option premiums, collected on such transactions.

(2) All related positions and transactions for future delivery or options on contracts for future delivery or on physicals on all contract markets.

(3) All related positions and transactions in cash commodities, their products, and by-products.

(f) *Internal controls.* (1) Each agricultural trade option merchant registered with the Commission shall prepare, maintain and preserve information relating to its written policies, procedures, or systems concerning the agricultural trade option merchant's internal controls with respect to market risk, credit risk, and other risks created by the agricultural trade option merchant's activities, including systems and policies for supervising, monitoring, reporting and reviewing trading activities in agricultural trade options; policies for hedging or managing risk created by trading activities in agricultural trade options, including a description of the types of reviews conducted to monitor positions; and policies relating to restrictions or limitations on trading activities.

(2) The financial statements of the agricultural trade option merchant must on an annual basis be audited by a certified public accountant in accordance with generally accepted auditing standards.

(3) The agricultural trade option merchant must file with the Commission a copy of its certified financial statements within 90 days after the close of the agricultural trade option merchant's fiscal year.

(4) The agricultural trade option merchant must perform a reconciliation of its books at least monthly.

(5) The agricultural trade option merchant:

(i) Must report immediately if its net worth falls below the level prescribed in § 3.13(d)(1)(i) of this chapter, and must report within three days discovery of a material inadequacy in its financial statements by an independent public accountant or any state or federal agency performing an audit of its financial statements, such report to be made to the Commission by facsimile, telegraphic or other similar electronic notice; and

(ii) Within five business days after giving such notice, the agricultural trade option merchant must file a written report with the Commission stating what steps have been taken or are being taken to correct the material inadequacy.

(6) If the agricultural trade option merchant's net worth falls below the level prescribed in § 3.13(d)(1)(i) of this chapter, it must immediately cease offering or entering into new option transactions and must notify customers having premiums which the agricultural trade option merchant is holding under paragraph (a)(4) of this section that such customers can obtain an immediate refund of that premium amount, thereby closing the option position.

(g) *Exemption.*

(1) The provisions of §§ 3.13, 32.2, 32.11 of this chapter and this section shall not apply to a commodity option offered by a person which has a reasonable basis to believe that:

(i) The option is offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or byproducts thereof;

(ii) Such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such; and

(iii) Each party to the option contract has a net worth of not less than $10 million or the party's obligations on the option are guaranteed by a person which has a net worth of $10 million and has a majority ownership interest in, is owned by, or is under common ownership with, the party to the option.

(2) Provided, however, that § 32.9 continues to apply to such option transactions.

Issued this 29th day of November, 1999, in Washington, DC, by the Commodity Futures Trading Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 99–31453 Filed 12–3–99; 8:45 am]

BILLING CODE 6351–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release Nos. IC–24177, IA–1846; File No. S7–22–98]

RIN 3235–AH02

Temporary Exemption for Certain Investment Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting amendments to the rule under the Investment Company Act of 1940 that permits an investment adviser to advise an investment company under a temporary contract that the investment company's shareholders have not approved. The amendments expand the circumstances in which the exemption provided by the rule is available, to include a merger or similar business combination involving an investment company's adviser. The amendments also lengthen the maximum duration of the temporary contract. The amendments will permit more investment advisers to rely on the rule rather than seek individual exemptions from the Commission, and will continue to protect the interests of investors pending their vote on a new advisory contract.

EFFECTIVE DATE: The rule amendments will be effective December 13, 1999.

FOR FURTHER INFORMATION CONTACT: Penelope W. Saltzman, Senior Counsel, (202) 942–0690, or C. Hunter Jones, Assistant Director, Office of Regulatory Policy, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the ''Commission'') today is adopting amendments to rule 15a–4 (17 CFR 270.15a–4) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the ''Investment Company Act'' or the ''Act'').[1]

Table of Contents

I. Executive Summary

The Commission is adopting amendments to rule 15a–4 under the Investment Company Act, the rule that permits an investment adviser to an investment company (''fund'') to serve for a short period of time under a contract that shareholders have not approved (''interim contract''). The amendments expand and clarify coverage of the rule by:

- Clarifying the timing of the board of directors' approval of the interim contract;

[1] Unless otherwise noted, all references to ''amended rule 15a–4,'' ''rule 15a–4, as amended,'' or any paragraph of the rule will be to 17 CFR 270.15a–4, as amended by this release.

