

MEMORANDUM IN SUPPORT OF HEARING REQUEST

SUMMARY

Since 1995, the Commission has granted multimanager voting exemptions to hundreds of mutual funds. These exemptions strip shareholders of their most fundamental right under the Investment Company Act: the right to approve the fund's investment adviser. The exemptions also effectively strip shareholders of their right to approve increases in the fund manager's advisory fee.

The original multimanager voting exemption was granted to the Frank Russell funds. Frank Russell is a *bona fide* multimanager fund complex, on average employing four or more subadvisers for each of its funds. The funds' manager actively oversees the funds subadvisers, frequently recommending firing underperforming subadvisers and hiring replacements.

The Frank Russell Funds claimed that the shareholder voting requirement interfered with the funds' ability to operate as their shareholders intended. The funds contended that shareholders chose the funds specifically to delegate responsibility for the selection of the funds' subadvisers to the funds' manager, and that requiring frequent shareholder votes on new subadvisers would be unnecessarily costly and burdensome. The funds' offering documents reflected their multimanager philosophy, emphasized the central role played by the funds' manager, and downplayed the role of the individual subadvisers.

Since the Frank Russell exemption, the scope of the multimanager voting exemptions has expanded far beyond the context considered by the Commission in connection with the Frank Russell application. Dozens of funds – perhaps hundreds -- that have obtained a multimanager exemption employ not multiple subadvisers, but a single subadviser, often for years on end. Subadviser changes are few and far between. The funds' offering documents suggest that investors should look to each fund's subadviser, rather than the manager, as the entity responsible for the fund's performance. Indeed, the name of the fund's subadviser is often included in the name of the fund.

The conditions proposed by Hillview Investment Trust II and Hillview Capital Advisors, LLC (“Applicants” or “Hillview”), which are standard conditions for multimanager voting exemptions, have failed to prevent the abuses of the multimanager voting exemption. A hearing is necessary to determine whether new conditions are needed to ensure that Hillview will operate as a *bona fide* multimanager fund, and that the funds' shareholders' voting rights are protected.

A. BACKGROUND

1. The Frank Russell Exemption

The first multi-manager voting exemption was granted to the Frank Russell Investment Company and the Russell Insurance Funds (the “Frank Russell Funds”) on June 28, 1995, following protracted discussions with the SEC staff spanning more than four years.¹

The long interim between Frank Russell’s initial public filing on February 19, 1991, and the granting of the order reflects the importance of the shareholder rights at issue. The Frank Russell Funds’ request would deprive shareholders of one of their most important rights under the Investment Company Act: the right to approve the Funds’ investment adviser.

Section 15(a) of the Investment Company Act (the “Act”) provides that no person may serve as the investment adviser to a registered investment company (which includes a mutual fund) except pursuant to a written contract that has been approved by a vote of the majority of the outstanding voting securities of such registered investment company.

This requirement, in effect, entitles shareholders to vote not only on the identity of their funds’ investment advisers, but also on any material change in the advisory contract that would render it a new contract, such as a material increase in the fees paid under the contract.

Section 2(a)(19) of the Act defines the term “investment adviser” of an investment company to include “(A) any person . . . who . . . furnishes [investment] advice to such company,” and “(B) any other person who pursuant to a contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A).”

Thus, Congress expressly defined “investment adviser” to include, for example, subadvisers that were solely responsible for managing a fund’s portfolio. Fund shareholders’ right to approve advisory contracts therefore applies to certain subadvisers as well as to the fund’s principal investment adviser (referred to herein as the “manager”).²

¹ The Commission previously granted multimanager relief to the Vanguard funds in 1993. The basis for the Vanguard relief was its structure as an internally managed fund complex. This structure avoids the conflicts that arise when a fund is managed by an external investment adviser. See generally, The Vanguard Group, Investment Company Act Release No. 19411, 1993 WL 128766 (Apr. 16, 1993).

² Congress also provided that the term “investment adviser” shall “not include such other persons as the Commission may by rules and regulations or order determine not to be within the intent of this definition.” Investment Company Act § 2(19)(B)(v). No multimanager voting exemption has been granted under this authority.

Frank Russell argued in its application that shareholder approval of subadvisers and subadvisory contracts was unnecessary in context of the unique structure of its funds.³ Frank Russell explained that its funds employed a “multi-style, multi-manager” investment philosophy that entailed the use, under Frank Russell’s supervision, of multiple subadvisers employing a range of investment styles.

