

**PUBLIC**

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SECTION 3(c)(10) 202(a)(11), 203(c)  
RULE \_\_\_\_\_  
PUBLIC  
AVAILABILITY 4/3/98

April 3, 1998  
Our Ref. No. 97-522-CC  
Daughters of Charity  
National Health System, Inc.  
RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT File No. 132-3

Your letter of March 20, 1998 requests assurance that the staff would not recommend enforcement action to the Commission if the Daughters of Charity National Health System, Inc. ("DCNHS") expands the categories of institutions that may participate in DCNHS's cash management system and investment program (together, the "Health System Depository") and reallocates certain expenses relating to the Health System Depository among participants in the depository without: (1) registering DCNHS or the Health System Depository as an investment company in reliance on Section 3(c)(10) of the Investment Company Act of 1940 (the "Investment Company Act"); (2) registering DCNHS as an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act"); (3) registering interests in the Health System Depository under the Securities Act of 1933 (the "Securities Act") or the Securities Exchange Act of 1934 (the "Exchange Act") in reliance on Section 3(a)(4) of the Securities Act and Section 12(g)(2)(D) of the Exchange Act; or (4) registering DCNHS or the Health System Depository as a broker or dealer under Section 15(b) of the Exchange Act.

#### Facts

You represent that DCNHS is a not-for-profit Roman Catholic organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code. DCNHS serves as a holding company for 33 wholly controlled and three 50% controlled subsidiaries that manage hospitals or other health care facilities ("Members"). 1/ You represent that each Member is a not-for-profit organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code.

DCNHS offers its Members access to certain services including insurance, purchasing services, auditing services, and the Health System Depository. You represent that DCNHS has established the Health System Depository to assist its Members in

1/ You represent that all of the wholly controlled subsidiaries are Roman Catholic health care organizations. You also represent that of the three subsidiaries that are 50% controlled by DCNHS, the remainder of control is held by a Baptist hospital, in one case, and by community-controlled hospitals in the other two cases. You state that each of these three subsidiaries has agreed to abide by the ethical and religious directives for Roman Catholic health care facilities.

managing their cash and investments. 2/ The Health System Depository consists of two components: a cash management system through which Members may pool excess daily cash balances from their checking accounts in a short-term investment fund (the "Short-Term Fund"), and an investment program through which Members may invest funds from other sources (including endowment funds and other funds not needed for daily operations) in the Short-Term Fund or in a longer-term investment fund (the "Long-Term Fund;" together with the Short-Term Fund, the "Funds"). You represent that a Member may invest in the Funds only those assets to which the Member has immediate, unrestricted, and exclusive use, benefit, and enjoyment. You further represent that none of the assets invested may be attributable to a retirement plan providing for employee contributions or variable benefits. In addition, you represent that no participant in the Health System Depository may assign, encumber, or transfer its interest in the Funds.

You represent that the board of directors of DCNHS has ultimate responsibility for setting the investment objectives of the investment program, but takes no part in implementing those objectives. Rather, DCNHS retains professional investment advisers registered under the Advisers Act to make day-to-day decisions regarding investment of the Funds' assets. 3/ You represent that the investment committee of the board of directors of DCNHS monitors the performance of the advisers and, if it determines that the performance of an adviser is unsatisfactory, will recommend to the board of directors that it replace the adviser. If the board of directors agrees with the recommendation, it would authorize the investment committee to make the recommended change. You state that third-party custodians hold the assets of the Funds. You represent that Members are informed that DCNHS is not registered as an investment adviser under the Advisers Act or as a broker-dealer under the Exchange Act, and that neither DCNHS nor the Health System Depository is registered as an investment company under the Investment Company Act.

Currently, the incidental expenses of administering the Health System Depository are charged to Members on a pro rata

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2/ You represent that the Health System Depository does not have a legal existence separate from that of DCNHS.

3/ You represent that these investment advisers will have no affiliation with DCNHS, its Members, or, as discussed below, any of its proposed non-Member participants. You further represent that all securities trades will be executed only by a bank, or a broker or dealer registered under the Exchange Act that is not affiliated with DCNHS, its Members, or any of its proposed non-Member participants.

basis according to assets invested. These expenses include investment management fees and office administration expenses for the division of DCNHS that administers the Health System Depository. 4/ You propose to modify this method of allocating expenses so that certain expenses of the Health System Depository will be allocated in part on a usage basis, rather than solely on the basis of assets invested. In addition, you propose that Members also pay overhead expenses relating to the Health System Depository.

You also propose to expand participation in the Health System Depository to include other not-for-profit health care organizations exempt from taxation under Section 501(c)(3) of the Internal Revenue Code. Specifically, you propose to add two general categories of non-Member participants: (1) entities that would utilize more than one service provided by DCNHS and would enter into a relationship with DCNHS for a period of more than one year ("Affiliates"); and (2) entities that would utilize only one of the services provided by DCNHS and would not necessarily enter into a long-term relationship with DCNHS ("Limited Service Participants"). You represent that each non-Member participant will be a Roman Catholic health care organization.

You further represent that assets invested by any non-Member participant, like those invested by Members, will be limited to assets to which the participant has immediate, unrestricted, and exclusive use, benefit, and enjoyment, and which are not attributable to a retirement plan providing for employee contributions or variable benefits. In addition, you represent that non-Member participants, like Members, will be informed that DCNHS is not registered as an investment adviser under the Advisers Act or as a broker-dealer under the Exchange Act, and that neither the Health System Depository nor DCNHS is registered as an investment company under the Investment Company Act.

You state that monthly financial reports and a quarterly newsletter containing financial reports are currently distributed to all Members and will be distributed to all non-Member participants. You represent that DCNHS is audited on an annual basis, and distributes audit reports to all participants in the Health System Depository.

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4/ You state that these expenses include salaries, benefits including health insurance, disability insurance, pension contributions and a tuition reimbursement plan, computer time, a portion of accounting expenses, and out-of-pocket expenses. You do not request relief, and we take no position, regarding whether the current allocation of these expenses among Members is consistent with DCNHS's opinion that it currently is not acting as an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act.

You represent that the activities of DCNHS and its officers, directors, and employees will comply with the requirements of Rule 3a4-1 under the Exchange Act, and that their activities will be limited to those permitted by paragraph (a)(4)(iii) of the rule. 5/ In particular, you represent that no representative or other associated person of DCNHS who communicates with participants in the Health System Depository will be subject to a statutory disqualification described in paragraph (a)(1) of the rule, and that no associated person of DCNHS will receive any transaction-based compensation. In addition, you represent that associated persons of DCNHS will limit their activities with respect to participants in the Health System Depository to ministerial and clerical matters, and preparation and delivery of written communications that have been approved by an officer of DCNHS.

You also represent that DCNHS will not solicit potential non-Member participants through general advertising or other broad-based solicitation methods. Rather, you represent that DCNHS will limit its solicitation of potential non-Member participants to other not-for-profit health care systems that are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code, have an existing relationship with DCNHS or one of its Members, and share the charitable goals of DCNHS.

#### Analysis

Based on the facts and representations in your letter, we would not recommend enforcement action to the Commission under Section 7(a) of the Investment Company Act if neither DCNHS nor the Health System Depository registers as an investment company in reliance on Section 3(c)(10)(A) of the Investment Company Act. 6/ Our position is based particularly on your representations that: (1) DCNHS and the Health System Depository will be organized and operated, at all times, exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and no part of the net earnings of DCNHS or the Health System Depository will inure to the benefit of a private shareholder or individual; (2) only Members, Affiliates,

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5/ Rule 3a4-1 provides a safe harbor under which associated persons of an issuer will not be deemed to be brokers under the Exchange Act, provided that they limit their activities to those specified by the rule.

