

**PUBLIC**

21 APR 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-147-CC  
Federated Investors  
File No. 132-3

Your letter of March 16, 1994 requests our assurance that we would not recommend enforcement action to the Commission under Section 17(a) of the Investment Company Act of 1940 (the "1940 Act") 1/ if certain registered investment companies distributed and administered by affiliates of Federated Investors (the "Funds") engage in the transactions described in your letter.

Each Fund is advised by a bank (or affiliated person of a bank), which also is a fiduciary of a common trust fund and/or collective investment fund ("Common Trust"). 2/ The Fund advisers have determined that it would be in the best interests of the Funds' shareholders for the Funds to acquire the assets of the Common Trusts. 3/ In this regard, you state that the proposed transactions would provide each Fund with additional assets consistent with its investment objective and policies, permit greater diversification, and contribute to economies of scale in the management of each Fund's assets. Consequently, the advisers propose to cause the Funds to purchase substantially all of the assets of the Common Trusts in exchange for Fund shares, which shares would be distributed to the participating trust accounts of the Common Trusts.

You represent that, except for the requirement that the transaction be a purchase or sale for cash, each proposed transaction will comply with all the requirements of Rule 17a-7 under the 1940 Act. 4/ Specifically, you state that (1) securities purchased or sold in the proposed transactions will be valued in accordance with each Fund's traditional

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- 1/ Section 17(a) generally prohibits affiliated persons of a registered investment company from selling securities to, or purchasing securities from, the investment company.
  - 2/ Telephone conversation with Matthew G. Maloney on Mar. 28, 1994.
  - 3/ The banks, as fiduciaries, have determined that it would be in the best interests of the Common Trusts for the Funds to acquire the assets of the Common Trusts.
  - 4/ Rule 17a-7 conditionally exempts from the prohibitions of Section 17(a) certain purchases and sales of securities between registered investment companies and certain affiliated persons, where the affiliation arises solely by reason of having a common investment adviser, common directors, and/or common officers.

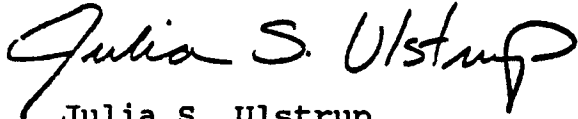
valuation methods used to calculate net asset value and, in particular, will be consistent with the requirements of Rule 17a-7(b); (2) the proposed transactions are consistent with the investment objective and policies of each Fund; (3) the proposed transactions will not involve payment of any brokerage commission, fee (other than customary transfer fees), or other remuneration; and (4) each Fund will comply with paragraphs (e) and (f) of Rule 17a-7 in connection with the proposed transactions. In addition, you represent that, other than the bank in its fiduciary capacity, no affiliated person of a Fund, or affiliated person of an affiliated person of the Fund, will have any beneficial interest in the Common Trust involved in the proposed transaction with the Fund.

On the basis of the facts and representations in your letter and without necessarily agreeing with your legal analysis, we would not recommend enforcement action to the Commission under Section 17(a) if the Funds engage in the transactions described in your letter. 5/ This response only expresses the Division's

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5/ See The First National Bank of Chicago (pub. avail. Sept. 22, 1992); The First National Bank of Chicago (pub. avail. Feb. 5, 1986); American National Medical Association Retirement Plan (pub. avail. Jan. 15, 1987); Lincoln National Investment Management Company (pub. avail. Apr. 25, 1976).

position on enforcement action and does not purport to express any legal conclusions on the questions presented. 6/



Julia S. Ulstrup  
Senior Counsel

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6/ In The First National Bank of Chicago (pub. avail. Sept. 22, 1992), the staff, because of conflict-of-interest concerns, conditioned a similar grant of relief under Section 17(a) on an undertaking from a fund's adviser that it would follow certain procedures when it had the authority to vote fund shares held in a fiduciary capacity. While we remain concerned about potential conflicts of interest when an adviser can control the voting of fund shares, we have reconsidered our position. Because the proposed transaction itself does not require the adviser to vote fund shares, we have not conditioned Federated Investors' no-action relief on this type of undertaking, and will not do so in response to future requests for substantially similar relief. We note, however, that, if a fund's adviser is a fiduciary for an employee benefit plan, Section 406(b) of the Employee Retirement Income Security Act of 1974, as amended, may prohibit the fiduciary from voting any fund shares owned by the plan on a matter in which the fiduciary has an interest (e.g., approval of the advisory contract). Section 406(b) prohibits a plan fiduciary from dealing with the assets of the plan in its own interest.