• Allowing an adviser to serve under an interim contract after a merger or other business combination involving the adviser or a controlling person of the adviser (''adviser merger''); and

• Lengthening the maximum duration of the interim contract from 120 to 150 days.

The amendments are designed to permit more funds and investment advisers to rely on the rule rather than seek exemptive relief, while protecting fund investors until they can approve a new advisory contract.

II. Background

Section 15(a) of the Investment Company Act prohibits a person from serving as an investment adviser to a fund except under a written advisory contract that the fund's shareholders have approved.[2] Section 15(a) also requires that an advisory contract terminate automatically if it is assigned.[3] This section is designed to give shareholders a voice in a fund's investment advisory contract and to prevent trafficking in fund advisory contracts.[4] An unintended effect of the law, however, may be to leave a fund without an investment adviser if the fund's contract with the adviser terminates before the fund's shareholders can vote on a new contract.[5] To prevent funds from being harmed by losing investment advisory services before shareholders can approve a new contract, the Commission in 1980 adopted rule 15a–4, which provides a temporary exemption from the requirement that a fund's shareholders approve its advisory contract. The rule permits a fund to be advised under a short-term contract until shareholders can vote on a new contract.[6]

Rule 15a–4 was designed to deal with unforeseeable assignments of advisory contracts by permitting the board to act on an emergency basis to prevent the fund from being harmed by the absence of advisory services. The rule did not extend to an interim contract entered into after an adviser merger, which benefits the adviser, and which generally is foreseeable. When the rule was adopted, the Commission explained that when an adviser intends to assign its advisory contract under reasonably foreseeable circumstances, the investor protection concerns underlying section 15(a) were better fulfilled if shareholders had the opportunity to approve the relationship with the successor adviser before the adviser served the fund.[7] In recent years, as a result of greater consolidation in the financial services industry, applicants have sought an increasing number of exemptive orders in connection with adviser mergers. We have granted exemptive relief in these situations subject to conditions designed to protect shareholders pending their vote on a new advisory contract.

We proposed last year to amend rule 15a–4 to: (i) Clarify some of its provisions; (ii) expand the availability of the rule to include interim contracts entered into as a result of an adviser merger; and (iii) extend the period of time when a fund can be advised under an interim contract.[8] We received six comment letters in response to the proposal.[9] Commenters generally supported the proposed amendments, but each recommended specific changes.[10] Today we are adopting the amendments substantially as proposed, with minor modifications that reflect issues raised by commenters.[11]

III. Discussion

A. Board Approval

Under section 15 of the Act and rule 15a–4, the board of directors of a fund must approve an interim contract before or at the time the fund enters into the contract. If an advisory contract terminates as a result of an unforeseeable event, prior board approval of an interim contract may be impracticable.[12] To address this concern, we proposed to allow the board of directors seven calendar days (*i.e.,* one week) to approve an interim contract. At the suggestion of one commenter, we are extending the period to ten business days to provide investment advisers sufficient time to prepare documentation supporting approval of an interim contract and to give fund directors sufficient time to consider proposals for the new contract.[13] We also are adopting, as proposed, an amendment that permits the board to participate in a meeting to approve an interim contract by any means of communication that allows all participants to hear each other at the same time, such as a telephone conference.[14]

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[2] 15 U.S.C. 80a–15(a). Section 15(a) requires that a majority of the fund's outstanding voting securities approve the contract.

[3] 15 U.S.C. 80a–15(a)(4) (requiring that an advisory contract provide for its automatic termination upon assignment). An ''assignment'' of an investment advisory contract includes a transfer of the contract to another investment adviser, as well as a transfer of a controlling block of the investment adviser's voting securities. 15 U.S.C. 80a–2(a)(4).

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

[5] This situation could occur if, for example, a controlling shareholder of the fund's adviser suddenly dies and control of the adviser passes to an heir. *See* Temporary Exemption for Certain Investment Advisers, Investment Company Act Release No. 23325 (July 22, 1998) [63 FR 40231 (July 28, 1998)] (''Proposing Release'') at nn.5–6 and accompanying text.

