

**PUBLIC**

5 MAY 1993

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 93-188-CC  
Defined Asset Funds-  
Equity Income Fund-  
Select Ten Series  
File No. 33-46842

Your letter of April 8, 1993, requests our assurance that we would not recommend enforcement action to the Commission under Sections 17(a)(1) or 17(a)(2) of the Investment Company Act of 1940 ("1940 Act") if an existing unit investment trust ("Trust") of the Select Ten Series, a series of the Defined Asset Funds - Equity Income Fund, which has reached its mandatory termination date, ("Terminating Trust") sells portfolio securities to a unit investment trust of the same series in formation ("New Trust") in compliance with all provisions of Rule 17a-7 under the 1940 Act except paragraph (e). 1/

Each Trust invests in securities in accordance with a strategy described in "Beating the Dow," by John Downes and Michael O'Higgins. Under this strategy, a Trust invests 10% of its assets in each of the ten stocks in the Dow Jones Industrial Average ("DJIA") with the highest dividend yield. You state that each Trust holds these securities for approximately one year, and that the sponsor will offer a New Trust for the following year as each Trust terminates. You also state that generally there is some overlap from one year to the next in the ten securities having the highest dividend yield in the DJIA. You state that to date each Terminating Trust has sold, and each New Trust has purchased, all of its securities on the New York Stock Exchange. In the two most recent cases where a Terminating Trust sold portfolio securities which were identical to those purchased by a New Trust, the purchase and sale commissions were approximately \$150,000.

Section 17(a)(1) generally makes it unlawful for an affiliated person of a registered investment company, or any affiliated person thereof, acting as principal, knowingly to sell any security or other property to the company. Section 17(a)(2) generally makes it unlawful for the same persons, acting as

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1/ The staff believes that an offer to unitholders to invest redemption proceeds upon the liquidation of an existing series into a new series, at net asset value plus a reduced sales charge (a "rollover option"), is an exchange offer for purposes of Section 11(c) of the 1940 Act. Section 11(c) prohibits any offer of exchange of the securities of a unit investment trust for the securities of any other investment company absent a Commission order. The Select Ten Series prospectus states that the sponsors have received exemptive orders under Section 11(c) which they believe permit them to offer a rollover option.

principal, knowingly to buy any security or other property from the investment company. Rule 17a-7 exempts from the prohibitions of Section 17(a) certain purchases and sales between registered investment companies and certain affiliated persons, where the affiliation arises solely by reason of having a common investment adviser, common directors, and/or common officers. You state that each Trust may be considered an affiliated person of each other Trust because they share the same sponsors and/or the same trustees. Because a New Trust would not be affiliated with a Terminating Trust through any relationship specified in the Rule, they may not rely on the exemption provided therein. Of course, where a transaction subject to Section 17(a) is not exempted from Section 17(a) by Rule 17a-7, Section 17(b) provides a specific mechanism by which the transaction might proceed. That provision permits a person to file an application for an order exempting a proposed transaction from Section 17(a). The Commission may exempt a proposed transaction from Section 17(a), if (1) the terms of the transaction are fair and reasonable and do not involve overreaching; (2) the transaction is consistent with the investment company's policies; and (3) the proposed transaction is consistent with the general purposes of the 1940 Act.

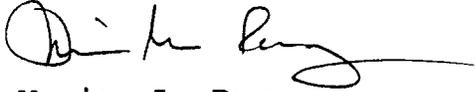
Paragraph (e) of Rule 17a-7 requires the board of directors, including a majority of the disinterested directors, of the investment company to (1) adopt procedures pursuant to which these purchases and sales are effected, which are reasonably designed to ensure compliance with paragraphs (a) through (d) of the Rule; (2) review at least annually the continuing appropriateness of these procedures; 2/ and (3) determine at least quarterly that all purchases and sales made during the preceding quarter were effected in compliance with such procedures.