Frank Russell represented that it conducted internal due diligence on each subadviser and thereafter monitored its performance through quantitative and qualitative analysis, as well as actual consultations with the subadvisers. Frank Russell assumed responsibility for communicating performance expectations and evaluations to subadvisers, supervising compliance with the portfolios’ investment policies and objectives, and recommending the termination and hiring of subadvisers. Frank Russell prominently described its multimanager philosophy and responsibilities in its prospectus, and limited discussion of subadvisers to their names and addresses.

Frank Russell claimed that its operating method was unique because of the large number of subadvisers and the active evaluation process. Whereas investors typically select a single-manager fund based largely on the identity of the entity managing the fund’s assets, investors in the Frank Russell funds select the funds based on the identity of the entity managing the fund’s subadvisers.

Frank Russell contended that, in this unique context, obtaining shareholder approval for every new subadviser or change in a subadvisory agreement would be inconsistent with shareholders’ expectations and impose undue costs and delays on the funds. On the basis of Frank Russell’s unique structure, the Commission exempted the Frank Russell funds from Section 15(a)’s shareholder approval requirement for new subadvisers and amendments to subadvisory contracts.

2. The Basis for Multimanager Voting Relief

Numerous fund complexes applied for multimanager voting exemptions following the issuance of the Frank Russell order. To guide its evaluation of these applications, the SEC staff considered certain factors in determining whether the applicants’ situation involved a *bona fide* multimanager fund.

In SEC staff comment letters sent to applicants, two requirements emerged as essential to the Commission’s decision to grant the Frank Russell exemption, and central to the conceptual basis for multimanager relief: the employment and active management

³ For a discussion of the Frank Russell application, see Frank Russell Investment Company, Investment Company Act Release No. 21108, 1995 WL 358131 (June 2, 1995).

of multiple subadvisers, and the holding out of the fund to the public as a multimanager fund.⁴

a. Active Management of Multiple Subadvisers

Until 1997, SEC letters to applicants generally reflect the premise underlying the Frank Russell Funds exemption that the manager would be engaged in the active management of multiple subadvisers. Many of these letters stated, for example, that:

To distinguish an applicant using a bona fide multi-manager strategy from more traditional funds that employ one or more subadvisers, the Division considers the discussion of management structure and investment strategy in the fund's prospectus. Prospectus disclosure alone is not sufficient, however. The Division also examines the number of sub-advisors employed for each portfolio, and the fund's operating history.⁵

The staff often indicated that the exemptive relief was premised on multiple subadvisers being employed for each portfolio.⁶

In 1997, however, references to funds' operating histories and the number of subadvisers employed by the fund disappeared from the staff's letters.⁷ It appears that, in

⁴ The letters, which were obtained through a Freedom of Information Act Request ("FOIA"), cover the period from March 7, 1995 to April 5, 2000. On February 9, 2001, Fund Democracy requested all staff letters relating to the Hillview application and all staff letters relating to the Frank Russell application dated before 1995. Fund Democracy asked for expedited treatment, under which the letters are required to be produced within ten days of the request, on the ground that they would be used in connection with this hearing request. As of the date of this letter, the Commission had provided a partial, but not complete, response to the FOIA request. If the Commission intends to deny this request, Fund Democracy hereby requests an extension of the deadline for filing a hearing request until three business days after the Commission has fully responded to the FOIA request.

⁵ Letter from David M. Goldenberg to Lawrence P. Stadulis (May 5, 1995); see also Letters from Deepak Pai to Karen Balisteri (Dec. 13, 1995); Courtney Thornton to Paul Belval (Feb. 13, 1996); Courtney Thornton to Marc Duffy (Apr. 3, 1996); Christine Greenlees to Cary Klafter (July 18, 1996); Harry Eisenstein to Steven Drachman (Aug. 29, 1996); and Kathleen Knisely to Jeremiah Garvey (Feb. 7, 1996).

⁶ E.g., Letter from Deepak Pai to Philip Fina (Sep. 8, 1995) ("Multi-manager applications have been premised on the fact that the relevant fund is designed so that investors look to the principal adviser, rather than the sub-advisers, as the party primarily responsible for the fund's investment performance. We are not convinced that this is the case in the present application because each of applicants' portfolios currently has only one sub-adviser and no history of sub-advisory changes."); see also Letter from David M. Goldenberg to Lawrence P. Stadulis (May 5, 1995) (portfolios should "employ two or more managers").

