

**PUBLIC**

**FEB 2 1993**

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 92-602-CC  
North American  
Security Trust and  
NASL Series Trust  
File Nos. 811-5797 and  
811-4146

Your letter of October 8, 1992, requests our assurance that we would not recommend that the Commission take any enforcement action under Section 10(f) of the Investment Company Act of 1940 (the "1940 Act") if the investment portfolios of North American Security Trust ("NAST") and NASL Series Trust ("Series Trust") (collectively, the "Funds") engage in the transactions described in your letter. 1/

The Funds are open-end series investment companies registered under the 1940 Act. NAST currently has seven portfolios and Series Trust has thirteen portfolios. NASL Financial Services, Inc. ("NASL Financial"), a registered investment adviser and broker-dealer, is the investment adviser for each portfolio of the Funds. Under the terms of its advisory agreements, NASL Financial selects, contracts with, monitors, and compensates sub-advisers for the portfolios (the "Sub-advisers"). The Funds currently have a combined total of six Sub-advisers. 2/ Each Sub-adviser makes all decisions regarding the purchase and sale of securities for the portfolios it manages. No Sub-adviser's contract with NASL Financial permits it to make investment decisions with respect to other portfolios. In addition, no Sub-adviser is an "affiliated person" of any other Sub-adviser, NASL Financial, or any officer, trustee or employee of the Funds.

Because some of the Sub-advisers are major securities underwriters, you believe that all of the Funds' portfolios should not be precluded, during the existence of an underwriting or selling syndicate, from purchasing securities principally underwritten by, among others, either a Sub-adviser or an affiliated person of a Sub-adviser. You acknowledge that the

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- 1/ Section 10(f), in relevant part, prohibits a registered investment company from knowingly purchasing or otherwise acquiring, during the existence of any underwriting or selling syndicate, any security (except a security of which the company is the issuer) a principal underwriter of which is an investment adviser of the company or an affiliated person of any investment adviser. Section 2(a)(3) of the 1940 Act defines "affiliated person."
- 2/ The Sub-advisers are Oechsle International Advisers, L.P., Salomon Brothers Asset Management Inc., Goldman Sachs Asset Management, Wellington Management Company, Fidelity Management Trust Company, and Roger Engemann Management Co., Inc.

prohibitions of Section 10(f) would apply to a portfolio's purchase of securities principally underwritten by that portfolio's Sub-adviser or an affiliated person of the Sub-adviser. You assert, however, that Section 10(f) should not prohibit a portfolio from purchasing securities principally underwritten by a Sub-adviser (1) that does not manage the purchasing portfolio and (2) is not an affiliated person of the portfolio's Sub-adviser, NASL Financial, or any officer, trustee or employee of the Fund (the "Proposed Transactions.")

When Congress considered legislation in 1940 to regulate the investment company industry, it expressed concern over sponsors of investment companies improperly using these companies as customers for certain securities. 3/ Concern was particularly expressed over two practices: "dumping," the practice of selling unmarketable securities to a controlled company, and "bailing out," a transaction in which a controlled company receives securities to alleviate the financial distress of the sponsor. We do not believe that the Proposed Transactions raise the type of concerns that Section 10(f) was intended to address because, while an underwriting or selling syndicate exists, no portfolio will purchase securities principally underwritten by the portfolio's Sub-adviser (or an affiliated person of the Sub-adviser), NASL Financial, or any officer, trustee or employee of the Fund. 4/

Accordingly, on the basis of the facts and representations in your letter, we would not recommend that the Commission take any enforcement action under Section 10(f) if the portfolios of the Funds engage in the Proposed Transactions. 5/ Because this response is based on the facts and representations in your

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3/ This concern is described in the Report of the Securities and Exchange Commission, Investment Trusts and Investment Companies, Part Three, Chapter VII, "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies," H.R. Doc. No. 279 76th Cong., 2d Sess. 2581, 2589 (1940).

4/ We are not persuaded that each portfolio of a series company should always be treated as a separate investment company for purposes of Section 10(f).