6/ Section 3(c)(10)(A) excepts from the definition of investment company "[a]ny company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . . ."

and Limited Service Participants may invest in the Funds; (3) each Member, Affiliate, and Limited Service Participant will be a Roman Catholic health care organization; 7/ (4) DCNHS and each participant in the Health System Depository will be exempt at all times from taxation under Section 501(c)(3) of the Internal Revenue Code; (5) each participant in the Health System Depository will invest only those assets to which it has immediate, unrestricted, and exclusive use, benefit, and enjoyment, and no participant may assign, encumber or otherwise transfer any part of its interest in the Health System Depository; (6) participants will not invest assets that are attributable to a retirement plan providing for employee contributions or variable benefits; (7) certified public accountants annually will prepare a written report on DCNHS and the Health System Depository, and will send the report to participants; and (8) each participant will be informed that neither DCNHS nor the Health System Depository is an investment company registered under the Investment Company Act. 8/

You assert that DCNHS is not an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act. Section 202(a)(11) provides, in relevant part, that an investment adviser is "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." We believe that DCNHS's activities with respect to setting the investment objectives of the investment program, choosing registered investment advisers to manage the Funds, monitoring the performance of these advisers, and replacing an adviser if the adviser's performance is unsatisfactory may constitute the provision of investment advice. 9/ Because DCNHS performs these functions on a regular basis, and receives compensation for such advice in the form of reimbursement for certain operating expenses, we believe that DCNHS may be

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7/ In the case of the partially controlled Members, each Member will be at least 50% controlled by DCNHS, and will agree to abide by the ethical and religious directives for Roman Catholic health care facilities.

8/ See, e.g., National Association of Congregational Christian Churches of the United States (pub. avail. Aug. 11, 1995); American Heart Association (pub. avail. Feb. 26, 1993).

9/ See Investment Advisers Act Release No. 1092 (Oct. 8, 1987) ("[a] person providing advice to a client as to the selection or retention of an investment manager . . . under certain circumstances, would be deemed to be 'advising' others within the meaning of Section 202(a)(11).").

considered an investment adviser within the meaning of Section 202(a)(11). 10/

We would not recommend enforcement action to the Commission, however, if DCNHS does not register as an investment adviser under the Advisers Act in reliance on Section 203(b)(4) of that Act. 11/ Our position is based on the facts and representations in your letter, particularly your representations that: (1) DCNHS is a charitable organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code; and (2) DCNHS will provide investment advice only to Members, Affiliates, and Limited Service Participants, all of which will be charitable organizations exempt from taxation under Section 501(c)(3) of the Internal Revenue Code.

The staff of the Division of Corporation Finance has asked us to tell you that, on the basis of the facts presented, noting in particular that: (1) the Health System Depository, as defined in your letter, does not have a separate legal status and is not a legal entity separate from DCNHS; (2) DCNHS, its Members and its Non-Member Participants, as each is defined in your letter, will at all times be organizations that are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code; (3) Non-Member Participants will be health care related entities or entities involved in a community-based network with current Members, and will meet the criteria set forth in your letter; (4) any monies invested in DCNHS by Members and Non-Member Participants must represent monies over which the Members and Non-Member Participants have immediate, unrestricted and exclusive use, benefit and enjoyment; (5) monies that are attributable to a retirement plan providing for employee contributions or variable benefits may not be invested in DCNHS; (6) all benefits, profits, and income generated from DCNHS will inure only to Members and Non-Member Participants and will be distributed exclusively to the Members or Non-Member

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10/ See id. (the compensation element of Section 202(a)(11) is satisfied by the receipt of "any economic benefit"); Northeastern Pennsylvania Synod of the Evangelical Lutheran Church in America (pub. avail. May 25, 1988) (reimbursement for expenses, including salaries, supplies, and office costs associated with investment program, may constitute "compensation" within the meaning of Section 202(a)(11)).

11/ Section 203(b)(4), in relevant part, exempts from registration under the Advisers Act any investment adviser that is a charitable organization as defined in Section 3(c)(10)(B) of the Investment Company Act and whose advice is provided only to other charitable organizations. Section 3(c)(10) defines a charitable organization to include an organization described in Section 501(c)(3) of the Internal Revenue Code.

Participants, as the case may be, and will be used solely for their tax-exempt purposes; (7) independent certified public accountants annually will prepare a written report on DCNHS's financial condition and performance, which will include audited annual financial statements of each of DCNHS and the Health System Depository and will be sent to Members and Non-Member Participants; and (8) Members and Non-Member Participants may not assign, encumber, or otherwise transfer any part of their interest in DCNHS; it will not recommend any enforcement action to the Commission if DCNHS, in reliance on your opinion as counsel that the exemptions afforded by Section 3(a)(4) of the Securities Act and Section 12(g)(2)(D) of the Exchange Act are available, implements the Health System Depository in the manner described without registration under the Securities Act and the Exchange Act.

The staff of the Division of Market Regulation has asked us to inform you that, based on the facts and representations in your letter, and strict adherence thereto by DCNHS and its officers, directors, and employees, it would not recommend enforcement action to the Commission under Section 15(a)(1) of the Exchange Act if DCNHS engages in the activities described in your letter without DCNHS, its officers, directors, or employees registering with the Commission as brokers or dealers under Section 15(b) of the Exchange Act.

In reaching this position, the staff of the Division of Market Regulation notes particularly your representations that, in connection with its communications to prospective participants in the Health System Depository, DCNHS, its officers, directors, and employees will comply with the requirements set forth in Rule 3a4-1 under the Exchange Act, and their activities will be limited to those permitted by paragraph (a)(4)(iii) of the rule. Consequently, among other things, those activities will not involve the oral solicitation of potential participants. In addition: (1) only qualified entities maintaining a relationship with DCNHS (as described in your letter) will be offered an opportunity to participate in the Health System Depository; (2) neither DCNHS, its affiliates, nor any of their officers, directors, or employees will receive any transaction-based compensation in connection with the establishment or operation of the Health System Depository; (3) neither DCNHS, its affiliates, nor any of their officers, directors, or employees engaging in any activities in connection with the Health System Depository will be an associated person of a broker-dealer; (4) neither DCNHS, its affiliates, nor any of their officers, directors, or employees will hold funds or securities in connection with the establishment or operation of the Health System Depository; (5) each transaction in the portfolio of securities held by the Health System Depository will be effected by a registered broker-dealer that will not be affiliated with DCNHS, its Members, its Affiliates, or the Limited Service Participants; and (6) all

investment decisions will be made by registered investment advisers that will have no affiliation with DCNHS or any of its Members, Affiliates, or Limited Service Participants.

Because these positions are based on the representations made in your letter, you should note that any different facts or circumstances may require different conclusions. Further, this letter expresses the positions of the Divisions of Corporation Finance and Market Regulation on enforcement action only and does not express any legal conclusions on the questions presented.

*Sarah Wagman*

Sarah A. Wagman  
Special Counsel



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1933 Act/3 (a) (4)  
1934 Act/12 (g) (2) (D);  
3 (a) (4);  
3 (a) (5);  
Company Act/3 (c) (10);  
Advisers Act/202 (a) (11);  
203 (b) (4)

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March 20, 1998

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Barry Mendelsohn, Esq.  
Paula Jensen, Esq.  
Sarah Wagman, Esq.  
Office of the Chief Counsel  
Division of Corporation Finance  
Division of Investment Management  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

Re: Daughters of Charity National Health System, Inc.

Dear Mr. Dunn, Mr. Mendelsohn, Ms. Jensen and Ms. Wagman:

Daughters of Charity National Health System, Inc. ("DCNHS"), a Missouri not-for-profit corporation, exempt from taxation under Section 501(c)(3) of the Internal Revenue Code (the "Tax Code") has authorized us to request a No-Action Letter from the staff of the Commission (the "Staff") regarding the applicability of the Securities Act of 1933, as amended (the "Securities Act"), the Exchange Act of 1934, as amended (the "Exchange Act"), the Investment Company Act of 1940, as amended (the "Investment Company Act"), and the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act"), to both the expansion of the categories of institutions permitted to participate in a cash management system (the "Cash Management System") and investment program (the "Investment Program") (collectively the "Health System Depository") provided by DCNHS, and a proposal to allocate certain expenses relating to the Health System Depository among participants in such Depository. At present, the Health System Depository is made available only to Members of DCNHS and it is proposed to extend its availability to Affiliates and Limited Services Participants (as such terms are hereinafter defined at pages 9-10).