The requirements that the board of directors adopt appropriate procedures and review such transactions are fundamental to the exemption the Rule provides. They were added to the Rule in 1981, the last time the Commission modified the Rule. In proposing paragraph (e) to Rule 17a-7, the Commission stated its belief that these requirements accorded with its general objective of "enhancing, insofar as feasible, the role of investment company directors and particularly disinterested directors as watchdogs of shareholder interests. The Commission believes that the first line of responsibility for determining compliance with the proposed amendment should be with each

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2/ While the Commission has proposed eliminating the annual director review requirement from certain rules, including Rule 17a-7, it has not proposed deleting the other board of directors' requirements. Investment Company Act Rel. No. 19192 (Dec. 30, 1992).

investment company's directors." 3/ Because of the importance of paragraph (e), we are unwilling to permit these unit investment trusts to rely on Rule 17a-7. Therefore, on the basis of the facts and representations in your letter, we cannot assure you that we would not recommend enforcement action to the Commission under Sections 17(a)(1) or 17(a)(2) if a Terminating Trust sells portfolio securities to a New Trust, or a New Trust buys portfolio securities from a Terminating Trust, in the manner described in your letter.



Monica L. Parry  
Senior Counsel

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3/ Investment Company Act Rel. No. 11136 (Apr. 21, 1980)  
(proposing amendments to Rule 17a-7).

DAVIS POLK & WARDWELL

450 LEXINGTON AVENUE

NEW YORK, N.Y. 10017

212-450-4000

FAX: 212-450-4800

WRITER'S DIRECT NUMBER:

1 CHASE MANHATTAN PLAZA  
NEW YORK, N.Y. 10005

1300 I STREET, N.W.  
WASHINGTON, D.C. 20005

4, PLACE DE LA CONCORDE  
75008 PARIS

1 FREDERICK'S PLACE  
LONDON EC2R 8AB

2-1, MARUNOUCHI 1-CHOME  
CHIYODA-KU, TOKYO 100

MESSEURM  
6000 FRANKFURT AM MAIN 1

1940 Act: Section 17(a)  
and Rule 17a-7

April 8, 1993

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

ACT ICA of 1940  
SECTION \_\_\_\_\_  
RULE 17a-7  
PUBLIC \_\_\_\_\_  
AVAILABILITY 5/5/93

Dear Sirs:

We are special counsel to Merrill Lynch, Pierce, Fenner & Smith Incorporated and the other Sponsors of Defined Asset Funds - Equity Income Fund, a unit investment trust registered under the Investment Company Act of 1940 (the "1940 Act") comprised of various separate portfolios or series (each, a "Trust"). On behalf of the Sponsors, we request confirmation from the Staff of the Division of Investment Management that it will not recommend enforcement action if, in compliance with Rule 17a-7 under the 1940 Act (other than paragraph (e) thereof), an existing Trust of the Select Ten Series which has reached its mandatory termination date (a "Terminating Trust") sells portfolio securities to a Trust of the Select Ten Series then in formation (a "New Trust") at the closing sales prices of the securities on the New York Stock Exchange on the date of sale.

Background. The investment objective of each Trust of the Select Ten Series is to seek a greater total return than the stocks comprising the entire Dow Jones Industrial Average (the "DJIA"). Each trust acquires approximately equal values of the ten stocks in the DJIA having the highest dividend yields as of one or two business days before the Trust is created and holds those stocks for approximately one year. The Sponsors intend that, as each Trust terminates, a new Trust will be offered for the next

year.<sup>1</sup> This investment approach is discussed in the book Beating the Dow by John Downes and Michael O'Higgins (New York: Harper Collins, 1991), wherein the authors conclude that over a twenty year period a strategy of initially buying the ten highest dividend yielding stocks in the DJIA, and annually replacing stocks no longer in the highest yielding ten with new stocks that are, would have produced a greater annual total return than the DJIA in 15 of the 20 years, and a significantly higher compounded return over the entire 20 years.

