ROYCE VALUE TRUST, INCORPORATED

Publicly Available December 22, 1986

SEC LETTER

Rule 205–3(b)(2)

November 20, 1986

In your letters of November 12 and 17, 1986, you request our assurance that we would not recommend any enforcement action to the Commission under Section 205(1) of the Investment Advisers Act of 1940 ("Act") if Royce Value Trust, Inc. ("Company") and Quest Advisory Corp. ("Adviser") enter into an advisory agreement with the performance-based fee described in your letters that, inter alia, (i) decreases at a greater rate than it increases; and (ii) provides for no compensation if the net asset value per share of the Company declines. You believe that this arrangement should not be deemed to violate Section 205(1) because it conforms with the policies inherent in Section 205(1) and is not the type of performance-based fee Congress sought to eliminate.

The legislative history of Section 205(1) does not indicate whether Congress ever considered this type of arrangement. However, we believe that Congress primarily sought to ensure that performance-based fees would not increase by an amount or rate greater than that by which they decreased.1 Therefore, without necessarily agreeing with your legal analysis, we would not recommend any enforcement action to the Commission under Section 205(1) of the Act if the Company and Adviser enter into the performance-based fee arrangement described in your letters. We wish to emphasize that our position relates only to the two aspects of the fee arrangement outlined above. In addition, because this position is based on the representations made to us in your letters, you should note that any different facts or conditions might require a different conclusion. Finally, this response only expresses our position on enforcement action and does not purport to express any legal conclusion on the question presented.

This language suggests that Congress sought to ensure that a fulcrum fee penalized an adviser for substandard performance as must as it rewarded the adviser for superior performance. In addressing fulcrum fees, the Division has focused on this concern. For example, the staff, in refusing to give no-action assurance in a situation where the fulcrum fee could increase more than it could decrease, cited the legislative history of Section 205(1) and stated that "Congress ... specified that an investment adviser charging an incentive fee must face as much risk of decrease in his fee for poor performance as increase in his fee for good performance." Incentive Investments, Inc. (pub. avail. May 20, 1982). In addition, in a letter to John W. James (pub. avail. Jan. 4, 1985), the staff explained that, in amending Section 205, Congress was concerned "about an adviser having nothing to lose and everything to gain from taking unnecessary risks with a client's funds...."

Gerald T. Lins
Attorney

Footnote

1 The Senate Report on the bill amending Section 205 states that

> If a contract provides a limit to the reduction from a specified fee, it must provide a corresponding limit to the increase above such specified fee. For example, if a contract provides for an increase in compensation of one-eighth of 1 percent of average net assets if the company's investment performance exceeds the record of a specified securities index by 10 percent, it must also provide for a decrease in compensation of one-eighth of 1 percent of average net assets if the company's investment performance is 10 percent below the record of the index.
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> S.Rep.No. 184, 91st Cong., 1st Sess. 45–46 (1969).

INCOMING LETTER

Gerald Lins, Esq.
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Royce Value Trust, Inc.

Dear Mr. Lins:

On behalf of Royce Value Trust, Inc., a recently-organized Maryland corporation (the "Company"), we hereby request confirmation that the Division of Investment Management will not recommend that the Securities and Exchange Commission take enforcement action on the facts set forth below.

Facts.

The Company has filed a Registration Statement on Form N–2 (File Nos. 33–9514 and 811–4875) the "Registration Statement"), a copy of which is enclosed herewith, relating to the initial offering of shares of its common stock under the Securities Act of 1933 and the initial registration of the Company under the Investment Company Act of 1940 as a closed-end diversified management investment company. The primary investment objective of the Company will be long-term capital appreciation through investing principally in common stocks of small and medium-sized companies, generally with stock market capitalizations ranging from $15,000,000 to $300 million. The Company's investment adviser is Quest Advisory Corp. ("Quest"), a New York corporation and an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act").

Quest proposes to enter into an Investment Advisory Agreement (the "Agreement") with the Company, a copy of which is or will be an exhibit to the Registration Statement, pursuant to which Quest will receive a monthly advisory fee ranging from 1/12 of .5% to 1/12 of 1.5% of the total net assets of the Company, depending on the investment performance of the Company relative to the investment record of the Standard & Poors 500 Composite Stock Price Index (the "S & P 500"). For the first full eleven months, the monthly advisory fee will be a flat 1/12 of 1% of the Company's total net assets. Thereafter, the monthly advisory fee will be equal to 1/12 of 1% of the Company's total net assets if the Company's investment performance equals the investment record of the S & P 500 or exceeds it by not more than 2 percentage points or is below it by not more than 1 percentage point, in each case determined on the basis of a rolling performance period of up to thirty-six (36) months. Outside of this "null zone", the fee will be increased by 1/12 of .05% for each percentage point by which the Company's investment performance exceeds the S & P 500 record (up to a maximum of 12 percentage points, for a maximum increase of .5%), and will be reduced by 1/12 of .1% for each percentage point by which the Company's investment performance is less than the S & P 500 record (up to a maximum of 6 percentage points, for a maximum decrease of 5%). Thus, the fee will be reduced twice as quickly for below index performance than it will be increased for above index performance. Attached hereto as Exhibit A is a table showing the level of the advisory fee under the Agreement at various levels of Company investment performance relative to the S & P 500 record. In addition, the Agreement will provide that after the first eleven months Quest will not be entitled to receive any fee for any performance period in which the net asset value per share of the Company, after giving effect to reinvestment of dividends and other distributions, has declined.

Legislative History.