## A. Factual Background

### 1. General

DCNHS is a not-for-profit corporation and serves as a holding company for thirty-three (33) wholly controlled but separate subsidiaries (the "Full Members") that manage or operate hospitals and other health care related organizations throughout the United States and three (3) similar operating organizations over which DCNHS exercises fifty percent (50%) control (the "Associate Members" and collectively with the Full Members, the "Members"). All Full Members of DCNHS are Roman Catholic health care organizations. The 50% control of the three Associate Members that does not rest in DCNHS, itself a Roman Catholic organization, is as follows: In one case, it is in a Baptist hospital and in the other two cases in community-controlled hospitals. However, both the Baptist and the community-controlled hospitals each have agreed to abide by the ethical and religious directives for Catholic health care facilities. Each of the thirty-six (36) Members is a not-for-profit organization exempt from taxation under Section 501(c)(3) of the Tax Code. DCNHS through its Board of Directors, the managing board (the "DCNHS Board" or the "Board"), creates the policies and operating procedures which govern the management of each of the Members. As all of the entities are not-for-profit, there is no equity or financial investment involved and therefore there can be no control stemming from a financial interest. With respect to the three (3) Associate Members, the decision making power is split equally between DCNHS and another entity. By analogy to a for-profit corporate context, thirty-three (33) of the thirty-six (36) Members, the Full Members, would be wholly-owned direct subsidiaries and the three Associate Members would be fifty percent (50%) owned.

DCNHS provides to its Members a variety of shared services which are designed to further the benevolent objectives of the Members by achieving, on their behalf, economies of scale. Such shared services include access to insurance, purchasing services, internal auditing, and the Health System Depository. The purpose of these services, including the Health System Depository, is to maximize the utilization of the Members' financial resources and produce greater efficiency in the Members' operations. This no-action request concerns the proposed expansion of the Health System Depository to offer certain services to other not-for-profit health care related participants that are not controlled by DCNHS. The request includes a proposal to allocate to the Members and proposed new participants certain expenses related to the Health System Depository.

The DCNHS Obligated Group (the "Obligated Group") provides an example of the benefits DCNHS can attain on behalf of its Members by uniting Members' resources and credit strengths with the result of furthering the Members' charitable mission that includes

providing the best health care services to the areas served at the most economical cost.<sup>1</sup> DCNHS, twenty-four (24) Full Members and 10 other entities, that are either an Associate Member or a subsidiary of an Associate Member, make up the thirty-five (35) Members of the Obligated Group. In September, 1997, DCNHS issued three series of bonds (the "Bonds") for the benefit of DCNHS and certain Members, which are participants in the Obligated Group (collectively, the "Borrowers"). Pursuant to a Master Trust Indenture, the Obligated Group has assumed financial obligations related to the payment of debt service with respect to the Bonds. The Obligated Group's combined cash and other investment assets as of June 30, 1997 totaled approximately \$1.7 billion, equal to one hundred seventy-four percent (174%) of the Obligated Group's outstanding long-term debt. Pursuant to the Master Trust Indenture, Members of the Obligated Group are jointly and severally obligated to make payments under the Loan Agreements relating to the Bonds.

The Master Trust Indenture imposes upon the Obligated Group a payment obligation that is simultaneous with that of the applicable Borrower for each bond series. The Obligated Group is treated as a single entity for financing purposes. Due to the simultaneous payment obligation, individual member hospitals which could not have obtained satisfactory financing, because of the nature of the credit risk they present, are able to obtain financing and on much more favorable terms. The Bonds have received "AA" ratings from Fitch and Standard and Poor's. Moody's has rate all such DCNHS transactions Aa since 1983. The hospitals most benefitted by this financing arrangement are those that serve patients with the greatest financial need and are often located in troubled communities.

Because of the combined financial power of the Obligated Group, the joint and several liability feature and the simultaneous payment obligation of the Obligated Group, the Borrower is able to borrow at terms much more favorable than any the member Borrower could achieve individually. In the event that a Borrower lacks funds to meet debt service obligations, the shortfall needed to meet the obligation is loaned to the Borrower by the Obligated Group. The Obligated Group exemplifies the overriding goal of DCNHS to utilize its Members' resources efficiently and for the maximum benefit of the individual Members. The Health System Depository similarly promotes Member goals by means of the combination of individual Member funds.

## 2. The Health System Depository

The Health System Depository is the system established by DCNHS to manage the cash of the Members employed in their day-to-day operations and to manage the investment of their assets. The Members' assets, including excess cash, are pooled for the purposes of investment, thereby achieving the benefits of professional money management, diversification

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<sup>1</sup> No relief is requested on account of any activities of the Obligated Group.

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and economies of scale. The Health System Depository does not have a separate legal status and is not a legal entity separate from DCNHS. Although the Health System Depository is audited separately from DCNHS for the information of its various participants, its operating results and balance sheet are also included in DCNHS' consolidated financial statements. Certain expenses of DCNHS that relate to the operation of the Health System Depository are charged to the Health System Depository. The Health System Depository operating statements separately break out and reflect those categories of expenses. The ability to pool the excess cash through a cash management program allows Members to act as a single entity with respect to cash management and investments. One of the underlying premises of the Health System Depository is that by combining the Members' excess working capital, the Members are able to participate in the benefits inherent in the management of larger sums of money, including: (i) access to professional money managers, (ii) reduction in proportionate costs of investing funds, (iii) maintenance of liquidity, (iv) availability of diversification greater investment and (v) ability to occasionally finance projects internally. The end result is the maximization of Members' resources for the promotion of the charitable purposes of the Members and the benefit of the local communities served by the Members.

The components of the Health System Depository are the Cash Management System and the Investment Program which are described in further detail below. Participants in the Cash Management System automatically participate in the Investment Program. Members may participate in the Investment Program without participating in the Cash Management System. Members have been informed that DCNHS is not registered as an investment adviser under the Investment Advisers Act or as a broker-dealer under the Exchange Act and that neither DCNHS nor the Health System Depository is registered as an investment company under the Investment Company Act.

(a) The Cash Management System

One of the two components of the Health System Depository is the Cash Management System, the role of which is to manage the operating cash of the Members and to keep it invested at all times. Under the Cash Management System, each Member maintains an individual checking account through a third-party bank. Currently that bank is Mellon Bank, in Pittsburgh, Pennsylvania. The checking account is the day-to-day operating account and it is utilized for both the deposit of income and donations generated by the Member and the payment of expenses that the Member incurs. It includes only assets to which the Member has immediate, unrestricted and exclusive use, benefit and enjoyment and does not include assets attributable to a retirement plan providing for employee contributions or variable annuities.

At the end of each day, if the net balance of any Member's individual checking account at Mellon Bank is positive, the balance is swept into a sweep account under DCNHS' control also at Mellon Bank (the "Sweep Account"), leaving the Member's checking account

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balance at zero for each day. If the aggregate net balance of the funds of all the various Members in the Sweep Account is positive at the end of the day, then the net balance is swept into a pooled investment fund, consisting of investments with an average maximum maturity of two-years (the "Short-Term Investment Fund") and managed by a registered investment adviser (the "Adviser"). This sweep process, leaves the Sweep Account at zero at the end of each day. If the aggregate net balance of the Sweep Account at the end of the day is negative, it would be replenished to zero by a transfer from the Short-Term Investment Fund. An internal record keeping system keeps track of the funds and balances of each individual

Member. If at the end of any day the net checking account balance of a Member is positive that balance passes through the Sweep Account into the Short Term Investment Fund to the credit of the Member. Conversely, if at the end of any day the Member's net checking account balance is negative, a call for funds passes through the Sweep account and is satisfied by a charge to the Member's assets in the Short Term Investment Fund. The result is that the Member's individual checking account is returned to zero by reducing the funds being invested in the Short Term Investment Fund on its behalf. If, however, there were insufficient funds to the credit of the Member in the Short-Term Investment Fund an advance in the nature of a loan to the Member would be made from the Short-Term Investment Fund. If arrangements had already been made for a line of credit and the advance was within the limits of the line, the interest charged on the loan would be equal to the Bond Buyers Index rate. Otherwise, the loan would be treated as coverage of an overdraft and the interest rate would be one and one-half times the Bond Buyers Index rate. All interest generated by this arrangement is credited to the Short-Term Investment Fund and further credited to the accounts of the Members in proportion to their respective interests in such Fund. Future participants who are not Members would be covered for shortfalls in their accounts with the Cash Management System but only to the extent that such future participants who experience shortfalls have sufficient funds to their respective credit in the Short-Term Investment Fund. If a future participant has a shortfall in its checking account at Mellon Bank, DCNHS would attempt to satisfy the shortfall by a charge to the participant's assets in the Short-Term Investment Fund, but a line of credit or loan would not be available to the participant. Interest at market rates on positive balances in the Short-Term Investment Fund is credited to the respective account of the Members based on their assets in that Fund.