As might be expected, there is normally some overlap from one year to the next in the stocks having the highest dividend yields in the DJIA. Accordingly, there is likely to be some degree of congruity between the portfolios of a Terminating Trust and a New Trust. In the most recent case, 9 of the 10 securities were identical. However, as these Trusts may be considered affiliates of one another, to date each Terminating Trust<sup>2</sup> has, in connection with its termination, sold all of its securities on the New York Stock Exchange as quickly as practicable but over a period of time so as to minimize any adverse impact on the market price. Likewise, the portfolio of a New Trust is acquired in purchase transactions on the New York Stock Exchange. This procedure has resulted in both the Terminating Trust and the New Trust, and, consequently, the holders of units of both Trusts, incurring substantial brokerage commissions on securities of the same issue. Although commissions vary, the Sponsors estimate that the brokerage charge on a purchase or sale transaction averages approximately 5 cents a share. In the two most recent cases where a Terminating Trust sold portfolio securities which were identical to portfolio securities purchased by a New Trust, aggregate

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<sup>1</sup> Because each Trust is structured, for federal income tax purposes, as a grantor trust, it is not possible to vary the investments in a Trust to conform to changes in the DJIA and thereby continue the Trust for the next year.

<sup>2</sup> As a technical matter, holders of units of a Terminating Trust who choose to acquire units of a New Trust are treated as having redeemed their units of the Terminating Trust in kind and received shares in each of the stocks in the portfolio of the Terminating Trust. The trustee of the Terminating Trust, on behalf of these holders, thereafter sells the shares of stock distributed to them on the New York Stock Exchange. For purposes of this letter, however, the sales should be considered as being made on behalf of the Terminating Trust.

commissions paid in these purchase and sale transactions were estimated by the Sponsors to be \$150,000.

Legal Analysis. Unless exempted from Section 17(a), investment companies under common control may be considered affiliates of one another and therefore unable to enter into exchanges of securities without SEC approval. Each Trust is sponsored by Merrill Lynch, Pierce, Fenner & Smith Incorporated, Prudential Securities Inc. and PaineWebber Incorporated. A sponsor (also referred to as a "depositor") is included in the definition of "affiliated person" in Section 2(a)(3)(F) of the 1940 Act. The trustee of the Trusts established to date has been either Chase Manhattan Bank, N.A. or The First National Bank of Chicago and Investors Bank & Trust Company, as co-trustees. Accordingly, while we know of no precedent with respect to unit investment trusts, it is likely that each Trust would be considered an affiliate of the others.

Rule 17a-7, adopted in 1966, was designed to permit registered investment companies which might be deemed under common control by reason of common investment advisers, directors and/or officers, to exchange securities with one another at an independently determined price, provided there was no consideration other than cash payment against prompt delivery, the transaction was consistent with the policy of each registered company, and no brokerage commission, fee or other remuneration was paid in connection with the transaction.<sup>3</sup> When the Rule was amended in 1981, as explained in Rel. IC-11676 (March 10, 1981), because funds were given greater flexibility in determining the independent price, a new condition (paragraph (e)) required adoption and monitoring<sup>4</sup> by the fund's board of directors (including a majority of those directors who are not interested persons) of procedures to assure compliance with the revised rule. Unfortunately, this amendment effectively foreclosed unit investment trusts (which by definition have no board of directors) from realizing similar savings for their holders.

We submit that, in the circumstances described above, a sale of securities by a Terminating Trust to a New Trust in a transaction appropriate to the investment

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<sup>3</sup>See Rel. IC-11136 (April 21, 1980).

<sup>4</sup>The Commission, in its recent Release No. IC-19192 (December 30, 1992), has proposed eliminating the annual director review requirement from certain rules, including Rule 17a-7.

objectives of each, at the closing price on the New York Stock Exchange on the date of the sale, without any brokerage charges or other remuneration except customary transfer fees, if any, satisfies each of the requirements of Rule 17a-7 other than paragraph (e) thereof - i.e., it meets each of the requirements of Rule 17a-7 as in effect until the 1981 amendment. Satisfying the additional condition of board review is obviously impossible for a unit investment trust. Additionally, the rationale behind the on-going monitoring requirement of paragraph (e) is not applicable to exchange-listed securities, especially where the securities are 10 of the 30 most well established and actively traded stocks in the United States. Accordingly, we hereby request confirmation that the Staff would not recommend enforcement action under Sections 17(a)(1) or 17(a)(2) of the 1940 Act if a Terminating Trust sells securities as described above to a New Trust.

Please feel free to call the undersigned (at 212-450-4525), Linda Simpson (at 212-450-4332) or Gary L. Granik (at 212-450-4721) if you have any questions regarding this request.

Respectfully submitted,



Pierre de Saint Phalle