required, the fund also would be required to explain any family relationship between the persons listed in the table. *See* current Item 401(d) of Regulation S–K, through Item 22(b)(4) of Schedule 14A; Item 13(b) of Form N–1A; Item 18.1 of Form N–2; Item 20(a) of Form N–3; proposed Item 22(b)(1) of Schedule 14A; proposed Item 13(a)(1) of Form N–1A; proposed Item 18.1 of Form N–2; proposed Item 20(a) of Form N–3.

[158] Proposed Instruction 4 to Item 22(b)(1) of Schedule 14A; proposed Instruction 2 to Item 13(a)(1) of Form N–1A; proposed Instruction 2 to Item 18.1 N–2; proposed Instruction 2 to Item 20(a) of Form N–3.

[159] *See* Item 401(e)(2) and Instruction to Item 401(e)(2) of Regulation S–K, through Item 22(b)(4) of Schedule 14A; Item 13(c) and Instruction to Item 13(c) of Form N–1A; Item 18.2 and Instruction to Item 18.2 of Form N–2; Item 20(b) and Instruction to Item 20(b) of Form N–3.

[160] Proposed Item 22(b)(1) of Schedule 14A; proposed Item 13(a)(1) of Form N–1A; proposed Item 18.1 of Form N–2; proposed Item 20(a) of Form N–3.

aligned with those of shareholders.[161] Although a director need not necessarily hold securities of funds in a fund complex to be an effective advocate for shareholders, the interests of a director who holds shares in the complex will tend to be aligned with the interests of other shareholders.[162] We are therefore proposing to require disclosure of the aggregate dollar amount of equity securities of funds in the fund complex owned beneficially and of record by each director.[163]

We are not proposing to require separate disclosure of a director's holdings of equity securities in the fund itself. We are concerned that this information might have limited meaning because of the many reasons that a director could have for not holding shares of any specific fund, *e.g.*, that its investment objective did not fill a need in the director's portfolio.

Funds would provide information on director holdings in an easy-to-read tabular format including: (1) Name of director; (2) identity of fund complex; and (3) aggregate dollar amount of equity securities owned of funds in the complex. The information, as of the most recent practicable date, would be provided in the fund's SAI and in any proxy statement relating to the election of directors. This would ensure that the information is available to prospective investors upon request and is provided to shareholders whenever they are asked to vote to elect directors.[164]

''Fund complex'' is currently defined in the proxy rules as two or more funds that (1) hold themselves out to investors as related companies for purposes of investment and investor services; or (2) have a common investment adviser or an investment adviser that is an affiliated person of the investment adviser of any of the other funds.[165] The Commission is proposing to use this definition to determine a director's holdings in a fund complex.[166]

We request comment on whether information on director holdings of shares in a fund complex would be useful to shareholders. If so, should the Commission use the definition of ''fund complex'' that is currently contained in the proxy rules? Or should the Commission use another definition, such as ''family of investment companies'' used in Form N–SAR?[167] Should disclosure of director holdings be limited to holdings in the fund itself, the group of funds overseen by a director, or some other group of funds? The Commission also requests comment on whether there is other information that bears on the alignment of interests of shareholders and directors and should be disclosed.

3. Conflicts of Interest

(a) Statutory Scheme Governing Conflicts of Interest. As described above, Congress provided that at least 40 percent of the board of directors of an investment company must be independent and assigned a special role to the independent directors—to supply a check on management and act as independent watchdogs for investors.[168] Under the Investment Company Act, an independent director is an individual who is not an ''interested person'' of the fund.[169]

In section 2(a)(19) of the Act, Congress enumerated individuals who are ''interested persons'' of a fund and who, therefore, are not considered independent directors. These individuals include: (1) Any affiliated person of the fund, (2) any member of the immediate family of any natural person who is an affiliated person of the fund, (3) any interested person of any investment adviser of or principal underwriter for the fund, (4) any person or partner or employee of any person who at any time since the beginning of the last two completed fiscal years of the fund has acted as legal counsel for the fund, and (5) any broker or dealer registered under the Exchange Act or any affiliated person of a broker or dealer.[170]

Congress also gave the Commission authority to determine by order that a director is an interested person even though he is not covered by the categories enumerated in the statute.[171] The Commission may determine that a natural person is an interested person of a fund by reason of having had, at any time since the beginning of the last two completed fiscal years of the fund, a material business or professional relationship with the fund, the principal executive officer of the fund, any other investment company having the same investment adviser or principal underwriter, or the principal executive officer of the other investment

---

[161] *See supra* note 148 and accompanying text.

[162] *See* Peter McKenna, *Mutual Funds Are Built to Last With Embedded Checks, Balances*, Investor's Business Daily, May 1, 1998, at B4 (quoting fund industry consultant Geoffrey H. Bobroff) (''It's useful to see how many shares are owned by members of the board. * * * Most investors like board members to share the fund's risk and possible reward.'').

[163] Proposed Item 22(b)(4) of Schedule 14A; proposed Item 13(b)(4) of Form N–1A; proposed Item 18.7 of Form N–2; proposed Item 20(f) of Form N–3.

[164] As noted earlier, *supra* note 149, closed-end funds are not required to update their registration statements annually; however, shareholders would receive the information annually in proxy statements for the election of directors.

[165] *See* Item 22(a)(1)(v) of Schedule 14A.

[166] *See* proposed Instruction 1(a) to Item 13 of Form N–1A; proposed Instruction 1.b. to Item 18 of Form N–2; proposed Instruction 1.a. to Item 20 of Form N–3. The proposed definition of ''fund complex'' also would apply to the proposed disclosure requirement for basic information about directors. *See supra* note 157 and accompanying text (proposing to require disclosure for each director of the number of portfolios overseen within the fund complex and other directorships held outside of the fund complex).

[167] *See* Item H of Form N–SAR [17 CFR 274.101] (defining ''family of investment companies'' to mean any two or more investment companies that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services); *see also* Rule 11a–3 under the Act [17 CFR 270.11a–3] (defining ''group of investment companies'' to mean any two or more open-end investment companies that hold themselves out to investors as related companies for purposes of investment and investor services and that either (1) have a common investment adviser or principal underwriter or (2) the investment adviser or principal underwriter of one of the companies is an affiliated person of the investment adviser or principal underwriter of each of the other companies).

[168] *See supra* notes 20, 22, and 23 and accompanying text.

[169] *See* section 10(a) of the Act.

[170] Sections 2(a)(19)(A)(i)–(v) of the Act [15 U.S.C. 80a–2(a)(19)(A)(i)–(v)]. Section 2(a)(3) of the Act [15 U.S.C. 80a–2(a)(3)] defines affiliated person of another person to mean: (1) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

Section 2(a)(19) of the Act [15 U.S.C. 80a–2(a)(19)] defines immediately family member to mean any parent, spouse of a parent, child, spouse of a child, spouse, brother, or sister, and includes step and adoptive relationships.

Sections 2(a)(19)(B)(i)–(v) of the Act [15 U.S.C. 80a–2(a)(19)(B)(i)–v] define an interested person of an investment adviser or principal underwriter of a fund to include: (1) Any affiliated person of the investment adviser or principal underwriter; (2) any member of the immediate family of any natural person who is an affiliated person of the investment adviser or principal underwriter; (3) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by the investment adviser or principal underwriter or by a controlling person of the investment adviser or principal underwriter; (4) any person or partner or employee of any person who at any time since the beginning of the last two completed fiscal years of the fund has acted as legal counsel for the investment adviser or principal underwriter; and (5) any broker or dealer registered under the Exchange Act or any affiliated person of a broker or dealer.

[171] *See* H.R. Rep. No. 1382, 91st Cong., 2d Sess. 14–15 (1970).

company.[172] We also may determine that a natural person is an interested person of an investment adviser or principal underwriter of a fund (and therefore of the fund itself) by reason of having had, at any time since the beginning of the last two completed fiscal years of the fund, a material business or professional relationship with the investment adviser or principal underwriter or with the principal executive officer or any controlling person of the investment adviser or principal underwriter.[173] For example, in appropriate circumstances, the Commission may find that a director who was an employee of a fund's investment adviser within the past two years is an ''interested person'' under section 2(a)(19)(B)(vi) of the Act by reason of having a material business or professional relationship with the investment adviser.[174]

(b) Need for Disclosure Changes. The proxy rules currently require significant information about conflicts of interest of directors.[175] The proxy rules require disclosure of positions held with the investment adviser and any securities holdings or material interests in the investment adviser and any person controlling, controlled by, or under common control with the investment adviser.[176] A mutual fund also must disclose any material interests of a director in the fund's principal underwriter or administrator.[177] In addition, a fund must disclose any material interests of a director in any material transactions with the fund, the investment adviser, the principal underwriter, the administrator, or any person controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator.[178]

We are proposing to enhance the disclosure required in the proxy rules because we believe that there are other situations that could involve conflicts of interest. We also are proposing to include the proposed conflicts disclosure about directors in the SAI because mutual funds no longer prepare proxy statements on a regular basis.[179]

We believe disclosure of directors' potential conflicts of interest would serve three purposes. First, this disclosure would bring to the attention of shareholders circumstances that may affect the directors' allegiance to shareholders. With this information, shareholders may decide for themselves whether an independent director has any potential conflicts of interest that could affect the director's ability to protect the interests of shareholders.

Second, disclosure would provide the public, including the press and other third-party information providers, access to information about directors' potential conflicts of interest. The resulting public dissemination may discourage the selection of independent directors who have relationships or engage in activities that raise questions about their independence.

Third, the information would assist the Commission in evaluating whether it should exercise its authority to determine that a director is ''interested'' under section 2(a)(19)(A)(vi) or (B)(vi) of the Act even though he is not within one of the categories of ''interested persons'' specifically enumerated by Congress in other provisions of section 2(a)(19).[180] The legislative history of section 2(a)(19) states that the Commission could issue an order determining that a director is an interested person if the Commission found that a director's ''business or professional relationship [with certain related persons] was material in the sense that it might tend to impair the independence of such director.'' [181] In providing the Commission with this authority, Congress contemplated that the Commission would look at each situation on a case-by-case basis.[182] The proposed disclosure would assist the Commission in determining whether it would be appropriate to make a further inquiry into a director's independence.

We believe that the proposed disclosure would give shareholders the tools to help determine how effectively the directors serve their interests and encourage the selection of directors that are independent in the spirit intended by Congress. We first discuss our general approach to the disclosure requirements and then discuss the specific requirements.

(c) General Approach to Disclosure—(1) Circumstances Raising Potential Conflicts of Interest. The Commission is proposing to require disclosure of three types of circumstances that could affect the allegiance of mutual fund directors to their shareholders: positions, interests, and transactions and relationships of directors. In specifying the circumstances where disclosure is required, we have drawn on the current proxy rules, which require disclosure of positions, interests, and transactions of directors.[183]

The Commission is proposing to require disclosure of positions held by a director with the fund and persons related to the fund.[184] A director who holds such a position may be influenced to act in the interest of persons related to the fund rather than the interest of fund shareholders. We also are proposing to require disclosure of directors' interests, including securities holdings, in entities related to the fund.[185] A director who holds an

---

[172] Section 2(a)(19)(A)(vi) of the Act [15 U.S.C. 80a–2(a)(19)(A)(vi)]. The statute also provides that no person shall be deemed an interested person of a fund solely by reason of being a member of its board of directors or advisory board or an owner of its securities, or his membership in the immediate family of any person who is a member of the fund's board of directors or advisory board or an owner of its securities. *Id.*

[173] Section 2(a)(19)(B)(vi) of the Act [15 U.S.C. 80a–2(a)(19)(B)(vi)].

Section 2(a)(9) of the Act [15 U.S.C. 80a–2(a)(9)] defines control to mean the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 percent of the voting securities of a company shall be presumed to control such company. Any person who does not own more than 25 percent of the voting securities of any company shall be presumed not to control such company.

[174] *See* Interpretive Release, *supra* note 1.

[175] *See supra* note 145 and accompanying text.

[176] *See* Item 22(b)(1) of Schedule 14A.

[177] *See* Item 22(b)(2) of Schedule 14A.

[178] *See* Item 22(b)(3) of Schedule 14A, and Item 404(a) of Regulation S–K, through Item 22(b)(4) of Schedule 14A.

[179] *See supra* note 149 and accompanying text.

[180] *See supra* note 170 and accompanying text.

[181] *See* H.R. Rep. No. 1382, 91st Cong., 2d Sess. 14–15 (1970). Ordinarily, a business or professional relationship would not be deemed to impair independence where the benefits flow from the director of an investment company to the other party to the relationship. *Id.*

[182] *Id.* Over the years, Division of Investment Management staff analyzed issues arising under sections 2(a)(19)(A)(vi) or (B)(vi) of the Act on the particular facts of each case to determine whether a director's relationships might tend to impair the independence of the director. *See, e.g., Travelers Equities Fund Inc.*, SEC No-Action Letter (Jan. 11, 1982); *Securities Groups*, SEC No-Action Letter (Apr. 20, 1981); *Equitable of Iowa Variable Annuity Account A*, SEC No-Action Letter (Jan. 6, 1980); *American Medical Association*, SEC No-Action Letter (Dec. 5, 1979); *American Medical Association Tax-Exempt Income Fund, Inc.*, SEC No-Action Letter (Jun. 18, 1978); *Cal-Western Separate Account A*, SEC No-Action Letter (Mar. 8, 1976); *Southwestern Investors, Inc.*, SEC No-Action Letter (Jun. 13, 1971).

Beginning in 1984, the staff stated that it did not believe that it was appropriate for the staff to consider no-action requests under section 2(a)(19)(A)(vi) or (B)(vi) as a matter of policy. *Capital Supervisors Helios Fund, Inc.*, SEC No-Action Letter (Jun. 13, 1984); *see also Daniel Calabria*, SEC No-Action Letter (Sept. 12, 1984). *See also* Interpretive Release, *supra* note 1.

[183] *See* Items 22(b)(1) (positions with the interests in the investment adviser), 22(b)(2) (interests in the principal underwriter or administrator), 22(b)(3) (interests in transactions with the investment adviser, principal underwriter, or administrator), and 22(b)(4) (interests in transactions with the fund) of Schedule 14A.

[184] Proposed Item 22(b)(3) of Schedule 14A; proposed Item 13(b)(3) of Form N–1A; proposed Item 18.6 of Form N–2; proposed Item 20(e) of Form N–3.

[185] Proposed Items 22(b)(5) and (6) of Schedule 14A; proposed Items 13(b)(5) and (6) of Form N–

interest in an entity related to the fund may be tempted to place his financial interest in the entity ahead of shareholders' interests in the fund. Finally, we are proposing to require disclosure of directors' transactions and relationships with the fund and persons related to the fund.[186] A director who is involved in a transaction or relationship with the fund or related persons may have financial or other interests that compete with those of fund shareholders.

The Commission requests comment on whether disclosure of directors' positions, interests, and transactions and relationships is appropriate. Are there other types of circumstances that also raise conflict of interest concerns and should be disclosed?

(2) Persons Covered by Disclosure Requirements; Directors and Immediate Family Members. The Commission is proposing to follow the approach taken in the current proxy rules and require conflicts of interest disclosure about all directors, both interested and independent.[187] The Commission requests comment on whether this approach is appropriate, or whether there are any proposed requirements that should apply only to independent directors. If so, which requirements should apply only to independent directors?

The Commission also proposes to extend the disclosure requirements to the immediate family members of directors because the involvement of family members with the fund or persons related to the fund could raise the same conflicts of interest for a director as if the director was involved directly in the situation. The Commission proposes to define ''immediate family member'' to mean any spouse, parent, child, sibling, mother- or father-in-law, son- or daughter-in-law, or sister- or brother-in-law, including step and adoptive relationships.[188] This definition is similar to the definition of immediate family member in the current proxy rules.[189] We are proposing to add step and adoptive relationships, based on the definition of ''immediate family member'' in section 2(a)(19) of the Act. Our proposed definition would be slightly broader than the definition in section 2(a)(19) of the Act, which does not include mother- or father-in-law or sister- or brother-in-law relationships. We request comment on whether the proposed definition is appropriate, or whether it should be expanded or narrowed.

Related Persons. The Commission is proposing to require disclosure about circumstances involving directors, on the one hand, and the fund and persons related to the fund, on the other. We looked to the Act for guidance in determining which related persons should be covered by our disclosure requirements. The Commission's statutory authority to determine that a director is an ''interested person'' is based on finding a relationship with the fund; its investment adviser, principal underwriter, or a person controlling the investment adviser or principal underwriter; another investment company with the same investment adviser or principal underwriter; or the principal executive officer of the fund, its investment adviser or principal underwriter, or another investment company with the same investment adviser or principal underwriter.[190]

We are proposing to require disclosure with respect to circumstances involving these persons and other persons that we have concluded may pose similar conflicts of interest. The additional persons include: (1) a fund's administrator or a person directly or indirectly controlling the administrator; (2) a person directly or indirectly controlled by or under common control with the fund's investment adviser, principal underwriter, or administrator; (3) any other investment company with the same administrator as the fund; (4) any other investment company with an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the fund; and (5) any officer of (i) the fund; (ii) the investment adviser, principal underwriter, or administrator of the fund; (iii) a person directly or indirectly controlling, controlled by, or under common control with the fund's investment adviser, principal underwriter, or administrator; (iv) an investment company with the same investment adviser, principal underwriter, or administrator as the fund; or (v) an investment company with an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the fund.[191]

We are following the approach of the current proxy rules in proposing to require disclosure regarding directors' relationships with mutual fund administrators. As administrators take on an increasing role in the operations of funds, the relationships of independent directors with these entities may affect the directors' ability to safeguard the interests of fund shareholders.[192]

As in the current proxy rules, we are proposing to require mutual funds to disclose circumstances involving the director and persons controlling, controlled by, or under common control with some parties related to the fund.[193] We believe that situations involving a director and persons controlled by or under common control with persons related to the fund could pose conflicts of interest that are similar to situations involving controlling persons, which are referenced in section 2(a)(19) of the Act. We are concerned that the burden on mutual funds of expanding disclosure beyond these persons, however, may outweigh the value of the information to investors. The Commission requests comment on whether it should extend the proposed disclosure requirements beyond persons controlling, controlled by, or under common control with parties related to the fund, or limit the proposed disclosure requirements to

1A; proposed Items 18.8 and 18.9 of Form N–2; proposed Items 20(g) and (h) of Form N–3.

[186] Proposed Items 22(b)(7) and (8) of Schedule 14A; proposed Items 13(b)(7) and (8) of Form N–1A; proposed Items 18.10 and 18.11 of Form N–2; proposed Items 20(i) and (j) of Form N–3.

[187] *See* Items 22(b)(1) (positions and interests); 22(b)(2) (interests); 22(b)(3) (transactions); and 22(b)(4) (transactions) of Schedule 14A.

[188] Proposed Item 22(a)(1)(vi) of Schedule 14A; proposed Instruction 1(b) to Item 13 of Form N–1A; proposed Instruction 1.b. to Item 18 of Form N–2; proposed Instruction 1.b. to Item 20 of Form N–3.

[189] *See* Instruction 2 to Item 404(a) of Regulation S–K, through Item 22(b)(4) of Schedule 14A.

[190] *See* sections 2(a)(19)(A)(vi) and (B)(vi) of the Act [15 U.S.C. 80a–2(a)(19)(A)(vi) and (B)(vi)].

[191] Separate accounts offering variable insurance products that are registered as management companies also would be required to disclose circumstances involving the insurance company that sponsors the separate account. We are proposing to define ''sponsoring insurance company'' in the proxy rules to mean the insurance company that establishes and maintains the separate account and that owns the assets of the separate account. Proposed Item 22(a)(1)(x) of Schedule 14A.

[192] *See supra* notes 89–90 and accompanying text.

[193] *See* Items 22(b)(1) of Schedule 14A (requiring funds to disclose directors' ownership of any securities and any other material direct or indirect interest in the investment adviser or any person controlling, controlled by, or under common control with the investment adviser unless the director is a general partner or director of the investment adviser) and 22(b)(3) of Schedule 14A (requiring funds to disclose any material interest, direct or indirect, of any director or nominee for election as director in any material transactions or any proposed material transactions to which the investment adviser, principal underwriter, the administrator, or a person controlling, controlled by, or under common control with those entities (other than a fund) was or is to be a party).

controlling persons as specified in section 2(a)(19) of the Act.

