PUBLIC

JAN 10 1997

Our Ref. No. 96-237-CC
Lazard Freres Asset
Management
File No. 801-65681

RESPONSE OF THE OFFICE OF CHIEF COUNSEL,
DIVISION OF INVESTMENT MANAGEMENT

By letter dated January 10, 1997, you request assurance that we would not recommend enforcement action to the Commission under Section 12(d)(1)(F) of the Investment Company Act of 1940 (the "Investment Company Act") if the Emerging World Funds Portfolio, a newly formed series of The Lazard Funds, Inc. (the "Lazard Funds") and the TIFF Emerging Markets Fund (together with the Emerging World Funds Portfolio, the "Portfolios"), a series of the TIFF Investment Program, Inc. ("TIP"), do not aggregate, for purposes of Section 12(d)(1)(F), their purchases of the stock of offshore investment companies not registered in the United States ("Foreign Funds") with the stock of Foreign Funds owned or acquired by certain private accounts (the "Private Accounts") managed by Lazard Freres Asset Management ("LFAM"), a registered investment adviser.

The Lazard Funds and TIP are investment companies registered under the Investment Company Act. The Portfolios are managed by LFAM and intend to invest primarily in the securities of Foreign Funds in reliance on Section 12(d)(1)(F) of the Investment Company Act.[1] The Private Accounts have investment objectives similar to those of the Emerging World Funds Portfolio and currently invest in Foreign Funds. You state that, at present, the Private Accounts collectively own in excess of 3% of the outstanding stock of a number of Foreign Funds. You maintain that if the Portfolios and the Private Accounts are deemed to be affiliated persons by virtue of having a common investment adviser,[2] the Portfolios'

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1 Section 12(d)(1)(A) limits the ability of a registered investment company to acquire the securities of other investment companies (whether registered or unregistered). Section 12(d)(1)(F) provides an exception from the limitations of Section 12(d)(1)(A) with respect to securities purchased or otherwise acquired by a registered investment company, provided that, among other things, (i) the registered investment company and all its affiliated persons own no more than 3% of the total outstanding stock of the acquired investment company; and (ii) the registered investment company does not offer or sell its shares to the public at a public offering price that includes a sales load of more than 1-1/2%. No acquired investment company is obligated to redeem the securities held by a registered investment company relying Section 12(d)(1)(F) in an amount exceeding 1% of its outstanding securities during any period of less than thirty days.

2 The definition of "affiliated person" set forth in Section 2(a)(3) of the Investment Company Act includes any person under common control with another person. Section 2(a)(9) defines control as "the power to exercise a
(continued...)

ability to invest in some or all of the Foreign Funds whose securities are held by the Private Accounts would be limited or prohibited. You seek limited relief from Section 12(d)(1)(F) so that the stock of Foreign Funds held by the Private Accounts need not be aggregated with the stock of Foreign Funds held by the Portfolios for purposes of the 3% limitation imposed by Section 12(d)(1)(F)(i).[3]

Analysis

You state that Congress adopted the 3% restriction of Section 12(d)(1)(F)(i) to address the concern that the top-tier fund in a fund-of-funds structure may have the ability to exercise control over the acquired fund, to the detriment of the acquired fund's other shareholders.[4] By requiring the aggregation of the holdings of a top-tier fund with those of its affiliated persons, Section 12(d)(1)(F)(i) limits the ability of a person to acquire a controlling interest

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[2](...continued)

controlling influence over the management and policies of a company." While, in some circumstances, the nature of an advisory relationship may give an adviser control over its client's management or policies, whether an investment company and another entity are under "common control" by virtue of having a common investment adviser is a factual question that the staff will not address in the context of a no-action request. See FundTrust (pub. avail. Apr. 24, 1987) (declining to address request for no-action relief under Section 12(d)(1)(F)); see also Investment Company Act Release No. 4697 (Sept. 8, 1966) (adopting Rule 17a-7) ("affiliation based on control would depend on the facts of the given situation, including such factors as extensive interlocks of officers, directors or key personnel, common investment advisers or underwriters, etc."). For purposes of this letter, however, the Private Accounts and the Portfolios are presumed to be affiliated persons.