[6] The rule permits a fund to be advised under a temporary contract when (i) the fund's directors or shareholders terminate or decide not to renew the contract or (ii) a fund's advisory contract is assigned (and therefore terminates) under circumstances in which the investment adviser, or a controlling person of the adviser, does not receive any money or other benefit. Under the rule, the fund's board of directors, including a majority of directors who are not interested persons (''independent directors''), must approve the interim contract, and the compensation paid under the interim contract must not exceed the compensation under the previous contract. Rule 15a–4(a)–(b). *See* Exemptions for Certain Investment Advisers and Principal Underwriters of Investment Companies, Investment Company Act Release No. 11005 (Jan. 2, 1980) (45 FR 1860 (Jan. 9, 1980)).

[7] Exemptions for Certain Investment Advisers and Principal Underwriters of Investment Companies, Investment Company Act Release No. 10809 (Aug. 6, 1979) (44 FR 47100 (Aug. 10, 1979)) at text preceding n.11. As noted in the Proposing Release, funds also typically do not participate in adviser mergers, and their interests generally are not represented in the transaction. *See* Proposing Release, *supra* note 5, at text following n.20.

[8] Proposing Release, *supra* note 5.

[9] The commenters included two closed-end fund investors, an investment adviser, a trade association, a bar association, and a law firm. The comment letters are available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC (File No. S7–22–98).

[10] Two commenters suggested that the Commission address certain issues that arise in connection with the approval of advisory contracts by closed-end fund shareholders. Because these issues relate specifically to shareholder votes on new advisory contracts, and not to an exemption from the shareholder approval requirement, we have not addressed these issues in the final rule.

[11] In addition to the changes described below, we are adopting certain technical modifications to the rule, such as including in the definition of the term ''fund'' a series of an investment company. *See* amended rule 15a–4(a)(1).

[12] *See* Proposing Release, *supra* note 5, at n.11 and accompanying text.

[13] Amended rule 15a–4(b)(1)(ii). The ten-day period for board approval does not apply to interim contracts following adviser mergers, which are discussed below.

[14] Section 15(c) of the Act requires the board to meet ''in person'' to approve an advisory contract. 15 U.S.C. 80a–15(c). Directors must be physically present to satisfy the ''in person'' requirement. *See* Investment Company Amendments Act of 1969, S. Rep. No. 184, 91st Cong., 1st Sess. 39 (1969); Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 334–35 (1966); Provisions of Investment Company Amendments Act of 1970 (Pub. L. 91–547) Concerning Approval of Investment Advisory Contracts and Other Matters Which Should Be Considered by Registrants in Connection with their 1971 Annual Meetings, Investment Company Act Release No. 6336 (Feb. 2, 1971) [36 FR 2867 (Feb. 11, 1971)] at n.3 and accompanying text.

B. Adviser Mergers

As noted above, the Commission proposed to expand the availability of rule 15a–4 to permit funds to operate under an interim advisory contract when the previous contract is terminated as a result of an adviser merger (*i.e.,* when the adviser or a controlling person of the adviser has received a benefit in connection with the assignment of the previous contract). We are adopting these amendments substantially as proposed. The amendments largely codify individual exemptive orders we have issued over the years, and are designed to preserve the quality of advisory or other services that the fund received before the merger until the shareholders have voted on a new contract.

Under amended rule 15a–4, the board of directors, including a majority of independent directors, must find that the scope and quality of the advisory services to be provided under the interim contract are at least equivalent to the scope and quality of the services provided under the previous contract.[15] The board also must approve the interim contract before the previous contract is terminated.[16] The interim contract must contain generally the same terms and conditions as the previous contract, and provide compensation to the adviser that is no greater than the compensation under the previous contract.[17] The interim contract also must provide that the board may terminate the contract with no more than ten days written notice.[18] Finally, any fees earned by the adviser during the interim contract must be placed in an interest-bearing escrow account and be paid to the adviser only if shareholders approve the new advisory contract.[19] If shareholders do not approve the new contract, the adviser may receive the lesser of the fees provided under the interim contract or the costs of providing services under the interim contract.[20]

We are not adopting suggestions by several commenters that the rule allow fund boards broad discretion in approving interim contracts after adviser mergers.[21] Exemptive relief in those circumstances would be inconsistent with the statutory requirement that *shareholders* approve advisory contracts.[22] Thus, the amendments are designed to preserve the status quo while shareholder approval is sought for a new contract. The 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.