As noted above, we also are proposing to require disclosure of circumstances involving any officer of (1) the fund; (2) the investment adviser, principal underwriter, or administrator of the fund; (3) a person directly or indirectly controlling, controlled by, or under common control with the fund's investment adviser, principal underwriter, or administrator; (4) an investment company with the same investment adviser, principal underwriter, or administrator as the fund; or (5) an investment company with an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the fund. We are proposing to require disclosure for all officers who perform policy-making functions, not only the principal executive officer as referred to in sections 2(a)(19)(A)(vi) and (B)(vi) of the Act, because we believe that situations involving a director and other officers may raise conflict of interest concerns that are similar to those involving a director and the principal executive officer. Form N–1A defines ''officer'' to mean president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.[194] We are proposing to add this definition to the proxy rules.[195]

The Commission requests comment on the scope of its general approach to disclosure outlined above, including whether there are any other circumstances that could raise potential conflicts of interest that should be disclosed, and whether the scope of persons covered by the disclosure requirements is appropriate. Having discussed the general concepts of our proposal, we now turn to the specific proposed requirements for disclosure in the SAI and proxy statements for the election of directors.

(d) Specific Disclosure in the Proxy Rules and SAI—(1) Positions. The Commission is proposing to require disclosure of any positions, including as an officer, employee, director, or general partner, held during the past five years by directors and their immediate family members with: (1) the fund; (2) an investment company having the same investment adviser, principal underwriter, or administrator as the fund or an investment adviser, principal underwriter, or administrator that controls, is controlled by, or is under common control with the fund's investment adviser, principal underwriter, or administrator;[196] (3) an investment adviser, principal underwriter, administrator, or affiliated person of the fund; or (4) any person controlling, controlled by, or under common control with the fund's investment adviser, principal underwriter, or administrator.[197]

We request comment on the proposed disclosure of director positions. Should we limit the disclosure required to certain positions, such as managerial or policy-making positions? Have we appropriately specified the entities with respect to which positions should be disclosed? Should any entities be added to or eliminated from the required disclosure? Should disclosure be required for five years as proposed consistent with the current proxy rules, or for a longer or shorter period?[198]

(2) Interests. The Commission is proposing to require disclosure of securities currently owned, and material direct or indirect interests held during the past five years, by each director and his immediate family members in (i) an investment adviser, principal underwriter, or administrator of the fund; or (ii) a person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator.[199] Information about securities owned would be provided in a table, including the value of the securities and percent of each class owned.[200] The value of the securities and percent of each class owned would be provided in the aggregate for each director and his immediate family members.[201] This information would be provided as of the most recent practicable date.[202]

We request comment on the proposed disclosure of director interests. Have we appropriately defined the scope of the interests required to be disclosed? Should disclosure be required of current securities ownership, and of material interests for the past five years, as in the current proxy rules, or should longer or shorter periods be used? Should securities ownership be aggregated or presented separately for a director and his immediate family members? Should the Commission establish any *de minimis* threshold for the disclosure of material interests? If so, what should it be, *e.g.*, interests exceeding $5,000, $10,000, $50,000, or some other amount?

(3) Transactions and Relationships

Transactions and Relationships Generally. The Commission is proposing to require disclosure of transactions and relationships of directors with the fund and parties related to the fund. The parties related to the fund that would be covered by this requirement are: (i) an officer of the fund; (ii) an investment company

---

[194] Instruction 1 to Item 13(b) of Form N–1A; *see also* Instruction 1 to Item 18.1 of Form N–2 and Instruction 1 to Item 20(a) of Form N–3.

[195] Proposed Item 22(a)(1)(vii) of Schedule 14A; proposed Instruction 1(c) to Item 13 of Form N–1A; proposed Instruction 1.c. to Item 18 of Form N–2; proposed Instruction 1.c. to Item 20 of Form N–3.

[196] This category would include a foreign fund (*i.e.*, an investment company that is organized under the laws of a jurisdiction other than the United States). The proposed rule also would require disclosure of positions with a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act. *See* proposed Item 22(b)(3)(ii) of Schedule 14A; proposed Item 13(b)(3)(ii) of Form N–1A; proposed Item 18.6(b) of Form N–2; proposed Item 20(e)(ii) of Form N–3.

[197] Proposed Item 22(b)(3) of Schedule 14A; proposed Item 13(b)(3) of Form N–1A; proposed Item 18.6 of Form N–2; proposed Item 20(e) of Form N–3. *Cf.* Item 13(b) of Form N–1A, Item 18.1 of Form N–2, and Item 20(a) of Form N–3 (requiring disclosure of directors' positions with the fund); Item 13(c) of Form N–1A, Item 18.2 of Form N–2; and Item 20(b) of Form N–3 (requiring disclosure of directors' positions with affiliated persons of the fund and the principal underwriter); Item 22(b)(1) of Schedule 14A (requiring the fund to identify each director or nominee who is, or was during the past five years, an officer, employee, director, general partner, or shareholder of the investment adviser); and Item 401(a) and (b) of Regulation S–K, through Item 22(b)(4) of Schedule 14A (requiring disclosure of directors' and executive officers' positions and offices with the fund). We have proposed to include disclosure of positions with affiliated persons of the fund consistent with current SAI requirements.

Separate accounts offering variable insurance products that are registered as management companies also would be required to disclose directors' positions with the insurance company that sponsors the separate account. *See supra* note 191.

[198] *See* Item 22(b)(1) of Schedule 14A.

[199] Separate accounts offering variable insurance products that are registered as management companies also would be required to disclose directors' interests in the insurance company that sponsors the separate account. *See supra* note 191.

[200] Proposed Items 22(b)(5) and (6) of Schedule 14A; proposed Items 13(b)(5) and (6) of Form N–1A; proposed Items 18.8 and 18.9 of Form N–2; proposed Items 20(g) and (h) of Form N–3. *Cf.* Item 22(b)(1) of Schedule 14A (generally requiring disclosure of directors' current ownership of securities, and material interests during the past five years, in the investment adviser or any person controlling, controlled by, or under common control with the investment adviser); Item 22(b)(2) of Schedule 14A (requiring disclosure of director's material interests during the past five years in a fund's principal underwriter and administrator).

[201] Proposed Instruction 4 to Item 22(b)(5) of Schedule 14A; proposed Instruction 4 to Item 13(b)(5) of Form N–1A; proposed Instruction 4 to Item 18.8 of Form N–2; proposed Instruction 4 to Item 20(g) of Form N–3.

[202] Proposed Instruction 1 to Item 22(b)(5) of Schedule 14A; proposed Instruction 1 to Item 13(b)(5) of Form N–1A; proposed Instruction 1 to Item 18.8 of Form N–2; proposed Instruction 1 to Item 20(g) of Form N–3.

having the same investment adviser, principal underwriter, or administrator as the fund or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the fund;[203] (iii) an officer of an investment company described in (ii); (iv) an investment adviser, principal underwriter, or administrator of the fund; (v) an officer of an investment adviser, principal underwriter, or administrator of the fund; (vi) a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the fund; or (vii) an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the fund (together ''Related Parties'').[204]

We are proposing to require disclosure of any material interest, direct or indirect, of any director or his immediate family member in any material transaction, or material series of similar transactions, since the beginning of the last two completed fiscal years (or currently proposed), to which the fund or a Related Party was or is to be a party.[205] Transactions would include loans, lines of credit, and other indebtedness.

For material interests in material transactions, a mutual fund would be required to state the name of the director or family member whose interest is described, the nature of the circumstances by reason of which the interest is required to be described, the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.[206] For indebtedness, a mutual fund would be required to indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the latest practicable date, and the rate of interest paid or charged.[207]

We also are proposing to require disclosure of any material relationship, direct or indirect, of any director or his immediate family member that exists, or has existed at any time since the beginning of the last two completed fiscal years, or is currently proposed, with the fund or a Related Party. Relationships would include payments for property or services, provision of legal or investment banking services, and any consulting or other relationship that is substantially similar in nature and scope to any of the foregoing relationships.[208]

For material relationships, a fund would be required to state the name of the director or family member whose relationship is described, the nature of the circumstances by reason of which the relationship is required to be described, the nature of the relationship, and the amount of business done between the director or family member and the fund or Related Party since the beginning of the last two completed fiscal years or proposed to be done during the current fiscal year.[209]

A fund would not be required to disclose routine, retail transactions and relationships between directors or immediate family members and the fund or Related Parties. For example, a mutual fund need not disclose that a director holds a credit card or bank or brokerage account with a fund or Related Party, unless the director is accorded special treatment, such as preferred access to initial public offerings.[210]

Indirect, as well as direct, material interests in material transactions and material relationships would be required to be disclosed. A director or family member who has a position or a relationship with, or interest in, a company that engages in a transaction or has a relationship with a fund or Related Party may have an indirect interest in the transaction or an indirect relationship by reason of the position, relationship, or interest.[211] The interest in the transaction or the relationship of the director or family member, however, would not be deemed material if the interest or the relationship arises solely from the holding of an equity interest (excluding a general partnership interest) or a creditor interest in a company that engages in a transaction or has a relationship with the fund or Related Party if the transaction or the relationship is not material to the company.

We request comment on the proposed disclosure of director transactions and relationships. Have we appropriately defined the scope of transactions and relationships to be disclosed? Should disclosure be required for the period since the beginning of the last two completed fiscal years, as proposed based on the time period specified in section 2(a)(19) of the Act,[212] or only since the beginning of the most recently completed fiscal year as required in the

---

[203] This category would include a foreign fund (*i.e.*, an investment company that is organized under the laws of a jurisdiction other than the United States). The proposed rule also would require disclosure of transactions with a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act. *See* proposed Item 22(b)(7)(iii) of Schedule 14A; proposed Item 13(b)(7)(iii) of Form N–1A; proposed item 18.10(c) of Form N–2; proposed Item 20(i)(iii) of Form N–3.

[204] Proposed Items 22(b)(7) and (8) of Schedule 14A; proposed Items 13(b)(7) and (8) of Form N–1A; proposed Items 18.10 and 18.11 of Form N–2; proposed Items 20(i) and (j) of Form N–3. *Cf.* Item 22(b)(3) of Schedule 14A (generally requiring disclosure of directors' material interests in material transactions since the beginning of the most recently completed fiscal year, or proposed material transactions, to which the investment adviser, principal underwriter, administrator, or a person controlling, controlled by, or under common control with those entities was or is to be a party). *See also* Item 404(a) of Regulation S–K [17 CFR 229.404(a)], through Item 22(b)(4) of Schedule 14A (requiring disclosure of transactions since the beginning of the last fiscal year, or proposed transactions, to which the fund was or is to be a party, in which any director or immediate family member had, or will have, a material interest and which the amount involved exceeds $60,000).

Separate accounts offering variable insurance products that are registered as management companies also would be required to disclose directors' transactions with the insurance company that sponsors the separate account. *See supra* note 191.

[205] Proposed Item 22(b)(7) of Schedule 14A; proposed Item 13(b)(7) of Form N–1A; proposed Item 18.10 of Form N–2; proposed Item 20(i) of Form N–3.

[206] Proposed Instructions 1 and 2 to Item 22(b)(7) of Schedule 14A; proposed Instructions 1 and 2 to Item 13(b)(7) of Form N–1A; proposed Instructions 1 and 2 to Item 18.10 of Form N–2; proposed Instructions 1 and 2 to Item 20(i) of Form N–3.

[207] Proposed Instruction 9 to Item 22(b)(7) of Schedule 14A; proposed Instruction 9 to Item 13(b)(7) of Form N–1A; proposed Instruction 8 to Item 18.10 of Form N–2; proposed Instruction 8 to Item 20(i) of Form N–3.

[208] Proposed Item 22(b)(8) of Schedule 14A; proposed Item 13(b)(8) of Form N–1A; proposed Item 18.11 of Form N–2; proposed Item 20(j) of Form N–3.

[209] Proposed Instructions 1 and 2 to item 22(b)(8) of Schedule 14A; proposed Instructions 1 and 2 to Item 13(b)(8) of Form N–1A; proposed Instructions 1 and 2 to Item 18.11 of Form N–2; proposed Instructions 1 and 2 to item 20(j) of Form N–3.

[210] Proposed Instruction 10 to Item 22(b)(7) and Instruction 8 to Item 22(b)(8) of Schedule 14A; proposed Instruction 10 to Item 13(b)(7) and Instruction 8 to Item 13(b)(8) of Form N–1A; proposed Instruction 9 to Item 18.10 of and instruction 7 to Item 18.11 of Form N–2; proposed Instruction 9 to Item 20(i) and Instruction 7 to Item 20(j) of Form N–3. *See* H.R. Rep. No. 1382, 91st Cong., 2d Sess. 14–15 (1970) (''[A] director ordinarily would not be considered to have a material business relationship with the investment adviser simply because he is a brokerage customer who is not accorded special treatment.''); Interpretive Release, *supra* note 1.

[211] Proposed Instruction 7 to Item 22(b)(7) and Instruction 5 to Item 22(b)(8) of Schedule 14A; proposed Instruction 7 to Item 13(b)(7) and Instruction 5 to Item 13(b)(8) of Form N–1A; proposed Instruction 6 to Item 18.10 and Instruction 4 to Item 18.11 of Form N–2; proposed Instruction 6 to Item 20(i) and Instruction 4 to Item 20(j) of Form N–3.

[212] *See* sections 2(a)(19)(A)(vi) and 2(a)(19)(B)(vi) of the Act.

current proxy rules, or for some other time period?

We also request comment on whether we should specify a minimum dollar amount involved in a transaction or relationship that would trigger the disclosure requirements rather than simply requiring disclosure of ''material'' transactions or relationships. If so, what should the threshold be, *e.g.*, transactions exceeding $60,000, or some other amount?[213] Similarly, should we require disclosure of transactions or relationships only when the interest of a director or his immediate family member is greater than a specified dollar amount? If so, what should the dollar amount be, *e.g.*, interests exceeding $5,000, $10,000, $50,000, or some other amount?

We also request comment on whether we should limit disclosure of transactions or relationships where the interest of a director or his immediate family member arises indirectly through ownership of an interest in a company that is involved in a transaction or relationship with a fund or Related Party. For example, should disclosure of a transaction or relationship not be required when a director and his immediate family members, in the aggregate, have less than a specified threshold interest in a company that is a party to the transaction or relationship with the fund or Related Party?[214] If so, what should the threshold percentage be, *e.g.* 5%, 10%, or some other amount? Or should the Commission set a threshold dollar amount ownership interest in the company? If so, what should the dollar amount be, *e.g.*, $5,000, $10,000, $50,000, or some other amount? In determining whether the threshold is exceeded, should a director's interests be aggregated with those of his immediate family members, other directors or nominees, executive officers, security holders who own more than 5% of any class of the registrant's voting securities, or any other persons?[215]

Cross-Directorships. Finally, the Commission is proposing to require a mutual fund to disclose situations where an officer of an investment adviser, principal underwriter, or administrator of a fund, or an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the fund serves, or has served since the beginning of the last two completed fiscal years of the fund, as a director of a company of which a fund director or his immediate family member is, or was, an officer.[216] The fund would be required to identify (i) the company involved; (ii) the individual who serves or has served as a director of the company and the period of service as director; (iii) the investment adviser, principal underwriter, or administrator, or person controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator where the individual named in (ii) holds or held office and the office held; and (iv) the director of the fund or immediate family member who is or was an officer of the company, the office held, and the period of holding office.

We believe that cross-directorships could potentially create a conflict of interest for a director because the position that he or his immediate family member holds in another company could be affected by an officer of the investment adviser, principal underwriter, or administrator, or an officer of a party controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator.[217] We request comment on the proposed disclosure of cross-directorships. Have we appropriately defined the scope of the circumstances to be disclosed? Should disclosure be required for a shorter or longer period than since the beginning of the last two completed fiscal years of the fund?

4. Board's Role in Fund Governance

The Commission is proposing to modify disclosure of matters related to the board's role in governing a fund currently required in the proxy rules and the SAI. We believe that this information would help shareholders more readily determine whether the directors are effectively representing shareholders' interests, independent of fund management.

The proxy rules require a mutual fund to discuss in reasonable detail the material factors and conclusions that formed the basis for the board of directors' recommendation that the shareholders approve an investment advisory contract, including a discussion of any benefits derived or to be derived by the investment adviser from the relationship with the fund such as soft dollar arrangements by which brokers provide research to the fund or its investment adviser in return for allocating fund brokerage.[218] We are proposing to require similar disclosure in the SAI so that investors will be able to evaluate the board's basis for approving the renewal of an existing investment advisory contract.[219]

Director responsibility for evaluating and approving a mutual fund's advisory contract is one of the most important fund governance obligations assigned to directors under the Investment Company Act.[220] In approving an investment advisory contract, independent directors must review the level of fees charged to a fund by an investment adviser. Participants at the Roundtable discussed the important role of independent directors in negotiating these fees and expenses.[221] We believe that a discussion of the factors considered by the board in retaining an investment adviser will help investors understand and evaluate the board's basis for that action.

We also are proposing to modify disclosure in the proxy rules and the SAI relating to a fund's committees of the board of directors. The proxy rules currently require mutual funds to disclose information about standing audit, nominating, and compensation committees.[222] In the SAI, mutual funds

[213] *Cf.* Item 404(a) of Regulation S–K, through Item 22 (b)(4) of Schedule 14A (requiring disclosure of a director's or immediate family member's material interest in a transaction with the fund only when the amount involved in the transaction is greater than $60,000).

[214] Currently, Instruction 8(A) of Item 404(a) of Regulation S–K states that a director's interest in a material transaction is not material when he and all other directors, nominees, executive officers, security holders who own more than 5% of any class of the registrant's voting securities, and immediate family members, in the aggregate, own less than a 10% equity interest in another person that is a party to the transaction.

[215] *See supra* note 214 (Instruction 8(A) of Item 404(a) of Regulation S–K.

[216] Proposed Item 22(b)(9) of Schedule 14A; proposed Item 13(b)(9) of Form N–1A; proposed Item 18.12 of Form N–2; proposed Item 20(k) of Form N–3.

Separate accounts offering variable insurance products that are registered as management companies also would be required to disclose cross-directorships involving the insurance company that sponsors the separate account. *See supra* note 191.

[217] *Cf. Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee* at 11 (1999) (director not independent when he is employed as an executive of another company where any of the corporation's executives serves on that company's compensation committee).

[218] Item 22(c)(11) of Schedule 14A.

[219] Proposed Item 13(b)(10) of Form N–1A; proposed Item 18.13 of Form N–2; proposed Item 20(l) and Form N–3.

[220] *See* sections 15 (a) and (c) of the Investment Company Act [15 U.S.C. 80a–15 (a) and (c)].

[221] *See* Negotiating Fees and Expenses Panel, Roundtable Transcript of Feb. 23, 1999 at 26–91.

[222] The fund must state whether it has a standing audit, nominating, compensation, or similar committee, identify each committee member, state the number of committee meetings held by each committee during the last fiscal year, and describe briefly the functions performed by the committees. Item 7(e)(1) of Schedule 14A. If the fund has a nominating or similar committee, the fund must state whether the committee will consider nominees recommended by security holders and, if

are required to identify members of any executive or investment committee, and provide a concise statement of the duties and functions of each committee.[223]

We are proposing to modify this disclosure to require mutual funds to identify each standing committee of the board in the SAI and proxy statements for the election of directors. As in the current proxy rules, funds would be required to provide a concise statement of the functions of each committee; identify the members of the committee; indicate the number of committee meetings held during the last fiscal year; and state whether its nominating committee will consider nominees recommended by fund shareholders and, if so, describe the procedures for submitting recommendations.[224]

5. Separate Disclosure

Currently, mutual funds must indicate with an asterisk the directors who are interested persons of the fund within the meaning of section 2(a)(19) of the Act for certain disclosure items in the proxy statements and the SAI.[225] To provide more prominent disclosure about independent directors, we are proposing to require funds to present all disclosure for independent directors separately from disclosure for interested directors in the SAI, proxy statements for the election of directors, and annual reports to shareholders.[226] For example, when information is furnished in a table, funds should provide separate tables (or separate sections of a single table) for independent directors and for interested directors. When presenting information in narrative form, funds should clearly indicate, by heading or other means, which directors are interested and which are independent.

6. Technical and Conforming Amendments

The Commission is proposing to clarify that Item 22 of Schedule 14A applies to business development companies.[227] This proposed change reflects current requirements.