[3] We note that you represent that LFAM will treat all Private Accounts in which LFAM or any entity that controls LFAM, is controlled by LFAM or is under common control with LFAM has a proprietary investment interest, other than as a general partner whose interest is only to the extent necessary to enable the Private Account to qualify as a partnership for Federal tax purposes, as an affiliated person of the Portfolios for purposes of Section 12(d)(1)(F)(i).

[4] See S. Rep. No. 184, 91st Cong., 1st Sess. 29-31 (1969); H.Rep. No. 1382, 91st, Cong, 2d Sess. 10-11, 23-24 (1970); see also Securities and Exchange Commission, Public Policy Implications of the Investment Company Growth (1966) at 315 (providing recommendations to Congress for amending Section 12(d)(1) of the Investment Company Act).

in an acquired fund by purchasing the acquired fund's securities through several affiliated top-tier funds.

You maintain that when the acquired fund is a Foreign Fund, however, aggregation of a top-tier fund's holdings with those of an affiliated unregistered fund or other private account does not serve the purpose of the 3% restriction. Aggregation in this context merely frustrates the ability of both funds to achieve fully their objectives.

Because Section 12(d) of the Investment Company Act does not prohibit an unregistered investment company or other unregulated entity from acquiring more than 3% of the stock of another unregistered investment company, the Private Accounts currently are not limited in the amount of securities of Foreign Funds that they may acquire.[5] Requiring the aggregation of the Private Accounts' stock holdings of a Foreign Fund with those of the Portfolios for purposes of the 3% restriction will not, therefore, prevent the Private Accounts from acquiring a controlling interest in the Foreign Fund. Rather, you state that as a practical matter, such aggregation will simply prevent the Portfolios from acquiring any interest in the Foreign Fund. Similarly, permitting the Portfolios to acquire a 3% interest in a Foreign Fund over and above the interest held by the Private Accounts will have no effect on the ability of the Private Accounts to acquire a controlling interest in the Foreign Fund, because, as noted above, the Private Accounts may already do so.

We would not recommend that the Commission take any enforcement action under Section 12(d)(1) if LFAM excludes the stock of the Foreign Funds held by the Private Accounts when calculating compliance by the Portfolios with the 3% limitation imposed by Section 12(d)(1)(F)(i). Our position is based on the facts and representations in your letter, in particular your representations that (1) the Foreign Funds are offshore funds that are not required to register with the Commission under the Investment Company Act; and (2) the stock of the Foreign Funds held by the Portfolios and Private Accounts in which LFAM or any entity that controls LFAM, is controlled by LFAM or is under common control with LFAM has a proprietary interest, other than as a general partner whose interest is only to the extent necessary to enable the Private Account to qualify as a partnership for Federal tax purposes, will be aggregated for purposes of the 3% limitation imposed by Section 12(d)(1)(F).[6] Different facts or representations may require a different conclusion. Further,

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[5] The language and legislative history of Section 12(d)(1)(F) indicate that Congress was primarily concerned with the effect of the pyramiding of control in a fund-of-funds arrangement on underlying registered investment companies. Id.

[6] We note that if the Private Accounts were managed in a manner that would require them to be registered under the Investment Company Act, the stock of the Foreign Funds held by the Private Accounts would be subject to (continued...)

this response expresses the Division's position on enforcement action only, and does not purport to express any legal conclusions on the questions presented.[7]

Phillip S. Gillespie
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Phillip S. Gillespie
Senior Counsel

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[6](...continued)
aggregation under Section 12(d)(1)(F). See In Re Clark Lanzen Skalla Investment Firm, et al., Investment Advisers Act Release No. 1501 (June 16, 1995) (finding investment program holding clients' assets in an omnibus account and investing assets in an identical manner to be an unregistered investment company); Investment Company Act Release No. 21260 (July 27, 1995) (reproposing Rule 3a-4).