Finally, we are not adopting the suggestion of some commenters that advisers receive the full fee under the interim contract without escrow arrangements, regardless of whether shareholders approve the new advisory contract. Like our exemptive orders, the amendments permit the adviser to receive all of the fees due it under the interim contract if the new contract is renewed and shareholders have, in effect, ratified the interim contract. Unlike our exemptive orders, which precluded the adviser from receiving any fees due it under the interim contract when shareholders fail to approve the new advisory contract, the amendments permit the adviser to be compensated for its costs. We believe that this new approach sufficiently addresses the concerns of fund advisers without compromising investor interests.

C. Duration of Interim Contract

The amended rule extends the maximum duration of an interim contract from 120 days to 150 days, in order to provide additional time to solicit proxies and obtain a quorum of voting shareholders.[23] Although some commenters argued for a longer period,[24] our experience has shown that funds generally have not needed more than 150 days for an interim contract.[25]

IV. Effective Date

The amendments to rule 15a–4 will be effective December 13, 1999. This

[15] Amended rule 15a–4(b)(2)(iii). *See* Proposing Release, *supra* note 5, at nn.22–24 and accompanying text.

[16] Amended rule 15a–4(b)(2)(ii).

[17] Amended rule 15a–4(b)(2)(i), (v).

[18] Amended rule 15a–4(b)(2)(iv). Two commenters argued that this requirement is unnecessary and that any termination provisions should be left to the board's discretion. We believe that the termination clause helps to protect the fund by enabling the board to respond quickly to declining quality of services under the interim contract.

[19] The escrow account must be maintained with a bank or the fund's custodian. Amended rule 15a–4(b)(2)(vi)(A).

[20] Amended rule 15a–4(b)(2)(vi). Any amounts remaining in the account would be returned to the fund. *Id.*

The amended rule does not prohibit (as many of our exemptive orders have prohibited) the fund from paying costs of shareholder solicitation for approval of a new contract after an adviser merger. Nevertheless, if an advisory contract is terminated as a result of an adviser's action that benefits the adviser (such as an adviser merger), issues may arise under other sections of the Act if the fund pays the costs of soliciting shareholder approval of a new contract. *See* 1979 Proposing Release, *supra* note 5, at n.13. The 1979 Proposing Release notes that if a fund were to bear any of the costs caused by an adviser merger, including costs associated with conducting a special shareholders' meeting, payment of those costs might constitute compensation to the investment adviser and raise questions regarding the availability of section 15(f) (15 U.S.C. 80a–15(f)) (creating safe harbor under which investment advisers may receive a benefit in connection with a sale of securities of, or a sale of any other interest in, an investment adviser that results in an assignment of an investment advisory contract, if certain conditions are met). The 1979 Proposing Release further comments that a fund's payment of those costs also may raise questions under sections 15(a)(1) (15 U.S.C. 80a–15(a)(1)) (advisory contract must precisely describe all compensation to be paid under the contract) and 36(b) [15 U.S.C. 80a–35(b)] (investment adviser's fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by the fund or its shareholders)). *But see* Travelers Group Inc., et al., Investment Company Act Release Nos. 22873 (Nov. 3, 1997) (62 FR 60540 (Nov. 10, 1997)) (notice) and 22911 (Nov. 26, 1997) (65 SEC Docket 2962 (Dec. 23, 1997)) (order) (adviser to pay costs of soliciting shareholder approval of new advisory contract, except that if solicitation is in conjunction with fund's annual meeting at which other matters are to be discussed, fund may pay portion of costs).