The Commission is proposing changes to cross-references in Items 8 and 10 of Schedule 14A to reflect the proposed amendments to Item 22 of Schedule 14A. We also are proposing to amend current Item 22(b)(4) of Schedule 14A. This item requires funds to provide the information required by Items 401, 404(a) and (c), and 405 of Regulation S–K. Because proposed Item 22(b)(7) of Schedule 14A requires much of the information now required by Item 401 of Regulation S–K, we are proposing to modify Item 22(b)(4) of Schedule 14A to require funds to provide the information required by Items 401(f) and (g), 404(a) and (c), and 405 of Regulation S–K.[228]

Because we have defined the term ''officer'' to mean the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions, we are proposing to change the reference in the compensation table from ''executive officer'' to ''officer.'' [229] In addition, we are proposing to amend the definition of ''administrator'' in the proxy rules to conform to the proposed definition of ''administrator'' in rule 0–1(a)(5).[230]

We also are proposing conforming changes to the SAI. Because we are proposing enhanced disclosure about directors' positions, we are proposing to require disclosure of officers' positions, which remains unchanged, as a separate item.[231] We are proposing amendments to the SAI to conform to the proxy rules by requiring a brief description of any arrangement or understanding between a director or officer and any other person pursuant to which he was selected as a director or officer.[232]

We also are proposing changes to rule 30d–1 under the Investment Company Act.[233] Rule 30d–1(d) allows a fund to send to shareholders a copy of its currently effective prospectus or SAI, or both, instead of a shareholder report required by the rule, provided that the prospectus or SAI, or both, include certain financial information and information about directors' compensation. We are proposing to amend the rule to require a prospectus or SAI, or both, serving as a shareholder report to include all the information that would otherwise be required in the shareholder report.[234]

7. Compliance Date

If we adopt the proposed disclosure requirements, we expect to require all new registration statements and post-effective amendments that are annual updates to effective registration statements, proxy statements for the election of directors, and reports to shareholders filed on or after the effective date of the amendments to comply with the proposed amendments. The Commission requests comment on this proposed compliance date.

F. Recordkeeping Regarding Director Independence

To assure that independent directors are able to fully carry out the important

so, describe the procedures to be followed by security holders in submitting such recommendations. Item 7(e)(2) of Schedule 14A.

[223] Instruction 3 to Item 13(b) of Form N–1A; Instruction 3 to Item 18.1 of Form N–2; Instruction 3 to Item 20(a) of Form N–3.

[224] Proposed Item 22(b)(13) of Schedule 14A; proposed Item 13(b)(2) of Form N–1A; proposed Item 18.5 of Form N–2; proposed Item 20(d) of Form N–3. *Cf.* Item 7(e)(1) of Schedule 14A.

Because this proposed disclosure requirement covers information that is similar to that already required for proxy statements in Item 7(e) of Schedule 14A, the Commission is proposing to amend Item 7 to state that investment companies must furnish the information on committees proposed in Item 22(b)(13) in lieu of the information currently required in Item 7(e). *See* proposed Items 7 (d) and (e) of Schedule 14A. We also recently proposed to require additional information about a closed-end fund's audit committee. *See* Audit Committee Disclosure, Securities Exchange Act Release No. 41987 (Oct. 7, 1999) [64 FR 55648 (Oct. 14, 1999)] (proposed Item 7(e)(3) of Schedule 14A).

[225] *See* Instruction 1 to Item 22(b)(4) of Schedule 14A (table containing information about director's background and experience and table containing information about directors' transactions with the fund); Instruction 4 to Item 13(b) of Form N–1A (management information table).

[226] Proposed Instruction 3 to Item 22(b) of Schedule 14A; proposed Instruction 2 to Item 13 of Form N–1A; proposed Instruction 2 to Item 18 of Form N–2; proposed Instruction 2 to Item 20 of Form N–3.

[227] Proposed Item 22(a)(1)(viii) of Schedule 14A. Business development companies are subject to special provisions under the Act designed to accommodate their venture capital investments. *See* sections 54–65 of the Investment Company Act [15 U.S.C. 80a–53 to 80a–64]. Business development companies are required to have a majority of directors who are not ''interested persons.'' *See* section 56 of the Investment Company Act [15 U.S.C. 80a–55].

[228] We also are proposing to redesignate Item 22(b)(4) as Item 22(b)(10). Funds would not be required to provide information for directors, nominees, and their immediate family members as required by Items 404(a) and (c) of Regulation S–K, through Item 22(b)(10) of Schedule 14A, because we are proposing to require the information under Item 22(b)(7) of Schedule 14A. Proposed Instruction to Item 22(b)(10) of Schedule 14A.

[229] Proposed Item 22(b)(12) of Schedule 14A; proposed Item 13(c) of Form N–1A, proposed item 18.14 of Form N–2; proposed Item 20(m) of Form N–3.

[230] *See* Proposed Item 22(a)(1) of Schedule 14A.

[231] *See* Item 13(c) of Form N–1A; Item 18.2 of Form N–2; Item 20(b) of Form N–3; proposed Item 13(a)(2) of Form N–1A; proposed Item 18.2 of Form N–2; proposed Item 20(b) of Form N–3 (requiring disclosure of officers' positions with affiliated persons of the fund and the principal underwriter).

[232] Proposed Item 22(b)(2) of Schedule 14A; proposed Item 13(a)(3) of Form N–1A; proposed Item 18.3 of Form N–2; proposed Item 20(c) of Form N–3. *See* Items 401(a) and 401(b) of Regulation S–K and Instruction 1 to Items 401(a) and 401(b) of Regulation S–K, through Item 22(b)(4) of Schedule 14A.

[233] 17 CFR 270.30d–1.

[234] Proposed rule 30c–1(d) under the Investment Company Act. We also are proposing to amend rule 30d–1(a) to require funds to include in their shareholder reports any information (not just financial statements) required to be included in those reports by the company's registration statement form under the Investment Company Act. Proposed rule 30e–1(a) under the Investment Company Act. We are redesignating rules 30d–1 and 30d–2 as rules 30e–1 and 30e–2 respectively to reflect the National Securities Markets Improvement Act of 1996 amendments to section 30 of the Act. [Pub. L. No. 104–290, 110 Stat. 3416 (1996) (codified in various sections of the United States Code)].

duties assigned to them, the Act and our rules establish standards concerning their financial and other interests.[235] A fund must determine whether the individuals who serve as independent directors in fact satisfy these standards when it prepares certain disclosure documents for investors.[236] The process that a fund uses to make these determinations should reflect diligent efforts to evaluate each director's relevant business and personal relationships that might affect his independent judgment.

We are proposing to amend our rule requiring funds to preserve certain records to enable the Commission to monitor funds' assessments of the independence of their directors. The proposed amendment would require funds to preserve any record of the initial determination that a director qualifies as an independent director, and each subsequent determination of whether the director continues to qualify as an independent director.[237] We propose that funds preserve these documents for a period of six years, the first two years in an easily accessible place.[238]

Because funds already should be collecting relevant information when they make and review their determinations of director independence,[239] we believe that our proposed recordkeeping requirement would not impose substantial costs or other burdens on funds. Comment is requested on the necessity of this information, and on the costs of maintaining these records. We also request comment on the effects that this proposed recordkeeping requirement would have on funds' internal compliance policies and procedures. Are there feasible alternatives to the proposal that would enable the Commission to monitor funds' assessments of the independence of their directors, while minimizing the burdens imposed on funds?[240]

G. General Request for Comments

The Commission requests comment on the new rules, rule amendments, and form amendments proposed in this Release, suggestions for additional provisions or changes to existing rules or forms, and comments on other matters that might have an effect on the proposals contained in this Release. We also request comment whether the proposals, if adopted, would promote efficiency, competition, and capital formation. We will consider those comments in satisfying our responsibilities under section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and section 3(f) of the Exchange Act.[241] For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[242] we also request information regarding the potential effect of the proposals on the U.S. economy on an annual basis. Commenters are requested to provide empirical data to support their views.

As discussed above, the ICI Advisory Group Report recommended several measures that are similar to our proposed amendments as well as several additional practices and policies. We request comment whether we should adopt any of these ''best practices'' recommendations as further measures to enhance the effectiveness of independent directors.[243]

III. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules.

A. Proposed Amendments to the Exemptive Rules

The Commission is proposing to amend the Exemptive Rules[244] to require that, for funds relying on those rules: (i) independent directors constitute either a majority or a super-majority (two-thirds) of their boards; (ii) independent directors select and nominate other independent directors; and (iii) any legal counsel for the fund's independent directors be an independent legal counsel. These proposals are designed to enhance the independence and effectiveness of fund directors who are charged with overseeing the fund's activities and transactions that are covered by the Exemptive Rules. Boards that meet these conditions should be more effective at exerting an independent influence over fund management. Their independent directors should be more likely to have their primary loyalty to the fund's shareholders rather than the adviser, and should be better able to evaluate the complex legal issues that are often faced by fund boards with an independent and critical eye. These proposed amendments, therefore, would provide substantial benefits to shareholders by helping to ensure that independent directors are better able to fulfill their role of representing shareholder interests and supplying an independent check on management.

The proposed amendments to the Exemptive Rules may impose some costs on funds that choose to rely on those rules. Funds that do not rely on an Exemptive Rule, however, will not be subject to the proposed conditions, or any costs associated with those conditions. These costs are discussed below.

Independent directors as a majority of the board. First, the Commission is making two alternative proposals regarding the representation of independent directors on fund boards. Under one proposal, funds relying on the Exemptive Rules would be required to have independent directors constitute a simple majority of their boards. Because, as noted above, most mutual funds today have boards with independent majorities,[245] it appears that this proposal would not impose substantial costs on funds as a group. Under the alternative proposal, funds relying on the Exemptive Rules would be required to have independent directors constitute two-thirds of their boards. Because fewer funds currently have boards of which two-thirds of the directors are independent, this alternative proposal could have higher costs for funds as a group.[246]

Under either of these alternative proposals, funds that currently do not have the required percentage of independent directors on their boards (whether a simple majority or two-

---

[235] *See supra* notes 21, 170 and accompanying text.

[236] A fund must indicate which individuals are independent directors in its registration statement, as well as in proxy statements for the election of directors. *See supra* note 225 and accompanying text.

[237] Proposed rule 31a–2(a)(4). The proposed rule states that these records must include any questionnaire and any other document used to determine that a director qualifies as independent.

[238] *Id.*

[239] *See, e.g.*, ICI Advisory Group Report, *supra* note 28, at 21 (recommending that funds require independent directors to complete a questionnaire each year on business, financial, and family relationships that could affect their independence).

[240] *See* section 31(a)(2) of the Act [15 U.S.C. 80a–30(a)(2)] (requiring Commission to consider and request public comment on minimizing recordkeeping compliance burdens).

[241] Section 2(c) of the Investment Company Act [15 U.S.C. 80a–2(c)], section 2(b) of the Securities Act [15 U.S.C. 77b(b)], and section 3(f) of the Exchange Act [15 U.S.C. 78c(f)] require 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.

[242] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

[243] *See supra* notes 34–35 and accompanying and following text.

[244] *See supra* text following note 33.

[245] *See supra* note 39 and accompanying text.

[246] *See supra* note 44. As noted above, however, the ICI Advisory Group Report has recommended that independent directors constitute two-thirds of a fund's board. *See supra* note 42 and accompanying text. It is therefore likely that in the future the number of funds following this practice will increase, even absent the Commission's proposal.

thirds) and that would like to rely on the Exemptive Rules may incur some costs. The Commission, however, has no reasonable basis for estimating those costs. Those funds could come into compliance with either alternative proposal in a number of ways. For example, funds could: (i) decrease the size of their boards and allow some inside directors to resign; (ii) maintain the current size of their boards and replace some inside directors with independent directors; or (iii) increase the size of their boards and elect new independent directors.

Where new independent directors are elected, whether to replace inside directors or to fill new positions that expand the size of the board, the fund would incur the costs of preparing a proxy statement and holding a shareholder meeting to elect those independent directors, as well as the costs of compensating those directors.[247] The Commission, however, has no reasonable basis for determining how many funds that currently do not have independent directors as a simple majority of their boards would choose to comply with either proposal through electing new independent directors. Similarly, we have no reasonable basis for determining how many funds that currently have independent directors as a simple majority, but not as a two-thirds majority, would choose to comply with the alternative proposal through electing new independent directors. We also have no reasonable basis for estimating the average compensation that would be paid to those newly elected independent directors, or the costs to those funds of preparing proxy statements and holding shareholder meetings to elect those directors.

We request comment on the potential costs of each of these alternative proposals. Comment is specifically requested on the differences in costs to funds of the two alternatives.

Independent director self-selection and self-nomination. Second, the proposed amendments to the Exemptive Rules would require that independent directors select and nominate any other independent directors. It appears that this proposal would not impose significant new costs on funds, because many funds already have adopted this practice.[248] Although some funds do not currently follow this practice and would need to adopt it in order to rely on the Exemptive Rules, we are not aware of any costs that would result from requiring a fund's incumbent independent directors to select and nominate other independent directors. Comment is requested on the costs associated with independent director self-selection and self-nomination. Are those costs greater than the costs that would otherwise be incurred by a fund in selecting qualified independent directors?

Independent legal counsel. Finally, the proposed amendments to the Exemptive Rules would require that any legal counsel to a fund's independent directors be an independent legal counsel.[249] The proposal would not require independent directors to *retain* legal counsel, but only that any person that does act as counsel to the independent directors qualify as an independent legal counsel. Independent directors who are represented by counsel who does not meet the proposed definition of ''independent legal counsel'' thus would be required to retain different counsel if their fund chooses to rely on any of the Exemptive Rules. The Commission, however, has no reasonable basis for determining whether this substitution of counsel is likely to cause the independent directors' costs of legal counsel to increase. We request comment on the costs associated with this proposal. Do law firms frequently offer fee arrangements that include, for example, discounts for providing services to both a fund's independent directors and the fund's adviser, which could disqualify the firm from serving as an independent legal counsel?

B. Definition of Independent Legal Counsel

Rule 0–1 defines certain terms for purposes of the rules and regulations under the Investment Company Act. The Commission is proposing to amend this rule to add a definition of the term ''independent legal counsel.'' Under the proposed definition, a person is an independent legal counsel if (i) a fund reasonably believes that the person has not acted as legal counsel to the fund's adviser, principal underwriter, administrator,[250] or any of their control persons[251] during the last two years, or (ii) a majority of the fund's independent directors determines that the person's representation of the fund's adviser, principal underwriter, administrator, or a control person is or was so limited that it would not adversely affect the person's ability to provide impartial, objective and unbiased legal counsel to the independent directors. The basis of the independent directors' determination must be recorded in the minutes of the directors' meeting.

The proposed definition of ''independent legal counsel'' should help to ensure that independent directors' counsel is able to provide impartial legal advice concerning the complex legal issues faced by those directors. This proposal thus should benefit both shareholders and independent directors by helping those directors to better fulfill their role as shareholder representatives. Shareholders also would benefit from the requirement that the independent directors' determinations be recorded in the minute books of the fund, because this requirement would make it possible for the Commission staff to review independent directors' determinations that their counsel qualifies as independent legal counsel.

The proposed definition would impose costs on some funds that rely on the Exemptive Rules and thus would be required to use this definition.[252] We assume that approximately 3,200 funds rely on at least one of the Exemptive Rules annually.[253] We further assume that the independent directors of approximately one-third of those funds (1,065) would be required to make the specified determination in order for their counsel to meet the definition of

---

[247] Under some circumstances a vacancy on the board may be filled by the board of directors. *See* section 16(a) of the Act. In those cases, the fund would only incur the costs of compensating the new independent directors.

[248] *See supra* note 66 and accompanying text.

[249] As discussed above, we are proposing to amend rule 0–1 to include a definition of ''independent legal counsel.'' *See supra* note 87 and accompanying text; *see also infra* notes 250–256 and accompanying text (discussing the costs and benefits of this proposed definition).

[250] In connection with this proposal, we also are proposing to amend rule 0–1 to define an ''administrator'' as any person who provides significant administrative or business affairs management services to a fund. This definition is substantially similar to the definition of administrator that is currently contained in Item 22(a)(1)(i) of Schedule 14A and Item 15(h)(1) of Form N–1A. Adding this definition to rule 0–1 should benefit funds by helping to clarify the scope of the proposed definition of independent legal counsel. We are not aware of any costs that would be associated with this definition of administrator.

[251] We are proposing to amend rule 0–1 to define ''control person'' as any person (other than a registered investment company) directly or indirectly controlling, controlled by or under common control with a fund's investment adviser, principal underwriter, or administrator. This definition should benefit funds by helping to clarify the scope of the proposed definition of independent legal counsel. We are not aware of any costs that would be associated with this definition.

[252] Among other things, the proposed amendments to the Exemptive Rules would require that, for funds relying on those rules, any legal counsel for the independent directors of the fund be an ''independent legal counsel.''

[253] Based on statistics compiled by Commission staff from January 1, 1997 through December 31, 1998, we estimate that there are approximately 3,560 funds that could rely on one or more of the Exemptive Rules. Of those funds, we assume that approximately 90 percent (3,200) actually rely on at least on Exemptive Rule annually.

''independent legal counsel.'' [254] We estimate that each of these 1,065 funds would be required to spend, on average, 0.75 hours annually to comply with the proposed requirement that this determination be recorded in the fund's minute books,[255] for a total annual burden of approximately 799 hours. Based on this estimate, the total annual cost to funds of this proposed definition would be approximately $70,505.[256] The Commission is not aware of any other costs that would be associated with this proposal. Comment is requested on these estimated costs.

C. Suspension of Board Composition Requirements

Proposed rule 10e–1 would increase the periods for which the independent director minimum percentage requirements of the Act, and of the rules under the Act, are temporarily suspended if the death, disqualification, or bona fide resignation of an independent director causes the representation of independent directors on the board to fall below that required by the Act or our rules. This proposal would benefit funds by helping to ensure that a fund that dips below the independent director minimum percentage requirements in these circumstances does not immediately face the severe consequences of losing the availability of the Exemptive Rules.

We are not aware of any costs to funds that would result from this proposal. Because we believe that the periods for which the rule would suspend the independent director minimum percentage requirements are consistent with concerns for investor protection, it also appears that this proposal would not have any costs for investors.

D. Limits on Coverage of Directors Under Joint Insurance Policies

Rule 17d–1(d)(7) under the Act permits funds to purchase joint liability insurance policies without first obtaining a Commission order permitting this joint arrangement, provided that certain conditions are met. The Commission is proposing amendments to this rule that would make the rule available only for joint liability insurance policies that do not exclude coverage for independent directors' litigation expenses in the event that they are sued by the fund's adviser. This proposal should benefit shareholders by making it possible for independent directors to engage in the good faith performance of their responsibilities under the Act and our rules without concern for their personal financial security. For the same reasons, the proposal also should benefit independent directors.

Because obtaining this type of coverage may cause the premiums charged by some insurance providers for joint liability insurance policies to increase, this proposed amendment may have some costs for funds.[257] The Commission, however, has no reasonable basis for estimating the possible increase in premiums that may result from this proposal. Comment is requested on these costs.

E. Exemption From Ratification of Independent Public Accountant Requirement for Funds With Independent Audit Committees

Section 32(a)(2) of the Act requires that the selection of a fund's independent public accountant be submitted to shareholders for ratification or rejection. Proposed rule 32a–4 would exempt a fund from this requirement if the fund has an audit committee consisting entirely of independent directors to oversee the fund's auditor. This proposed exemption could provide significant benefits to shareholders. Many believe shareholder ratification of a fund's independent auditor has become a perfunctory process, with votes that are rarely contested. As a consequence, we believe that the ongoing oversight provided by an independent audit committee can provide greater protection to shareholders than shareholder ratification of the choice of auditor.

Proposed rule 32a–4 may impose certain costs on those funds that choose to rely on the exemption. It appears that these costs likely would be minimal and would be justified by the relief provided by the exemption. To rely on the exemption, among other things, a fund's board of directors must adopt an audit committee charter that sets forth the committee's structure, duties, powers, and methods of operation. The fund also must preserve that charter, and any modifications to the charter, permanently in an easily accessible place.[258] We estimate that there are approximately 3,490 investment companies that may rely on the proposed rule.[259] We assume that approximately 15 percent (524) of those funds are likely to rely on the exemption. For each of those funds, we estimate that the adoption of the audit committee charter would require, on average, 2 hours of director time and 2 hours of professional time,[260] for a total one-time burden of approximately 2,096 hours, and a total one-time cost of approximately $655,000.[261] We also estimate that each of the funds relying on the rule would be required to spend approximately 0.2 hours annually to comply with the proposed requirement that they preserve permanently their audit committee charters,[262] for an additional total annual hour burden of 105 hours, and an additional total annual cost of approximately $5,425.[263] We request comment on these estimated costs.