5/ We note that the portfolios of the Funds have obtained an exemption from Section 17(a) of the 1940 Act to engage in the Proposed Transactions. See Investment Company Act Rel. Nos. 18860 (July 22, 1992)(notice) and 18899 (Aug. 18, 1992)(order). We express no opinion as to whether the portfolios are "under common control" because they have the same investment adviser and the same officers and trustees.

letter, you should note that different facts or representations may require a different conclusion. Moreover, this response expresses the Division's position on enforcement action only and does not purport to express any legal conclusions on the questions presented.

*Lawrence P. Stadulis*

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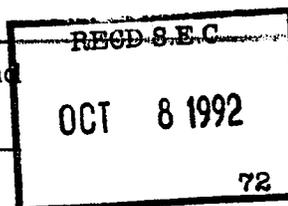
1940 Act  
Section 10(f)

October 8, 1992

Thomas S. Harman, Esq.  
Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

Act	ICA-40
Section	10 (f)
Rule	
Public Availability	2/2/93

Re: North American Security Trust and  
NASL Series Trust  
Request for No-Action Letter



Dear Mr. Harman:

We are writing on behalf of North American Security Trust ("NAST") and NASL Series Trust (the "Series Trust," collectively with NAST, the "Funds") to request the staff's concurrence in our view that the transactions described below are not subject to the prohibitions of Section 10(f) of the Investment Company Act of 1940 (the "Act"). Alternatively, we request the staff's assurance that it will not recommend that the Commission take any enforcement action against the Funds alleging a violation of Section 10(f) of the Act if the various investment portfolios of the Funds engage in such transactions.

This letter presents the issue of whether, in the context of a series investment company, the entity subject to the prohibitions of Section 10(f) is the registered management investment company or its individual portfolios, an issue that may depend in part upon whether an investment adviser is considered to be an investment adviser of all portfolios of the series company or only of the portfolio(s) that it manages. We believe that treating the individual portfolios as the entities subject to Section 10(f) and an investment adviser as an investment adviser of only the portfolio(s) that it manages is most consistent with the language and purposes of Section 10(f) of the Act and with Commission positions with regard to the regulation of series companies under the Act.

## BACKGROUND

### The Funds

The Series Trust is a Massachusetts business trust registered under the Act as an open-end, management investment company (File No. 811-4146). The Series Trust currently has thirteen investment portfolios, each of which offers a separate series of shares of beneficial interest. The thirteen portfolios are: the Equity Trust, the Growth Trust, the Pasadena Growth Trust, the Growth and Income Trust, the Strategic Income Trust, the Investment Quality Bond Trust, the U.S. Government Securities Trust, the Money Market Trust, the Global Equity Trust, the Global Government Bond Trust, the Conservative Asset Allocation Trust, the Moderate Asset Allocation Trust and the Aggressive Asset Allocation Trust. The investment objectives, policies and restrictions applicable to each portfolio of the Series Trust are described in the Series Trust's registration statement on Form N-1A (File No. 2-95157).

Shares of the Series Trust are not offered directly to the public. Rather, the Series Trust currently serves as the underlying investment medium for sums invested in variable annuity contracts issued by North American Security Life Insurance Company ("Security Life") and its wholly-owned subsidiary, First North American Life Assurance Company ("First North American"). Security Life is a wholly-owned subsidiary of North American Life Assurance Company, a mutual life insurance company based in Toronto Canada.

NAST is a Massachusetts business trust registered under the Act as an open-end, management investment company (File No. 811-5797). NAST currently has seven investment portfolios, each of which offers a separate series of shares of beneficial interest to the public. The seven portfolios are: the Global Growth Trust, the Growth Trust, the Growth and Income Trust, the Investment Quality Bond Trust, the U.S. Government Securities Trust, the Money Market Trust and the Asset Allocation Trust. The investment objectives, policies and restrictions applicable to each portfolio of NAST are described in NAST's registration statement on Form N-1A (File No. 33-27958).

