NOV 26 1971

Mr. Robert Kagan
Assistant to Chairman of the
Price Commission
2000 M Street, N. W.
Washington, D. C.

Dear Mr. Kagan:

In accordance with our telephone conversation, I am writing to explain certain problems which have arisen under the Price Freeze involving fees charged registered investment companies by their investment advisers, and to seek your advice.

Investment advisers for mutual funds typically charge, as a so-called base fee for their services, a percentage of the net asset value of the fund. Typically, this fee is 1/2 of 1 percent per annum of the average net asset value of the fund. Performance increments are also frequently included in determining the advisory fee, these constitute additions to, and deductions from the base fee described above. For example, an investment adviser may receive an additional 1/4 of 1 percent of the average net asset value of the fund if the performance of the fund exceeds by a specified percentage the performance of a designated securities index. Conversely, performance which is below that of the designated index by a specified percentage results in some fee arrangements in a deduction from the base fee. Prior to recent amendatory legislation described below, many fee arrangements provided only for additions to the base fee for good performance but for no corresponding reductions in the fee for poor performance.

The Investment Company Amendments Act of 1970 (P.D. 91-547) amended Section 205 of the Investment Advisers Act of 1940, effective December 14, 1971, to make unlawful any advisory contract between a registered investment company and its investment adviser which provided for a performance fee arrangement unless the contract provided penalties for poor performance equivalent to the rewards obtained for good performance. Since many advisory fees contained only additions for good performance and since under the Investment Company Act of 1940, such changes in an advisory contract have to be approved by shareholders, many funds sought approval from shareholders during Phase I of the Price Freeze for fee arrangements which would comport with new Section 205. These new fee arrangements frequently involved an increase in some element of the fee. In this connection, the Commission's staff took the position that the Price Freeze was applicable to any revision of existing contracts with respect to advisory fees

which might result in increased payments to the investment adviser. The position was further taken that in the proposed advisory contract, and also in the proxy materials sent to shareholders, it be stated, in effect, that, if approval was obtained from shareholders, any increases in advisory fees or in other charges were to take effect only when and to the extent permissible under the Price Freeze. The effect of this position was that for the period of the freeze the lesser of the fee provided by the new contract or by the old contract was to be collected.

In addition, during this period, a number of funds with fee arrangements which did not have to be changed to comport with new Section 205 sought increases in advisory fees. The staff took the same position with respect to such increases, i.e., that, although approval could be obtained, the increase could not be put into effect until and to the extent permissible under the Price Freeze and any subsequent regulation. In this category of companies, the staff further insisted that, if as a result of an extension of the Price Freeze, the increase could not be put into effect until more than 6 months after the date on which approval of shareholders had been obtained, the Fund would resolicit its shareholders. This latter position was taken because the composition of the shareholder groups is constantly changing, and, for shareholder approval to be meaningful, those shareholders who are affected by the fee increase must approve the new contract.

After the requisite shareholder approvals had been obtained, the funds with new fee arrangements generally amended their registration statements or stickered their prospectuses to disclose the new fee arrangement and to state that any increases would be put into effect only when and to the extent permissible under the Price Freeze and any subsequent regulation. We anticipate that such funds will now seek to put these increases into effect during present Phase II, and in doing so will file proposed amendments to their registration statements or proposed stickers to attach to their prospectuses. These amendments and stickers are expected to state that, beginning with a specified date, their fees will be computed and paid on the new and increased basis and that in their view it is permissible under Phase II to put the new increased fee into effect.

The proposed amendments and stickers described above will have to be reviewed by the Commission's staff for the purpose of full and adequate disclosure. In this connection, it is of interest to the staff whether the increase can properly be put into effect, because the charging of a fee illegal under Phase II could have adverse consequences for the Fund and its shareholders in that the net asset value of the Fund for sale and redemption purposes might be miscalculated. It is also important that the adviser upon whom the Fund so heavily relies will not suffer adverse consequences through charging illegal fees.

Accordingly, we would like to assure, insofar as possible, that any fee increase which goes into effect is lawful under Phase II. In order to assure that the fees are being properly put into effect, I would instruct our staff to obtain from counsel for the Fund a letter of opinion setting forth the status of the proposed increase under Phase II and stating that the proposed increase complies with the applicable regulations. A copy of a favorable ruling or interpretation from the Price Commission with respect to implementation of the price increase would be required to accompany the letter of opinion. The registration statement or sticker would contain a statement as to the letter of opinion and its essentials and as to the Price Commission ruling or interpretation. The same approach will be taken with respect to Funds which may now for the

first time seek approval from shareholders for increases in fees and charges to be paid their advisers.

We would appreciate your advice and guidance as to the propriety and practicality of the approach which we have described.

Sincerely,

Solomon Freedman
Director

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