In addition, some funds pay their directors an extra fee for each committee

---

[254] We assume that the independent directors of the remaining two-thirds of those funds (2,135) either would not have legal counsel, or would have legal counsel who meets the requirements of the first part of the proposed definition, so that no determination by the independent directors would be necessary.

[255] This estimate is based on a staff assessment of the burden associated with this proposed recordkeeping requirement in light of the estimated hour burdens currently associated with other rules under the Act that impose similar collection of information requirements.

[256] To calculate this total annual cost, the Commission staff assumed that two-thirds of the total annual industry hour burden (532 hours) would be incurred by professionals with an average hourly wage rate of $125 per hour, and one-third of that annual hour burden (267 hours) would be incurred by clerical staff with an average hourly wage rate of $15 per hour ((532 × $125/hour) + (267 × $15/hour) = $70,505).

[257] As discussed above, the ICI Mutual Insurance Company (''ICI Mutual''), which insures funds representing approximately 70 percent of all open-end fund assets, recently announced that it is making available to funds a standard policy endorsement that permits independent directors to recover defense costs, settlements, and judgments in ''insured vs. insured'' claims otherwise covered under the policy. *See supra* note 111. According to an ICI Mutual representative, that company is not charging funds any additional premiums for this coverage. It is possible, however, that other insurance providers will charge funds additional premiums for providing this type of coverage.

[258] These conditions are designed to enable the Commission staff to monitor the duties and responsibilities of an independent audit committee formed by a fund relying on the exemption.

[259] This estimate is based on statistics compiled by Commission staff from January 1, 1997 through December 31, 1998.

[260] This estimate is based on a review of the estimated hour burdens currently associated with other rules under the Act that impose similar collection of information requirements.

[261] To calculate this one-time cost, the Commission staff used $500 per hour as the average cost of directors' time and $125 per hour as an average hourly wage for professionals ((2 hours × 524 funds × $500/hour) + (2 hours × 524 funds × $125/hour) = $655,000).

[262] This estimate is based on a review of the estimated hour burdens associated with other rules under the Act that impose similar collection of information requirements.

[263] To calculate the total annual cost of the proposed rule, the Commission staff assumed that one-third of the total annual hour burden (35 hours) would be incurred by professionals with an hourly wage rate of $125 per hour, and two-thirds of that annual hour burden (70 hours) would be incurred by clerical staff with an hourly wage rate of $15 per hour ((35 × $125/hour) + (70 × $15/hour) = $5,425).

on which they serve.[264] Those funds may incur the additional costs of audit committee fees if they establish an audit committee in order to rely on the proposed exemption. Of those funds likely to rely on the exemption, however, we have no basis for determining the number that would pay their independent directors a separate fee for service on the audit committee, or the likely amount of those fees.[265] Comment is requested on these additional costs that may be associated with this proposed exemption.

F. Qualifications as an Independent Director

The proposed amendment to rule 2a19–1 and proposed new rule 2a19–3 should benefit shareholders, funds, and independent directors by working to prevent qualified individuals from being unnecessarily disqualified from serving as independent directors. The proposed amendment to rule 2a19–1 would make the rule more flexible for all funds, particularly funds with small boards of directors. Proposed rule 2a19–3 would benefit both funds and their independent directors by clarifying the status of independent directors who own shares of index funds.

The Commission is not aware of any costs to funds that would result from these proposals. There also should be no costs to investors because, consistent with concerns for investor protection, these proposals would not permit individuals who have affiliations or business interests that could impair their independence to serve as independent directors.

G. Disclosure of Information About Fund Directors

As discussed above, the purpose of the proposed amendments to the proxy rules and Forms N–1A, N–2, and N–3 is to provide fund investors with improved information about directors. Because independent directors are the shareholders' representatives and advocates, shareholders have a significant interest in knowing who the independent directors are, whether the independent directors' interests are aligned with shareholders' interests, whether the independent directors have any conflicts of interest, and how the directors govern the fund. This information would help a fund shareholder to evaluate whether his designated representatives can, in fact, act as independent, vigorous, and effective representatives.

We believe that the proposed amendments would benefit investors in several ways. The proposed requirement that mutual funds disclose basic information about directors in an easy-to-read tabular format in the fund's annual report to shareholders, SAI, and proxy statements for the election of directors would benefit shareholders by ensuring that shareholders receive information about the identity and experience of their directors both annually and whenever they are asked to elect directors. Moreover, this information would benefit prospective investors who may obtain the information upon request.

Our proposal to require disclosure in the SAI of the aggregate dollar amount of equity securities of funds in the fund complex owned beneficially and of record by each director will allow shareholders and prospective investors to better calculate whether the interests of directors are aligned with their interests. In addition, shareholders also would benefit by receiving this information in the proxy statements whenever they are asked to elect directors.

Our proposal to improve the disclosure of possible conflict of interest circumstances for directors will enable investors to decide for themselves whether an independent director would be an effective advocate. Disclosure of this type of information also would result in its public dissemination, bring these circumstances to the attention of fund shareholders, and encourage the selection of independent directors who are independent in the spirit of the Act. Finally, this information would assist the Commission in determining whether to exercise its authority under section 2(a)(19) of the Act to find that a person is an interested person of a fund by reason of having had, at any time since the beginning of the last two completed fiscal years of the fund, a material business or professional relationship with the fund and certain persons related to the fund.

The proposed modifications to the disclosure requirements of matters related to the board's role in governing a mutual fund would benefit shareholders by allowing them to determine more readily whether the directors are effectively representing shareholders' interests, independent of fund management.

The proposed amendments would impose certain costs on the fund industry. The costs associated with the proposed amendments would include the resources expended by funds in determining what information needs to be disclosed about fund directors (in the case of proxy statements, also nominees) and preparing the disclosure documents.

Proxy Statements. The current hour burden for preparing proxy statements is 96.2 hours per proxy statement, and we estimate that approximately ⅓ of those hours—or 32 hours—are expended collecting and disclosing information about directors and nominees.[266] We estimate the additional burden hours that would be imposed by the proposed disclosure requirements to be 10 hours per proxy statement.[267]

We estimate the annual industry cost of the proposed amendments to the proxy statements to be 10,000 hours, or $1.25 million, based on an estimated 1,000 proxy statements that are filed annually.[268]

Registration Statements. Because the information proposed to be disclosed in the registration statement would be the same as in the proxy statements, we believe the hour burden for the proposed amendments per registration statement would be approximately the current hour burden for collecting and disclosing director information under the current proxy rules plus the hour burden for the proposed amendments to the proxy rules. As stated above, we estimate the current hour burden for collecting and disclosing information about directors and nominees in proxy statements to be 32 hours per proxy statement and the burden hours for collecting and disclosing the enhanced information about directors and nominees to be 10 hours per proxy statement, for a total of 42 hours.

[264] In some cases, funds pay these additional committee fees only if the committee meeting is held on a day when a board meeting is not scheduled.

[265] We also have no basis for determining how many funds would choose to avoid those fees by scheduling audit committee meetings for the same day as a board meeting.

[266] This estimate is based on Commission staff assessment of the different types of information currently required to be disclosed in proxy statements.

[267] This estimate is based upon a Commission staff assessment of the proposed amendments in light of the current hour burden and current reporting requirements. As stated above, the additional hours are based on the additional time funds would devote to determining what information needs to be disclosed and preparing the disclosure documents.

[268] The estimated number of proxy statements is based on the approximate number of proxy statements filed with the Commission in calendar year 1998. The total industry cost of the proposed amendments to the proxy statement is calculated by multiplying the annual number of proxy statements (1,000) by the additional hour burden imposed by the proposed amendments (10 hours) by the hourly wage rate ($125). The hourly wage rate is based upon consultations with a sample of filers and represents the Commission's estimate for an appropriate wage rate for the legal, financial, and accounting skills commonly used in preparation of registration statements, shareholder reports, and proxy statements.

Form N–1A. The hour burden for Form N–1A is on a per portfolio basis and not per registration statement filed with the Commission. Based on the Commission staff's experience with Form N–1A, we estimate that there are approximately 1.75 portfolios per registration statement filed on Form N–1A. The average hour burden per portfolio for disclosing the information about directors would be the hour burden per registration statement (42) divided by the average number of portfolios per registrant (1.75), or 24 hours per portfolio.[269] Because mutual funds would only have to update information in post-effective amendments, we expect that the hour burden would be ⅙ of the hours expended for the initial registration statement, or 4 hours per portfolio for post-effective amendments.[270]

We estimate that 280 portfolios file initial registration statements and 7,875 portfolios file post-effective amendments annually on Form N–1A.[271] Thus, we estimate the annual industry cost of the proposed amendments to Form N–1A to be 38,220 hours, or $4.78 million.[272]

Form N–2. The hour burden for Form N–2 is on a per registration statement basis because funds registering on Form N–2 register one portfolio per registration statement. Because the proposed disclosure would be the same for Form N–2 as for Form N–1A, except that it would be for one portfolio per registration statement, we estimate the additional hour burden for the proposed amendments to be 42 hours for each initial registration statement. Because funds would only have to update information in post-effective amendments, we expect that the hour burden would be approximately ⅙ of the hours expended for the initial registration statement, or 7 hours per post-effective amendment.[273]

We estimate that 110 funds file initial registration statements and 20 file post-effective amendments annually on Form N–2.[274] Thus, we estimate annual industry cost of the proposed amendments to Form N–2 to be 4,760 hours, or $595,000.[275]

Form N–3. The hour burden for Form N–3 is on a per portfolio basis and not per registration statement filed with the Commission. Based on the Commission staff's experience with Form N–3, we estimate that there are approximately 4 portfolios per investment company registering on Form N–3. The average hour burden per portfolio for disclosing the information about directors would be the hour burden per registration statement (42) divided by the approximate number of portfolios per registrant (4), or 10.5 hours per portfolio. Because funds would only have to update information in post-effective amendments, we expect that the hour burden would be ⅙ of the hours expended for the initial registration statement, or 1.75 hours per portfolio for post-effective amendments.[276]

We estimate that 20 portfolios file initial registration statements and 40 portfolios file post-effective amendments annually on Form N–3.[277] Thus, we estimate the annual industry cost of the proposed amendments to Form N–3 to be 280 hours, or $35,000.[278]

Shareholder Reports. Because the disclosure of basic tabular information, which is proposed to be required in annual shareholder reports, is a subset of the information that would be required in the initial registration statement of a fund and any post-effective amendments, we expect that the annual burden for complying with the proposed amendments to the shareholder report requirements would be minimal. Based upon the amount of information proposed to be disclosed, we estimate that the hour burden would be one-half hour per investment company for each annual shareholder report. We estimate that there are 3,490 management investment companies that are subject to the annual report requirements.[279] Thus, we estimate the annual industry cost of the proposed amendments for annual shareholder reports to be 1,745 hours, or $218,125.[280]

H. Recordkeeping Regarding Director Independence

The Commission also is proposing to amend rule 31a–2 under the Act, which requires funds to preserve certain records for specified periods of time. The proposed amendments to rule 31a–2 would require funds to preserve for a period of at least six years any record of: (i) the initial determination that a director qualifies as an independent director, and (ii) each subsequent determination of whether the director continues to qualify as an independent director. This proposal would benefit both shareholders and the Commission by enabling the Commission's staff to monitor a fund's assessments of the independence of its directors. This would make it possible for the Commission to ascertain whether a fund's assessments reflect diligent efforts to evaluate each director's relevant business and personal relationships that might affect the director's independent judgment. The proposed amendment would impose certain minimal costs on funds. The Commission staff estimates that each investment company currently spends

[269] Our estimated hour burden may significantly overstate the burden for those portfolios that are part of a fund complex in which multiple registered investment companies have the same board of directors because the burden of collecting and disclosing information about the common board would be spread over a larger number of portfolios.

[270] Although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[271] These estimates are based on filings received in calendar year 1998.

[272] The total annual industry cost is calculated by multiplying he total annual industry hour burden ((280 portfolios × 24 hours) + (7,875 portfolios × 4 hours)) by the hourly wage rate of $125.

[273] Although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[274] These estimates are based on filings received in calendar year 1998.

[275] The total annual industry cost is calculated by multiplying the total annual industry hour burden ((110 funds × 42 hours) + (20 funds × 7 hours)) by the hourly wage rate of $125.

[276] Although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[277] These estimates are based on filings received in calendar year 1998.

[278] The total annual industry cost is calculated by multiplying the total annual industry hour burden ((20 portfolios × 10.5 hours) + (40 portfolios × 1.75 hours)) by the hourly wage rate of $125.

[279] This estimate is based on statistics compiled by Commission staff from January 1, 1997 through December 31, 1998.

[280] The industry cost of the proposed annual shareholder reporting requirements is calculated by multiplying the total annual hour burden for the industry (0.5 hours × 3,490 registered management investment companies) by the hourly wage rate of $125.

about 27.8 hours per year complying with the record preservation requirements of rule 31a–2.[281] Approximately 3,490 investment companies would be affected by the proposal to amend the rule to require funds to preserve records regarding the independence of their directors.[282] The Commission staff estimates that each of those investment companies would be required to spend an additional 0.2 hours annually to comply with the proposed amendment,[283] for a total additional burden for all funds of approximately 698 hours. Based on this estimate, the total annual cost for all funds of the proposed amendment to rule 31a–2 would be $36,100.[284] The Commission is not aware of any other costs that would result from the proposed amendments to rule 31a–2. Comment is requested on the costs associated with this proposal.

To assist in the evaluation of the costs and benefits that may result from the proposed rules and rule amendments, the Commission requests that commenters provide views and data relating to any costs and benefits associated with these proposals.

IV. Paperwork Reduction Act

Certain provisions of Forms N–1A, N–2, and N–3, and rules 0–1, 20a–1, 30e–1, 31a–2, and 32a–4 under the Investment Company Act, and Schedule 14A under the Exchange Act contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501–3520].[285] The Commission has submitted those rules and forms to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for the collections of information are: (1) ''Rule 0–1 under the Investment Company Act of 1940, Definition of terms used in this part;'' (2) ''Rule 20a–1 under the Investment Company Act of 1940, Solicitation of Proxies, Consents and Authorizations;'' (3) ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies;'' (4) ''Form N–2—Registration Statement of Closed-End Management Investment Companies;'' (5) ''Form N–3—Registration Statement of Separate Accounts Organized as Management Investment Companies;'' (6) ''Rule 30e–1 under the Investment Company Act of 1940, Reports to Stockholders of Management Companies;'' (7) ''Rule 31a–2 under the Investment Company Act of 1940, Records to be preserved by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies;'' and (8) ''Rule 32a–4 under the Investment Company Act of 1940, Exemption from ratification or rejection requirement of section 32(a)(2) for registered investment companies with independent audit committees.'' An agency may not sponsor, conduct, or require response to an information collection unless a currently valid OMB control number is displayed.

Forms N–1A (OMB Control No. 3235–0307), N–2 (OMB Control No. 3235–0026), and N–3 (OMB Control No. 3235–0316) were adopted pursuant to section 8(a) of the Investment Company Act [15 U.S.C. 80a–8] and section 5 of the Securities Act [15 U.S.C. 77e]. Rule 0–1 was adopted pursuant to section 38(a) of the Investment Company Act [15 U.S.C. 80a–37(a)]. Rule 20a–1 (OMB Control No. 3235–0158) and rule 30e–1 (OMB Control No. 3235–0025) were promulgated under sections 20(a) and 30(e) [15 U.S.C. 80a–20 and 80a–29], respectively, of the Investment Company Act. Rule 31a–2 (OMB Control No. 3235–0179) was adopted under sections 31 [15 U.S.C. 80a–30] and 38(a) of the Investment Company Act. Rule 32a–4 is proposed pursuant to sections 6(c) [15 U.S.C. 80a–6(c)] and 38(a) of the Investment Company Act.

Rule 0–1

The proposed amendments to rule 0–1 include collection of information requirements. Rule 0–1 defines certain terms for purposes of the rules and regulations under the Investment Company Act. The proposed amendments would add a definition of the term ''independent legal counsel'' to this rule. Under the proposed definition, a person is an independent legal counsel if (i) a fund reasonably believes that the person has not acted as legal counsel to the fund's adviser, principal underwriter, administrator, or any of their control persons [286] during the last two years, or (ii) a majority of the fund's independent directors determines that the person's representation of the fund's adviser, principal underwriter, administrator, or a control person is or was so limited that it would not adversely affect the person's ability to provide impartial, objective, and unbiased legal counsel to the independent directors. The basis of the independent directors' determination must be recorded in the minutes of the fund. The purpose of this recordkeeping requirement is to make it possible for the Commission staff to review these determinations.

Any fund that relies on an Exemptive Rule would be required to use this proposed definition of independent legal counsel.[287] We assume that approximately 3,200 funds rely on at least one of the Exemptive Rules annually.[288] We further assume that the independent directors of approximately one-third (1,065) of those funds would need to make the required determination in order for their counsel to meet the definition of ''independent legal counsel.'' [289] We estimate that each of these 1,065 funds would be required to spend, on average, 0.75 hours annually to comply with the proposed recordkeeping requirement concerning this determination,[290] for a total annual burden of approximately 799 hours.

Compliance with the proposed rule 0–1 definition of independent legal counsel would be necessary to obtain the benefit of relying on the Exemptive Rules. Responses will not be kept confidential.

Rule 20a–1

Rule 20a–1 requires persons soliciting proxies regarding investment companies to comply with the proxy solicitation requirements of Regulation 14A under the Exchange Act, including Schedule 14A, which, with the proposed amendments, contains collection of information requirements. The likely respondents to this information

[281] Commission staff surveyed representatives of several funds to determine the current burden hour estimate for rule 31a–2.

[282] This estimate is based on statistics compiled by Commission staff from January 1, 1997 through December 31, 1998.

[283] This estimate is based on a Commission staff assessment of the hour burden that would be imposed by the proposed amendment in light of the estimated hour burden currently imposed by the requirements of the rule.

[284] In calculating the total annual industry cost of the proposed amendment, the Commission staff assumed that one-third of the total annual industry hour burden (233 hours) would be incurred by professionals with an average hourly wage rate of $125 per hour, and two-thirds of that annual hour burden (465 hours) would be incurred by clerical staff with an average hourly wage rate of $15 per hour ((233×$125/hour)+(465×$15/hour)=$36,100).

[285] Because we are proposing to redesignate rule 30d–1 as rule 30e–1, were refer to the newly designated rule 30e–1 in this section.

[286] The term ''control person'' is defined as any person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with a fund's investment adviser, principal underwriter, or administrator.

[287] Among other things, the proposed amendments to the Exemptive Rules would require that, for funds relying on those rules, any legal counsel for the independent directors of the fund be an independent legal counsel.

[288] *See supra* note 253.

[289] *See supra* note 254.

[290] *See supra* note 255 for the basis of this estimate.

collection are investment companies and other persons filing proxy statements for investment companies. We estimate that 1,000 proxy statements are filed annually for investment companies and that the current hour burden for proxy statements is 96.2 hours per statement.[291]

We estimate that the proposed amendments would increase the hour burden per filing of a proxy statement by 10 hours.[292] Thus, we estimate the hour burden per proxy statement would be 106.2 hours, for a total industry annual hour burden of 106,200 hours.

Compliance with the disclosure requirements of rule 20a–1 and Schedule 14A is mandatory. Responses to the disclosure requirements will not be kept confidential.

Form N–1A

Form N–1A, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are open-end funds registering with the Commission on Form N–1A. We estimate that 160 initial registration statements are filed annually on Form N–1A, registering 280 portfolios, and that the current hour burden per portfolio per filing is 800 hours, for an annual hour burden of 224,000 hours.[293] We estimate that 4,500 post-effective amendments to registration statements are filed annually on Form N–1A, for 7,875 portfolios, and that the current hour burden per portfolio per post-effective amendment filing is 100 hours, for an annual hour burden of 787,500 hours.[294] Thus, we estimate a current total annual hour burden of 1,011,500 hours for the preparation and filing of Form N–1A.

We estimate that the proposed amendments would increase the hour burden per portfolio per filing of an initial registration statement by 24 hours and would increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 4 hours.[295] Thus, if the proposed amendments to Form N–1A are adopted, the total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments on Form N–1A would be 1,049,720 hours.[296]

Compliance with the disclosure requirements of Form N–1A is mandatory. Responses to the disclosure requirements will not be kept confidential.

Form N–2

Form N–2, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are closed-end funds registering with the Commission on Form N–2. We estimate that 110 initial registration statements are filed annually on Form N–2, at a current hour burden per filing of 500 hours, for an annual hour burden of 55,000 hours.[297] We estimate that 20 post-effective amendments to registration statements are filed annually on Form N–2, at a current hour burden of 100 hours, for an annual hour burden of 2,000.[298] Thus, we estimate a current total annual hour burden of 57,000 hours for the preparation and filing of Form N–2.