Under Massachusetts law and their respective Declarations of Trust and Bylaws, both Funds are managed under the direction of their Trustees. Currently, the officers and Trustees of NAST are the same persons as the officers and Trustees of the Series Trust. Each portfolio of each Fund has as its investment adviser, NASL Financial Services, Inc. ("NASL Financial"), a wholly-owned subsidiary of Security Life that is registered with the Commission both as an investment adviser and as a broker-dealer. NASL Financial also serves as the principal underwriter of the variable annuity contracts issued by Security Life and First North American that are funded by investment in the Series Trust, and as the distributor for NAST.

Under the terms of its advisory agreements with the Funds, NASL Financial selects, contracts with, and compensates subadvisers for the Funds' investment portfolios (the "Subadvisers"). NASL Financial monitors the compliance of the Subadvisers with the investment objectives and related policies of each portfolio and reviews the performance of the Subadvisers and reports periodically on their performance to the Trustees. NASL Financial also provides certain administrative services and expense guarantees to each Fund.

### **The Subadvisers**

The Funds currently have a combined total of six Subadvisers. Oechsle International Advisors, L.P. ("Oechsle"), Salomon Brothers Asset Management Inc ("SBAM"), Goldman Sachs Asset Management ("GSAM") and Wellington Management Company ("Wellington") each manages one or more portfolios of each Fund. Fidelity Management Trust Company ("Fidelity") manages four portfolios of the Series Trust and Roger Engemann Management Co., Inc. ("REMC") manages one portfolio of the Series Trust. Each Subadviser makes all decisions regarding the purchase and sale of securities by the portfolios that it manages. Each Subadviser other than Fidelity is registered with the Commission as an investment adviser. Fidelity is not an investment adviser for purposes of the Investment Advisers Act of 1940, because it satisfies the definition of "bank" in Section 202(a)(2) of that act.

Oechsle, a Delaware limited partnership, serves as Subadviser to the Global Equity and Global Government Bond portfolios of the Series Trust and the Global Growth portfolio of NAST. SBAM, a New York corporation that is an indirect, wholly-owned subsidiary of Salomon Inc, serves as Subadviser to the Strategic Income portfolio of the Series Trust and to the U.S. Government Securities portfolio of each Fund. GSAM, a division of Goldman Sachs & Co ("Goldman Sachs"), a New York limited partnership, serves as Subadviser to the Asset Allocation portfolios of NAST and to the Growth Trust of each Fund. Wellington, a Massachusetts partnership, serves as Subadviser to each Fund's Growth and Income, Investment Quality Bond and Money Market portfolios. Fidelity, a Massachusetts corporation that is a wholly-owned subsidiary of FMR Corp., serves as Subadviser to the Equity, Conservative Asset Allocation, Moderate Asset Allocation and Aggressive Asset Allocation portfolios of the Series Trust. REMC, a California corporation, serves as Subadviser to the Pasadena Growth Trust of the Series Trust.

Each Subadviser is completely independent of each other Subadviser; no Subadviser is an "affiliated person" of any other Subadviser as that term is defined in Section 2(a)(3) of the Act. Moreover, in economic reality, each Subadviser competes directly or indirectly with each other Subadviser in the investment advisory business and certain of the Subadvisers or their affiliates directly or indirectly compete as securities dealers. None of the

Subadvisers is an affiliated person of the Funds' adviser (NASL Financial) or of any officer, trustee or employee of either Fund.

#### Relevant Provisions of the Act

Section 10(f) of the Act, in relevant part, prohibits a registered investment company from knowingly purchasing or otherwise acquiring, during the existence of any underwriting or selling syndicate, any security (except a security of which the investment company is the issuer) a principal underwriter of which is an investment adviser of the registered investment company or is a person of which any investment adviser of the registered investment company is an affiliated person.

Section 2(a)(20) of the Act, in relevant part, defines an investment adviser of an investment company as

(A) any person . . . who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company and (B) any other person who pursuant to contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A)

. . . .

#### The Interpretive Problem

Other than purchases permitted by Rules 10f-1, 10f-2 and 10f-3, purchases by a Fund portfolio of securities of which that portfolio's Subadviser, or a person of which that Subadviser is an affiliated person, is a principal underwriter are clearly prohibited by Section 10(f). However, it is unclear whether the prohibitions of Section 10(f) extend to purchases by a portfolio of securities of which a Subadviser to one of the other portfolios of the same Fund, or a person of which such a Subadviser is an affiliated person, is a principal underwriter. For convenience, subsequent references to a Subadviser as a principal underwriter will include persons of which the Subadviser is an affiliated person.