Section 205(1) of the Advisers Act excepts from the bar on performance-based fees an investment advisory contract with a registered investment company which "provides for compensation based on the asset value of the company or fund under management averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company or fund over a specified period in relation to the investment record of an appropriate index of securities prices...." For

the reasons set forth below, we are of the opinion that the advisory fee contemplated by the Agreement is in conformity with the policies and legislative history underlying Section 205(1) and the Advisers Act and is a permissible advisory fee arrangement under such Act.

Until the Investment Company Amendments Act of 1970, an investment adviser whose only clients were investment companies was not prohibited from charging such clients a performance fee. In the Advisers Act as originally proposed, as well as in the Investment Company Act of 1940 as originally proposed, advisers to investment companies would have been prohibited from charging any performance fee. S. 3580 and H.R. 8935, 76th Cong., 3d Sess. § 205 (1940). During hearings on the Senate bill before the Senate Subcommittee, David Schenker, SEC Chief Counsel, stated:

> "What we aim at really is to kill profit-sharing arrangements, where a man makes an arrangement to the effect that he will take a cut of the profits but he does not take any cut of the losses. It is one of these 'heads I win and tails you lose' propositions. By and large, I do not think the industry finds any difficulty with this provision." Hearings on S. 3580 Before a Subcommittee of the Committee on Banking and Currency, 76th Cong., 3d Sess. at 252 (1940).

The legislation as finally adopted did not contain such a prohibition, the SEC stating that "... the Commission recommends, but does not insist, that certain types of profit-sharing contracts be outlawed." Hearings on H.R. 10065 Before a Subcommittee of the Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 98 (1940).

The issue of performance fees for investment companies was not revisited until consideration of the bills which were to become the Investment Company Act Amendments of 1970. During the hearings on these bills, the SEC argued that, in practice, these fees were unfair because they generally provided for bonuses for above-index performance but no or proportionately small penalties for below index performance and that the fee reductions often took the form of deferrals against future fees or rebates, with no assurance of creditworthiness of the investment adviser. Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737, Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 91st Cong., 1st Sess. 870–872 (1969). In other words, the concern was the same "heads I win and tails you lose" type of performance fee arrangement discussed, but left unregulated, at the time of the initial adoption of the Advisers Act.

Analysis.

It is clear on its face that the advisory fee arrangement contemplated by the Agreement does not provide for "proportionate" increases and decreases as the word is literally defined. However, the concept of proportionality has to be viewed, in this context, in light of the legislative history of Section 205(1) and the abuses against which the statute is designed to protect. Section 205(1) was adopted against a background of advisory fee arrangements that provided rewards for above index performance but no, or disproportionately small, penalities for below index performance. Such arrangements were viewed as manifestly unfair to investors, both by their terms and by the incentive they provide the investment adviser to take undue risks with investors' money.

By contrast, the fee arrangement contemplated by the Agreement should be considered "proportionate" within the meaning of Section 205(1). Not only does it not provide greater rewards for above-index performance, it takes exactly the opposite position. Quest will be penalized twice as much for below index performance than it will be rewarded for comparable above index performance. Such an arrangement by its terms is fair to investors. The nature of the arrangement, and the fact that increases and decreases in the fee are limited, ensure that there is no incentive for Quest to take undue risks in its role as investment adviser to the Company.

Similarly, the provision that no advisory fee will be paid for any performance period in which the net asset value per share of the Company, after giving effect to reinvestment of dividends and other distributions, has declined is just another aspect of a fee which, although arguably decreasing "disproportionately" as the word is literally defined, is part of an advisory fee arrangement which is fair to investors, and will provide the adviser with no incentive to take the kind of undue risks with investors' money that Section 205(1) was enacted to prevent.

In summary, the legislative history of Section 205(1) of the Advisers Act indicates that the "proportionality" sought to be achieved by the statute was to protect investors from advisory fee arrangements which unfairly rewarded advisers at the expense of the investor. One example of a fair arrangement is one where increases and decreases around the index are equal. However, an advisory fee such as the one contemplated by the Agreement, which clearly does not unfairly benefit the adviser at the expense of investors, would seem to be "proportionate" for purposes of Section 205(1), and would therefore be a permitted advisory fee arrangement under the Advisers Act.

Based upon the foregoing, and in reliance on our opinion that the advisory fee arrangement outlined above is permissible under the Advisers Act, please confirm that the Division of Investment Management will not recommend that the Securities and Exchange Commission take any enforcement action against the Company or Quest if they enter into an agreement containing the advisory fee arrangement described above.

Please call the undersigned at (212) 903–7847 or Howard J. Kashner, Esq. at (212) 903–7803 if you have any questions or would like additional information.

Sincerely,

Howard R. Herman

INCOMING LETTER

November 17, 1986

Gerald Lins, Esq.
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Royce Value Trust, Inc.

Dear Mr. Lins:

Pursuant to our discussion, this is to supplement my letter to you dated November 12, 1986 concerning the advisory fee arrangement proposed to be entered into by Royce Value Trust, Inc. (the "Company") with its investment adviser, Quest Advisory Corp. ("Quest").

The November 12, 1986 letter indicated that for the first full eleven months, the monthly advisory fee would be a flat 1/12 of 1% of the Company's total net assets, without being adjusted for the Company's performance vis a vis the S & P 500 or for a decline in the net asset value per share of the Company. It has now been proposed to provide that the fee for the first eleven months be subject to adjustment in the same manner as set forth in the letter for all subsequent periods, with the amount of the fee (if any) payable in respect of the first twelve-month period not being paid until the end of such twelfth-month period. As we discussed, this change was made at the request of the staff of the Securities and Exchange Commission, and the analysis set forth in the November 12, 1986 letter applies with equal force to the advisory fee arrangement as modified.

Please call the undersigned at (212) 903–7847 or Howard J. Kashner, Esq. at (212) 903–7803 if you have any questions or would like additional information.

Sincerely,

Howard Herman