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DIRECT DIAL  
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March 16, 1994

1940 Act/17(a)

Office of Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

ACT ICA § 1940  
SECTION \_\_\_\_\_  
RULE 17a-7  
PUBLIC \_\_\_\_\_  
AVAILABILITY 4/21/94

Ladies and Gentlemen:

On behalf of the registered investment companies (the "Funds") advised and/or distributed by affiliates of Federated Investors ("Federated"), we respectfully request that the Staff of the Division of Investment Management confirm that it will not recommend enforcement action to the Securities and Exchange Commission (the "SEC") under Section 17(a) of the Investment Company Act of 1940 (the "1940 Act") with respect to the transactions described below. This letter supersedes our prior correspondence with the Staff dated September 17, 1992, March 25, 1993, August 9, 1993 and October 29, 1993 and reflects the series of discussions we have had telephonically with various members of the Staff since the date of our original submission in September 1992.

## Facts

The Funds are management investment companies. Certain of the Funds are advised by a bank or affiliated persons of a bank and distributed and administered by affiliates of Federated (collectively, "Private Label Funds"). In a number of cases, a bank which serves as investment adviser to a Private Label Fund maintains a common trust fund and/or a commingled investment fund (the "Common Trust") established under applicable state or federal laws for the commingled investment of securities held by the bank in its fiduciary capacity.

At the present time, the investment advisers and Funds listed on Exhibit A hereto are considering engaging in the transactions described below. As confirmed in the telephone conversation of October 14, 1992, however, we specifically request that the requested relief be made available not only to these Funds and advisers but to all other existing and to-be-established Private Label Funds which from time to time propose to engage in transactions of the character described

herein subject, of course, to compliance with the conditions described herein.

Proposed Transaction

In their capacities as investment advisers to one or more Private Label Funds and fiduciaries with respect to one or more Common Trusts, a number of banks have determined that it would be in the best interests of both the Private Label Fund and the Common Trust for the Private Label Fund to purchase substantially all of the assets held by the Common Trust. The bank has determined that ownership by the Private Label Fund of the assets held by the Common Trust would be consistent with the investment objective and policies of the Private Label Fund, and would be in the best interests of its shareholders. In addition, the transaction would be effected in accordance with, and pursuant to, procedures approved by the Private Label Fund's Board of Directors or Trustees which are designed to ensure substantial compliance with Rule 17a-7.

Accordingly, the bank proposes to cause the Private Label Fund to acquire substantially all the assets of the Common Trust, and the Private Label Fund simultaneously proposes to issue to the Common Trust shares of the Private Label Fund which immediately thereafter would be distributed to the participating trust accounts of the Common Trust. The aggregate net asset value of Private Label Fund shares issued to the Common Trust would be equal in value to the total fair market value of the assets acquired by the Private Label Fund. Securities purchased or sold in the proposed transaction would be valued in accordance with the Private Label Fund's traditional valuation methods used to calculate net asset value and, in particular, would be consistent with the requirements of Rule 17a-7(b). As fiduciary for the Common Trust and all fiduciary accounts participating therein, the bank has determined that it has the power and authority to engage in the proposed transaction, and would comply with all obligations imposed upon it by applicable fiduciary laws.

The proposed transactions would not involve payment of any brokerage commission, fee (other than customary transfer fees), or other remuneration. Except for the requirement that the transaction be a purchase or sale for no consideration other than cash, the proposed transactions would comply with the requirements of Rule 17a-7 and would be subject to the procedures adopted by the Private Label Fund's Board of Directors or Trustees to ensure compliance with the requirements of Rule 17a-7. Other than the bank, no person who is an affiliated person of the Private Label Fund, or an affiliated person of an affiliated person of the Private Label Fund, within the meaning

of Section 2(a)(3) of the 1940 Act would have a beneficial interest in the proposed transaction.