(b) The Investment Program

The second component of the Health System Depository is the Investment Program, the role of which is to invest funds of the Members not anticipated to be needed for day-to-day operations, on a longer term basis. The Investment Program pools the funds of the participants for the purposes of investment, while also recording separately the account balance of each Member in the program. The source of these funds includes endowments, donations, certain statutory contributions relating to Medicare requirements, funded

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depreciation,<sup>2</sup> as well as any funds not needed for daily operations and allocated by the participant to the Investment Program. The Investment Program has its short-term arm, the Short-Term Investment Fund already referred to, which invests entirely in debt instruments as well as a long-term arm (the "Long-Term Investment Fund") which invests sixty percent (60%) in fixed-income securities and forty percent (40%) in equity securities. The participant determines the percentage of its funds to be invested in each fund.

The Investment Program invests in a short-term fund (i) the daily net balances of the Sweep Accounts, as indicated above, and (ii) the funds in the Short-Term Investment Fund of its Members as designated by them for such investment. It also invests its Members' funds in the Long-Term Investment Fund as designated by them for such investment. The DCNHS Board has ultimate responsibility for setting the investment objectives of the Investment Program, but takes no part in implementing those objectives. The Investment Committee of the Board annually reviews, and makes recommendations to the Board regarding the investment objectives of the Investment Program. Upon approval by the Board of the recommendations, the Investment Committee retains professional registered investment advisers to make the day-to-day investment decisions and to implement the objectives. The Investment Committee monitors the performance of such investment advisers and if it were found to be unsatisfactory, would recommend to the Board that a change in an investment adviser or advisers be made. If the Board agreed, it would, pursuant to its authority, authorize the Investment Committee to make the recommended change. The investment advisers to be retained by the Investment Committee to make investment decisions concerning the Investment Program will be registered under the Investment Advisers Act and will be entirely independent of and will have no affiliation with DCNHS or any of its Members, Affiliates, or Limited Services Participants. Securities trades will be pursuant to orders issued by the investment adviser or advisers having management responsibility and will be effected only by a bank or a broker or dealer registered under the Exchange Act who is not affiliated with DCNHS, its Members, its Affiliates or the Limited Services Participants (a "Registered Broker-Dealer"). Third-party custodians, hold the assets employed in the Investment Program. Currently, State Street Bank is custodian of the Long-Term Investment Fund assets and J.P. Morgan is custodian of the Short-Term Investment Fund assets.

Members may invest assets in the Investment Program over and above the amounts invested from the Sweep Account at the end of each day. However, a Member is permitted to invest only those assets to which such Member has immediate, unrestricted and exclusive use,

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<sup>2</sup> Funded depreciation refers to funds generated from a past Medicare reimbursement statute which permitted providers to treat depreciation as a reimbursable expense so long as an amount in cash equal to the amount treated as depreciation were placed in a separate account. Although the statute which provided for this treatment has since been repealed, DCNHS continues to require its Members to make contributions to their accounts for funded depreciation.

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benefit and enjoyment. None of the assets may be attributable to a retirement plan providing for employee contributions or variable benefits.

Each Member's share of the Sweep Account and any additional assets committed to the Investment Program (the "Member's Investment Assets" or in the aggregate the "Members' Investment Assets") may be invested in one of two portfolios, the Short-Term Investment Fund and the Long-Term Investment Fund, or a combination of the two. As indicated above, the Short-Term Investment Fund is the vehicle mandated for the Sweep Account assets. Each portfolio is invested consistent with announced objectives and strategies, and the incidental expenses of the Investment Program, discussed infra, are allocated pro-rata among the Members based on the Member's deposits invested in each such fund. Similarly, the incidental expenses of the Cash Management System are allocated pro rata among the Members based upon the Member's assets in the System. No participant in the Health System Depository may assign, encumber or transfer its interest in the Health System Depository.

Current asset allocation guidelines call for seventy percent (70%) of the assets in the Short-Term Investment Fund to be invested in instruments with an average maximum life of one year. The remaining thirty percent (30%) of the assets may be invested in the discretion of the Adviser provided that the maximum average life of the entire portfolio does not exceed two years.

Currently, Members are permitted to withdraw their assets from the Investment Program at will, but DCNHS does not allow more than three withdrawals in a three-month period from the Long-Term Investment Fund. Withdrawals of Ten Million dollars (\$10,000,000) or more from the Long-Term Investment Fund are subject to an advance notice requirement of up to thirty (30) days so as to avoid the necessity of liquidating investments in a fire-sale atmosphere.

It is our belief that neither the current practice of DCNHS regarding withdrawals nor the imposition of the notice requirement with respect to significant withdrawals would constitute an impermissible restriction on access to the participants' funds. In several past No-Action Letters, various non-profit entities received no-action relief despite similar or more severe restrictions on access to funds. In Florida Baptist Investment Services (June 30, 1994), the certificates at issue could be redeemed upon notice but redemptions were limited to one a month. In AASCU Capital Fund (October 19, 1988) withdrawals were permitted only annually and on a specified date. The YMCA required at least thirty days' notice prior to redemption in National Council of Young Men's Christian Associations (October 29, 1990). Finally, Common Fund (April 23, 1971) contained a restriction that was more limiting than the one proposed above by DCNHS in that the Common Fund program required three months' written notice prior to withdrawal.

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Furthermore, any participant can terminate its participation in the Health System Depository at any time and at no cost other than the repayment of any debts owed to DCNHS. This unrestricted right of withdrawal in and of itself provides a level of access that we believe should be sufficient.

### 3. Expenses

Currently, the incidental expenses of administering the Investment Program are charged pro-rata among the Members based on the Member's invested assets. Besides the investment management fees, the Investment Program's assets contribute to office administrative expenses of that division of DCNHS devoted entirely to the Health System Depository. These expenses constitute salaries, fringe benefits, computer time, a small portion of accounting expenses and out-of-pocket expenses. Fringe benefits include such usual employee benefits as health insurance, disability insurance, pension contributions, and a tuition reimbursement plan, and are benefits that are strictly standard within the health care industry.

At this time the Health System Depository charges the expenses of the Cash Management System checking accounts against all earnings with the result that these expenses are paid by participants pro-rata to their investment in the Cash Management System and not necessarily in relation to usage. Management feels that this system of allocation has become unfair to those who use the Cash Management System less than their counterparts. In the future the Health System Depository will instead bill participants for these expenses based more on usage. All other expenses of the Cash Management System ("General Services Expenses") will continue to be charged against earnings and therefore will be borne by present and future participants pro-rata to their investments in the Cash Management System. Expenses currently being charged the participants exclude overhead. It is contemplated that in the future overhead pertaining to the Health System Depository will be included in General Services Expenses and will be charged as well. However, these expenses are not significant. Annual administrative or operating expenses, as a percentage of total assets, is only .21 of 1% at this date. With the inclusion of overhead, the percentage would increase .02% to .23 of 1%. In the past five years, the expenses of the Health System Depository as charged to Members has constituted between .16 of 1% and .21 of 1% of total assets. This expense ratio compares very favorably to the Management costs of mutual funds that are marketed to institutional investors.

### **B. Expanded Participation**

To date, participation in the Health System Depository has been a benefit provided only to Members of DCNHS. Recent changes in the health care industry, especially the trend towards consolidation, has led DCNHS to conclude that it would be in the best interests of its Members, and the other not-for-profit health care entities with which it seeks to collaborate,



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to expand participation in the Health System Depository beyond current Members to include certain other not-for-profit health care entities.