[21] Two commenters, for example, recommended that the exemption related to adviser mergers contain only the conditions that apply to interim contracts in circumstances *other than* adviser mergers (*i.e.,* board approval and no increase in compensation). Another commenter suggested that instead of the specific terms and conditions proposed, the rule should require the board to find that the interim contract is in the ''best interests'' of shareholders, and allow the board to approve materially different terms and conditions in the interim contract when appropriate. These suggestions would increase the board's discretion by allowing it to reduce services under the interim contract or increase services for a higher fee.

[22] *See* text accompanying note 7, *supra.*

[23] In response to the suggestion of one commenter, and consistent with our exemptive orders, the amended rule also clarifies that the exemptive period begins as of the date the previous contract terminates. Amended rule 15a–4(a)(2)(ii).

[24] Three commenters recommended extending the period further, largely for administrative convenience. Two recommended a period of up to 180 days because of the increasing complexity of adviser mergers. One of these commenters and another commenter also advocated extending the exemptive period, for funds that hold annual shareholder meetings, until the next annual meeting. These funds are generally closed-end funds, the shares of which typically are listed on an exchange that requires listed companies to hold annual shareholder meetings. *See, e.g.,* New York Stock Exchange Listed Cmpany Manual ¶ 302.00. We are not adopting these suggested changes. Permitting an extension until the next annual meeting could result in an interim contract of up to one year. We believe that the shareholders' interest in limiting the duration of an advisory contract that they have not approved outweighs the possible cost savings to advisers if the shareholder vote is postponed beyond 150 days.

[25] In 1998, all applications for exemptive relief from section 15(a) concerning interim contracts in connection with an adviser merger, sought relief for 150 days or less, and half (10 out of 20) sought relief for periods between 60 and 120 days. The one applicant that sought to extend its original 120-day exemption for an additional 60 days, did so to explore possibilities of merging funds before seeking approval of new advisory contracts. *See* DG Investor Series, Investment Company Act Release Nos. 23420 (Aug. 31, 1998) (63 FR 47540 (Sept. 8, 1998)) (notice) and 23445 (Sept. 22, 1998) (68 SEC Docket 232) (order).

effective date is less than 30 days after publication so that funds and advisers may benefit sooner from the rule amendments.[26]

V. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits that result from its rules. In the Proposing Release, we requested comment and specific data regarding the costs and benefits of the proposed amendments, but commenters did not address any specific costs or quantify any benefits.

We believe the amendments are likely to result in cost savings for investment advisers by removing the need to seek exemptive relief in the case of adviser mergers.[27] Based on orders issued in 1998, we estimate that the total annual cost savings for investment advisers resulting from the proposed amendments would be approximately $400,000, and possibly more. In 1998, the Commission issued 20 orders granting exemptive relief in connection with adviser mergers at an estimated cost to the applicants of $20,000 for each application.[28] We expect that cost savings could be greater in the future based on the steady increase in orders issued in connection with adviser mergers over the past four years.[29] In addition, we believe the conditions of the rule will not result in increased costs for funds or their investors. The condition regarding director findings should not be burdensome in view of the fact that section 15(c) already requires the fund's independent directors to review and approve the new advisory contract. In addition, we expect funds and advisers that are eligible for exemptive relief under circumstances other than after an adviser merger[30] will realize cost savings because directors may participate in the meeting to approve the advisory contract ''by any means of communication that allows all directors participating to hear each other simultaneously during the meeting.'' This provision should result in savings in time and travel costs.[31]

Unlike most prior exemptive orders, the amendments do not prohibit funds from paying costs associated with soliciting shareholder approval of a new advisory contract after an adviser merger. Thus, the amendments could result in increased costs for funds if they bear those expenses in the future. In most investment adviser business combinations, however, the advisers bear the costs of the transaction.[32] While we cannot predict what will happen after the rule is amended, we believe that advisers, consistent with their other obligations under the statute,[33] are likely to continue to pay these costs and, therefore, the amendments are not likely to result in increased shareholder solicitation costs for funds.

VI. Effects on Efficiency, Competition and Capital Formation

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is consistent with the public interest, to consider whether the action will promote efficiency, competition, and capital formation.[34] As discussed above, the Commission anticipates that the amendments to rule 15a–4 will result in cost savings for investments advisers, funds and investors. We also have considered, in addition to the protection of investors, whether the amendments adopted today will promote efficiency, competition or capital formation.