[7] We recognize that under Section 12(d)(1)(F), a Foreign Fund is not obligated to redeem securities held by the Portfolios in an amount exceeding 1% of its outstanding securities during any period of less than thirty days, while redemptions by the Private Accounts are not similarly restricted. Section 206 of the Investment Advisers Act of 1940, however, obligates LFAM to exercise its redemption rights on behalf of all of its clients in a manner that does not advantage one client at the expense of another. Accordingly, Section 206 may restrict the ability of LFAM to effect a redemption of Foreign Fund shares on behalf of the Private Accounts if doing so would harm the interests of one of the Portfolios. See, e.g., In Re Kemper Financial Services, Inc., Investment Company Act Release No. 1387 (Oct. 20, 1993) (finding allocation of trades and investment decisions between accounts untimely and inequitable); see also, SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) (holding that Advisers Act Section 206 imposes a fiduciary duty on investment advisers).

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ACT ICA
SECTION 12(d)(1)(F)
RULE
PUBLIC AVAILABILITY 1/10/97

212 806 5400
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1940 Act; Section 12(d)(1)(F)

January 10, 1997

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

Ladies and Gentlemen:

On behalf of our client, Lazard Freres Asset Management ("LFAM"), we request confirmation that the Division would not recommend enforcement action to the Commission if, under the circumstances described herein, the Emerging World Funds Portfolio (the "Emerging World Portfolio"), a newly-formed series of The Lazard Funds, Inc. (the "Lazard Funds"), and the TIFF Emerging Markets Fund (the "TIFF Portfolio" and, together with the Emerging World Portfolio, the "Portfolios"), a series of TIFF Investment Program, Inc. ("TIP"), did not aggregate their purchases of securities of off-shore funds not registered in the United States ("Foreign Funds") with those by certain unregulated accounts managed by LFAM for purposes of calculating the 3% limitation (the "3% limitation") under Section 12(d)(1)(F) of the Investment Company Act of 1940, as amended (the "1940 Act").

As more fully described below, the Portfolios, subject to certain limitations, may purchase in the aggregate up to 3% of the securities of other investment companies, registered or unregistered.[1] LFAM's unregulated accounts may purchase, without limitation, securities of unregistered investment companies. Because LFAM advises both the Portfolios and these accounts an anomaly results--the otherwise permitted activities

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[1] For purposes of the requested relief only, LFAM agrees to treat each Portfolio as an affiliated person of the other for purposes of Section 12(d)(1)(F)(i).

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of both would be limited and, significantly, for the Portfolios, their ability to purchase in the aggregate 3% of the securities of one or more Foreign Funds would be eroded.

The Portfolios and Unregulated Accounts.

Both the Lazard Funds and TIP are registered investment companies under the 1940 Act. The Lazard Funds have engaged LFAM to act as each of its series' investment adviser. The TIFF Portfolio has engaged LFAM to manage a portion of its assets.[2]

The Emerging World Portfolio will invest primarily in securities of Foreign Funds which in turn invest in securities of emerging market issuers. As respects its assets advised by LFAM, the TIFF Portfolio will invest primarily in securities of these Foreign Funds. The securities of the Foreign Funds in which the Portfolios will invest will be listed principally on recognized international exchanges or traded in recognized international markets.

For more than 10 years, LFAM has advised clients in the purchase of the types of securities in which the Portfolios propose to invest. These clients currently include institutional investors, such as pension plans of major U.S. corporations and state teachers' retirement plans, none of which are required to register under the 1940 Act (collectively, "Unregulated Accounts"), as well as private accounts with respect to which LFAM does not have discretionary investment authority and certain other series of the Lazard Funds. The Unregulated Accounts have investment objectives substantially similar to the Emerging World Portfolio's objective.

As of January 31, 1996, Unregulated Accounts had approximately $625 million in aggregate net assets and invested in over 168 funds, including 24 registered in the United States. Each Unregulated Account separately invests in approximately 60 funds. As of such date, with respect to 33 of the 168 funds, the aggregate investment in each such fund by Unregulated Accounts was over 3% of the total outstanding stock of the fund. The Unregulated Accounts are not subject to the limitations on investing in the securities of investment companies set forth in Section 12(d)(1)(F) of the 1940 Act.