The attention to costs related to the provision of health care services has led to an industry-wide effort to trim costs through structural reorganizations and consolidations. For-profit entities have increasingly moved to acquire assets and build large organizations that can draw on economies of scale in the operation of health care facilities. Not-for-profit entities, whose eleemosynary goals supported and fueled the health care industry for many years, have had to adapt to the changing environment in order to preserve the effectiveness of their charitable mission and continue to serve the local communities commitment with their tradition. DCNHS believes that there are business areas where distinct not-for-profit health care entities can work together to maximize resources and yet still remain independent so as to offer the health care consumer more choice and cost efficiencies while preserving the viability of not-for-profit institutions devoted to the provision of health care services.

DCNHS proposes to extend its participation in the Health System Depository solely to other not-for-profit tax exempt health care-oriented organizations. The By-Laws of DCNHS describe the membership classes that may participate in the Health System Depository. Currently, Members include Regional Corporation Members, Full Members and Associate Members, each of which have in common the fact that they are controlled in some degree by DCNHS. DCNHS proposes to expand participation in the Health System Depository to include entities which will comprise four new types of non-membership categories. All such new participants would be not-for-profit entities exempt from taxation under Section 501(c)(3) of the Tax Code ("Exempt Organizations"). The following is a description of the four new types of participants, i.e. three categories of Affiliates, and the category of Limited Services Participants:

There are three categories of Affiliates. Participants in each of these categories would utilize more than one service provided by DCNHS and would enter into a relationship with DCNHS with a duration of more than one year. For example, an Affiliate might participate in the Health System Depository and DCNHS' programs for risk management. The categories of Affiliates include (i) a single organization, (ii) a system of health care or health care related organizations and (iii) an entity involved in a community-based network with one of the Members of DCNHS.

Limited Services Participants are entities that would access only one of the services provided by DCNHS and would not necessarily anticipate a long-term relationship with DCNHS. A limited services participant can be a single not-for-profit hospital or other not-for-profit health care entity or an entire system of not-for-profit hospitals.

All of the Affiliates and Limited Services Participants (collectively "Non-Member Participants") will be health care related organizations or entities involved in a community-

based network with a Member. Furthermore, the assets invested would be limited to assets to which the Non-Member Participants had immediate, unrestricted and exclusive use, benefit and enjoyment and which were not attributable to a retirement plan providing for employee contributions or variable benefits. Moreover, the Non-Member Participants would be informed that DCNHS is not registered as an investment adviser under the Investment Advisers Act or as a broker-dealer under the Exchange Act. In addition, the Non-Member Participants would be informed that neither the Health System Depository nor DCNHS is a company registered under the Investment Company Act.

Currently, monthly financial reports and a quarterly newsletter containing financial reports of DCNHS are distributed to all Members and will be distributed to all Non-Member Participants. In addition, an annual audit of DCNHS, which includes the Health System Depository as well as a separate audit of the Health System Depository itself, is conducted by an independent "Big Six" accounting firm, and will be distributed to Members and Non-Member Participants.

DCNHS is in the process of preparing explanatory material describing its services, including the Health System Depository, to be furnished to prospective Non-Member Participants. DCNHS, in targeting prospective Non-Member Participants to which it would offer the opportunity to participate in the Health System Depository, would include other not-for-profit exempt health care systems that are Exempt Organizations and do not have a similar system in place. DCNHS will not solicit Non-Member Participants in the Health System Depository through general advertising or broad-based solicitation means. Rather, DCNHS will utilize the informative material to contact only those entities with which it or one of its Members has an existing relationship and which share the mission of the Daughters of Charity organization. All Non-Member Participants will be Exempt Organizations and will tend to be other religiously affiliated entities.

One of the primary purposes of any relationship with a Non-Member Participant is to assist the Non-Member Participant having common values with DCNHS to meet the needs of the sick and the poor. Among the criteria to become a Non-Member Participant are (1) that it be a Roman Catholic health-care organization, (2) that the organization's historical behaviors and actions indicate that its values are compatible with the DCNHS core values, (3) that the organization is committed to high quality patient care and to maintaining an effective quality and utilization management program and (4) that the organization complies with federal and state anti-discrimination statutes and regulations.

### **C. No-Action Request**

We wish to confirm that the Staff would not recommend any enforcement action if (i) access to the Health System Depository were expanded to include Non-Member Participants, and/or (ii) General Services Expenses were allocated to participants in the Health System

Depository in accordance with the proposal described in Section A.3. above if, in each case, there were no registration of (x) interests in the Health System Depository, including the Investment Program (the "Interests") under Section 12(g) of the Exchange Act or under the Securities Act, or (y) DCNHS, or the Health System Depository, as an investment company under the Investment Company Act, as an investment adviser under the Investment Advisers Act, or as a broker or dealer under the Exchange Act.

#### **D. Analysis of Applicable Securities Laws**

We are of the opinion that neither the intended expansion of the Health System Depository nor the proposed method of allocation of General Services Expenses should require (i) the Interests to be registered under the Securities Act or the Exchange Act or (ii) DCNHS or the Health System Depository to be registered as an investment company under the Investment Company Act, as an investment adviser under the Investment Advisers Act or as a broker or dealer under the Exchange Act. The Staff has recognized such a position previously with respect to other not-for-profit entities that operated pooled investment funds on behalf of not-for-profit entities engaged in similar missions.

##### **1. The Securities Act**

We are of the opinion that the Interests are exempt from registration and certain other provisions of the Securities Act based on Section 3(a)(4), which exempts therefrom "any security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any person, private stockholder, or individual." Furthermore, neither the expansion of the Health System Depository to include Non-Member Participants nor the allocation of General Services Expenses, as proposed herein, alters that opinion.

In the National Ass'n of Congregational Christian Churches of the United States (April 11, 1995)(hereinafter "National Association No-Action Letter"), the Staff indicated that satisfaction of the following six elements involving "participating Members" was necessary for the subject Trust to qualify for the Section 3(a)(4) exemption:

First, any monies invested must represent monies over which the participant had immediate, unrestricted and exclusive use and could not be attributable to a retirement plan that provides for employee contributions.

Second, the Association must notify Member churches of the establishment of the Trust through a written communication, either in the form of a letter or in the Association's newsletter. In such communications, Members would be instructed to call or write the Association's national office to obtain detailed information and the

information would be provided only to Member churches, all of which are not-for-profit organizations. Furthermore, prior to the time when a Member elected to participate in the Trust, each Member would have been fully informed about the Trust's policies, operations and objectives. All written communication would be approved by the Association's management and would specifically state that (i) neither the Association nor the Corporation is a registered broker-dealer; (ii) the Corporation, the Association and the Trust will not be registered as investment companies under the Investment Company Act; and (iii) neither the Corporation nor the Association will be registered under the Investment Advisers Act.

Third, all financial benefits, chiefly income and the right of a participant to redeem all or any portion of its interest in the trust, less fees and expenses, would be distributed only to Members, and would be used only for tax exempt purposes.

Fourth, independent certified public accounts would prepare a written report regarding the Trust's financial condition and performance in connection with the annual review of the Association's books and records. The report would include audited financial statements of the Trust and would be sent to participating members. All participating Members would be permitted to inspect the books and records relating to the Trust.

Fifth, no participating Member could assign, encumber or otherwise transfer any part of its interest in the fund.

Sixth, the Trust would not purchase the securities of, or otherwise invest in, the Corporation, the Association or any Member.

The Health System Depository satisfies all six elements specified in the National Association No-Action Letter. First, the assets invested in the Health System Depository have been and will continue to be assets of which the participant has sole, exclusive use and would not be attributable to a retirement plan providing for employee contributions. Second, as stated previously, a brochure describing the program will be distributed to all future participants. All Members and Non-Member Participants will be informed that DCNHS is not registered as an investment adviser under the Investment Advisers Act and that neither DCNHS nor the Health System Depository is registered as an investment company under the Investment Company Act. Third, all benefits, profits, and income generated from the Health System Depository will inure only to the Members, and Non-Member Participants, all of which are Exempt Organizations, and all such proceeds will be used only for tax-exempt purposes. Net earnings of the Health System Depository are distributed to each participant pro-rata to its invested assets. Fourth, also as stated previously, monthly financial reports and a quarterly newsletter is currently distributed to all Members and an annual audit is conducted by an independent "Big Six" accounting firm, and will be distributed to Members. Fifth, neither a Member or a Non-Member Participant may assign, encumber or otherwise transfer

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any part of its interest in the Health System Depository. Finally, neither DCNHS or the Health System Depository will invest in or purchase the securities of any Member or Non-Member Participant.