⁷ Because the Commission has not voted on any multimanager voting exemption since it approved the initial Frank Russell exemption, it appears that many exemptions subsequently granted under the Division's delegated authority are invalid. The Division has delegated authority to grant an exemptive order only if, among other things, the Director believes that the application "presents no significant issues that have not been previously settled by the Commission." 17 CFR § 200.30-5(a)(2). As discussed in the memorandum,

light of the noncompliance of many funds with the implicit requirements of multimanager relief, as discussed below, the staff abandoned the principle on which the Commission had based the Frank Russell order that multimanager relief was appropriate only when the manager intended to actively manage multiple subadvisers.

b. Holding Out To The Public As A Multimanager Fund

As stated by the SEC staff, “the discussion of management structure and investment strategy in the fund’s prospectus is critical to ensuring that a fund operates as a multi-manager fund.”⁸ Accordingly, the SEC requires as a condition of the exemptive relief, that:

Each portfolio will disclose in its prospectus the existence, substance, and effect on the order. In addition, each portfolio will hold itself out to the public as employing the management structure described in the application. The prospectus will prominently disclose that the manager has ultimate responsibility to oversee [subadvisers] and recommend their hiring, termination, and replacement.⁹

The SEC staff also has insisted that the name of the fund not include the name of the subadviser. The staff reasoned that including the subadviser’s name in the fund’s name:

suggests that investors should not rely on the manager, but rather on the [subadviser] whose name is part of the [fund’s] name. This is inconsistent with the fundamental concept on which multi-manager applications have been premised. The Division is unwilling to support the requested relief if a [subadviser’s] name is included in the name of the [fund].¹⁰

exemptions granted to Equitable and American Skandia, for example, raised issues that were not addressed, much less settled, by the Commission when it considered the Frank Russell exemption.

⁸ Letter from Kathleen Knisely to Jeremiah Garvey (Feb. 7, 1997).

⁹ EQ Advisors Trust and EQ Financial Consultants, Inc., Investment Company Act Release No. 23093 (Mar. 30, 1998).

¹⁰ Letter from Brian Hourihan to Jane Kanter (Mar. 7, 1997); see Letter from Christine Greenlees to Robert Zakem (Oct. 9, 1996). The staff noted that “[m]ulti-manager applications have been premised on the fact that the relevant fund is designed so that investors look to the principal adviser, rather than the subadvisers, as the primarily responsible for the fund’s investment performance.” *Id.*, see also Letters from Mary Kay Frech to Gregg Shulklapper (June 9, 1995); Marc Duffy to William Vastardis (June 9, 1995); Deepak Pai to Karen Balisteri (Dec. 13, 1995); and Kathleen Knisely to Jeremiah Garvey (Feb. 7, 1997).

The staff even stated that it would require that the fund amend its prospectus and remove the name of the subadviser from the fund's name before the fund relied on the exemptive order.¹¹

As with the requirement for active management of subadvisers, the staff again appears to have abandoned one of the core principles under which multimanager relief was granted: that the fund would be held to the public as a *bona fide* multimanager fund.

B. CORRUPTION OF THE MULTIMANAGER EXEMPTION

Since the Commission approved the Frank Russell exemption in 1995, the staff, under delegated authority, has granted multimanager voting exemptions to dozens of funds that have operated in ways that are inconsistent with the basis of the Frank Russell exemption.

The following sections discuss the practices of 111 funds offered by three registered investment companies in two fund complexes that illustrate the corruption of the multimanager voting exemption. Fund Democracy will, at a hearing on the Hillview application, present further evidence demonstrating conclusively that widespread abuse of the multimanager exemptions necessitates either denying applicants' request or imposing new conditions designed to protect shareholders' interests.

1. Multimanager Funds Have Operated as Single-Manager Funds

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

Among these 111 funds, some of which are more than 8 years old, there have been only 26 new subadviser hirings and 22 subadviser firings. Ninety-two, or 83 %, of these funds have never changed subadvisers.