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2 LFAM believes that the issues discussed herein arise as to the TIFF Portfolio only as respects the portion of its assets LFAM advises and the discussion herein about the TIFF Portfolio pertains only to LFAM's activities on its behalf.

Section 12(d)(1)(F) of the 1940 Act, among other things, prohibits a registered investment company ("RIC") from purchasing or otherwise acquiring securities of other investment companies (whether or not registered) if immediately thereafter more than 3% of the total outstanding stock of such issuer is owned by such RIC and all affiliated persons of the RIC. If the Portfolios and the Unregulated Accounts were deemed to be affiliates because LFAM advises both, and the 3% limitation were applied to both the Portfolios and the Unregulated Accounts, then each Portfolio's ability to invest in some or all of the Foreign Funds whose securities are held by the Unregulated Accounts would be limited or prohibited. For the reasons set forth herein, we believe that such a restrictive interpretation of the 3% limitation is not necessary to protect the interests of the shareholders of either Portfolio. Accordingly, LFAM is requesting limited relief for each Portfolio from Section 12(d)(1)(F) so that, as applied to holdings in the Foreign Funds, the holdings of the Unregulated Accounts need not be aggregated with each Portfolio's for purposes of the 3% limitation.[3]

Section 12(d)(1) Historical Perspective.

The present restrictions in Section 12(d)(1) and the exception from those restrictions afforded by Section 12(d)(1)(F) were enacted in 1970 as part of the Investment Company Amendments Act of 1970. Those amendments resulted from recommendations made by the Commission in its 1966 Report, Public Policy Implications of Investment Company Growth (the "Report"). Before these amendments, Section 12(d)(1) prohibited a RIC from purchasing more than 5% of the total outstanding voting stock of any other investment company which concentrated its investments in a particular industry or group of industries, or more than 3% of the total outstanding voting securities of any other type of investment company.

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[3] For purposes of the requested relief only, LFAM agrees to treat Unregulated Accounts in which LFAM or any entity that controls LFAM, is controlled by LFAM or is under common control with LFAM has a proprietary investment interest, other than as a general partner whose interest is only to the extent necessary to enable the Unregulated Account to qualify as a partnership for Federal tax purposes, as an affiliated person of the Portfolios for purposes of Section 12(d)(1)(F)(i).

The Report's discussion of Section 12(d)(1) evidenced principally a concern for protecting U.S. registered open-end investment companies and their shareholders. It focused almost exclusively on a number of unregistered, foreign-based fund holding companies which invested without limitation in RICs. The Report expressed concern that unregulated pyramiding of investment companies would provide, for those in control at the top of the pyramid, an element of power and domination over funds further down the pyramid. Such a holding company's existence as a substantial mutual fund shareholder might subvert the investment policies of the subsidiary RIC; for example, the RIC would have to leave a high percentage of its assets in liquid investments to meet the possibility of a substantial redemption demand.

In addition, the threat of large scale redemptions would allow fund holding companies to exercise undue influence over the RICs in which they invested, at the expense of the mutual fund's other shareholders.[4] In the Commission's view:

> An unregistered foreign based fund holding company, free of any statutory limitation on the percentage of the outstanding stock of mutual funds which it may purchase for its portfolio, can acquire very substantial or even controlling interests in its portfolio funds....The managements of portfolio funds in such circumstances must be continually aware that a possible large redemption carries with it a loss of advisory fees in approximate proportion to the percentage of the fund redeemed....Further, to the extent that managements of the portfolio funds derive income from brokerage transactions for their funds, redemption and the corresponding restriction in net assets would also decrease the opportunity to realize such income in the future.[5]

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4 The Report at 315 (citing the 1940 Act: "'The national public interest and the interest of investors are adversely affected when investment companies are organized and operated...in the interest of other investment companies...rather than in the interest of all classes of such companies' securities holders, or when control of investment companies is unduly concentrated through pyramiding or inequitable methods of control.'")