In No-Action Letters such as National Council of Young Men's Christian Associations (April 29, 1991)(hereinafter "YMCA No-Action Letter), the National Association No-Action Letter, AASCU Capital Fund (October 19, 1988)(hereinafter "AASCU No-Action Letter", and Common Fund for Non-profit Organizations (April 23, 1971)(hereinafter "Common Fund No-Action Letter"), the Staff failed to require registration under the Securities Act since all of the participants in the investment programs organized by the entities involved were organizations exempt from taxation under Section 501(c)(3) of the Tax Code and, therefore able to benefit from the exemption provided in Section 3(a)(4) of the Securities Act.

The investment programs were created by each of the entities referred to in the YMCA, AASCU and Common Fund No-Action Letters for the purpose of furthering their respective charitable goals and those of the participants involved in the related investment programs. As stated above, the Health System Depository complies with the six factors specified in the National Association No-Action Letter. Therefore, the objectives underlying the Health System Depository and the investment programs created by the YMCA, the AASCU, and the National Association of Congregational Christian Churches, and discussed in the No-Action Letters cited in the preceding paragraph, would be identical: to better promote the charitable purposes for which the entities were established.

In Mennonite Foundation (September 10, 1980)(hereinafter "Mennonite Foundation No-Action Letter"), the Staff granted no-action relief under the Securities Act to the Foundation based on the representation that "all institutions and organizations advised by the Foundation would be exempt organizations under Section 501(c)(3) of the Tax Code and would be either (i) affiliates of the Mennonite Church, meaning organizations which are officially parts of that denomination whose activities are carried out as programs of the Mennonite Church, (ii) affiliates of the General Conference of the Mennonite Brethren Church, or (iii) aligned in outlook with the Mennonite Church, meaning organizations which are not officially affiliated with the Mennonite Church, but whose stated purposes or activities further the mission of the Mennonite Church."

The expanded participation anticipated by DCNHS would involve entities with a similar outlook and objectives, analogous to the relationship between the Mennonite Church and the entities participating in the Mennonite Foundation. The objective of the Investment Program would be identical to the objective of the programs of each of the participants: namely, to contribute as much as possible to the well-being of society through the provision of high quality, affordable health care services.

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Based on the above No-Action Letters and the similarity of the participants in the programs discussed therein to DCNHS's current and proposed future activities, we are of the opinion that the Interests, if offered to Non-Member Participants as proposed, would be exempt from registration under Section 3(a)(4) of the Securities Act. Furthermore, we are of the opinion that registration would not be required even if the contemplated allocation of a portion of the General Services Expenses, as described herein, were implemented.

## 2. The Exchange Act

We are of the opinion that the Interests are exempt from registration pursuant to Section 12(g)(2)(D) of the Exchange Act. Furthermore, neither the expansion of the Health System Depository to include Non-Member Participants nor the proposed allocation of a portion of the General Services Expenses, as proposed herein, alters that opinion. Section 12(g) of the Exchange Act provides for the registration of equity securities when held by seven hundred fifty (750) or more persons. DCNHS will not attain that number of participants, even after the contemplated expansion of the Health System Depository. Nevertheless, Section 12(g)(2)(D) exempts from registration "securities of an issuer organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any private shareholder or individual." As the applicant stated in the AASCU No-Action Letter, "the exemption is intended to exempt offerings and issuers with respect to which the protections of the federal securities laws are not necessary because such offerings are not made by profit-motivated principals, promoters or salesmen or for the benefit of any private person." The investment program created by the AASCU was exempt from registration under the Exchange Act based on much the same rationale as its exemption from the Securities Act.

The Exchange Act exemption is equally applicable to the factual circumstances surrounding DCNHS's contemplated future expansion of the Health System Depository and the implementation of the proposed allocation of some General Services Expenses. The protection of the federal securities law is unnecessary with respect to DCNHS or the Health System Depository because no profit-motivated person has been involved in the organization, promotion, and expansion of the Health System Depository, and no profit-motivated person will derive any benefit from the operation or performance of the Health System Depository.

Finally, neither DCNHS nor the Health System Depository would come within the definition of broker or dealer under the Exchange Act. Sections 3(a)(4) and 3(a)(5), respectively, define "broker" and "dealer". The definitions are similar in that both require the respective regulated person to be "engaged in the business." The business in which a dealer would be engaged would be buying and selling securities for that person's own account. The business in which a broker would be engaged would be that of "effecting transactions in securities for the account of others." Neither DCNHS nor the Health System Depository can

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be regarded as being "engaged in the business." Securities trades will be pursuant to orders issued by the investment adviser or advisers having management responsibility and will be effected only by a bank or a Registered Broker-Dealer. The activities of DCNHS and its officers, directors and employees, in disseminating information about the Health System Depository to actual participants and foreseeable participants will comply with the requirements of Rule 3a4-1 under the Exchange Act (the "Rule"), and their activities will be limited to those permitted by paragraph (a)(4)(iii) of the Rule. No representative or other associated person of DCNHS who has communications with participants in the Health System Depository (an "Associated Person") will be subject to a statutory disqualification described in paragraph (a)(1) of the Rule and no Associated Person will receive any transaction based compensation. Furthermore, each Associated Person's activities with participants in the Health System Depository will be restricted to ministerial and clerical matters and preparation and delivery of written communications that have been approved by an officer of DCNHS.

In American Heart Ass'n, (February 26, 1993)(hereinafter "American Heart Association No-Action Letter") the Staff exempted the American Heart Association (the "AHA") from registration under Section 15(b) of the Exchange Act. The AHA contended that neither it nor its employees would be "engaged in the business," since a registered broker-dealer would make all securities trades and employees would be engaged only in ministerial activities and not specially compensated through commissions or salaries based on the amount or performance of the investments.

The Staff also exempted the AASCU Capital Fund from registration under the Exchange Act. The AASCU Capital Fund engaged a registered investment adviser. No part of the net earnings of the AASCU Capital Fund would inure to the benefit of any private shareholder or individual. Moreover, the participants in the AASCU Capital Fund would reimburse the AASCU Capital Fund for the actual cost incurred in acting as a representative of the participating institutions, would be charged for the fees imposed by the investment adviser, and under the Administration Agreement, would reimburse the AASCU for its direct expenses in administering the Fund and for indirect costs according to a fee schedule based on the market value of the securities and the amount of cash held by the Fund as necessary incidental expenses.

Neither DCNHS nor the Health System Depository can be considered to be "engaged in the business" under the Exchange Act. The Health System Depository is similar to the programs in the American Heart Association No-Action Letter and the AASCU No-Action Letter. DCNHS has employed and will continue to employ a registered investment adviser. The employees of DCNHS will continue to perform only administrative and ministerial duties regarding the Health System Depository and the Members pay only direct costs associated with the administration of the Health System Depository. It is proposed that the Members and Non-Member Participants pay a portion of General Services Expenses for such indirect costs as building and maintenance, pro-rata to their investments and for banking fees on a

usage basis. This proposed arrangement is consistent with the arrangement described in the AASCU No-Action Letter. Since the Members and Non-Member Participants will pay only administrative expenses, the Health System Depository has contracted for and will continue to use the services of a registered investment adviser, and employees of the Health System Depository will remain responsible only for administrative and ministerial duties regarding the Health System Depository, we are of the opinion that neither DCNHS nor the Health System Depository will be "engaged in the business" as either a broker or dealer under the Exchange Act.

### 3. The Investment Company Act

Section 3(c)(10) of the Investment Company Act excludes from the definition of an investment company "any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual." Since Section 3(c)(10) of the Investment Company Act is virtually identical to Section 3(a)(4) of the Securities Act and Section 12(g)(2)(D) of the Exchange Act, we are of the opinion that the discussion of the applicability of these exemptions to the Health System Depository and DCNHS as well as the No-Action Letters cited above, is equally relevant here. See also, American Heart Association No-Action Letter. Consequently, neither DCNHS nor the Health System Depository should be considered an investment company and each should be exempt from registration under the Investment Company Act pursuant to Section 3(c)(10) thereof.