Both the bank and the Private Label Fund desire to consummate the proposed transaction because it would provide the Private Label Fund with additional assets consistent with its investment objective and policies, permit greater diversification and contribute to economies of scale in the management of the Private Label Fund's assets, which will benefit existing shareholders of the Private Label Fund.

#### Legal Considerations

Section 17(a)(1) of the 1940 Act states that "[i]t shall be unlawful for any affiliated person \* \* \* of \* \* \* a registered investment company \* \* \* or any affiliated person of such a person \* \* \* acting as principal \* \* \* knowingly to sell any security or other property to such registered investment company \* \* \*." The bank is an affiliated person of the Private Label Fund by virtue of being its investment adviser,<sup>1</sup> and also would be deemed to be an affiliated person of the Common Trust by virtue of the control it exercises over it as trustee.<sup>2</sup> Since the Common Trust itself proposes to sell securities to the Private Label Fund, and the Private Label Fund proposes to purchase such securities from the Common Trust, it may be argued that an affiliated person, or an affiliated person of an affiliated person, of the Private Label Fund, acting as principal, proposes to sell securities to the Private Label Fund and that such transaction would violate Section 17(a).

The SEC has previously determined, however, that certain transactions which involve the purchase or sale of securities by a registered investment company from another person which is an affiliated person, or affiliated person of an affiliated person, of such an investment company, solely by reason of having common investment advisers, directors or officers do not necessarily give rise to the concerns underlying Section 17(a) of the 1940 Act and may be effected without exemptive relief provided certain safeguards are in place to prevent the abuses designed to be prevented by Section 17(a). Thus, for example, Rule 17a-7

<sup>1</sup> Section 2(a)(3)(E) of the 1940 Act defines an "affiliated person" of another person as "if such other person is an investment company, any investment adviser thereof, or any member of an advisory board thereof."

<sup>2</sup> Section 2(a)(3)(C) of the 1940 Act defines an "affiliated person" of another person as "any person directly or indirectly controlling, controlled by, or under common control with, such other person."

permits the purchase or sale of securities between an investment company and another investment company or other account advised by the same (or affiliated) investment adviser provided the conditions set forth in the rule are met.

Rule 17a-7 states that a "purchase or sale transaction \* \* \* between a registered investment company \* \* \* and a person which is an affiliated person of such registered investment company (or affiliated person of such person) solely by reason of having a common investment advisor \* \* \* is exempt from Section 17(a) of the Act" provided that certain enumerated conditions are met. As indicated in the above description of the proposed transaction, sections (b)-(f) of Rule 17a-7 will be satisfied by the transaction participants.

Rule 17a-7 exempts transactions involving affiliation solely by virtue of having a common investment adviser. Although the Bank is technically not an investment adviser to the Common Trust, its position as trustee with respect to the Common Trust and each of its participating fiduciary accounts is functionally equivalent to that of an investment adviser. As a practical matter, the bank, as fiduciary, manages the investment and reinvestment of the Common Trust's assets in the same manner as an investment adviser provides advisory services to an investment company. Consequently, the bank effectively serves as investment adviser to both the Private Label Fund and the Common Trust.

As structured, the requirement of Rule 17a-7(a) that cash be the sole consideration for the proposed purchase or sale would not be met. As proposed, the Private Label Fund would not pay cash for the assets of the Common Trust, but instead would issue Private Label Fund shares to the Common Trust in an aggregate amount equal to the net asset value of the cash and securities acquired, which shares would then be distributed by the Common Trust to its participants.