5 Id.

The Report also expressed the Commission's concerns for the layering of costs and the utility of the fund holding company structure as an investment vehicle. The Report criticized the utility of a fund holding company by characterizing its diversification benefits as largely "illusory."[6]

The Commission concluded that "(i)n view of the excessive costs to investors . . .; the lack of utility and useful investment purpose of the fund holding company as an investment vehicle; and the very serious problems of control and influence over registered investment companies, their portfolio companies and the securities markets, which the redemption power in such companies creates, appropriate statutory protection must be provided."[7] The Commission recommended that the 1940 Act be amended to prohibit altogether the creation of investment company holding companies.[8] The 1967 proposed amendments to the 1940 Act followed this recommendation.[9] But, after considering the Commission's 1966 recommendations, Congress concluded in 1970 that it was possible to deal effectively with the abuses discussed by the Commission in the Report and to allow the creation and operation of domestic fund holding companies under limited circumstances, which for purposes of our discussion are embodied in Section 12(d)(1)(F).

Discussion.

A RIC complying with the three conditions--the 3% limitation, the 1-1/2% sales load limitation and the 1% redemption limitation--of Section 12(d)(1)(F) may pyramid investment vehicles and invest 100% of its assets in securities issued by investment companies. The reason is that Section 12(d)(1)(F)

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6 Id. at 320.

7 Id. at 323.

8 Id. ("The Commission therefore recommends that section 12(d)(1) of the [1940] Act be amended so as to prevent the creation and operation of fund holding companies." The Commission, however, suggested that the prohibition should not cover foreign-based unregistered unit trusts organized by domestic investment companies in order to provide foreign investors with a vehicle to invest in domestic registered funds without the problem posed by U.S. estate tax. Id. at n.43); see generally, id. at 311-324.

9 Hearings on S. 1659 Before the Sen. Comm. on Banking and Currency, 90th Cong., 1st Sess. pt. 1 at 43 (1967) (statement of SEC Chairman Manuel F. Cohen).

substantially addresses the concerns that led to the 1970 amendments of Section 12(d)(1).

First, the exception from the provisions of Section 12(d)(1) provided by Section 12(d)(1)(F) is available only to RICs, thereby addressing the concern that unregistered funds could acquire substantial or even controlling interests in domestic mutual funds.

Second, the 1-1/2% sales load limitation addresses the concern about layering of costs. Apart from the general language of Section 36(b), Congress did not deem it necessary to address specifically the issue of layering advisory fees.

Third, the 1% redemption limitation addresses the concern of substantial forced redemptions.

Significantly, although Congress deemed it appropriate to limit (i) in Section 123(d)(1)(A), a RIC's purchase of both registered and unregistered investment companies and (ii) in Section 12(d)(1)(B), sales by a RIC to both registered and unregistered investment companies, no provision of the 1940 Act limits in this manner purchases by unregistered investment companies of securities issued by unregistered investment companies. Thus, the Unregulated Accounts currently are not restricted in their purchases of the Foreign Funds.

Also, Congress has deemed permissible the investment by a RIC, such as the Portfolio, of 100% of its assets in investment companies of all manner[10] and the control by a RIC of up to 3% of any investment company's voting securities.[11] However, because LFAM advises both the Portfolios and the Unregulated Accounts, the aggregation provisions of Section 12(d)(1)(F) may restrict both groups of entities and may frustrate their ability to achieve fully their objectives by imposing the 3% limitation on their combined activities.

To avoid this result, LFAM seeks confirmation that the Division would not recommend enforcement action to the Commission if the Portfolios did not aggregate their purchases of shares of Foreign Funds with those by the Unregulated Accounts. In all other respects, each Portfolio's purchases of the securities of investment companies would continue to be subject to the limitations set forth in Section 12(d)(1)(F) of the 1940 Act.

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[10] Section 12(d)(1)(F) of the 1940 Act.

[11] Section 12(d)(1)(F)(i) of the 1940 Act.

Should members of the Staff require any additional information or have any questions or comments regarding this letter, please telephone Stuart H. Coleman at (212) 806-6049 or David Stephens at (212) 806-6138.

Very truly yours,

Stroock & Stroock & Lavan

STROOCK & STROOCK & LAVAN