### 4. The Investment Advisers Act

Section 202(a)(11) of the Investment Advisers Act defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities... ." Whether the proposed expansion of the Health System Depository to include Non-Member Participants or the proposed allocation of some General Services Expenses would cause DCNHS or the Health System Depository to be an investment adviser under this definition depends on whether DCNHS or the Health System Depository would (a) provide advice regarding securities, (b) be in the business of providing such advice to others, and (c) provide such advice for compensation. As the YMCA stated in its letter of inquiry, to be an investment adviser all three elements of Section 202(a)(11) must be satisfied.

We are of the opinion that neither DCNHS nor the Health System Depository would be an investment adviser under Section 202(a)(11) of the Investment Advisers Act. Because the proposed expansion of the Health System Depository would only increase the number of participants, but not the involvement or interaction of DCNHS in the Health System



Depository, DCNHS would, in spite of such expansion, continue to be exempt from the requirements of the Investment Advisers Act since it would not provide advice regarding securities, nor be "in the business of" providing such advice to others, nor would it do either for compensation. Furthermore, the inclusion of a portion of General Services Expenses in the costs being allocated would not alter that opinion. However, should the Staff not agree with our conclusion that neither DCNHS nor the Health System Depository is an investment adviser under Section 202(a)(11) of the Investment Advisers Act, we also believe that DCNHS and the Health System Depository are exempt from registration pursuant to Section 203(b)(4) of the Investment Advisers Act.

- (a) Neither DCNHS nor the Health System Depository will give investment advice.

Based on the Staff's position in the American Heart Association and the National Association No-Action Letters, neither DCNHS nor the Health System Depository should be subject to regulation as an investment adviser. DCNHS, like the AHA and the National Association of Congregational Christian Churches, has retained and will continue to retain professional money managers, all of which will be registered investment advisers under the Investment Advisers Act, to manage the assets of the Investment Program. The role of the Investment Committee is similar to the roles of the Corporation and Association in the National Association No-Action Letter and of the AHA in the American Heart Association No-Action Letter. Those entities, like the Investment Committee, chose the investment adviser, promulgated guidelines or investment objectives, and had ultimate supervisory responsibility for the investment program, but played no role in the choice of investments. Although DCNHS recommends participation in the Health System Depository to its Members and expects to recommend such participation to proposed Non-Member Participants, it does not and will not require such participation; it will merely offer the opportunity to participate as did the AHA in the American Heart Association No-Action Letter and the Association and Corporation involved in the program discussed in the National Association No-Action Letter.

- (b) Neither DCNHS nor the Health System Depository would be in the "business of" providing advice regarding securities to others.

- (1) Inclusion of Some General Services Expenses as Costs Allocated among DCNHS and its Subsidiaries

The allocation of expenses among a parent and its controlled subsidiaries, pursuant to the current and proposed allocation arrangements, raises issues that are an internal matter not falling within the ambit of protection under the Investment Advisers Act. Until the expanded participation occurs, DCNHS has been and will be allocating expenses among entities that, except in the case of three Associate Members, which it partially controls, it wholly controls. Equitable Capital Management Corporation (April 18, 1989)(hereinafter "Equitable Capital

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No-Action Letter") suggests that the expense arrangement between a parent and subsidiary, can be distinguished from traditional fee arrangements between an investment adviser and its client. In the Equitable Capital No-Action Letter, a subsidiary registered under the Investment Advisers Act provided investment advisory services for the parent. At times, the advisory arrangement provided for performance-based fees in violation of Section 205 of the Investment Advisers Act. However, the Staff granted no-action relief based on the fact that the request related only to the subsidiary's management of the parent's assets and the management of the assets of other wholly-owned subsidiaries. The subsidiary argued that the clear focus of the Investment Advisers Act is with regard to persons who are in the business of giving advice to the "public." Moreover, it observed that there is no public interest to be served in the regulation of the internal business arrangements between a corporate parent and its subsidiary.

The principles underlying the Equitable Capital No-Action Letter are equally if not more applicable to the allocation of expenses between DCNHS and those wholly controlled and partially controlled Members in the current expense situation. The Investment Advisers Act, which seeks to protect the clients of investment advisers, should not play as urgent a role where the entities are wholly-controlled or partially controlled. An investment adviser is defined as a person who advises "others." A controlled entity appears less like others and more like an extension of self. Moreover, DCNHS's expense allocation arrangement is merely the administration of internal business between parent and subsidiary. The aggregate expenses allocated on an annual basis to the Full Members' and Associate Members' assets amount to less than twenty-three one hundredths of a percent (.23%) of the Members' investment assets. Even if the proposed allocation of some indirect expenses were implemented, the percentage would not rise above one-fourth of one percent (.25%). Finally, as the Equitable Capital No-Action Letter suggests, the level of scrutiny under the Investment Advisers Act for parent-subsidiary interaction and investment services is lessened.

Therefore, we are of the opinion that neither the current arrangements to allocate expenses among Members nor the proposed expansion of the expenses being allocated among Members so as to include some General Services Expenses would cause DCNHS or the Health System Depository to be in the "business of" providing advice regarding securities to others.

- (2) Expansion of entities to which expenses are charged to include Non-Member Participants

Furthermore, it is our opinion that neither DCNHS nor the Health System Depository will be engaged in the "business of" providing advice regarding securities to others upon the addition of Non-Member Participants to the Health System Depository and the charging of expenses to such Non-Member Participants.

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The purpose of DCNHS in establishing the Health System Depository and in offering the other services provided by it is to further the charitable goals of the Exempt Organizations that are its Members. The activities of the Health System Depository are wholly incidental to the promotion and advancement of the charitable goals of all current and proposed participants. The rationale underlying the existence and expansion of the Health System Depository is identical to the rationale underlying the programs created by the AHA and the National Association of Congregational Christian Churches (the "National Association") in that the investment programs are wholly incidental to, and a means to fulfill the charitable purposes of the respective institutions.

The Health System Depository, the Investment Trust created by the National Association, and the Equity and Intermediate Funds created by the AHA each pool the assets of their non-profit participants in order to increase the investment power of such participants and thus provide opportunities that the participants would not have had individually. As will be the case with the Non-Member Participants, none of the participants, in the case of the National Association or the AHA, appeared to be entirely controlled by the National Association or AHA respectively.

Section 202(a)(11) of the Investment Advisers Act states that an investment adviser is a "person who, for compensation, engages in the business of advising *others*... ." The concept of "others" would not encompass Non-Member Participants which become participants of the Health System Depository. The Letter of Inquiry submitted to the Staff in connection with the Equitable Capital No-Action Letter suggests that the clear focus of the Investment Advisers Act is with regard to persons who are in the business of giving advice to the "public" and that the Investment Advisers Act was not intended to regulate internal relationships. Although the Staff did not speak to this point directly, the Staff did grant Equitable Capital's request, the Staff's response being based "particularly on the fact that your request relates only to Equitable Capital's management of the general account assets of Equitable and the general account assets of other wholly-owned life insurance subsidiaries of Equitable."

As a policy matter, we are of the opinion that the factual circumstances surrounding the proposed expansion of the Health System Depository are analogous to the facts in the Equitable Capital No-Action Letter despite the fact that the Non-Member Participants would not be wholly controlled entities of DCNHS. First, the expansion of the Health System Depository would allow only charitable health care related institutions to participate as Non-Member Participants. The Non-Member Participants would have the same charitable goals and interests as the current Members and the Health System Depository would be offering the Non-Member Participants the same choices and cost efficiencies as offered to the Members who would, in turn, contribute to the ability of such Non-Member Participants to preserve the viability of their ability to provide health care services without the motive of profit. Participation in DCNHS and the Health System Depository would not be open to the public

since participation would be limited to entities that meet certain criteria thus assuring that their goals and purposes were similar to those of the Members. Second, the magnitude of expenses being charged would remain minimal in comparison to the assets invested by the Non-Member Participants and the services provided by the Health System Depository. As discussed herein, the Staff has permitted some charging of expenses for services provided by charitable institutions for the benefit of other charitable institutions which do not appear wholly controlled.

Despite the expansion of the Health System Depository to Non-Member Participants, the Health System Depository would retain a common identity, purpose, and interest among all of its participants to provide health care related services without a profit motive. Such common goals and interests should not trigger the concerns and protections for which the Investment Advisers Act was promulgated.

