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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

INVESTMENT ADVISERS ACT OF 1940
Release No. 316

NOTICE OF PROPOSAL UNDER THE INVESTMENT ADVISERS ACT OF 1940, AS AMENDED, TO ADOPT RULE 205-1 DEFINING "INVESTMENT PERFORMANCE" OF AN INVESTMENT COMPANY AND "INVESTMENT RECORD" OF AN APPROPRIATE INDEX OF SECURITIES PRICES

File No. S7-437

NOTICE IS HEREBY GIVEN that the Securities and Exchange Commission has under consideration the adoption of a Rule under the Investment Advisers Act of 1940 ("the Act"), as amended by the Investment Company Amendments Act of 1970 (the "1970 Act"). The proposed rule is designed to make clear that amended Section 205 of the Act, which became effective on December 14, 1971, requires that (a) realized capital gains distributions and dividends from investment income paid by investment companies and (b) all cash distributions paid on the stocks of the companies which comprise the index of securities prices chosen to measure the relative performance of the investment company, shall be treated as reinvested in computing "investment performance" of the investment company and the "investment record" of the index. The rule would be adopted pursuant to the authority granted to the Commission under Sections 205 and 211 of the Act.

Prior to the amendment of Section 205 many investment company performance fee arrangements were unfair to investment companies. Many such fees did not decrease for poor performance; or, if they did, decreases were disproportionate to increases. The amendments to Section 205 were designed to align, as nearly as possible, the interests of the adviser and the investment company by correcting imbalances in incentive fee arrangements. Thus, under the section, as amended, all performance fees are prohibited unless compensation under them increases and decreases proportionately with investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation or order may specify. The point from which increases and decreases in compensation are measured must be the fee which is paid or earned when the investment performance of the company is equivalent to that of the index.

Section 211 of the Act gives the Commission authority to issue such rules and regulations as are necessary or appropriate to the exercise of the functions and powers conferred upon it under the Act.

For investment company "investment performance" to be comparable to the "investment record" of an index within the meaning of Section 205 all increments, both in the performance of the investment company and of the index,must be taken into account. A survey of existing investment company performance fee arrangements indicates that while substantially all investment companies treat realized capital gains distributions as reinvested in computing their performance, most do not accord similar treatment to dividends paid out of their investment income and to cash dividends and distributions of the companies which comprise the index of securities prices. On the average, the dividends paid by the companies whose stocks comprise an index have exceeded the dividends from investment income paid by investment companies with incentive fee arrangements. This practice of not including dividends and distributions in measuring performance has resulted in an advantage to investment advisers and is unfair to investment companies and their stockholders.

The attached rule proposal makes clear that the "investment record" of the index differs from the index price. The rule would require that in computing the "investment performance" of the investment company and the "investment record" of the index, dividends paid by the investment company out of its investment income and all cash distributions of the companies whose stocks comprise the index shall be treated as reinvested. In computing the "investment performance" of investment companies realized capital gains shall also be treated as reinvested.

Ideally, cash dividends and any other cash distributions on the securities of the companies which comprise the index should be treated as reinvested on their ex-dividend dates or record dates. Information with which to calculate such reinvestments in this manner may not be readily available for the companies which comprise the index. To assure that such dividends and distributions are accorded appropriate weight, the rule requires that the value, computed consistently with the index, of cash distributions made by companies whose securities comprise the index shall be included in the "investment record" of the index and shall be treated as reinvested in the index at least as frequently as the end of each quarter following the payment of the dividend. 1/ Investment

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1/ For example, the latest quarterly dividends of the companies whose stocks comprise the Standard & Poor's 500 Stock Composite Index, are published monthly under "Dividends per share, 12 months moving total adjusted to index" in Standard & Poor's Trade and Securities Statistics: Current Statistics. An illustration of the manner in which this index may be adjusted for 1971 by the use of this data is set forth as an Exhibit to this release.

company capital gains distributions and dividends may be treated as reinvested at the net asset value at the close of business on the record date for the payment of such distributions or dividends.