We estimate that the proposed amendments would increase the hour burden per filing of an initial registration statement by 42 hours and would increase the hour burden per filing of a post-effective amendment to a registration statement by 7 hours.[299] Thus, if the proposed amendments to Form N–2 are adopted, the total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments on Form N–2 would be 61,760 hours.[300]

Compliance with the disclosure requirements of Form N–2 is mandatory. Responses to the disclosure requirements will not be kept confidential.

Form N–3

Form N–3, including the proposed amendments, contains collection of information requirements. The likely respondents to this information collection are separate accounts organized as management investment companies registering with the Commission on Form N–3. We estimate that 5 initial registration statements are filed annually on Form N–3, including approximately 20 portfolios, and that the current hour burden per portfolio in a filing is 900 hours, for an annual hour burden of 18,000 hours.[301] We estimate

---

[291] The estimated number of proxy statements filed is based on the approximate number of proxy statements filed with the commission in calendar year 1998. The current approved Paperwork Reduction Act (''PRA'') hour burden for rule 20a–1 is 96.2 hours.

[292] This estimate is based upon a Commission staff assessment of the proposed amendments in light of the current hour burden and current reporting requirements.

As stated above, the additional hours are based on the additional time funds would devote to determining what information needs to be disclosed and preparing the disclosure documents.

[293] These estimates are based on filings received in calendar year 1998. The current approved PRA hour burden per portfolio for an initial Form N–1A is 800 hours.

[294] These estimates are based on filings received in calendar year 1998. The current approved PRA hour burden per portfolio for post-effectmens amendmends to Form N–1A is 100 hours.

[295] *See supra* 269 and 270 and accompanying text. As stated above, the additional hours are based on the additional time funds would devote to determining what information needs to be dislosed and preparing the disclosure documents.

For post-effective amendments, although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[296] This total annual hour burden is calculated by adding the hour burden for initial registration statements and the hour burden for post-effective amendments, based on the proposed amendments. The annual hour burden per portfolio for an initial filing would be 824 hours (800 plus 24), for 280 portfolios, for a total of 230,720 hours. The annual hour burden per portfolio for a post-effective amendment would be 104 hours (100 plus 4), for 7,875 portfolios, for a total of 819,000 hours. The total annual hour burden for all funds for preparing and filing of initial registration statements and post-effective amendments on Form N–1A would be 1,049,720 hours (230,720 plus 819,000).

[297] These estimates are based on filings received in calendar year 1998. The current approved PRA hour burden per initial Form N–2 is 500 hours.

[298] These estimates are based on filings received in calendar year 1998. The current approved PRA hour burden per initial Form N–2 is 100 hours.

[299] *See supra* Section III.F. As states above, the additional hours are based on the additional time funds would devote to determining what information needs to be disclosed and preparing the disclosure documents.

For post-effective amendments, although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[300] This total annual hour burden is calculated by adding the hour burden for initial registration statements and the hour burden for post-effective amendments, based on the proposed amendments. The annual hour burden per initial registration statement would be 542 hours (500 plus 42), for 110 filings, for a total of 59,620 hours. The annual hour burden per post-effective amendment would be 107 hours (100 plus 7), for 20 post-effective amendments, for a total of 2,140 hours. The total annual hour burden for all funds for preparing and filing of initial registration statements and post-effective amendments on Form N–2 would be 61.760 hours (59,620 plus 2,140).

[301] These estimates are based on filings received in calendar year 1998. The previous Paperwork Reduction Act submission for Form N–3 did not differentiate the hour burden between initial filings

that 10 post-effective amendments to registration statements are filed annually on Form N–3, including approximately 40 portfolios, at a current hour burden of 150 hours per portfolio in a filing, for an annual hour burden of 6,000.[302] Thus, we estimate a current total annual hour burden of 24,000 hours for the preparation and filing of Form N–3.

We estimate that the proposed amendments would increase the hour burden per portfolio per filing of an initial registration statement by 10.5 hours and would increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 1.75 hours.[303] Thus, if the proposed amendments to Form N–3 are adopted, the total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments on Form N–3 would be 24,280 hours.[304]

Compliance with the disclosure requirements of Form N–3 is mandatory. Responses to the disclosure requirements will not be kept confidential.

Rule 30e–1 Shareholder Reports[305]

Rule 30e–1, including the proposed amendments to Forms N–1A, N–2, and N–3, contains collection of information requirements.[306] There are approximately 3,490 management investment companies subject to rule 30e–1.[307] We estimate that the current hour burden for preparing and filing semi-annual and annual shareholder reports in compliance with rule 30e–1 is 202 hours.[308] With the proposed amendments, we estimate the hour burden to be 202.5 hours, for a total annual hour burden to the industry of 706,725 hours.[309]

Compliance with the disclosure requirements of rule 30e–1 is mandatory. Responses to the disclosure requirements will not be kept confidential.

Rule 31a–2

Rule 31a–2, including the proposed amendments, contains collection of information requirements. The rule requires funds and certain principal underwriters, broker-dealers, investment advisers and depositors of funds to preserve certain records for at least six years and other records permanently. Its purpose is to ensure that the Commission and the public have access to material business information about funds. The proposed amendments to rule 31a–2 would require funds to preserve for a period of at least six years any record of (i) The initial determination that a director qualifies as an independent director, and (ii) each subsequent determination of whether the director continues to qualify as an independent director. The purpose of this proposal is to enable the Commission to monitor funds' assessments of the independence of their directors.

We estimate that approximately 3,490 management investment companies are likely respondents to rule 31a–2,[310] and that each investment company currently spends about 27.8 hours per year complying with the rule, for a total industry burden of approximately 97,022 hours.[311]

Each of those 3,490 investment companies would be affected by the proposal to amend rule 31a–2 to require funds to preserve records regarding the independence of their directors. We estimate that each of these investment companies would be required to spend an additional 0.2 hours annually to comply with the proposed amendment,[312] for a total additional annual burden for all funds of approximately 698 hours. Thus, we estimate that the total annual burden for all funds of complying with rule 31a–2, as proposed to be amended, would be approximately 97,720 hours.

Compliance with rule 31a–2 is mandatory for every registered fund. The Commission may not keep confidential any records preserved in reliance on the rule.

Rule 32a–4

Proposed rule 32a–4 contains collection of information requirements. The rule provides an exemption from the requirement in section 32(a)(2) of the Act that the selection of a fund's independent public accountant be submitted to shareholders for ratification or rejection, if the fund establishes an audit committee consisting entirely of independent directors to oversee the fund's auditor. To rely on this exemption, among other things, the fund's board of directors must adopt an audit committee charter that sets forth the committee's structure, duties, powers and methods of operation. The fund also must preserve that charter, and any modifications to the charter, permanently in an easily accessible place. The purpose of these conditions is to ensure that the Commission staff will be able to monitor the duties and responsibilities of an independent audit committee formed by a fund relying on this exemption.

We estimate that there are approximately 3,490 investment companies that could rely on the proposed rule. We assume that approximately 15 percent (524) of those funds are likely to rely on the

---

and post-effective amendments. the approved hour burden at that time was 518.8 hours per filing based on 53 filings. Based upon experience with Form N–3, we have reevaluated the hour burden for Form N–3 and estimated that exclusive of the proposed amendments, the hour burden for initial filings is 900 hours.

[302] These estimates are based on filings received in calendar year 1998. The previous Paperwork Reduction Act submission for Form N–3 did not differentiate the hour burden between initial filings and post-effective amendments. The approved hour burden at that time was 518.8 hours per filing based on 53 filings. Based upon experience with Form N–3, we have reevaluated the hour burden for Form N–3 and estimated that exclusive of the proposed amendments, the hour burden for post-effective amendments is 150 hours.

[303] *See supra* Section III.F. As stated above, the additional hours are based on the additional time funds would devote the determining what information needs to be disclosed and preparing the disclosure documents.

For post-effective amendments, although funds would only have to update the information about current directors and add information about new directors, we anticipate that funds would incur some burden hours in regularly collecting information from directors, determining what information needs to be disclosed, and preparing the updated disclosure.

The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

[304] This total annual hour burden is calculated by adding the hour burden for initial registration statements and the hour burden for post-effective amendments, based on the proposed amendments. the annual hour burden per portfolio for an initial filing would be 910.5 hours (900 plus 10.5), for 20 portfolios, for a total of 18,210 hours. The annual hour burden per portfolio for a post-effective amendment would be 151.75 hours (150 plus 1.75), for 40 portfolios, for a total of 6,070 hours. The total annual hour burden for all funds for preparing and filing of initial registration statements and post-effective amendments on Form N–3 would be 24,280 hours (18,210 plus 6,070).

[305] Because we are proposing to redesignate rule 30d–1 as rule 30e–1, we refer to the newly designated rule 30e–1 in this section.

[306] The proposed amendments are to Forms N–1A, N–2, and N–3. Rule 30e–1 requires funds to include in the shareholder reports the information that is required by the fund's registration statement form.

[307] This estimate is based on statistics compiled by Commission staff from January 1, 1997 through December 31, 1998.

[308] The current approved PRA hour burden for rule 30e–1 is 202 hours per investment company.

[309] *See Supra* section III.F.

[310] The burdens associated with the rule's requirements that investment advisers, underwriters, brokers, dealers, and depositors preserve certain records have been addressed separately in connection with rules adopted under section 204 of the Investment Advisers Act [15 U.S.C. 80b–4] and section 17 of the exchange Act [15 U.S.C. 78q].

[311] The Commission staff surveyed representatives of several funds to determine the current burden hour estimate for rule 31a–2.

[312] *See suprs* note 283 for the basis of this estimate.

exemption. For each of those funds, we estimate that the adoption of the audit committee charter would require, on average, 2 hours of director time and 2 hours of professional time,[313] for a total one-time burden of 2,096 hours. We also estimate that each of the funds relying on the rule would be required to spend approximately 0.2 hours annually to comply with the proposed requirement that they preserve permanently their audit committee charters,[314] for an additional annual hour burden of 105 hours.

Compliance with rule 32a–4 is voluntary. The Commission may not keep confidential the records preserved pursuant to the rule.

Request for Comments

We request your comments on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, D.C. 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, with reference to File No. S7–23–99. The Office of Management and Budget is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release.

[313] *See supra* note 260 for the basis of this estimate.

[314] *See supra* note 262 for the basis of this estimate.

V. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA'' or ''analysis'') in accordance with 5 U.S.C. 603. The IRFA relates to proposed rules 2a19–3, 10e–1, and 32a–4, and the proposed amendments to rules 0–1, 2a19–1, 10f–3, 12b–1, 15a–4, 17a–7, 17a–8, 17d–1, 17e–1, 17g–1, 18f–3, 23c–3, and 31a–2 (the ''substantive rule proposals''). The IRFA also relates to the proposed amendments to Schedule 14A, Forms N–1A, N–2, and N–3, and rules 30e–1 and 30e–2 (the ''disclosure proposals'').[315] The following summarizes the IRFA.

The analysis explains that the substantive rule proposals contained in this Release include proposed amendments to the Exemptive Rules that are designed to enhance the independence and effectiveness of fund independent directors.[316] The proposals also include new rules and rule amendments that would prevent qualified individuals from being unnecessarily disqualified from serving as independent directors, protect independent directors from the costs of legal disputes with fund management, permit the Commission to monitor the independence of directors by requiring funds to preserve records of their assessments of director independence, and temporarily suspend the independent director minimum percentage requirements if a fund falls below the required percentage due to an independent director's death or resignation. In addition, the Commission is proposing to exempt funds from the requirement that shareholders ratify or reject the directors' selection of an independent public accountant, if the fund establishes an audit committee composed entirely of independent directors.

The analysis also explains that the proposals contained in this Release would require enhanced disclosure about directors that should allow a fund shareholder to evaluate whether his designated representatives can, in fact, act as independent, vigorous, and effective representatives. The analysis explains that the proposed amendments would impose enhanced disclosure requirements on all funds by requiring disclosure of basic information about directors to shareholders in the SAI, proxy solicitations for the election of directors, and annual reports to shareholders. The proposed amendments also would require improved disclosure in the SAI and proxy solicitations for the election of directors about fund shares owned by directors, information about directors that may raise conflict of interest concerns, and information on the board's role in governing the fund.

The analysis discusses the impact of the proposed amendments on small entities. For purposes of the Regulatory Flexibility Act, a fund is a small entity if the fund, 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.[317]

The analysis notes that as of December 1998, there were approximately 3,560 investment companies that may be affected by one or more of the substantive and disclosure rule proposals, including 320 investment companies that are small entities. The proposed amendments to the Exemptive Rules would affect any of these funds, including those that are small entities, that rely on an Exemptive Rule and do not already meet the proposed new conditions to those rules. The analysis explains that although it appears that funds may incur certain costs in complying with those proposed conditions, the Commission does not have a reasonable basis for estimating those costs. The analysis also explains that the Commission believes that the other substantive rule proposals are not expected to have a significant economic impact on funds, including those that are small entities. The analysis states that the Commission believes that the disclosure changes may have a significant impact on small entities.

The analysis also discusses the reporting, recordkeeping and other compliance requirements associated with the proposals contained in this Release. It notes that the proposed amendments to the Exemptive Rules would require that, for funds relying on those rules: (i) independent directors constitute either a majority or a super-majority (two-thirds) of the fund's board of directors; (ii) independent directors select and nominate other independent directors; and (iii) any legal counsel for

[315] Because we are proposing to redesignate rule 30d–1 as rule 30e–1, and rule 30d–2 as 30e–2, we refer to the newly designated rules 30e–1 and 30e–2 in this section.

[316] These proposals would require that, for funds relying on those exemptive rules, (i) independent directors constitute either a majority or a super-majority (two-thirds) of the fund's board of directors; (ii) independent directors select and nominate other independent directors; and (iii) any legal counsel for the independent directors be an independent legal counsel. In connection with these proposals, we also are proposing to amend rule 0–1 under the Act to add definitions of the terms ''independent legal counsel'' and ''administrator.''

[317] 17 CFR 270.0–10.

the independent directors be an independent legal counsel.

The analysis explains that the proposed amendments to rule 0–1 would add a definition of ''independent legal counsel.'' Under this proposed definition, a person is an independent legal counsel if (i) a fund reasonably believes that the person has not acted as legal counsel to the fund's adviser, principal underwriter, administrator, or any of their control persons during the last two years, or (ii) a majority of the fund's independent directors determines that the person's representation of the fund's adviser, principal underwriter, administrator, or a control person is or was so limited that it would not adversely affect the person's ability to provide impartial, objective, and unbiased legal counsel to the independent directors. The basis of the independent directors' determination must be recorded in the minutes of the fund. The analysis explains that each fund whose independent directors make a determination under the proposed definition would be required to spend approximately 0.75 hours annually to comply with the requirement that the determination be recorded in the minutes of the fund.[318]

Proposed rule 32a–4 would require any fund relying on the exemption provided by the rule to (i) establish an audit committee comprised solely of independent directors, (ii) adopt an audit committee charter, and (iii) preserve that charter, and any modifications to that charter, permanently in an easily accessible place. The analysis explains that the staff estimates that each fund relying on the proposed rule would be required to spend approximately 4 hours to comply with the requirement that it adopt an audit committee charter, and approximately 0.2 hours annually to comply with the requirement that it preserve that charter in an easily accessible place.[319]

In addition, the analysis notes that the proposed amendments to rule 31a–2 would require funds to preserve for a period of at least six years any record of (i) the initial determination that a director qualifies as an independent director, and (ii) each subsequent determination of whether the director continues to qualify as an independent director. The analysis explains the Commission staff estimates that each investment company that must comply with the rule would be required to spend 0.2 hours annually to comply with this new recordkeeping requirement.[320]

The disclosure proposals would require all funds subject to the amendments to provide enhanced disclosure about directors. As explained in the analysis, based upon staff assessment of the proposed amendments in light of the current hour burden and current reporting requirements, the Commission estimates it will take approximately 10 additional hours per proxy statement to include the proposed disclosure about directors; 24 additional hours per portfolio to prepare an initial registration statement on Form N–1A and 4 additional hours per portfolio to prepare post-effective amendments to the registration statement on Form N–1A that include the proposed disclosure about directors; 42 additional hours per registrant to prepare an initial registration statement on Form N–2 and 7 additional hours per registrant to prepare post-effective amendments to the registration statement on Form N–2 that include the proposed disclosure about directors; 10.5 additional hours per portfolio to prepare an initial registration statement on Form N–3 and 1.75 additional hours per portfolio to prepare post-effective amendments to the registration statement on Form N–3 that include the proposed disclosure about directors; and 0.5 additional hours per investment company to include the proposed basic information about directors in the annual report to shareholders.[321]

As stated in the analysis, the Commission considered several alternatives to both the substantive rule proposals and the disclosure proposals, including establishing different compliance or reporting requirements for small entities or exempting them from all or part of the proposed amendments. The Commission believes that establishing different substantive or disclosure requirements applicable specifically to small entities is inconsistent with the protection of investors. The Commission also believes that adjusting the proposals to establish different compliance requirements for small entities could undercut the purpose of the proposals: to enhance the effectiveness of independent directors, and thus better enable those directors to fulfill their role of protecting shareholder interests.

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 proposals and the impact of the proposals on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be placed in the same public comment file as comments on the proposals. A copy of the IRFA may be obtained by contacting Jennifer B. McHugh or Heather A. Seidel, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0506.

VI. Statutory Authority

The Commission is proposing rules 2a19–3, 10e–1, and 32a–4, and amendments to rules 0–1, 2a19–1, 10f–3, 12b–1, 15a–4, 17a–7, 17a–8, 17d–1, 17e–1, 17g–1, 18f–3, 23c–3, 30d–1, 30d–2, and 31a–2 pursuant to authority set forth in sections 6(c), 10(e), 30(e), 31, and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–10(e), 80a–29(e), 80a–30, 80a–37(a)]. The Commission is proposing amendments to Schedule 14A pursuant to authority set forth in sections 14 and 23(a)(1) of the Exchange Act [15 U.S.C. 78n, 78w(a)(1)] and sections 20(a) and 38 of the Investment Company Act [15 U.S.C. 80a–20(a), 80a–37]. The Commission is proposing amendments to Forms N–1A, N–2, and N–3 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act of 1933 [15 U.S.C. 77e, 77f, 77g, 77j, 77s(a)] and sections 8, 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a–8, 80a–24(a), 80a–29, 80a–37].

List of Subjects

17 CFR Parts 239 and 240

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules and Forms

1. 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:

[318] *See supra* note 255 for the basis of this estimate.

[319] *See supra* notes 260 and 262 for the basis of these estimates.

[320] *See supra* note 283 for the basis of this estimate.

[321] The hour burden for the first post-effective amendment to a registration statement filed by an existing fund after the rules take effect generally would be higher than for subsequent post-effective amendments because the fund would need to compile and disclose the required information for the first time.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.14a–101 is amended by revising paragraphs (d) and (e) of Item 7 to read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 7. Directors and executive officers.

* * * * *

(d)(1) State whether or not the registrant has standing audit, nominating and compensation committees of the Board of Directors, or committees performing similar functions. If the registrant has such committees, however designated, identify each committee member, state the number of committee meetings held by each such committee during the last fiscal year and describe briefly the functions performed by such committees.

(2) If the registrant has a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting such recommendations.

(e) In lieu of paragraphs (a) through (d) of this Item, investment companies registered under the Investment Company Act of 1940 must furnish the information required by Item 22(b) of this Schedule 14A.

* * * * *

3. In § 240.14a–101 amend Item 8(d), before the Instruction, by revising ''Item 22(b)(6)'' to read ''Item 22(b)(12)''.

4. In § 240.14a–101 amend the Instruction following Item 10(a)(2)(ii)(A) by revising ''Item 22(b)(6)'' to read ''Item 22(b)(12)''.

5. In § 240.14a–101 amend the Instruction following Item 10(b)(1)(ii) by revising ''Item 22(b)(6)(ii)'' to read ''Item 22(b)(12)(ii)''.

6. Item 22 of § 240.14a–101 is amended by:

A. Revising paragraph (a)(1)(i);

B. Redesignating paragraphs (a)(1)(vi), (vii), and (viii) as paragraphs (a)(1)(viii), (ix), and (xi);

C. Adding new paragraphs (a)(1)(vi), (vii), and (x); and

D. Revising newly designated paragraph (a)(1) (ix).

The revisions and additions read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 22. Information required in investment company proxy statement.

