SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 27844; 812-13288]

HealthShares™, Inc. and XShares Advisors LLC; Notice of Application

May 29, 2007


Action: Notice of an application for an order under section 12(d)(1)(J) of the Investment Company Act of 1940 (the "Act") for an exemption from sections 12(d)(1)(A) and (B) of the Act and under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and (2) of the Act.

Summary of the Application: The requested order would permit certain registered management investment companies and unit investment trusts registered under the Act (“UITs”) to acquire shares of certain registered open-end management investment companies and UITs, including those that operate as exchange-traded funds, that are outside the same group of investment companies as the acquiring investment companies.

Applicants: HealthShares™, Inc. (the “Corporation”) and XShares Advisors LLC (the “Advisor”).

Filing Dates: The application was filed on May 2, 2006 and amended on February 13, 2007 and May 29, 2007. Applicants have agreed to file an amendment during the notice period, the substance of which is reflected in this notice.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on June 20, 2007, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for
the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants, 420 Lexington Avenue, Suite 2626, New York, NY 10170.

For Further Information Contact: Laura J. Riegel, Senior Counsel, at (202) 551-6873, or Nadya B. Roytblat, Assistant Director, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application may be obtained for a fee at the Public Reference Desk, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-0102 (telephone (202) 551-5850).

Applicants’ Representations:

1. The Corporation is an open-end management investment company registered under the Act and organized as a Maryland corporation. The Corporation is comprised of separate series that pursue distinct investment objectives and strategies (the “Funds”). The existing Funds are offered as exchange-traded funds that operate in reliance on an order from the Commission permitting their shares to be redeemed in large aggregations (“Creation Units”).1 The Advisor is registered as an investment adviser under the Investment Advisers Act of 1940 (“Advisers Act”) and serves as investment adviser to the Funds.2

2. Applicants request relief to permit registered management investment companies and UITs that are not part of the same “group of investment companies,” within the meaning of


2 All references to the term “Advisor” includes successors-in-interest to the Advisor. Successors-in-interest are limited to any entity resulting from a name change, a reorganization of the Advisor into another jurisdiction or a change in the type of business organization.
section 12(d)(1)(G)(ii) of the Act, as the Corporation (such registered management investment companies are “Investing Management Companies”, such UITs are “Investing Trusts”, and Investing Management Companies and Investing Trusts are collectively “Funds of Funds”), to acquire shares of the Funds in excess of the limits in section 12(d)(1)(A) of the Act, and to permit a Fund, any principal underwriter for a Fund, and any broker or dealer registered under the Securities Exchange Act of 1934 (“Broker”) to sell shares of a Fund to a Fund of Funds in excess of the limits of section 12(d)(1)(B) of the Act. Applicants request that the relief apply to: (1) each registered open-end management investment company or UIT that currently or subsequently is part of the same “group of investment companies,” within the meaning of section 12(d)(1)(G)(ii) of the Act, as the Corporation, and is advised or sponsored by the Advisor or any entity controlling, controlled by, or under common control with the Advisor (such registered open-end management investment companies or their series are “Open-end Funds”, such UITs or their series are “UIT Funds,” and both Open-end Funds and UIT Funds are included in the term “Funds”); (2) each Fund of Funds that enters into a Participation Agreement (as defined below) with a Fund to purchase shares of the Fund; and (3) any principal underwriter to a Fund or Broker selling shares of a Fund. Applicants also seek an exemption from sections 17(a)(1) and (2) of the Act to permit a Fund to sell shares to, and redeem its shares from, and engage in certain in-kind transactions with, a Fund of Funds that owns 5% or more of the shares of a Fund. A sponsor of a UIT is referred to as a “Sponsor.”

3. Each Investing Management Company will be advised by an investment adviser within the meaning of section 2(a)(20)(A) of the Act and registered as an investment adviser under the Advisers Act (“Fund of Funds Adviser”). A Fund of Funds Adviser may contract with an

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3 All entities that currently intend to rely on the requested order are named as applicants. Any other entity that relies on the order in the future will comply with the terms and conditions of the application. A Fund of Funds may rely on the requested order only to invest in the Funds and not in any other registered investment company.
investment adviser which meets the definition of section 2(a)(20)(B) of the Act (“Fund of Funds Subadviser”). Applicants state that the Funds of Funds will be interested in using the Funds as part of their overall investment strategy.

Applicants’ Legal Analysis:

A. Section 12(d)(1)

1. Section 12(d)(1)(A) of the Act, in relevant part, prohibits a registered investment company from acquiring shares of an investment company if the securities represent more than 3% of the total outstanding voting stock of the acquired company, more than 5% of the total assets of the acquiring company, or, together with the securities of any other investment companies, more than 10% of the total assets of the acquiring company. Section 12(d)(1)(B) of the Act prohibits a registered open-end investment company, its principal underwriter, and any broker or dealer from selling its shares to another investment company if the sale will cause the acquiring company to own more than 3% of the acquired company’s voting stock, or if the sale will cause more than 10% of the acquired company’s voting stock to be owned by investment companies generally.