Accordingly, we are of the opinion that the proposed inclusion of Non-Member Participants among the entities to which expenses are charged would not cause DCNHS or the Health System Depository to be in the "business of" providing advice regarding securities to "others."

- (c) Neither DCNHS nor the Health System Depository will receive compensation.

In the AASCU No-Action Letter, the AASCU, which was not registered under the Investment Advisers Act, was permitted to be reimbursed for its direct expenses of administering the fund for member universities and educational systems that were not controlled by the AASCU, and, in addition, for a portion of its indirect costs, according to a fee schedule. The reimbursement was, according to the AASCU, a necessary incidental cost to the participating institutions of the operation of the investment program. Although the AASCU did not seek relief under the Investment Advisers Act, the Staff in its response did not state that registration thereunder was required. In Florida Baptist Investment Services, Inc. ("FBIS"), (June 30, 1994)(hereinafter the "FBIS No-Action Letter"), although the FBIS did not request relief under the Investment Advisers Act, the employees of FBIS were permitted to receive "reasonable compensation for services actually rendered in the performance of his or her regular duties" without the Staff addressing the necessity of registration under the Investment Advisers Act.

On the other hand, no-action relief was not granted to the United Methodist Foundation in United Methodist Foundation of the Baltimore Annual Conference, Inc., (September 29, 1988) (hereinafter "United Methodist Foundation No-Action Letter") because the Foundation charged a fee for its investment management services based on a percentage of the income generated in violation of Section 205(a)(1) of the Investment Advisers Act. In

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addition, the United Methodist Foundation was also criticized for the fact that it took custody of and managed funds and securities for certain United Methodist Churches.

In Northeastern Pennsylvania Synod of the Evangelical Lutheran Church in America, (May 2, 1988)(hereinafter "Synod No-Action Letter"), the Staff could not conclude that reimbursements for expenses that included travel and meal expenses, portions of salaries, supplies, and expenses associated with office costs and computers were not an economic benefit and thus, "compensation" under the Investment Advisers Act. However, the issue of compensation only became relevant because the Staff also came to the conclusion that the Synod was engaged in the "business of" providing advisory services under the Investment Advisers Act and therefore would have to register. That conclusion was based on a factual pattern not present in the case of DCNHS under which the Synod would provide hands-on advice by assisting each participant in evaluating its own financial situation and determining its own investment objectives and in communicating its decisions to the investment advisers. Furthermore, the Synod would conduct seminars and meetings on the investment program for the benefit of the participants.

DCNHS's current and proposed expense allocations and the degree of interaction between institution and participants is more analogous to the AASCU, the FBIS, and the National Association than to the United Methodist Foundation and the Synod. In the National Association No-Action Letter, assets from the Trust would pay for investment management fees, custodian's fees, and whatever out-of-pocket expenses were incurred in creating and organizing the Trust. As in the AASCU No-Action Letter, the allocation of expenses among the Members and proposed Non-Member Participants is minimal and only for the activities incidental to the management of the Health System Depository. The charging of costs would remain minimal even if the proposed indirect costs were also charged. As in the National Association No-Action Letter, only out-of-pocket costs are proposed to be charged. DCNHS does not go as far as the FBIS in that it does not seek compensation for services rendered. DCNHS seeks only to break even. It will not charge Members or Non-Member Participants based on the income generated, as did the United Methodist Foundation. Moreover, the degree of interaction between the participants and DCNHS is minimal. A third-party custodian holds the assets. DCNHS does not and will not provide advice on investment objectives as did the Synod; it merely provides Members and proposes to provide Non-Member Participants the opportunity to participate in the Health System Depository. As a charitable institution, DCNHS does not seek any profit from the provision of services pursuant to the Health System Depository. Therefore, we are of the opinion that neither the current expense allocation nor the proposed expansion of the expenses being charged Members and Non-Member would constitute compensation for the purposes of the Investment Advisers Act. Moreover, as discussed above, the Staff has granted no-action relief to charitable entities which charged similar expenses relating to services provided to other charitable entities.

The definition of investment adviser pursuant to Section 202(a)(11) of the Investment Advisers Act sets out a three-pronged test: first, the person must be providing advice regarding securities, second, the person must be in the business of providing such advice, and third, the person must do so for compensation. The United Methodist Foundation No-Action Letter and the Synod No-Action Letter reflect that the Staff focuses on compensation issues only after it determined that the person was "providing advice" and was "in the business of advising others." As indicated above, it is our opinion that DCNHS will not be providing advice regarding securities and would not be in the business of advising others regarding securities if the Health System Depository is expanded to include Non-Member Participants. Consequently, it is our further opinion that neither DCNHS nor the Health System Depository is required to register under the Investment Advisers Act, even if the charging of expenses were considered to create "compensation".

- (d) Even if DCNHS and/or the Health System Depository were deemed investment advisers under Section 202(a)(11) of the Investment Advisers Act, both DCNHS and the Health System Depository would qualify for exemption from registration pursuant to Section 203(b)(4) of the Investment Advisers Act.

Section 203(b)(4) was enacted to exempt certain charitable organizations that are considered investment advisers under the Investment Advisers Act. To qualify for the Section 203(b)(4) exemption, the entity must: (1) be a charitable organization as defined under Section 3(c)(10)(D) of the Investment Company Act and (2) provide advice only to charitable organizations, funds excluded from the definition of an investment company under Section 3(c)(10)(B) of the Investment Company Act or trusts or other institutions described in Section 3(c)(10)(B) of the Investment Company Act. DCNHS and the Health System Depository satisfy both components of the exemption:

First, DCNHS is an Exempt Organization whose benefits and net earnings do not inure to any private shareholder or individual. As stated above in the discussion of the Investment Company Act, we believe that DCNHS and the interests of the Health System Depository satisfy the requirements of Section 3(c)(10)(D) of the Investment Company Act since DCNHS is a charitable organization as defined in such section and the Health System Depository has no existence apart from DCNHS.

Second, all of the current Members of DCNHS and all participants in the Health System Depository are charitable organizations as defined by Section 501(c)(3) of the Tax Code. All proposed participants in the services to be offered by DCNHS would also be charitable organizations as so defined such that the advice provided as a service of the Health System Depository would be provided strictly to charitable organizations.

For these reasons, DCNHS and the Health System Depository, if deemed by the Staff to be "investment advisers" under Section 202(a)(11) of the Investment Advisers Act, would

nevertheless be exempt from registration according to Section 203(b)(4) of the Investment Advisers Act as all participants in the services offered by both DCNHS and the Health System Depository are Exempt Organizations.

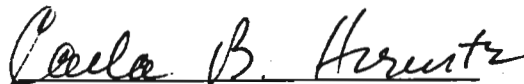
Since DCNHS and the Health System Depository would not be providing advice concerning securities, would not be in the business of providing such advice to others, would not provide such advice for compensation, and would also qualify for exemption from registration if found to be an investment adviser we are of the opinion that neither DCNHS nor the Health System Depository would be required to register as an investment adviser under the Investment Advisers Act upon the expansion of the Health System Depository.

#### E. Conclusion

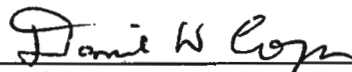
Pursuant to the above analysis of the Staff's position in past No-Action Letters, we are of the opinion that the proposed allocation of some of the General Services Expenses and the intended expansion of the Health System Depository to Non-Member Participants should not require that (i) the Interests (interests in DCNHS and the Health System Depository, including the Investment Program) be registered under the Securities Act or under the Exchange Act, or (ii) DCNHS or the Health System Depository be registered as a dealer or broker under the Exchange Act, or as an investment company under the Investment Company Act, or as an investment adviser under the Investment Advisers Act.

Accordingly, we respectfully request that the Staff advise us that it would not recommend any enforcement action to the Commission if neither DCNHS or the Health System Depository registers under the above-mentioned securities laws upon (x) the expansion of the Health System Depository to other health-care oriented not-for-profit entities and (y) the implementation of the proposal to charge General Services Expenses to Members and Non-Member Participants. We respectfully request the opportunity for a conference in advance of any adverse determination.

Very truly yours,



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