As some of the Subadvisers are major participants in the business of underwriting securities offerings, it can be important to the investment performance of a Fund portfolio that it not be restricted in its purchases of securities during an underwriting syndicate of which a principal underwriter is a Subadviser to other portfolios of that Fund. Although in some cases, it might prove beneficial to a Fund portfolio to be able to purchase securities a principal underwriter of which is its own Subadviser in excess of the amounts permitted by Commission rules, an exemptive order would be needed to engage in such purchases and, accordingly, such

purchases are beyond the scope of this interpretive request. In the absence of an exemptive order, each Fund portfolio will continue to purchase securities of which its Subadviser is a principal underwriter only to the extent permitted by rules under Section 10(f) of the Act.

#### OPINION AND BASIS THEREFOR

In our opinion, Section 10(f) does not prohibit a Fund portfolio from purchasing securities of which a Subadviser is a principal underwriter, provided that the Subadviser does not manage the purchasing portfolio and provided that none of the following is an affiliated person of that Subadviser: NASL Financial, the purchasing portfolio's Subadviser, or the officers, trustees or employees of the Fund. The phrase "Proposed Transactions" hereinafter will be used to refer to purchases by an existing Fund portfolio, or one that may be formed in the future, of securities a principal underwriter of which is a present or future Subadviser that (1) does not manage the purchasing portfolio and (2) is not a person of which NASL Financial, the purchasing portfolio's Subadviser, or any officer, trustee or employee of the Fund is an affiliated person.

As noted above, Section 10(f) prohibits purchases of securities by a "registered investment company" of securities a principal underwriter of which is that investment company's "investment adviser." For the Proposed Transactions to be deemed prohibited by Section 10(f), one must either conclude (1) that each Subadviser to a Fund portfolio is an investment adviser of every portfolio of that Fund or (2) that a Subadviser to any portfolio is an investment adviser to the Fund and that each purchase of securities by a Fund portfolio is made not by that portfolio but rather by the Fund. We believe that neither conclusion is required by the language of the Act and that either would contravene the policies underlying the Act.

Under Section 2(a)(20)(B), a Subadviser is an investment adviser of a portfolio it manages because, pursuant to a contract with NASL Financial, the Subadviser furnishes advice to the portfolio with respect to the desirability of investing in, purchasing and selling securities or other property and is empowered to determine what securities or other property shall be purchased or sold by the portfolio. However, because no Subadviser's contract with NASL Financial permits or empowers it to furnish such advice or make such investment decisions with respect to other portfolios of the Fund, it is not an investment adviser to the other portfolios within the meaning of Section 2(a)(20). Accordingly, if in the context of a series company such as one of the Funds the "investment company" referred to in Section 10(f) is the Fund portfolio rather than the Fund, then a Subadviser is an investment adviser only of those portfolios it manages and the prohibitions of Section 10(f) do not apply to the Proposed Transactions.

Section 3(a) of the Act defines "investment company" as any "issuer" which engages in the activities listed in paragraphs (1) through (3) of that section. As shares of beneficial interest are issued separately for each Fund portfolio and each portfolio engages independently in the activities listed in Section 3(a)(1) and 3(a)(3), it seems logical to conclude that the "issuer" of such shares, for purposes of the Section 3(a)(3) definition and thus for purposes of Sections 2(a)(20) and 10(f), is the individual portfolio.

In 1966, the Commission informed Congress that "The individual series of a registered investment company are, for all practical purposes, separate investment companies." SEC, Public Policy Implications of Investment Company Growth, H.R. Rep. 2337, 89th Cong., 2d Sess. 330-331 (1966). In explaining that conclusion, the Commission noted that the reasons entities such as insurance company separate accounts issuing variable annuities should be regulated as separate investment companies apply equally to the separate series of a series company. Id., at note 25.