The staff has stated that whether an applicant uses a *bona fide* multi-manager strategy is indicated in part by "the number of sub-advisors employed for each portfolio." Yet only 3 of the 111 funds have ever had more than 1 subadviser.¹² Only 1 has ever had more than 2 subadvisers.

¹¹ Letter from Brian Hourihan to Jane Kanter (Mar. 7, 1997).

¹² In the case of one of the three funds, EQ Advisor Trust's Calvert Socially Responsible fund, it is unclear whether the second subadviser actually acts as a subadviser to the fund, rather than merely as a consultant.

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

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

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

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

The retention of a single subadviser year after year suggests that the funds’ managers may be violating the condition of the exemption that requires that they “provide general management services to each portfolio, . . . and, subject to review and approval by the Board, . . . (ii) select Advisers, (iii) when appropriate, recommend to the

Board, the allocation and reallocation of a Portfolio's assets among multiple Advisers, [and] (iv) monitor and evaluate the investment performance of the Advisers."¹³

Indeed, the staff voiced this very suspicion in comments on the Equitable funds' request for multimanager relief. The Equitable application suggested that the manager might waive its management fee. The staff asked Equitable why it would so if the funds were "receiving economic benefits from the services performed by" Equitable, and expressed concern that Equitable's "willingness [to waive its fee] creates the impression that it is not performing meaningful services for the" fund.¹⁴ The staff's concern has been borne out by the Equitable funds' static, single-subadviser structure.

2. Multimanager Funds Have Not Held Themselves Out To The Public As Multimanager Funds

The Equitable and American Skandia funds also have disregarded the requirement they hold themselves out as multimanager funds.

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

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

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

In contrast, the description of the subadvisers, placed much earlier in the prospectus from pages 19 to 87, typically provides a description of the subadviser's experience in investment management, the amount of its assets under management, and the names and professional experience of the individual portfolio managers.

¹³ EQ Advisors Trust and EQ Financial Consultants, Inc., Investment Company Act Release No. 23093 (Mar. 30, 1998) (condition number 7).

¹⁴ Letter from Brian Hourihan to Jane Kanter (Mar. 7, 1997).

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

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

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

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

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

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

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

The disclosure in the Equitable and American Skandia prospectuses exposes the funds for what they are: conventional single-manager funds operating under the protection of an SEC multimanager voting exemption. The funds are, in fact, nothing more than conventional single-manager funds where an insurance company has interposed itself between the fund and its true investment adviser. The subadvisers are the entities to which shareholders should look for the funds' performance -- not Equitable or American Skandia.

Furthermore, Equitable and American Skandia have flouted the “holding out” requirement by offering at least 107 funds that include the full name of the subadviser in the name of the fund, notwithstanding the staff’s view that this practice is “inconsistent with the fundamental concept on which multi-manager applications have been premised.”¹⁵

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

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

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

3. Multimanager Funds Have Used the Exemption to Increase Their Fees

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

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

American Skandia exploited this loophole when it replaced subadvisers for eight multi-manager funds in 2000. As a result, Skandia stands to collect, on a net basis,

¹⁵ Supra note 11.

\$342,000 more annually as a result of changes in subadviser fees, based on the funds' asset sizes on the date the new fees went into effect and assuming no growth in fund assets.

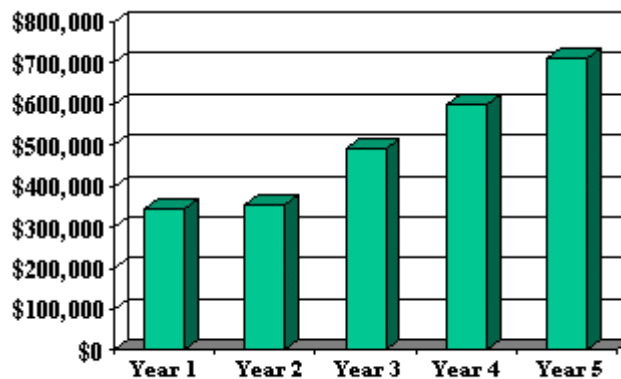
When American Skandia replaced Lord Abbett with Alliance Capital as the subadviser to the ASAF Alliance Growth and Income and AST Growth and Income funds, it reduced the subadviser's fee from 0.50% of fund assets to 0.30% of fund assets. As a result, Skandia saved itself approximately \$377,000 annually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

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

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

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

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



Source: SEC Filings

American Skandia has argued that it needs to be able to increase or reduce its share of the fund's advisory fee to reflect changes in the allocation of responsibilities between the manager and the subadviser.¹⁶

This argument fails for two reasons.