The text of the proposed rule is as follows:

<u>Rule 205-1</u>. <u>Definition of "investment performance" of an investment company and "investment record" of an appropriate index of securities prices.</u>

(a) "Investment performance" of an investment company for any period shall mean the sum of:

(1) the change in its net asset value per share during such period; and

(2) the value of its cash distributions per share accumulated to the end of such period;

expressed as a percentage of its net asset value per share at the beginning of such period. For this purpose, distributions by an investment company of realized capital gains and of dividends paid from investment income shall be treated as reinvested at the net asset value per share in effect at the close of business on the record date for the payment of such distributions or dividends.

(b) "Investment record" of an appropriate index of securities prices for any period shall mean the sum of:

(1) the change in the level of the index during such period; and

(2) the value, computed consistently with the index, of cash distributions made by companies whose securities comprise the index accumulated to the end of such period;

expressed as a percentage of the index level at the beginning of such period. For this purpose cash distributions on the securities which comprise the index shall be treated as reinvested in the index at least as frequently as the end of each calendar quarter following the payment of the dividend.

All interested persons are invited to submit their written views and comments on the proposed rule to Ronald F. Hunt, Secretary, Securities and Exchange Commission, Washington, D. C. 20549, on or before May 15, 1972 . All communications to the Secretary in this regard should refer to File No. S7-437, and will be available for public inspection.

Ronald F. Hunt
Secretary

Exhibit 1 IA-316

Method of Computing the Investment Record
of the Standard & Poor's 500
Stock Composite Index
for Calendar 1971

Index Value 1/		Quarterly Dividend Yield-Composite Index	
Quarter ending:		Annual Percent 2/	Quarterly percent 3/ (¼ of annual)
Dec. 1970	92.15		
March 1971	100.31	3.10	.78
June 1971	99.70	3.11	.78
Sept. 1971	98.34	3.14	.79
Dec. 1971	102.09	3.01	.75

Change in index value for 1971: 102.09 - 92.15 = 9.94

Accumulated value of dividends for 1971:

Quarter ending:	March		June		Sept.		Dec.		
Percent yield =	1.0078	x	1.0078	x	1.0079	x	1.0075	-	1.00 = .0314

Aggregate value of dividends paid, assuming quarterly reinvestment and computed consistently with the index:

(Percent yield as computed above) x (Ending index value) = Aggregate value of dividends paid

For 1971: .0314 x 102.09 = 3.21

Investment record of Standard & Poor's 500 stock composite index assuming quarterly reinvestment dividends:

$$\text{Investment record} = \frac{9.94 + 3.21}{92.15} = 14.27\%$$

1/ Source: Standard & Poor's Trade and Securities Statistics, Jan. 1972, p. 33.

2/ Id. See Standard & Poor's Trade and Securities Statistics Security and Price Index Record - 1970 Edition, p. 133, for explanation of quarterly dividend yield.

3/ Quarterly percentages have been rounded to two decimal places.

The same method can be extended to cases where an investment company's fiscal quarters do not coincide with the fiscal quarters of the S&P dividend record or to instances where a "rolling period" is used for performace comparisons as indicated by the following example of the calculation of the investment record of the Standard & Poor's 500 Stock Composite Index for the 12 months ended November 1971:

Index value Nov. 30, 1971	93.99
Index value Nov. 30, 1970	87.20
change in index value	6.79

Quarter ending:	Dividend Yield: Annual rate	Dividend Yield: ¼ of Annual	Rate for each month of quarter (1/12 of annual)
Dec. 1970	3.41	.85	.28
March 1971	3.10	.78	.26
June 1971	3.11	.78	.26
Sept. 1971	3.14	.79	.26
Dec. 1971	3.01	.75	.25

Accumulated value of dividends reinvested:

December	=	1.0028
Jan - March	=	1.0078
April - June	=	1.0078
July - Sept.	=	1.0079
Oct. - Nov.	=	1.0053 4/

4/ The rate for October and November would be two-thirds of the yield for the quarter ended September 30, (i.e. .667 x .79 = 5269) since the yield for the quarter ended December 31 would not be available as of November 30.

Dividend yield:

$$1.0028 \times 1.0078 \times 1.0078 \times 1.0079 \times 1.0053 - 1.00 = .0320$$

Aggregate value of dividends paid computed consistently with the index:

$$.0320 \times 93.99 = 3.01$$

Investment Record of the Standard & Poor's 500 Stock Composite Index for the 12 months ended November 30, 1971:

$$\frac{6.79 + 3.01}{87.20} = 11.24\%$$