(a) * * *

(1) * * *

(i) *Administrator.* The term ''Administrator'' shall mean any person who provides significant administrative or business affairs management services to a Fund.

* * * * *

(vi) *Immediate family member.* The term ''Immediate Family Member'' shall mean a person's spouse, parent, child, sibling, mother- or father-in-law, son- or daughter-in-law, or brother- or sister-in-law, and includes step and adoptive relationships.

(vii) *Officer.* The term ''Officer'' shall mean the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

* * * * *

(ix) *Registrant.* The term ''Registrant'' shall mean an investment company registered under the Investment Company Act of 1940 or a business development company as defined by section 2(a)(48) of the Investment Company Act of 1940.

(x) *Sponsoring Insurance Company.* The term ''Sponsoring Insurance Company'' of a Fund that is a separate account shall mean the insurance company that establishes and maintains the separate account and that owns the assets of the separate account.

* * * * *

7. Section 240.14a–101 is amended by revising paragraph (b) of Item 22 to read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 22. Information required in investment company proxy statement.

* * * * *

(b) *Election of directors.* If action is to be taken with respect to the election of directors of a Fund, furnish the following information in the proxy statement in addition to the information (and in the format) required by paragraphs (f) and (g) of Item 7 of Schedule 14A.

Instructions to introductory text of paragraph (b). 1. Furnish information with respect to a prospective investment adviser to the extent applicable.

2. If the solicitation is made by or on behalf of a person other than the Fund or an investment adviser of the Fund, provide information only as to nominees of the person making the solicitation.

3. When providing information about directors and nominees for election as directors in response to this Item 22(b), furnish information for directors or nominees who are or would be ''interested persons'' within the meaning of section 2(a)(19) of the Investment Company Act of 1940 separately from the information for directors or nominees who are not or would not be ''interested persons.'' For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors and nominees who are or would be interested persons and for directors or nominees who are not or would not be interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors or nominees who are or would be interested persons and the ones who are not or would not be interested persons.

4. No information need be given about any director whose term of office as a director will not continue after the meeting to which the proxy statement relates.

(1) Provide the information required by the following table for each director, nominee for election as director, Officer of the Fund, person chosen to become an Officer of the Fund, and, if the Fund has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director or Nominee for Director	Other Directorships Held by Director or Nominee for Director

Instructions to paragraph (b)(1). 1. For purposes of this paragraph, the term ''family relationship'' means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. No nominee or person chosen to become a director or Officer who has not consented to act as such may be named in response to this Item. In this regard, see Rule 14a–4(d) under the Exchange Act (§ 240.14a–4(d) of this chapter).

3. If fewer nominees are named than the number fixed by or pursuant to the governing instruments, state the reasons for this procedure and that the proxies cannot be voted for a greater number of persons than the number of nominees named.

4. For each director or nominee for election as director who is or would be an ''interested person'' within the meaning of section 2(a)(19) of the Investment Company Act of 1940, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director or nominee is or would be an interested person.

5. State the principal business of any company listed under column (4) unless the principal business is implicit in its name.

6. Include in column (5) the total number of separate portfolios that a nominee for election as director would oversee if he were elected.

7. Indicate in column (6) directorships not included in column (5) that are held by a director or nominee for election as director in any company with a class of securities registered pursuant to section 12 of the Exchange Act or subject to the requirements of section 15(d) of the Exchange Act or any company registered as an investment company under the Investment Company Act of 1940, 15 U.S.C. 80a, as amended, and name the companies in which the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same Fund Complex, identify the Fund Complex and provide the number of portfolios overseen as a director in the Fund Complex rather than listing each portfolio separately.

(2) Describe briefly any arrangement or understanding between any director, nominee for election as director, Officer, or person chosen to become an Officer, and any other person(s) (naming the person(s)) pursuant to which he was or is to be selected as a director, nominee, or Officer.

Instruction to paragraph (b)(2). Do not include arrangements or understandings with directors or Officers acting solely in their capacities as such.

(3) Unless disclosed in the table required by paragraph (b)(1) of this Item, describe any positions, including as an officer, employee, director, or general partner, held by a director, nominee for election as director, or Immediate Family Member of the director or nominee, during the past five years, with:

(i) The Fund;

(ii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company as the Fund or having an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund;

(iii) An investment adviser, principal underwriter, Administrator, Sponsoring Insurance Company, or affiliated person of the Fund; or

(iv) Any person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund.

Instruction to paragraph (b)(3). When an individual holds the same position(s) with two or more portfolios that are part of the same Fund Complex, identify the Fund Complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

(4) For each director or nominee for election as director, state the aggregate dollar amount of equity securities of Funds in the same Fund Complex as the Fund owned beneficially or of record by the director or nominee as required by the following table:

(1)	(2)	(3)
Name of Director or Nominee	Identity of Fund Complex	Aggregate Dollar Amount of Equity Securities in Fund Complex

Instructions to paragraph (b)(4). 1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange (§ 240.13d–3 of this chapter).

(5) For each director or nominee for election as director and his Immediate Family Members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(i) An investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund; or

(ii) a person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director or Nominee	Name of Owners and Relationships to Director or Nominee	Company	Title of Class	Value of Securities	Percent of Class

Instructions to paragraph (b)(5).

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d-3 under the Exchange Act (§ 240.13d-3 of this chapter).

3. Identify the company in which the director, nominee, or Immediate Family Member of the director or nominee owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company, describe the company's relationship with the investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company.

4. Provide the information required by columns (5) and (6) on an aggregate basis for each director (or nominee) and his Immediate Family Members.

(6) Unless disclosed in response to paragraph (b)(5) of this Item, describe any material interest, direct or indirect, of each director, nominee for election as director, or Immediate Family Member of a director or nominee, during the past five years, in:

(i) An investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund.

Instruction to paragraph (b)(6). A director, nominee, or Immediate Family Member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

(7) Describe briefly any material interest, direct or indirect, of any director, nominee for election as director, or Immediate Family Member of a director or nominee in any material transaction, or material series of similar transactions, since the beginning of the last two completed fiscal years of the Fund, or in any currently proposed material transaction, or material series of similar transactions, to which any of the following persons was or is to be a party:

(i) The Fund;

(ii) An Officer of the Fund;

(iii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company as the Fund or having an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund;

(iv) An Officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1)

and (c)(7)), having the same investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company as the Fund or having an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund;

(v) An investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund;

(vi) An Officer of an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund;

(vii) A person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund; or

(viii) An Officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund.

Instructions to paragraph (b)(7).

1. Include the name of each director, nominee, or Immediate Family Member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director, nominee, or Immediate Family Member of the director or nominee without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. If the proxy statement relates to multiple portfolios of a series Fund with different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Fund, use the earliest date of any series covered by the proxy statement.

7. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed ''material'' within the meaning of paragraph (b)(7) of this Item where the interest of the director, nominee, or Immediate Family Member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to the transaction with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item, and the transaction is not material to the company.

8. No information need be given as to any transaction where the interest of the director, nominee, or Immediate Family Member arises solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item and the director, nominee, or Immediate Family Member receives no extra or special benefit not shared on a pro rata basis by all holders of the class of securities.

9. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the latest practicable date, and the rate of interest paid or charged.

10. No information need be given as to any routine, retail transaction. For example, the Fund need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item unless the director is accorded special treatment.

(8) Describe briefly any material relationship, direct or indirect, of any director, nominee for election as director, or Immediate Family Member of a director or nominee that exists, or has existed at any time since the beginning of the last two completed fiscal years of the Fund, or is currently proposed, with any of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item. Relationships include:

(i) Payments for property or services to or from any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item;

(ii) Provision of legal services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item;

(iii) Provision of investment banking services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item, other than as a participating underwriter in a syndicate; and

(iv) Any consulting or other relationship that is substantially similar in nature and scope to the relationships listed in paragraphs (b)(8)(i) through (b)(8)(iii) of this Item.

Instructions to paragraph (b)(8). 1. Include the name of each director, nominee, or Immediate Family Member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director, nominee, or Immediate Family Member and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item as a result of the relationship since the beginning of the last two completed fiscal years of the Fund or proposed to be done during the Fund's current fiscal year.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. If the proxy statement relates to multiple portfolios of a series Fund with different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Fund, use the earliest date of any series covered by the proxy statement.

5. Disclose indirect, as well as direct, material relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item may have an indirect relationship by reason of the position, relationship, or interest. The relationship, however, will not be deemed ''material'' within the meaning of paragraph (b)(8) of this Item where the relationship of the director, nominee, or Immediate Family Member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that has a relationship with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item, and the relationship is not material to the company.

6. In the case of an indirect interest, identify the company with which a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item has a relationship; the name of the director,

nominee, or Immediate Family Member affiliated with the company and the nature of the affiliation; and the amount of business done between the company and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item since the beginning of the last two completed fiscal years of the Fund or proposed to be done during the Fund's current fiscal year.

7. In calculating payments for property and services for purposes of paragraph (b)(8)(i) of this Item, the following may be excluded:

A. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

B. Payments that arise solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

8. No information need be given as to any routine, retail relationship. For example, the Fund need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item unless the director is accorded special treatment.

(9) If an Officer of an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund, or an Officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company of the Fund, serves, or has served since the beginning of the last two completed fiscal years of the Fund, on the board of directors of a company where a director of the Fund, nominee for election as director, or Immediate Family Member of a director or nominee is, or was since the beginning of the last two completed fiscal years of the Fund, an Officer, identify:

(i) The company;

(ii) The individual who serves or has served as a director of the company and the period of service as director;

(iii) The investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company or person controlling, controlled by, or under common control with the investment adviser, principal underwriter, Administrator, or Sponsoring Insurance Company where the individual named in paragraph (b)(9)(ii) of this Item holds or held office and the office held; and

(iv) The director of the Fund, nominee for election as director, or Immediate Family Member who is or was an Officer of the company; the office held; and the period of holding the office.

Instruction to paragraph (b)(9). If the proxy statement relates to multiple portfolios of a series Fund with different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Fund, use the earliest date of any series covered by the proxy statement.

(10) Provide in tabular form, to the extent practicable, the information required by Items 401(f) and (g), 404(a) and (c), and 405 of Regulation S-K (§§ 229.401(f) and (g), 229.404(a) and (c), and 229.405 of this chapter).

Instruction to paragraph (b)(10). Information provided under paragraph (b)(7) of this Item 22 is deemed to satisfy the requirements of Items 404(a) and (c) of Regulation S-K for information about directors, nominees for election as directors, and Immediate Family Members of directors and nominees, and need not be provided under this paragraph (b)(10).

(11) Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the Fund's business, to which any director or nominee for director or affiliated person of such director or nominee is a party adverse to the Fund or any of its affiliated persons or has a material interest adverse to the Fund or any of its affiliated persons. Include the name of the court where the case is pending, the date instituted, the principal parties, a description of the factual basis alleged to underlie the proceeding, and the relief sought.

(12) For all directors, and for each of the three highest-paid Officers that have aggregate compensation from the Fund for the most recently completed fiscal year in excess of $60,000 (''Compensated Persons''):

(i) Furnish the information required by the following table for the last fiscal year:

COMPENSATION TABLE

(1)	(2)	(3)	(4)	(5)
Name of Person, Position	Aggregate Compensation From Fund	Pension or Retirement Benefits Accrued as Part of Fund Expenses	Estimated Annual Benefits Upon Retirement	Total Compensation From Fund and Fund Complex Paid to Directors

Instructions to paragraph (b)(12)(i). 1. For column (1), indicate, if necessary, the capacity in which the remuneration is received. For Compensated Persons that are directors of the Fund, compensation is amounts received for service as a director.

2. If the Fund has not completed its first full year since its organization, furnish the information for the current fiscal year, estimating future payments that would be made pursuant to an existing agreement or understanding. Disclose in a footnote to the Compensation Table the period for which the information is furnished.

3. Include in column (2) amounts deferred at the election of the Compensated Person, whether pursuant to a plan established under Section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)) or otherwise, for the fiscal year in which earned. Disclose in a footnote to the Compensation Table the total amount of deferred compensation (including interest) payable to or accrued for any Compensated Person.

4. Include in columns (3) and (4) all pension or retirement benefits proposed to be paid under any existing plan in the event of retirement at normal retirement date, directly or indirectly, by the Fund or any of its Subsidiaries, or by other companies in the Fund Complex. Omit column (4) where retirement benefits are not determinable.

5. For any defined benefit or actuarial plan under which benefits are determined primarily by final compensation (or average final compensation) and years of service, provide the information required in column (4) in a separate table showing estimated annual benefits payable upon retirement (including amounts attributable to any defined benefit supplementary or excess pension award plans) in specified compensation and years of service classifications. Also provide the estimated credited years of service for each Compensated Person.

6. Include in column (5) only aggregate compensation paid to a director for service on the board and other boards of investment companies in a Fund Complex specifying the number of such other investment companies.

(ii) Describe briefly the material provisions of any pension, retirement, or other plan or any arrangement other than fee arrangements disclosed in paragraph (b)(12)(i) of this Item pursuant to which Compensated Persons are or may be compensated for any services provided, including amounts paid, if any, to the Compensated Person under any such arrangements during the most recently completed fiscal year. Specifically include the criteria used to determine amounts payable under any plan, the length of service or vesting period required by the plan, the retirement age or other event that gives rise to payments under the plan, and whether the payment of benefits is secured or funded by the Fund.

(iii) With respect to each Compensated Person, business development companies must include the information required by Items 402(b)(2)(iv) and 402(c) of Regulation S–K (§§ 229.402(b)(2)(iv) and 229.402(c) of this chapter).

(13) Identify the standing committees of the Fund's board of directors, and provide the following information about each committee:

(i) A concise statement of the functions of the committee;

(ii) The members of the committee;

(iii) The number of committee meetings held during the last fiscal year; and

(iv) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

* * * * *

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

8. The authority citation for part 270 is amended by adding the following citation to read as follows:

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

* * * * *

Section 270.10e–1 is also issued under 15 U.S.C. 80a–10(e).

* * * * *

9. Section 270.0–1 is amended by adding paragraphs (a)(5) and (a)(6) to read as follows:

§ 270.0–1 Definition of terms used in this part.

* * * * *

(a) * * *

(5) The term *administrator* means any person who provides significant administrative or business affairs management services to an investment company.

(6)(i) A person is an *independent legal counsel* with respect to the directors who are not interested persons of an investment company (''disinterested directors'') if:

(A) The investment company reasonably believes that the person has not acted as legal counsel for the company's investment adviser, principal underwriter, administrator (collectively, ''management organizations''), or any of their control persons at any time since the beginning of the company's last two completed fiscal years; or

(B) A majority of the disinterested directors determine (and record the basis for that determination in the minutes of their meeting) that the person's representation of any of the company's management organizations or any of their control persons is or was so limited that it would not adversely affect the person's ability to provide impartial, objective, and unbiased legal counsel to the disinterested directors.

(ii) For purposes of paragraph (a)(6)(i) of this section:

(A) The term *person* has the same meaning as in section 2(a)(28) of the Act (15 U.S.C. 80a–2(a)(28)) and, in addition, includes a partner, co-member, or employee of any person; and

(B) The term *control person* means any person (other than an investment company) directly or indirectly controlling, controlled by, or under common control with any of the investment company's management organizations.

* * * * *

10. The section heading for § 270.2a19–1 is revised to read as follows:

§ 270.2a19–1 Certain investment company directors not considered interested persons because of broker-dealer affiliation.

* * * * *

11. Section 270.2a19–1 is amended by removing the phrase ''a minority of the directors f'' in paragraph (a)(3) and adding in its place the phrase ''one-half of the directors of''.

12. Section 270.2a19–3 is added to read as follows:

§ 270.2a19–3 Certain investment company directors not considered interested persons because of ownership of index fund securities.

If a director of a registered investment company (''Fund'') owns shares of a registered investment company (including the Fund) with an investment objective to replicate the performance of one or more securities indices (''Index Fund''), ownership of the Index Fund shares will not cause the director to be considered an ''interested person'' of the Fund or of the Fund's investment adviser or principal underwriter (as defined by section 2(a)(19)(A)(iii) and (B)(iii) of the Act (15 U.S.C. 80a–2(a)(19)(A)(iii) and (B)(iii))), if the value of the securities of the Fund's investment adviser or principal underwriter (or a controlling person of the investment adviser or principal underwriter) in any of the securities indices constitutes no more than five percent of the value of that index.

13. Section 270.10e–1 is added to read as follows:

§ 270.10e–1 Death, disqualification, or bona fide resignation of directors.

If a registered investment company, by reason of the death, disqualification, or bona fide resignation of any director, does not meet any requirement of the Act or any rule or regulation regarding the composition of the company's board of directors, the operation of the relevant subsection of the Act, rule, or regulation will be suspended as to the company:

(a) For 60 days if the vacancy may be filled by action of the board of directors; or

(b) For 150 days if a vote of stockholders is required to fill the vacancy.

14. Section 270.10f–3 is amended by redesignating paragraph (b)(11) as paragraph (b)(12) and adding new paragraph (b)(11) to read as follows:

§ 270.10f–3 Exemption for the acquisition of securities during the existence of an underwriting or selling syndicate.

* * * * *

(b) * * *

(11) *Board Composition, Selection, and Representation.* (i) [A majority/At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(ii) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

* * * * *

Section 270.12b–1 is amended by revising paragraph (c) to read as follows:

§ 270.12b–1 Distribution of shares by registered open-end management investment company.

* * * * *

(c) A registered open-end management investment company may rely on the provisions of paragraph (b) of this section only if:

(1) [A majority/At least two-thirds] of the directors of the company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel;

* * * * *

16. Section 270.15a–4 is amended by removing the word ''and'' at the end of paragraph (a), removing the period at the end of paragraph (b) and adding in its place ''; and'' and adding paragraph (c) to read as follows:

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

* * * * *

(c)(1) [A majority/At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

17. Section 270.17

a–7 is amended by:

A. Removing the ''and'' at the end of paragraph (e)(3), IPB. Redesignating paragraph (f) as paragraph (g), and

C. Adding new paragraph (f) to read as follows:

§ 270.17a–7 Exemption of certain purchase or sale transactions between an investment company and certain affiliated persons thereof.

* * * * *

(f)(1) [A majority/At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel; and

* * * * *

18. Section 270.17a–8 is amended by:

A. Removing the ‘‘, and’’ at the end of paragraph (a)(2) and in its place adding a semi-colon,

B. Removing the period at the end of paragraph (b) and adding in its place ‘‘; and’’, and

C. Adding paragraph (c) to read as follows:

§ 270.17a–8 Mergers of certain affiliated investment companies.

* * * * *

(c)(1) [A majority/At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

19. Section 270.17d–1 is amended by:

A. Removing the word ‘‘and’’ at the end of paragraph (d)(7)(ii),

B. Redesignating paragraph (d)(7)(iii) as paragraph (d)(7)(iv),

C. Removing the period at the end of newly designated paragraph (d)(7)(iv) and adding in is place ‘‘; and’’, and

D. Adding new paragraphs (d)(7)(iii) and (d)(7)(v) to read as follows:

§ 270.17d–1 Applications regarding joint enterprises or arrangements and certain profit-sharing plans.

* * * * *

(d) * * *

(7) * * *

(iii) The joint liability insurance policy does not exclude coverage for bona fide claims made against any director who is not an interested person of the investment company, or against the investment company if it is a co-defendant in the claim with the disinterested director, by another person insured under the joint liability insurance policy;

* * * * *

(v)(A) [A majority/At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(B) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

* * * * *

20. Section 270.17e–1 is amended by:

Removing the word ‘‘and’’ at the end of paragraph (b)(3), redesignating paragraph (c) as paragraph (d), and adding new paragraph (c) to read as follows:

§ 270.17e–1 Brokerage transactions on a securities exchange.

* * * * *

(c)(1) [A majority / At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel; and

* * * * *

21. Section 270.17g–1 is amended by revising paragraph (j) to read as follows:

§ 270.17g–1 Bonding of officers and employees of registered management investment companies.

* * * * *

(j) Any joint insured bond provided and maintained by a registered management investment company and one or more other parties shall be a transaction exempt from the provisions of section 17(d) of the Act (15 U.S.C. 80a–17(d)) and the rules thereunder, if:

(1) The terms and provisions of the bond comply with the provisions of this section;

(2) The terms and provisions of any agreement required by paragraph (f) of this section comply with the provisions of that paragraph; and

(3)(i) [A majority / At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(ii) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

* * * * *

22. Section 270.18f–3 is amended by redesigning paragraph (e) as paragraph (f), and adding new paragraph (e) to read as follows:

§ 270.18f–3 Multiple class companies.