The Commission has treated the individual portfolios of a series company as the registered investment company for purposes of Section 15(a) of the Act. Section 15(a) requires that contracts between an investment adviser to a registered investment company and a subadviser, pursuant to which the subadviser agrees to act or serve as an investment adviser to that registered investment company, be approved by a vote of the shareholders of the registered investment company. Paragraph (a) of Rule 18f-2 under the Act requires approval of an investment advisory contract by each portfolio series affected by that contract. Paragraph (c) of that rule deems approval of such a contract by vote of the shareholders of an individual portfolio sufficient to satisfy the requirements of Section 15(a) as to that portfolio, regardless of whether or not other portfolios have voted to approve it or of whether a majority of all of the company's outstanding securities have approved it (unless state law requires approval by a majority of all shares regardless of series). In effect, for purposes of Section 15(a), the "registered investment company" for which a Subadviser serves as an "investment adviser" is thus the individual portfolio rather than the Fund of which it is a part.

In defining the term "investment adviser," Section 2(a)(20) of the Act refers directly to the investment advisory contract with an investment company that must be approved by shareholders of that investment company under Section 15(a). That Rule 18f-2 deems such approval to be effective as to a portfolio upon approval of shareholders of that portfolio, even if shareholders of all portfolios do not approve the contract, provides persuasive support for the interpretation that the "registered investment company" of which a Subadviser is an investment adviser within the meaning of Section 2(a)(20) (and thus Section 10(f)) is the individual portfolio rather than the Fund.

The Commission has also concluded that individual portfolios should be treated as separate investment companies for certain regulatory purposes similar to those of Section 10(f). For example, the Commission has taken the position that Section 17 applies to portfolio series of an investment company as if each were a separate registered investment company. See, e.g., Investment Company Act Release Nos. 16431 (June 13, 1988) (amending Rule 17d-3) and 11676 (Mar. 10, 1981) (adopting Rule 17a-7). While the Commission has not specified that portfolios of a series company are separate investment companies for purposes of Section 10(f), the same analysis that would lead to the conclusion that they are separate companies for purposes of Section 17 should be applicable to a section of the Act, such as Section 10(f), which has a similar purpose of preventing self-dealing.

In evaluating whether each portfolio of a series investment company should be considered a separate investment company for purposes of Section 10(f), it is appropriate to examine the purposes of that section to make sure that such an interpretation would not frustrate those purposes. See generally Joseph R. Fleming, Regulation of Series Investment Companies Under the Investment Company Act of 1940, 44 BUS. LAW. 1179 (1989). When proposing amendments to Rule 10f-3 in 1979, the Commission discussed the purposes of Section 10(f), as revealed in the legislative history of that section, and noted that it was adopted in response to concerns about investment bankers "dumping" otherwise unmarketable securities on investment companies with which they were affiliated or which they controlled. Investment Company Act Release No. 10592 (Feb. 13, 1979).

The Congressional concern about dumping was included in a discussion of the dangers associated with a variety of transactions between an investment company and those with the direct or indirect power to control it. The legislative history of the Act clarifies the type of abuses that were intended to be precluded by such sections as Section 17 and Section 10(f).

The representatives of the investment trust industry were of the unanimous opinion that "self-dealing" -- that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated -- presented opportunities for gross abuse by unscrupulous persons, through unloading of securities upon the companies, unfair purchases from the companies, the obtaining of unsecured or inadequately secured loans from the companies, etc. The industry recognized that, even for the most conscientious managements, transactions between these affiliated persons and the investment companies present many difficulties. S. Rep. No. 1775, 76th Cong., 3d Sess. 6 (1940) (emphasis added).

David Schenker, one of the principal authors of the Act, made it clear that it is transactions where a person controlling an investment company has a pecuniary interest in the entity with which the investment company is dealing that present the potential for abuse that both Section 10(f) and Section 17 are intended to prevent. He used the metaphor of "sitting on both sides of the table" to explain the purposes of Section 17(a), but the nature of the concern is equally applicable to Section 10(f).

That is why this bill says that you cannot sit on both sides of the table when you are dealing with an investment trust. If you are a director or officer or manager or controlling person you cannot sell any property to an investment trust, because you are sitting on one side representing yourself where you have a pecuniary interest, and you are sitting on the other side representing the investment trust; and we say that fundamentally that should not be permitted.