VII. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis (''FRFA'') in accordance with 5 U.S.C. 604 relating to the amendments. A summary of the Initial Regulatory Flexibility Analysis (''IRFA''), which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release. We received no comments on the IRFA.

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

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

Rule 15a–4 applies to funds (including business development companies (''BDCs'')) and their investment advisers.[35] The rule does not affect funds that do not have an external investment adviser (*i.e.*, unit investment trusts or other internally managed funds).[36]

An investment adviser is a small entity for purposes of the Regulatory Flexibility Act (''Reg. Flex. Act'') if it (i) manages less than $25 million in assets, (ii) has total assets of less than $5 million on the last day of its most recent fiscal year, and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that manages $25 million or more in assets, or any person (other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year.[37] We estimate that approximately 165 out of 901 investment advisers that advise funds are small entities. A fund is a small entity for purposes of the Reg. Flex. Act if it, together with other funds in the same group of related funds, has net assets of $50 million or less as of the end of its most recent fiscal year.[38] We estimate that approximately 222 out of 3,560 active management companies, and approximately 34 out of 62 BDCs are small entities.

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[26] *See* 5 U.S.C. 553(d)(1) (permitting exemptive rules to become effective less than 30 days after publication).

[27] One of the standard conditions to the adviser merger orders is that the costs of the exemptive application will be paid by the adviser or advisers. As discussed above, several commenters agreed that removing the need to apply for an exemptive order would be a benefit, although none provided any specifics on the amount of savings that might be realized.

[28] This number is based on an estimate of the average cost provided by attorneys in private practice who have prepared these type of exemptive applications. The cost of preparing an application, however, may vary significantly depending on the applicant.

[29] From 1995 through 1998, the Commission issued 6, 11, 13 and 20 exemptive orders each year in connection with adviser mergers.

[30] *See supra* note 6.

[31] Several commenters also agreed that this provision would be a benefit, but none quantified the savings that funds might realize.

[32] *See* 1 Thomas P. Lemke, *et al.,* Regulation of Investment Companies § 24.02[1][c].

[33] *See supra* note 20.

[34] 15 U.S.C. 80a–2(c).

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

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

[37] 17 CFR 275.0–7

[38] 17 CFR 270.0–10.

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

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

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

We believe that further clarification, consolidation, or simplification of the compliance requirements is not necessary. Standards established in the amendments contain performance, rather than design standards.[39] An exemption from coverage of the rule for small advisers or small funds would prevent those entities from benefiting from rule 15a–4 and would not be consistent with the protection of investors.

To obtain a copy of the FRFA, contact Penelope Saltzman, Securities and Exchange Commission, 450 5th Street, NW, Washington, DC 20549–0506.

VIII. Statutory Authority

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

List of Subjects in 17 CFR Part 270

Investment companies, Securities.

Text of Final Rule

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

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

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

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

* * * * *

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

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

(a) For purposes of this section:

(1) *Fund* means an investment company, and includes a separate series of the company.

(2) *Interim contract* means a written investment advisory contract:

(i) That has not been approved by a majority of the fund's outstanding voting securities; and

(ii) That has a duration no greater than 150 days following the date on which the previous contract terminates.

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

(b) Notwithstanding section 15(a) of the Act (15 U.S.C. 80a–15(a)), a person may act as investment adviser for a fund under an interim contract after the termination of a previous contract as provided in paragraphs (b)(1) or (b)(2) of this section:

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

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

(ii) The fund's board of directors, including a majority of the directors who are not interested persons of the fund, has approved the interim contract within 10 business days after the termination, at a meeting in which directors may participate by any means of communication that allows all directors participating to hear each other simultaneously during the meeting.

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

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

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

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

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

[39] *See* amended rule 15a–4(b)(2)(iii).

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

(vi) The interim contract contains the following provisions:

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

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

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

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

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

Dated: November 29, 1999.

By the Commission.

Jonathan G. Katz,

Secretary.

[FR Doc. 99–31333 Filed 12–3–99; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 913

[SPATS No. IL–097–FOR, Part I]

Illinois Regulatory Program

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

ACTION: Final rule; approval of amendment.