* * * * *

(e)(1) [A majority / At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(2) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

* * * * *

23. Section 270.23c–3 is amended by revising paragraph (b)(8) to read as follows:

§ 270.23c–3 Repurchase offers by closed-end companies.

* * * * *

(b) * * *

(8)(i) [A majority / At least two-thirds] of the directors of the investment company are not interested persons of the company, and those directors select and nominate any other disinterested directors of the company; and

(ii) Any person who acts as legal counsel for the disinterested directors of the company is an independent legal counsel.

* * * * *

24. Redesignate § 270.30d–1 as § 270.30e–1; in newly designated § 270.30e–1, in paragraph (a), revise ‘‘financial statements’’ to read ‘‘information’’; and revise paragraph (d) to read as follows:

§ 270.30e–1 Reports to stockholders of management companies.

* * * * *

(d) An open-end company may transmit a copy of its current effective prospectus or Statement of Additional Information, or both, under the Securities Act, inplace of any report required to be transmitted to shareholders by this section, provided that the prospectus or Statement of Additional Information, or both, include all the information that would otherwise be required to be contained in the report by this section. Such prospectus or Statement of Additional Information, or both, shall be transmitted within 60 days after the close of the period for which the report is being made.

* * * * *

§ 270.30d–2 [Redesignated as § 270.30e–2]

25. Redesignate § 270.30d–2 as § 270.30e–2 and in newly designated § 270.30e–2 revise ‘‘Rule N–30D–1’’ to read ‘‘§ 270.30e–1 of this chapter’’ in the first and second sentence.

26. Section 270.31a–2 is amended by removing the period at end of paragraph (a)(3) and in its place adding a semi-

colon, and adding paragraphs (a)(4) and (a)(5) to read as follows:

§ 270.31a–2 Records to be preserved by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies.

(a) * * *

(4) Preserve for a period not less than six years, the first two years in an easily accessible place, any record of the initial determination that a director is not an interested person of the investment company, and each subsequent determination that the director is not an interested person of the investment company. These records must include any questionnaire and any other document used to determine that a director is not an interested person of the company; and

(5) Preserve for a period not less than six years, the first two years in an easily accessible place, any document used by an investment company to establish a reasonable belief that any person who acts as legal counsel to the directors who are not interested persons of the company is an independent legal counsel and any document used by the disinterested directors to determine that any current or prior representation is or was so limited that it will not adversely affect the counsel's ability to provide impartial, objective, and unbiased legal advice.

* * * * *

27. Section 270.32a–4 is added to read as follows:

§ 270.32a–4 Exemption from ratification or rejection requirement of section 32(a)(2) for certain registered investment companies with independent audit committees.

A registered management investment company or a registered face-amount certificate company is exempt from the requirement of section 32(a)(2) of the Act (15 U.S.C. 80a–31(a)(2)) that the selection of the company's independent public accountant be submitted for ratification or rejection at the next succeeding annual meeting of shareholders, if:

(a) The company's board of directors has established a committee that has responsibility for overseeing the fund's accounting and auditing processes (''audit committee'');

(b) The audit committee is composed solely of directors who are not interested persons of the fund;

(c) The company's board of directors has adopted a charter for the audit committee setting forth the committee's structure, duties, powers, and methods of operation; and

(d) The company maintains and preserves permanently in an easily accessible place a copy of the audit committee's charter and any modification to the charter.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

28. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u–5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a–8, 80a–24, 80a–29, 80a–30 and 80a–37, unless otherwise noted.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

29. The authority citation for part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, and 80a–29, unless otherwise noted.

Note: The text of Form N–1A does not and these amendments will not appear in the Code of Federal Regulations.

30. Item 13 of Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by adding Instructions 1 and 2 before paragraph (a); removing paragraphs (a), (b), and (c) and adding paragraphs (a) and (b) in their place; redesignating paragraphs (d) and (e) as paragraphs (c) and (d); and removing ''executive'' from the first sentence of newly redesignated paragraph (c) to read as follows:

Form N–1A

* * * * *

Item 13. Management of the Fund

Instructions

1. For purposes of this Item 13, the terms below have the following meanings:

(a) The term ''fund complex'' means two or more registered investment companies that:

(1) Hold themselves out to investors as related companies for purposes of investment and investor services; or (2) Have a common investment adviser or have an investment adviser that is an affiliated person of the investment adviser of any of the other registered investment companies.

(b) The term ''immediate family member'' means a person's spouse, parent, child, sibling, mother- or father-in-law, son- or daughter-in-law, or brother- or sister-in-law, and includes step and adoptive relationships.

(c) The term ''officer'' means the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

2. When providing information about directors, furnish information for directors who are interested persons separately from the information for directors who are not interested persons. For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors who are interested persons and for directors who are not interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors who are interested persons and the ones who are not interested persons.

(a) *Management Information.* (1) Provide the information required by the following table for each director and officer of the Fund, and, if the Fund has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director

Instructions

1. For purposes of this paragraph, the term ''family relationship'' means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. For each director who is an interested person, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director is an interested person.

3. State the principal business of any company listed under column (4) unless

the principal business is implicit in its name.

4. Indicate in column (6) directorships not included in column (5) that are held by a director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78*l*) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same fund complex, identify the fund complex and provide the number of portfolios overseen as a director in the fund complex rather than listing each portfolio separately.

(2) For each individual listed in column (1) of the table required by paragraph (a)(1) of this Item 13 who is not a director, describe any positions, including as an officer, employee, director, or general partner, held with affiliated persons or principal underwriters of the Fund.

Instruction. When an individual holds the same position(s) with two or more registered investment companies that are part of the same fund complex, identify the fund complex and provide the number of registered investment companies for which the position(s) are held rather than listing each registered investment company separately.

(3) Describe briefly any arrangement or understanding between any director or officer and any other person(s) (naming the person(s)) pursuant to which he was selected as a director or officer.

Instruction. Do not include arrangements or understandings with directors or officers acting solely in their capacities as such.

(b) *Board of Directors.*

(1) Briefly describe the responsibilities of the board of directors with respect to the Fund's management.

Instruction. A Fund may respond to this paragraph by providing a general statement as to the responsibilities of the board of directors with respect to the Fund's management under the applicable laws of the state or other jurisdiction in which the Fund is organized.

(2) Identify the standing committees of the Fund's board of directors, and provide the following information about each committee:

(i) A concise statement of the functions of the committee;

(ii) The members of the committee;

(iii) The number of committee meetings held during the last fiscal year; and

(iv) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

(3) Unless disclosed in the table required by paragraph (a)(1) of this Item 13, describe any positions, including as an officer, employee, director, or general partner, held by a director or immediate family member of the director during the past five years with:

(i) The Fund;

(ii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, or administrator as the Fund or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Fund;

(iii) An investment adviser, principal underwriter, administrator, or affiliated person of the Fund; or

(iv) Any person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund.

Instruction. When an individual holds the same position(s) with two or more portfolios that are part of the same fund complex, identify the fund complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

(4) For each director, state the aggregate dollar amount of equity securities of registered investment companies in the same fund complex as the Fund owned beneficially or of record by the director as required by the following table:

(1)	(2)	(3)
Name of Director	Identity of Fund Complex	Aggregate Dollar Amount of Equity Securities in Fund Complex

Instructions

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

(5) For each director and his immediate family members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(i) An investment adviser, principal underwriter, or administrator of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director	Name of Owners and Relationships to Director	Company	Title of Class	Value of Securities	Percent of Class

Instructions

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

3. Identify the company in which the director or immediate family member of the director owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator, describe the company's relationship with the investment adviser, principal underwriter, or administrator.

4. Provide the information required by columns (5) and (6) on an aggregate

basis for each director and his immediate family members.

(6) Unless disclosed in response to paragraph (b)(5) of this Item 13, describe any material interest, direct or indirect, of each director or immediate family member of a director, during the past five years, in:

(i) An investment adviser, principal underwriter, or administrator of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund.

Instruction. A director or immediate family member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

(7) Describe briefly any material interest, direct or indirect, of any director or immediate family member of a director in any material transaction, or material series of similar transactions, since the beginning of the last two completed fiscal years of the Fund, or in any currently proposed material transaction, or material series of similar transactions, to which any of the following persons was or is to be a party:

(i) The Fund;

(ii) An officer of the Fund;

(iii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, or administrator as the Fund or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Fund;

(iv) An officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a–3(c)(1) and (7)), having the same investment adviser, principal underwriter, or administrator as the Fund or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Fund;

(v) An investment adviser, principal underwriter, or administrator of the Fund;

(vi) An officer of an investment adviser, principal underwriter, or administrator of the Fund;

(vii) A person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund; or

(viii) An officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund.

Instructions

1. Include the name of each director or immediate family member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director or immediate family member of the director without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. If the Registrant is a Series company whose Series have different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Registrant, use the earliest date of any Series.

7. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed ''material'' within the meaning of paragraph (b)(7) of this Item 13 where the interest of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to the transaction with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13, and the transaction is not material to the company.

8. No information need be given as to any transaction where the interest of the director or immediate family member arises solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 and the director or immediate family member receives no extra or special benefit not shared on a pro rata basis by all holders of the class of securities.

9. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the latest practicable date, and the rate of interest paid or charged.

10. No information need be given as to any routine, retail transaction. For example, the Fund need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 unless the director is accorded special treatment.

(8) Describe briefly any material relationship, direct or indirect, of any director or immediate family member of a director that exists, or has existed at any time since the beginning of the last two completed fiscal years of the Fund, or is currently proposed, with any of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13. Relationships include:

(i) Payments for property or services to or from any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13;

(ii) Provision of legal services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13;

(iii) Provision of investment banking services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13, other than as a participating underwriter in a syndicate; and

(iv) Any consulting or other relationship that is substantially similar in nature and scope to the relationships

listed in paragraphs (b)(8)(i) through (b)(8)(iii) of this Item 13.

Instructions

1. Include the name of each director or immediate family member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director or immediate family member and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 as a result of the relationship since the beginning of the last two completed fiscal years of the Fund or proposed to be done during the Fund's current fiscal year.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. If the Registrant is a Series company whose Series have different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Registrant, use the earliest date of any Series.

5. Disclose indirect, as well as direct, material relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 may have an indirect relationship by reason of the position, relationship, or interest. The relationship, however, will not be deemed ''material'' within the meaning of paragraph (b)(8) of this Item 13 where the relationship of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that has a relationship with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13, and the relationship is not material to the company.

6. In the case of an indirect interest, identify the company with which a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 has a relationship; the name of the director or immediate family member affiliated with the company and the nature of the affiliation; and the amount of business done between the company and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 since the beginning of the last two completed fiscal years of the Fund or proposed to be done during the Fund's current fiscal year.

7. In calculating payments for property and services for purposes of paragraph (b)(8)(i) of this Item 13, the following may be excluded:

A. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

B. Payments that arise solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

8. No information need be given as to any routine, retail relationship. For example, the Fund need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 13 unless the director is accorded special treatment.

(9) If an officer of an investment adviser, principal underwriter, or administrator of the Fund, or an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Fund, serves, or has served since the beginning of the last two completed fiscal years of the Fund, on the board of directors of a company where a director of the Fund or immediate family member of a director is, or was since the beginning of the last two completed fiscal years of the Fund, an officer, identify:

(i) The company;

(ii) The individual who serves or has served as a director of the company and the period of service as director;

(iii) The investment adviser, principal underwriter, or administrator or person controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator where the individual named in paragraph (b)(9)(ii) of this Item 13 holds or held office and the office held; and

(iv) The director of the Fund or immediate family member who is or was an officer of the company; the office held; and the period of holding the office.

Instruction. If the Registrant is a Series company whose Series have different fiscal years, then, in determining the date that is the beginning of the last two completed fiscal years of the Registrant, use the earliest date of any Series.

(10) Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of directors approving the existing investment advisory contract. If applicable, include a discussion of any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating fund brokerage.

Instruction. Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Fund and the investment advisory contract.

* * * * *

31. Item 22 of Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by adding paragraphs (b)(5) and (b)(6) to read as follows:

Form N–1A

* * * * *

Item 22. Financial Statements

* * * * *

(b) * * *

(5) The management information required by Item 13(a)(1).

(6) A statement that the SAI includes additional information about Fund directors and is available, without charge, upon request, and a toll-free (or collect) telephone number for shareholders to call to request the SAI.

* * * * *

Note: The text of Form N–2 does not and these amendments will not appear in the Code of Federal Regulations

32. Item 18 of Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by adding Instructions 1 and 2 before paragraph 1; revising paragraphs 1 and 2; redesignating paragraphs 3 and 4 as paragraphs 4 and 14; adding new paragraphs 3 and 5 through 13; and removing ''executive'' from the first sentence of newly designated paragraph 14 to read as follows:

Form N–2

* * * * *

Item 18. Management

Instructions

1. For purposes of this Item 18, the terms below have the following meanings:

a. The term ''fund complex'' means two or more registered investment companies that:

(i) Hold themselves out to investors as related companies for purposes of investment and investor services; or

(ii) Have a common investment adviser or have an investment adviser

that is an affiliated person of the investment adviser of any of the other registered investment companies.

b. The term ''immediate family member'' means a person's spouse, parent, child, sibling, mother- or father-in-law, son- or daughter-in-law, or brother- or sister-in-law, and includes step and adoptive relationships.

c. The term ''officer'' means the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

2. When providing information about directors, furnish information for directors who are interested persons as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a–2(a)(19)) and the rules thereunder separately from the information for directors who are not interested persons. For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors who are interested persons and for directors who are not interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors who are interested persons and the ones who are not interested persons.

1. Provide the information required by the following table for each director and officer of the Registrant, and, if the Registrant has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Registrant	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director

Instructions

1. For purposes of this paragraph, the term ''family relationship'' means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. For each director who is an interested person as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a–2(a)(19)) and the rules thereunder, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director is an interested person.

3. State the principal business of any company listed under column (4) unless the principal business is implicit in its name.

4. Indicate in column (6) directorships not included in column (5) that are held by a director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78*l*) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same fund complex, identify the fund complex and provide the number of portfolios overseen as a director in the fund complex rather than listing each portfolio separately.

2. For each individual listed in column (1) of the table required by paragraph 1 who is not a director, describe any positions, including as an officer, employee, director, or general partner, held with affiliated persons or principal underwriters of the Registrant.

Instruction: When an individual holds the same position(s) with two or more registered investment companies that are part of the same fund complex, identify the fund complex and provide the number of registered investment companies for which the position(s) are held rather than listing each registered investment company separately.

3. Describe briefly any arrangement or understanding between any director or officer and any other person(s) (naming the person(s)) pursuant to which he was selected as a director or officer.

Instruction: Do not include arrangements or understandings with directors or officers acting solely in their capacities as such.

4. For each non-resident director or officer of the Registrant listed in column (1) of the table required by paragraph 1, disclose whether he has authorized an agent in the United States to receive notice and, if so, disclose the name and address of the agent.

5. Identify the standing committees of the Registrant's board of directors, and provide the following information about each committee:

(a) A concise statement of the functions of the committee;

(b) The members of the committee;

(c) The number of committee meetings held during the last fiscal year; and

(d) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

6. Unless disclosed in the table required by paragraph 1 of this Item 18, describe any positions, including as an officer, employee, director, or general partner, held by a director or immediate family member of the director during the past five years with:

(a) The Registrant;

(b) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, or administrator as the Registrant or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Registrant;

(c) An investment adviser, principal underwriter, administrator, or affiliated person of the Registrant; or

(d) Any person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant.

Instruction: When an individual holds the same position(s) with two or more portfolios that are part of the same fund complex, identify the fund complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

7. For each director, state the aggregate dollar amount of equity securities of registered investment companies in the same fund complex as the Registrant owned beneficially or of record by the director as required by the following table:

(1)	(2)	(3)
Name of Director	Identity of Fund Complex	Aggregate Dollar Amount of Equity Securities in Fund Complex

Instructions

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

8. For each director and his immediate family members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(a) An investment adviser, principal underwriter, or administrator of the Registrant; or

(b) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director	Name of Owners and Relationships to Director	Company	Title of Class	Value of Securities	Percent of Class

Instructions

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

3. Identify the company in which the director or immediate family member of the director owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator, describe the company's relationship with the investment adviser, principal underwriter, or administrator.

4. Provide the information required by columns (5) and (6) on an aggregate basis for each director and his immediate family members.

9. Unless disclosed in response to paragraph 8 of this Item 18, describe any material interest, direct or indirect, of each director or immediate family member of a director, during the past five years, in:

(a) An investment adviser, principal underwriter, or administrator of the Registrant; or

(b) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant.

Instruction: A director or immediate family member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

10. Describe briefly any material interest, direct or indirect, of any director or immediate family member of a director in any material transaction, or material series of similar transactions, since the beginning of the last two completed fiscal years of the Registrant, or in any currently proposed material transaction, or material series of similar transactions, to which any of the following persons was or is to be a party:

(a) The Registrant;

(b) An officer of the Registrant;

(c) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, or administrator as the Registrant or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Registrant;

(d) An officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same investment adviser, principal underwriter, or administrator as the Registrant or having an investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with an investment adviser, principal underwriter, or administrator of the Registrant;

(e) An investment adviser, principal underwriter, or administrator of the Registrant;

(f) An officer of an investment adviser, principal underwriter, or administrator of the Registrant;

(g) A person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant; or

(h) An officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant.

Instructions

1. Include the name of each director or immediate family member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director or immediate family member of the director without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs 10(a) through (h) of this Item 18 may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed ''material'' within the meaning of paragraph 10 of this Item 18 where the interest of the director or immediate

family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to the transaction with one of the persons specified in paragraphs 10(a) through (h) of this Item 18, and the transaction is not material to the company.

7. No information need be given as to any transaction where the interest of the director or immediate family member arises solely from the ownership of securities of a person specified in paragraphs 10(a) through (h) of this Item 18 and the director or immediate family member receives no extra or special benefit not shared on a pro rata basis by all holders of the class of securities.

8. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the latest practicable date, and the rate of interest paid or charged.

9. No information need be given as to any routine, retail transaction. For example, the Registrant need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs 10(a) through (h) of this Item 18 unless the director is accorded special treatment.

11. Describe briefly any material relationship, direct or indirect, of any director or immediate family member of a director that exists, or has existed at any time since the beginning of the last two completed fiscal years of the Registrant, or is currently proposed, with any of the persons specified in paragraphs 10(a) through (h) of this Item 18. Relationships include:

(a) Payments for property or services to or from any person specified in paragraphs 10(a) through (h) of this Item 18;

(b) Provision of legal services to any person specified in paragraphs 10(a) through (h) of this Item 18;

(c) Provision of investment banking services to any person specified in paragraphs 10(a) through (h) of this Item 18, other than as a participating underwriter in a syndicate; and

(d) Any consulting or other relationship that is substantially similar in nature and scope to the relationships listed in paragraphs 11(a) through (c) of this Item 18.

Instructions

1. Include the name of each director or immediate family member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director or immediate family member and the person specified in paragraphs 10(a) through (h) of this Item 18 as a result of the relationship since the beginning of the last two completed fiscal years of the Registrant or proposed to be done during the Registrant's current fiscal year.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. Disclose indirect, as well as direct, material relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs 10(a) through (h) of this Item 18 may have an indirect relationship by reason of the position, relationship, or interest. The relationship, however, will not be deemed ''material'' within the meaning of paragraph 11 of this Item 18 where the relationship of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that has a relationship with one of the persons specified in paragraphs 10(a) through (h) of this Item 18, and the relationship is not material to the company.

5. In the case of an indirect interest, identify the company with which a person specified in paragraphs 10(a) through (h) of this Item 18 has a relationship; the name of the director or immediate family member affiliated with the company and the nature of the affiliation; and the amount of business done between the company and the person specified in paragraphs 10(a) through (h) of this Item 18 since the beginning of the last two completed fiscal years of the Registrant or proposed to be done during the Registrant's current fiscal year.

6. In calculating payments for property and services for purposes of paragraph 11(a) of this Item 18, the following may be excluded:

a. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

b. Payments that arise solely from the ownership of securities of a person specified in paragraphs 10(a) through (h) of this Item 18 and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

7. No information need be given as to any routine, retail relationship. For example, the Registrant need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs 10(a) through (h) of this Item 18 unless the director is accorded special treatment.