. . . We tried to get the situations where it would be to his pecuniary interest to unload securities on the investment trust. We figured that if he had a 5-percent interest in the company that is selling the securities, then he has a sufficient interest to affect his judgment, and therefore we say that he cannot sell. Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 130-131, 261 (Testimony of David Schenker) (1940) (emphasis added).

The Schenker testimony, especially the emphasized language, shows that those who drafted the Act intended to preclude transactions where the judgment of a person acting on behalf of, or controlling the actions of, an investment company could be affected by a direct or indirect pecuniary interest opposed to that of the investment company.

When the person acting on behalf of an investment company has no direct or indirect pecuniary interest in a securities transaction as an underwriter, then there is no interest in the transaction that could affect the person's judgment and the abuse Section 10(f) is designed to prevent (dumping) is not present. That is precisely the situation in each Proposed Transaction. For example, if Wellington decides that one of the portfolios that it manages should purchase securities of which Goldman Sachs is a principal underwriter, Wellington can neither lose nor gain financially on the basis of whether the transaction is beneficial or detrimental to Goldman Sachs. In fact, Wellington's only pecuniary interest in such a transaction is that its subadvisory fees would be enhanced to the extent that the transaction is beneficial to the portfolio (by increasing the net assets under management), but reduced if it were not beneficial to the portfolio (by decreasing the net assets under management). This is precisely the arms-length-bargaining

situation that normally prevails when an adviser acts on behalf of an investment company; it is not one where it would be imprudent to trust the adviser's judgment. Accordingly, there is no more need to restrict a Subadviser's ability to cause a portfolio to engage in Proposed Transactions than there is for any other of the portfolio's securities purchases.

It would be contrary to the interests of the shareholders of a Fund portfolio to create artificial barriers to purchases by the portfolio of securities that conform to its investment objectives and policies where there is not even a theoretical possibility of self-dealing or dumping. The broader the universe of securities offerings available to a portfolio, the easier it is for the Subadviser to that portfolio to maximize investment performance. Only when there is some potential for harm to shareholders is it reasonable for that universe to be restricted artificially. Accordingly, we conclude that interpreting Section 10(f) of the Act as applying individually to each portfolio of a series company, rather than to the series company as a whole, is consistent with the purposes and policies underlying that section.

The staff of the Division of Investment Management has recently concluded that it is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act to permit principal transactions between Fund portfolios and Subadvisers (or affiliated persons thereof) other than the Subadviser to the trading portfolio. See North American Security Trust, et al., Investment Company Act Release Nos. 18860 (July 22, 1992) (notice) and 18899 (Aug. 18, 1992) (order). As a result, Fund portfolios are permitted to engage in principal transactions with Subadvisers of other portfolios in the ordinary course of business. The staff's issuance, pursuant to delegated authority, of a notice and order permitting unrestricted principal trading in this context suggests that interpreting Section 10(f) to permit the Proposed Transactions would be consistent with the purposes and policies of the Act and prior positions taken by the Commission and its staff.

#### CONCLUSION

On the basis of the foregoing, it is our opinion that the Proposed Transactions are not subject to the prohibitions of Section 10(f) of the Act. We respectfully request your advice that you concur with our opinion or that you will not recommend that the Commission take any enforcement action against the Funds alleging a violation of Section 10(f) of the Act if the Funds' portfolios engage in the Proposed Transactions.

Because this interpretive request involves a publicly-offered investment company and presents no issues peculiar to insurance products, we have directed this letter solely to your office.

However, because the Series Trust is a funding vehicle for an insurance company separate account that issues variable annuity contracts, we are providing a courtesy copy of this letter to Wendell M. Faria, Esq., Deputy Chief of Office, Office of Insurance Products and Legal Compliance. If you have any questions regarding this request, please feel free to contact the undersigned.

Very truly yours,

Jones & Blouch

By:   
W. Randolph Thompson

cc: Wendell M. Faria, Esq.  
John D. DesPrez, III, Esq.