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

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

C. THE EXEMPTION DOES NOT SATISFY THE STANDARDS OF SECTION 6(C)

Granting the Hillview application is not necessary or appropriate in the public interest, and is not consistent with the protection of investors or the purposes fairly intended by the policy and provisions of the Investment Company Act.

1. The Exemption is Not Necessary or Appropriate in the Public Interest

The conditions of the Application, as evidenced by the operation of the Equitable, American Skandia, and other "multimanager" funds that have previously obtained similar exemptions, are inadequate to ensure that the relief requested is necessary or appropriate in the public interest.

a. Shareholder Votes Would Not Impose Undue Costs

Exemptive relief also has been based on the costs that multimanager funds would incur if they were to undergo frequent subadviser changes. This is a real concern, as

¹⁶ Conversation between Mercer Bullard and Christian Thwaites, Senior Vice President, American Skandia, on February 6, 2001.

some *bona fide* multimanager funds have averaged more than 2 new subadviser hires each year.¹⁷

This is not, however, a real concern for the Equitable and American Skandia funds, as they have not experienced anywhere near the frequency of new subadviser hires that would impose undue costs on the funds. Of the 111 funds discussed above, 92, or 83%, have *never* hired a new subadviser. Of the remaining 19 funds, only five would have had to obtain shareholder approval of a new subadviser(s) more than once since their inceptions.

To the extent that increases in manager fees occur in connection with the replacement of fund's subadviser, obtaining approval of such fees would not impose undue costs on the funds for the reasons stated immediately above, *i.e.*, the infrequency of subadviser changes. In each example of a change in American Skandia's fee discussed above, the increase occurred in connection with the replacement of the fund's subadviser.

There is no evidence that a shareholder vote on a manager's fee increase – in the absence of a change in the subadviser -- would occur frequently enough to impose undue costs on a fund. In any case, there presumably is some limit to the amount of the fee that a manager can extract from the fund's subadviser, which would necessarily limit the frequency of shareholder votes on managers' fee increases. In any case, the more frequently the manager extracted a larger piece of the fee, the greater the need for shareholders to have the opportunity to vote on the increase.

b. Shareholder Approval Would Not Cause Undue Delays

Another unfounded basis for requesting multimanager voting exemption is the possibility that obtaining shareholder approval may delay the prompt replacement of underperforming subadvisers.

Under current law, funds that wish to replace subadvisers are not subject to any delay. Rule 15a-4 under the Investment Company Act provides that a new adviser or subadviser to a fund generally may serve under an interim contract for up to 150 days without shareholder approval. The 150-day period is based on the SEC's finding that funds generally have not needed more than 150 days to obtain shareholder approval.¹⁸

¹⁷ Frank Russell's Equity I Fund and Diversified Equity Fund each hired 9 new subadvisers from 1997 to 2000. Its International Fund and the International Securities Fund each hired 6 new subadvisers from 1997 to 1999.

¹⁸ It should be noted that, in many cases, funds seek shareholder approval of an adviser or subadviser after it has merged with or been acquired by another entity, even though the fund is not required to do so. The funds claim that shareholder must be obtained because these transactions constitute an assignment that, under Section 15(a)(4) of the Act, terminates the advisory contract. Rule 2a-6 under the Act, however, deems an assignment not to have occurred if there has been "no change of actual control or management." If funds continue to feel that shareholder approval is necessary when there has been no real change in control or management, the SEC should consider providing further guidance to clarify why shareholder approval is unnecessary. Granting multimanager relief, however, is not an appropriate solution to this

A number of funds experienced no delays in switching subadvisers before they were granted multimanager relief. For example, American Skandia's ASAF Oppenheimer Large-Cap Growth Fund switched subadvisers effective December 31, 1998. Shareholders were informed of the switch in a January 15, 1999, proxy solicitation that asked them to approve the advisory contract. The shareholder meeting was scheduled for February 25, 1999. Under old Rule 15a-4, the fund had until April 30, 1999 to obtain shareholder approval.¹⁹

Similarly, when American Skandia's ASAF Janus Small-Cap Growth Fund switched subadvisers effective January 1, 1999, shareholders were informed in a January 15, 1999, proxy solicitation that asked them to approve the advisory contract. The shareholder meeting was scheduled for February 25, 1999. Under old Rule 15a-4, the fund had until May 1, 1999 to obtain shareholder approval.