* * * * *

12. If an officer of an investment adviser, principal underwriter, or administrator of the Registrant, or an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser, principal underwriter, or administrator of the Registrant, serves, or has served since the beginning of the last two completed fiscal years of the Registrant, on the board of directors of a company where a director of the Registrant or immediate family member of a director is, or was since the beginning of the last two completed fiscal years of the Registrant, an officer, identify:

(a) The company;

(b) The individual who serves or has served as a director of the company and the period of service as director;

(c) The investment adviser, principal underwriter, or administrator or person controlling, controlled by, or under common control with the investment adviser, principal underwriter, or administrator where the individual named in paragraph 12(b) of this Item 18 holds or held office and the office held; and

(d) The director of the Registrant or immediate family member who is or was an officer of the company; the office held; and the period of holding the office.

13. Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of directors approving the existing investment advisory contract. If applicable, include a discussion of any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating fund brokerage.

Instruction: Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract.

* * * * *

33. Instruction 4 to Item 23 of Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by removing ''and'' from the end of paragraph c., removing the period at the end of paragraph d. and in its place adding a semi-colon, and adding paragraphs e. and f. to read as follows:

Form N–2

* * * * *

Item 23. Financial Statements

* * * * *

Instructions

* * * * *

4. * * *

e. the management information required by paragraph 1 of Item 18; and

f. a statement that the SAI includes additional information about directors of the Registrant and is available, without charge, upon request, and a toll-free (or collect) telephone number for shareholders to call to request the SAI.

* * * * *

Note: The text of Form N–3 does not and these amendments will not appear in the *Code of Federal Regulations.*

34. Item 20 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by adding instructions 1 and 2 before paragraph (a); revising paragraphs (a) and (b); redesignating paragraph (c) as paragraph (m); adding paragraphs (c) through (l); and removing ''executive'' from the first sentence of newly designated paragraph (m) to read as follows:

Form N–3

* * * * *

Item 20. Management

Instructions

1. For purposes of this Item 20, the terms below have the following meanings:

a. The term ''fund complex'' means two or more registered investment companies that:

(i) Hold themselves out to investors as related companies for purposes of investment and investor services; or

(ii) Have a common investment adviser or have an investment adviser that is an affiliated person of the investment adviser of any of the other registered investment companies.

b. The term ''immediate family member'' means a person's spouse, parent, child, sibling, mother- or father-in-law, son- or daughter-in-law, or brother or sister-in-law, and includes step and adoptive relationships.

c. The term ''officer'' means the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

2. When providing information about directors, furnish information for directors who are interested persons as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a–2(a)(19)) and the rules thereunder separately from the information for directors who are not interested persons. For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors who are interested persons and for directors who are not interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors who are interested persons and the ones who are not interested persons.

(a) Provide the information required by the following table for each member of the board of managers (''director'') and officer of the Registrant, and, if the Registrant has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Registrant	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director

Instructions

1. For purposes of this paragraph, the term ''family relationship'' means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. For each director who is an interested person as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a–2(a)(19)) and the rules thereunder, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director is an interested person.

3. State the principal business of any company listed under column (4) unless the principal business is implicit in its name.

4. Indicate in column (6) directorships not included in column (5) that are held by a director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78*l*) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same fund complex, identify the fund complex and provide the number of portfolios overseen as a director in the fund complex rather than listing each portfolio separately.

(b) For each individual listed in column (1) of the table required by paragraph (a) of this Item 20 who is not a director, describe any positions, including as an officer, employee, director, or general partner, held with affiliated persons or principal underwriters of the Registrant.

Instruction: When an individual holds the same position(s) with two or more registered investment companies that are part of the same fund complex, identify the fund complex and provide the number of registered investment companies for which the position(s) are held rather than listing each registered investment company separately.

(c) Describe briefly any arrangement or understanding between any director or officer and any other person(s) (naming the person(s)) pursuant to which he was selected as a director or officer.

Instruction: Do not include arrangements or understandings with directors or officers acting solely in their capacities as such.

(d) Identify the standing committees of the Registrant's board of managers, and provide the following information about each committee:

(i) A concise statement of the functions of the committee;

(ii) The members of the committee;

(iii) The number of committee meetings held during the last fiscal year; and

(iv) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

(e) Unless disclosed in the table required by paragraph (a) of this Item 20, describe any positions, including as an officer, employee, director, or general partner, held by a director or immediate family member of the director during the past five years with:

(i) The Registrant;

(ii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same Insurance Company, investment adviser, principal underwriter, or administrator as the Registrant or having an Insurance Company, investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant;

(iii) The Insurance Company or an investment adviser, principal underwriter, administrator, or affiliated person of the Registrant; or

(iv) Any person directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant.

Instruction:

When an individual holds the same position(s) with two or more portfolios that are part of the same fund complex, identify the fund complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

(f) For each director, state the aggregate dollar amount of equity securities of registered investment companies in the same fund complex as the Registrant owned beneficially or of record by the director as required by the following table:

(1)	(2)	(3)
Name of Director	Identity of fund Complex	Aggregate Dollar Amount of Equity Securities in Fund Complex

Instructions:

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

(g) For each director and his immediate family members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(i) The Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director	Name of Owners and Relationships to Director	Company	Title of Class	Value of Securities	Percent of Class

Instructions

1. Information should be provided as of the most recent practicable date. Specify the valuation date by footnote or otherwise.

2. Determine ''beneficial ownership'' in accordance with rule 13d–3 under the Exchange Act (§ 240.13d–3 of this chapter).

3. Identify the company in which the director or immediate family member of the director owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator, describe the company's relationship with the Insurance Company, investment adviser, principal underwriter, or administrator.

4. Provide the information required by columns (5) and (6) on an aggregate basis for each director and his immediate family members.

(h) Unless disclosed in response to paragraph (g) of this Item 20, describe any material interest, direct or indirect, of each director or immediate family member of a director, during the past five years, in:

(i) The Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant.

Instruction

A director or immediate family member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

(i) Describe briefly any material interest, direct or indirect, of any director or immediate family member of a director in any material transaction, or material series of similar transactions, since the beginning of the last two completed fiscal years of the Registrant, or in any currently proposed material transaction, or material series of similar transactions, to which any of the following persons was or is to be a party:

(i) The Registrant;

(ii) An officer of the Registrant;

(iii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same Insurance Company, investment adviser, principal underwriter, or administrator as the Registrant or having an Insurance Company, investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant;

(iv) An officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a–3(c)(1) and (c)(7)), having the same Insurance Company, investment adviser, principal underwriter, or administrator as the Registrant or having an Insurance Company, investment adviser, principal underwriter, or administrator that directly or indirectly controls, is controlled by, or is under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant;

(v) The Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant;

(vi) An officer of the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant;

(vii) A person directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant; or

(viii) An officer of a person directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant.

Instructions

1. Include the name of each director or immediate family member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director or immediate family member of the director without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs (i) through (viii) of paragraph (i) of this Item 20 may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed ''material'' within the meaning of paragraph (i) of this Item 20 where the interest of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to the transaction with one of the persons specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20, and the transaction is not material to the company.

7. No information need be given as to any transaction where the interest of the director or immediate family member arises solely from the ownership of securities of a person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 and the director or immediate family member receives no extra or special benefit not shared on a pro rata basis by all holders of the class of securities.

8. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the latest practicable date, and the rate of interest paid or charged.

9. No information need be given as to any routine, retail transaction. For example, the Registrant need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 unless the director is accorded special treatment.

(j) Describe briefly any material relationship, direct or indirect, of any director or immediate family member of a director that exists, or has existed at any time since the beginning of the last two completed fiscal years of the Registrant, or is currently proposed, with any of the persons specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20. Relationships include:

(i) Payments for property or services to or from any person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20;

(ii) Provision of legal services to any person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20;

(iii) Provision of investment banking services to any person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20, other than as a participating underwriter in a syndicate; and

(iv) Any consulting or other relationship that is substantially similar in nature and scope to the relationships listed in paragraphs (j)(i) through (j)(iii) of this Item 20.

Instructions

1. Include the name of each director or immediate family member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director or immediate family member and the person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 as a result of the relationship since the beginning of the last two completed fiscal years of the Registrant or proposed to be done during the Registrant's current fiscal year.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. Disclose indirect, as well as direct, material relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs (i) through (viii) of paragraph (i) of this Item 20 may have an indirect relationship by reason of the position, relationship, or interest. The relationship, however, will not be deemed ''material'' within the meaning of paragraph (j) of this Item 20 where the relationship of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that has a relationship with one of the persons specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20, and the relationship is not material to the company.

5. In the case of an indirect interest, identify the company with which a person specified in paragraphs (i)

through (viii) of paragraph (i) of this Item 20 has a relationship; the name of the director or immediate family member affiliated with the company and the nature of the affiliation; and the amount of business done between the company and the person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 since the beginning of the last two completed fiscal years of the Registrant or proposed to be done during the Registrant's current fiscal year.

6. In calculating payments for property and services for purposes of paragraph (j)(i) of this Item 20, the following may be excluded:

a. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

b. Payments that arise solely from the ownership of securities of a person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

7. No information need be given as to any routine, retail relationship. For example, the Registrant need not disclose that a director holds a credit card or bank or brokerage account with a person specified in paragraphs (i) through (viii) of paragraph (i) of this Item 20 unless the director is accorded special treatment.

(k) If an officer of the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant, or an officer of a person directly or indirectly controlling, controlled by, or under common control with the Insurance Company or an investment adviser, principal underwriter, or administrator of the Registrant, serves, or has served since the beginning of the last two completed fiscal years of the Registrant, on the board of directors of a company where a director of the Registrant or immediate family member of a director is, or was since the beginning of the last two completed fiscal years of the Registrant, an officer, identify:

(i) The company;

(ii) The individual who serves or has served as a director of the company and the period of service as director;

(iii) The Insurance Company, investment adviser, principal underwriter, or administrator or person controlling, controlled by, or under common control with the Insurance Company, investment adviser, principal underwriter, or administrator where the individual named in paragraph (k)(ii) of this Item 20 holds or held office and the office held; and

(iv) The director of the Registrant or immediate family member who is or was an officer of the company; the office held; and the period of holding the office.

(l) Discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board of managers approving the existing investment advisory contract. If applicable, include a discussion of any benefits derived or to be derived by the investment adviser from the relationship with the Registrant such as soft dollar arrangements by which brokers provide research to the Registrant or its investment adviser in return for allocating fund brokerage.

Instruction: Conclusory statements or a list of factors will not be considered sufficient disclosure. The discussion should relate the factors to the specific circumstances of the Registrant and the investment advisory contract.

* * * * *

35. Instruction 4 to Item 27 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by removing ''and'' from the end of paragraph (iii), removing the period at the end of paragraph (iv) and in its place adding a semi-colon, and adding paragraphs (v) and (vi) to read as follows:

Item 27. Financial Statements

* * * * *

Instructions

* * * * *

4. * * *

(v) The management information required by paragraph (a) of Item 20; and

(vi) A statement that the SAI includes additional information about members of the board of managers of the Registrant and is available, without charge, upon request, and a toll-free (or collect) telephone number for contract owners to call to request the SAI.

* * * * *

Dated: October 14, 1999.

By the Commission.

Jonathan G. Katz,

Secretary.

Note: Appendix A to the preamble will not appear in the Code of Federal Regulations.

APPENDIX A.—ANALYSIS OF PROPOSED AMENDMENTS TO SCHEDULE 14A UNDER THE EXCHANGE ACT AND FORM N–1A UNDER THE INVESTMENT COMPANY ACT

Proposed item 22 of Schedule 14A	Proposed items 13 and 22 of Form N–1A	Source of proposed items in current rules and forms
Item 22. Information Required in Investment Company Proxy Statement	Item 13. Management Information.	
	Instr. 1.a. to Item 13 (Defn. of fund complex)	Item 22(a)(v) of Schedule 14A.
22(a)(1)(i) (Defn. of Administrator)	.....	Item 15(h)(1) of Form N–1A.
22(a)(1)(vi) (Defn. of Immediate Family Member)	Instr. 1.b. to Item 13	Instruction 2 to 404(a) of Reg. S–K.
22(a)(1)(vii) (Defn. of Officer)	Instr. 1.c. to Item 13	Instruction 1 to Item 13(b) of Form N–1A.
22(a)(1)(ix) (Defn. of Registrant)	.....	Item 22(a)(1)(vii) of Schedule 14A.
22(a)(1)(x) (Defn. of Sponsoring Insurance Company.	.....	Instruction D. of General Instructions to Form N–3.
22(b) (Applies when there is an election of directors):		
Instr. 1	.....	Instruction 1 to Item 22(b) of Schedule 14A.
Instr. 2	.....	Instruction 2 to Item 22(b) of Schedule 14A.
Instr. 3	Instr. 2 to Item 13	New.
Instr. 4	.....	Instruction 3 to Item 401(a) of Reg. S–K.

APPENDIX A.—ANALYSIS OF PROPOSED AMENDMENTS TO SCHEDULE 14A UNDER THE EXCHANGE ACT AND FORM N–1A UNDER THE INVESTMENT COMPANY ACT—Continued

Proposed item 22 of Schedule 14A	Proposed items 13 and 22 of Form N–1A	Source of proposed items in current rules and forms
22(b)(1) (Table of core information about each director, nominee, officer, and advisory board member)	Item 13(a)(1)	Items 401(a), (b), (d), and (e) of Reg. S–K and Item 13 of Form N–1A.
Instr. 1	Instr. 1 to Item 13(a)(1)	Instruction to 401(d) of Reg. S–K and Instruction 1 to Item 13(b) of Form N–1A.
Instr. 2		Instruction 2 to Item 401(a) and Instruction 2 to Item 401(b) to Reg. S–K.
Instr. 3		Instruction 4 to Item 401(a) of Reg. S–K.
Instr. 4	Instr. 2 to Item 13(a)(1)	Instruction 1 to Item 22(b)(4) of Schedule 14A.
Instr. 5	Instr. 3 to Item 13(a)(1)	Instruction 2 to Item 13(b) of Form N–1A.
Instr. 6		New.
Instr. 7	Instr. 4 to Item 13(a)(1)	Item 401(e)(2) and Instruction to Item 401(e)(2) of Reg. S–K.
	Item 13(a)(2) (Positions held by officers):	Item 13(c) of Form N–1A.
	Instr. to Item 13(a)(2)	Instruction to Item 13(c) of Form N–1A.
22(b)(2) (Any agreement regarding selection as director, nominee, or officer).	Item 13(a)(3)	Items 401(a) and 401(b) of Reg. S–K.
Instr.	Instr. to Item 13(a)(3)	Instruction 1 to Item 401(a) and Instruction 1 to Item 401(b) of Reg. S–K.
	Item 13(b)(1) (Description of board responsibilities).	Item 13(a) of Form N–1A.
	Instr. to Item 13(b)(1)	Instruction to Item 13(a) of Form N–1A.

APPENDIX A—ANALYSIS OF PROPOSED AMENDMENTS TO SCHEDULE 14A UNDER THE EXCHANGE ACT AND FORM N–1A UNDER THE INVESTMENT COMPANY ACT

Proposed item 22 of Schedule 14A	Proposed items 13 and 22 of Form N–1A	Source of proposed items in current rules and forms
22(b)(3) (Positions held by director, nominee, or immediate family members at fund and related persons (*i.e.,* other funds in fund complex, investment adviser, principal underwriter, administrator, or control-affiliates of adviser, underwriter, or administrator).	Item 13(b)(3)	Item 22(b)(1) of Schedule 14A and Item 13(c) of Form N–1A.
Instr	Instr. to Item 13(b)(3)	Instruction to Item 13(c) of Form N–1A.
22(b)(4) (Ownership of funds in fund complex)	Item 13(b)(4)	New.
Instr. 1	Instr. 1 to Item 13(b)(4)	Item 403(b) of Reg. S–K.
Instr. 2	Instr. 2 to Item 13(b)(4)	Instruction 2 to Item 403 of Reg. S–K.
22(b)(5) (Ownership of securities of investment adviser, principal underwriter, administrator, and control-affiliates of adviser, underwriter, and administrator).	Item 13(b)(5)	Item 22(b)(1) of Schedule 14A.
Instr. 1	Instr. 1 to Item 13(b)(5)	Item 403(b) of Reg. S–K.
Instr. 2	Instr. 2 to Item 13(b)(5)	Instruction 2 to Item 403 of Reg. S–K.
Instr. 3	Instr. 3 to Item 13(b)(5)	New.
Instr. 4	Instr. 4 to Item 13(b)(5)	New.
22(b)(6) (Material interests in fund and related persons).	Item 13(b)(6)	Items 22(b)(1) and (2) of Schedule 14A.
Instr	Instr. to Item 13(b)(6)	Item 5(b)(1)(viii) of Schedule 14A.

APPENDIX A—ANALYSIS OF PROPOSED AMENDMENTS TO SCHEDULE 14A UNDER THE EXCHANGE ACT AND FORM N–1A UNDER THE INVESTMENT COMPANY ACT

Proposed item 22 of Schedule 14A	Proposed items 13 and 22 of Form N–1A	Source of proposed items in current rules and forms
22(b)(7) (Material interests in material transactions involving fund and related persons).	Item 13(b)(7)	Item 22(b)(3) of Schedule 14A and Item 404(a) of Reg. S–K.
Instr. 1	Instr. 1 to Item 13(b)(7)	Instruction 1 to Item 22(b)(3) of Schedule 14A.
Instr. 2	Instr. 2 to Item 13(b)(7)	Item 404(a) of Reg. S–K.
Instr. 3	Instr. 3 to Item 13(b)(7)	Instruction 3 of Item 404(a) of Reg. S–K.

APPENDIX A—ANALYSIS OF PROPOSED AMENDMENTS TO SCHEDULE 14A UNDER THE EXCHANGE ACT AND FORM N–1A UNDER THE INVESTMENT COMPANY ACT—Continued

Proposed item 22 of Schedule 14A	Proposed items 13 and 22 of Form N–1A	Source of proposed items in current rules and forms
Instr. 4	Instr. 4 to Item 13(b)(7)	Instruction 4 to Item 404(a) of Reg. S–K.
Instr. 5	Instr. 5 to Item 13(b)(7)	Instruction 2 to Item 22(b)(3) of Schedule 14A and Instruction 5 to Item 404(a) of Reg. S–K.
Instr. 6	Instr. 6 to Item 13(b)(7)	New.
Instr. 7	Instr. 7 to Item 13(b)(7)	Instruction 8 to Item 404(a) of Reg. S–K.
Instr. 8	Instr. 8 to Item 13(b)(7)	Instruction 7.C to Item 404(a) of Reg. S–K.
Instr. 9	Instr. 9 to Item 13(b)(7)	New.
22(b)(8) (Material relationships with fund and related persons).	Item 13(b)(8)	New. Derived from Item 404(b) of Reg. S–K.
Instr. 1	Instr. 1 to Item 13(b)(8)	New. Derived from Instruction 1 to Item 22(b)(3) of Schedule 14A.
Instr. 2	Instr. 2 to Item 13(b)(8)	New. Derived from Item 404(b) of Reg. S–K.
Instr. 3	Instr. 3 to Item 13(b)(8)	New. Derived from Instruction 3 of Item 404(a) of Reg. S–K.
Instr. 4	Instr. 4 to Item 13(b)(8)	New.
Instr. 5	Instr. 5 to Item 13(b)(8)	New. Derived from Instruction 8 of Item 404(a) of Reg. S–K.
Instr. 6	Instr. 6 to Item 13(b)(8)	New. Derived from Item 404(b) of Reg. S–K.
Instr. 7	Instr. 7 to Item 13(b)(8)	New. Derived from Instructions 2.A and B to 404(b) of Reg. S–K.
22(b)(9) (Cross-directorships)	Item 13(b)(9)	New.
Instr.	Instr. to Item 13(b)(9)	New.
22(b)(10) (Incorporates parts of Reg. S–K into Item 22).		Item 22(b)(4) of Schedule 14A.
Instr.		New.
22(b)(11) (Material pending legal proceedings)		Item 22(b)(5) of Schedule 14A.
22(b)(12) (Compensation table)	Item 13(c)	Item 22(b)(6) of Schedule 14A and Item 13(d) of Form N–1A.
22(b)(13) (Board committees)	Item 13(b)(2)	Item 7(e) (1) and (2) of Schedule 14A and Instruction 3 of Item 13(b) of Form N–1A.
	Item 13(b)(10) (Basis for approving advisory contract).	Item 22(c)(11) of Schedule 14A.
	Item 22. Financial Statements.	
	Item 22(b)(5) (Management information required by Item 13(a)(1).	New.
	Item 22(b)(6) (Reference to SAI)	New.

[FR Doc. 99–27442 Filed 11–2–99; 8:45 am]

BILLING CODE 8010–01–P