SUMMARY: The Office of Surface Mining Reclamation and Enforcement (OSM) is approving part of an amendment to the Illinois regulatory program (Illinois program) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). Illinois proposed revisions to its program concerning subsidence control, water replacement, performance bonds, siltation structures, impoundments, hydrologic balance, disposal of noncoal mine wastes, revegetation, backfilling and grading, prime farmland, and State inspections. This final rule document addresses Illinois' revisions concerning subsidence control and water replacement. The primary focus of these revisions is to address changes required by the Energy Policy Act of 1992 regarding repair or compensation for material damage caused by subsidence from underground coal mining operations and replacement of drinking, domestic, and residential water supplies that have been adversely impacted by underground coal mining operations. Illinois intends to revise its program to be consistent with the corresponding Federal regulations, to provide additional safeguards, and to improve operational efficiency.

EFFECTIVE DATE: December 6, 1999.

FOR FURTHER INFORMATION CONTACT: Andrew R. Gilmore, Director, Indianapolis Field Office, Office of Surface Mining, Minton-Capehart Federal Building, 575 North Pennsylvania Street, Room 301, Indianapolis, Indiana 46204–1521. Telephone: (317) 226–6700. Internet: INFOMAIL@indgw.osmre.gov.

SUPPLEMENTARY INFORMATION:

I. Background on the Illinois Program

On June 1, 1982, the Secretary of the Interior conditionally approved the Illinois program. You can find background information on the Illinois program, including the Secretary's findings, the disposition of comments, and the conditions of approval in the June 1, 1982, **Federal Register** (47 FR 23883). You can find later actions concerning the Illinois program at 30 CFR 913.15, 913.16, and 913.17.

II. Submission of the Proposed Amendment

By letter dated August 2, 1999 (Administrative Record No. IL–5044), the Illinois Department of Natural Resources (Department) sent us an amendment to the Illinois program under SMCRA. The Department proposed to amend Title 62 of the Illinois Administrative Code (IAC) in response to our letters dated May 20, 1996, June 17, 1997, and January 15, 1999 (Administrative Record Nos. IL–1900, IL–2000, and IL–5036, respectively), that we sent to Illinois under 30 CFR 732.17(c). The amendment also includes changes made at the Department's own initiative.

We announced receipt of the amendment in the August 17, 1999, **Federal Register** (64 FR 44674). In the same document, we opened the public comment period and provided an opportunity for a public hearing or meeting on the adequacy of the amendment. The public comment period closed on September 16, 1999. Because no one requested a public hearing or meeting, we did not hold one.

During our review of the amendment, we identified concerns relating to siltation structures, impoundments, performance bonds, and State inspections. We also identified some nonsubstantive editorial errors. We notified Illinois of these concerns and editorial problems by letter dated September 21, 1999 (Administrative Record No. IL–5048). Because we did not identify any concerns relating to Illinois' revisions for subsidence control and water replacement, we are separating Illinois' amendment into two parts. Part I concerns revisions to Illinois' regulations relating to subsidence control and water replacement. Part II concerns revisions to Illinois' regulations relating to performance bonds, siltation structures, impoundments, hydrologic balance, disposal of noncoal mine wastes, revegetation, backfilling and grading, prime farmland, and State inspections. This final rule **Federal Register** document addresses IL–097–FOR, Part I.

III. Director's Findings

Following, under SMCRA and the Federal regulations at 30 CFR 732.15 and 732.17, are our findings on Illinois' revisions pertaining to subsidence control and water replacement.

On March 31, 1995, OSM promulgated rules to implement new section 720(a) of SMCRA. Section 720(a), which took effect on October 24, 1992, as part of the Energy Policy Act of 1992, Public Law 102–486, 206 Stat. 2776, requires all underground coal mining operations conducted after October 24, 1992, to promptly repair or compensate for material damage caused by subsidence to noncommercial buildings and occupied residential dwellings and related structures. It also requires the replacement of drinking, domestic, and residential water supplies that have been adversely impacted by underground coal mining operations conducted after that date. By letter dated May 20, 1996, under 30 CFR 732.17(c), we notified Illinois to amend its program to be no less effective than