Obtaining a shareholder vote on a manager fee increase would not, by itself, result in any delay in replacing an underperforming subadviser when the increase was attendant upon the replacement of a subadviser. In this situation, the fee increase would be voted on during the Rule 15a-4 grace period, thereby resulting in no delay.

When the subadviser is not being replaced, there is no delay because there is nothing preventing the subadviser from continuing to serve pending the approval of the fee. In any case, an increase in the manager's fee for a *bona fide* multimanager, is likely to no more common than an increase in a conventional fund's advisory fee. As discussed above, a *bona fide* multimanager fund would have multiple subadvisers, thereby making it unlikely that the manager's duties would change frequently.

- 2. The Exemption is not Consistent With Investor Protection or the Investment Company Act**
 - a. The Conditions Are Inadequate to Protect Investors**
 - i. The Exemption Would Permit the Funds to Mislead Investors**

Applicants argue that the exemption is consistent with investor protection and the purposes fairly intended by the policy and provisions of the Investment Company Act because shareholders are relying on Hillview's experience to select subadvisers best suited to achieve a fund's desired investment objectives. Applicants argue that the

problem, as the relief is not limited to situations to which Rule 2a-6 applies, and it therefore deprives shareholders of their right to approve a fund's new subadviser in the event of an actual change in the control or management of the adviser.

¹⁹ The interim period was increased from 120 days effective December 13, 1999. Temporary Exemption for Certain Investment Advisers, Investment Company Act Release No. 24177, 1999 WL 1068475 (Nov. 29, 1999).

exemption therefore is consistent with the Act's requirements regarding the approval of fund subadvisers and subadvisory agreements.

As demonstrated by the operating history of the Equitable and American Skandia "multimanager" funds, the conditions proposed in the Hillview application are inadequate to ensure that investors will look to Hillview as the entity that is responsible for the fund's performance. The conditions of the applications do not prohibit Hillview from using only one subadviser for each fund for years on end, effectively running the fund as a single-manager fund the performance of which is entirely attributable to the subadviser's success in choosing investments, rather than Hillview's success in actively overseeing subadvisers. Under these circumstances, there is no justification for stripping shareholders of their statutory voting rights.

The conditions of the Application also have not prevented the Equitable and American Skandia funds from giving far greater prominence to their funds' subadvisers than to Equitable and American Skandia. Descriptions of the subadvisers appear earlier in the prospectuses and include far more detail than the descriptions of Equitable and American Skandia. The prospectuses include no discussion of Equitable's and American Skandia's multimanager philosophy. Thus, these funds' prospectuses give the impression that Equitable's and American Skandia's roles are secondary, and that investors should look to each fund's subadviser as the entity primarily responsible for the fund's performance.

Furthermore, as demonstrated by the Equitable and American Skandia "multimanager" funds, the conditions do not prohibit Hillview from including the name of the subadviser in the fund's name. Including the subadviser's name in the name of the fund reinforces the impression that investors should look to each fund's subadviser, rather than Equitable of American Skandia, as the entity most responsible for the fund's performance.

This practice directly contradicts that a condition of the relief granted to the Equitable and American Skandia funds that they would hold themselves out as employing a multimanager structure. This condition therefore must be strengthened in order to ensure that the Hillview funds do not similarly operate in a way that misleads investors by using the name of a subadviser in the fund's name.

ii. The Exemption Would Permit Self-Interested, Unauthorized Fee Increases

The multimanager voting exemption harms shareholders by leaving them defenseless against managers who use their unchecked authority to increase their own fees, potentially resulting in reduced or inferior subadvisory services.

As stated in the Division's recent Report on Mutual Fund Fees and Expenses, the investment company:

structure creates an inherent conflict of interest between the fund and its investment adviser because the directors of the fund (who typically have initially been selected by the adviser) approve the amount of the fees that the fund will pay to the adviser in exchange for all of the adviser's services to the fund. An investment adviser has an incentive to charge the highest possible fee for its services, while the fund and its shareholders wish to pay the lowest amount of fees possible because the fees directly reduce a fund's return on its investments.²⁰

To address this conflict of interest, Congress required that advisory contracts, including any increase in advisory fees paid by the fund, be approved by shareholders. The multimanager exemption enables fund advisers to circumvent this requirement by permitting them to increase their fees – without provide additional value -- through a reduction in the subadvisers' fees.