The absence of cash consideration has not precluded the staff from granting no-action relief in the past to similar transactions. For example, in Trustfunds Institutional Managed Trust (pub. avail. July 20, 1988), a transaction was proposed wherein two portfolios of a registered investment company would enter into a purchase and sale of securities. The transaction contemplated that the shareholders of one portfolio would "redeem" their shares and purchase shares of the other portfolio. Rather than receive cash from the first portfolio, however, it was proposed that the second portfolio issue its shares to the first portfolio's shareholders. Simultaneously, the second portfolio would acquire the portfolio securities with the shares treated as the consideration for such purchase. No cash changed hands.

Trustfunds Institutional Managed Trust argued that the proposed transaction was "encompassed" by Rule 17a-7 and within the exemption. No-action relief was granted by the Commission. No-action positions were granted on similar facts in The First National Bank of Chicago (pub. avail. Sept. 22, 1992), American Medical Association (pub. avail. Jan. 15, 1987), Metropolitan Series Fund, Incorporated (pub. avail. Aug. 29, 1986), and Cash Accumulation Trust (pub. avail. Nov. 30, 1984).

The common theme underlying the Staff's analysis in various no-action relief granted in reliance on Rule 17a-7 appears to be to focus on whether an affiliated person of the registered investment company or its investment adviser participates in and benefits directly from the transaction. In at least three no-action letters, the Staff conditioned the grant of relief on a requirement that no affiliated person of the participating investment company would have any beneficial interest in the account or fund selling securities to the registered investment company. See The First National Bank of Chicago (pub. avail. Feb. 5, 1986), American Medical Association (pub. avail. Jan. 15, 1987), and Lincoln National Investment Management Company (pub. avail. April 25, 1976). As stated above, no affiliated person of the Private Label Fund, other than the bank in its fiduciary capacity, would have any interest in the Common Trust.

The proposed transaction is consistent with Staff concerns as evidenced in no-action relief previously granted under Rule 17a-7. In addition, no-action relief granted under Rule 17a-7 demonstrate that failure to comply literally with the cash requirement of Rule 17a-7(a) is not fatal.

In a series of conversations with the undersigned since the date of our original submission, the Staff have articulated a view that any request for no-action relief should be conditioned upon an undertaking by the adviser to a Fund that such adviser, or any affiliate thereof which possesses voting rights in respect of Fund shares issued in a transaction described above, agree either to pass through such voting rights to a co-fiduciary or beneficiary or vote all such shares pro rata in a manner consistent with voting of other shares of the Fund for which the bank does not possess such voting rights. As indicated in our discussions, we believe that such a condition would be inappropriate and unnecessary.

#### Conclusion

The conditions of Rule 17a-7 were designed to safeguard the interests of investment company shareholders. An SEC Release indicates that the conditions were intended "to limit the

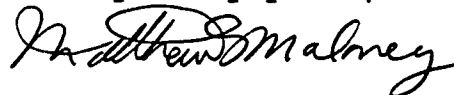


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exemption to those situations where the Commission, upon the basis of its experience, considers that there is no likelihood of overreaching of the investment companies participating in the transaction." Investment Company Act Release No. 4604, 31 Fed. Reg. 7913 (June 3, 1966). By substantially complying with the conditions of Rule 17a-7, the interests of the Private Label Fund shareholders are protected. Previous no-action relief granted under Rule 17a-7 demonstrates that compliance with the cash requirement of the Rule is not essential for the protection of the shareholders.

Accordingly, we respectfully request that the staff advise us that it will not recommend any enforcement action to the SEC if a Private Label Fund engages in the proposed transaction as described herein in reliance upon Rule 17a-7, subject to compliance by the Private Label Fund with all of the requirements of Rule 17a-7 except for the cash requirement of Rule 17a-7(a). If the Staff intends to issue a response that is adverse to this request, we respectfully further request the opportunity to have a conference prior to the issuance of such response. If you have any questions regarding this request, please contact the undersigned at (202) 828-2218.

Very truly yours,



Matthew G. Maloney

MGM/kld

cc: Julia Ulstrup

Exhibit A

Investment Adviser: Deposit Guaranty National Bank  
Fund: DG Investor Series

Investment Adviser: First Alabama Bank  
Fund: First Priority Funds

Investment Adviser: Mark Twain Bank  
Fund: Mark Twain Funds