If the increased fees received by Skandia (discussed above) had been subject to shareholders' scrutiny in a proxy statement, it might have been more inclined to share the savings with shareholders. The shareholder vote requirement has a deterrent or limiting effect on fee increases, which is exactly what Congress intended in requiring that shareholders vote on their funds' advisers and their contracts. The specter of shareholder vote gives fund directors more negotiating leverage, not to mention the moderating effect on management excesses that publicly filed proxies can have. Furthermore, there is always the possibility that shareholders will reject the fee increase. The multi-manager voting exemption removes these restraining influences.

The SEC itself reaffirmed the importance of protecting shareholders' right to approve changes in the services provided to a fund advisers when it amended Rule 15a-4. In response to requests to grant fund directors broad discretion to approve interim contracts, the Commission demurred, noting that the rule's "conditions are intended to prevent the new adviser (or new parent of the adviser) after an adviser merger from materially altering the services provided to a fund until shareholders have had an opportunity to consider those changes when they vote on a new advisory contract."²¹

Similarly, the Commission rejected requests to permit interim advisers to receive their full fee during the interim period, requiring instead that advisers receive their fees only after shareholders have ratified the contract. Thus, the SEC has recognized not only the importance of shareholder approval of new fund advisers, but also the importance of shareholder approval of increases in advisory fees by insisting that new advisers not be paid more under the interim contract than the old adviser was paid.

²⁰ Division of Investment Management, U.S. Securities and Exchange Commission 15 (Dec. 2000).

²¹ Supra note 19.

b. The Exemption Would Effectively Repeal Section 15(a) of The Act

An exemption cannot be consistent with Section 6(c) if, in principle, it effectively repeals the very statutory requirement to which it applies. Yet this is exactly what the multi-manager voting exemption does to Section 15(a)'s shareholder vote requirement as applied to subadvisers.

Section 15(a) expressly requires that an advisory contract with a subadviser that "regularly performs substantially all of the duties undertaken by" a fund's manager be approved by shareholders. Almost all of the Equitable and America Skandia multimanager funds discussed above have had only one subadviser from their inception, and in each case that subadviser is solely responsible for choosing the fund's investments.

If any fund, the investments of which are selected by a single subadviser, can qualify for the exemption, then there is no circumstance in which Section 15(a)'s shareholder vote requirement as applied to subadvisers remains inviolate. While Congress's grant of exemptive authority under Section 6(c) is broad, it could not have been intended to permit the SEC to entirely undo the statutory requirement at issue.

Indeed, the multimanager voting exemption, as applied by Equitable, American Skandia and others, as a practical matter renders meaningless shareholders' right to approve fund managers and subadvisers alike. Because the replacement of a fund manager is virtually unheard of in practice, voting on a new subadviser is the only situation in which shareholders realistically could ever be expected to have the opportunity to exercise right to approve a new investment adviser to a fund.

The multimanager exemption's nullification of shareholders' right to approve subadvisers arguably has the effect of depriving shareholders of any opportunity to vote on their funds' advisers. Thus, the exemption renders Congress's requirement that shareholders have the right to approve fund advisers effectively irrelevant.

C. CONCLUSION

As demonstrated by the operating history of the Equitable, American Skandia and other multimanager funds, the conditions contained in the Hillview application are not adequate to protect investors or to ensure that the operation of the Hillview funds is consistent with the purposes fairly intended by the policy and provisions of the Act.

For this reason, the Commission should hold a hearing on the application to consider what new conditions are needed to protect investors and ensure that multimanager relief is granted only in appropriate circumstances.

**ATTACHMENT A
TABLE 1
EQ ADVISORS TRUST**

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

ATTACHMENT A
TABLE 2
AMERICAN SKANDIA ADVISOR FUNDS

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

**ATTACHMENT A
TABLE 3
AMERICAN SKANDIA TRUST**

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

**ATTACHMENT B
TABLE 1
RUSSELL INSURANCE FUND**

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

**ATTACHMENT B
TABLE 2
FRANK RUSSELL INVESTMENT COMPANY**

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