2. Section 12(d)(1)(J) of the Act provides that the Commission may exempt any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision of section 12(d)(1) if the exemption is consistent with the public interest and the protection of investors. Applicants seek an exemption under section 12(d)(1)(J) to permit Funds of Funds to acquire shares of the Funds in excess of the limits in section 12(d)(1)(A), and a Fund, any principal underwriter for a Fund and any Broker to sell shares of a Fund to a Fund of Funds in excess of the limits of section 12(d)(1)(B).

3. Applicants state that the terms and conditions of the proposed arrangement will adequately address the policy concerns underlying sections 12(d)(1)(A) and (B), which include
concerns about undue influence by a fund of funds over underlying funds, excessive layering of fees, and overly complex fund structures. Accordingly, applicants believe that the requested exemption is consistent with the public interest and the protection of investors.

4. Applicants believe that neither a Fund of Funds nor a Fund of Funds Affiliate would be able to exert undue influence over the Funds. To limit the control that a Fund of Funds may have over a Fund, applicants propose a condition prohibiting the Fund of Funds Adviser or Sponsor of the Investing Trust, any person controlling, controlled by, or under common control with the Fund of Funds Adviser or Sponsor of the Investing Trust, and any investment company or issuer that would be an investment company but for section 3(c)(1) or 3(c)(7) of the Act that is advised or sponsored by the Fund of Funds Adviser or Sponsor of the Investing Trust, or any person controlling, controlled by, or under common control with the Fund of Funds Adviser or Sponsor of the Investing Trust (“Fund of Funds Advisory Group”) from controlling (individually or in the aggregate) a Fund within the meaning of section 2(a)(9) of the Act. The same prohibition would apply to the Fund of Funds Subadviser, any person controlling, controlled by or under common control with the Fund of Funds Subadviser, and any investment company or issuer that would be an investment company but for section 3(c)(1) or 3(c)(7) of the Act (or portion of such investment company or issuer) advised or sponsored by the Fund of Funds Subadviser or any person controlling, controlled by or under common control with the Fund of Funds Subadviser (“Fund of Funds Subadviser Group”). Applicants propose other conditions to limit the potential for undue influence over the Funds, including that no Fund of Funds or Fund of Funds Affiliate (except to the extent it is acting in its capacity as an investment adviser to an Open-end Fund or Sponsor to a UIT

4 A “Fund of Funds Affiliate” is a Fund of Funds Adviser, Fund of Funds Subadviser, a Sponsor of an Investing Trust, a promoter, or a principal underwriter of a Fund of Funds, and any person controlling, controlled by, or under common control with any of those entities. A “Fund Affiliate” is an investment adviser, Sponsor, promoter, or principal underwriter of a Fund, and any person controlling, controlled by, or under common control with any of
Fund) will cause a Fund to purchase a security in an offering of securities during the existence of any underwriting or selling syndicate of which a principal underwriter is an Underwriting Affiliate (“Affiliated Underwriting”). An “Underwriting Affiliate” is a principal underwriter in any underwriting or selling syndicate that is an officer, director, member of an advisory board, Fund of Funds Adviser, Fund of Funds Subadviser, Sponsor of the Investing Trust, or employee of the Fund of Funds, or a person of which any such officer, director, member of an advisory board, Fund of Funds Adviser, Fund of Funds Subadviser, Sponsor of the Investing Trust, or employee is an affiliated person. An Underwriting Affiliate does not include any person whose relationship to a Fund is covered by section 10(f) of the Act.

5. Applicants do not believe that the proposed arrangement will involve excessive layering of fees. The board of directors or trustees of each Investing Management Company, including a majority of the directors or trustees who are not “interested persons” (within the meaning of section 2(a)(19) of the Act) (“Disinterested Trustees”), will find that the advisory fees charged to the Investing Management Company are based on services provided that will be in addition to, rather than duplicative of, the services provided under the advisory contract(s) of any Open-end Fund in which the Investing Management Company may invest. In addition, a Fund of Funds Adviser, or trustee or Sponsor of an Investing Trust will waive fees otherwise payable to it by the Fund of Funds in an amount at least equal to any compensation (including fees received pursuant to any plan adopted by an Open-end Fund under rule 12b-1 under the Act) received from a Fund by the Fund of Funds Adviser, trustee or Sponsor of the Investing Trust, or an affiliated person of the Fund of Funds Adviser, trustee or Sponsor of the Investing Trust, other than any advisory fees paid to the Fund of Funds Adviser, trustee or Sponsor of the Investing Trust or its those entities.
affiliated person, by an Open-end Fund, in connection with the investment by the Fund of Funds in
the Fund. Applicants also state that with respect to registered separate accounts that invest in a
Fund of Funds, no sales load will be charged at the Fund of Funds level or at the Fund level. Other
sales charges and service fees, as defined in Rule 2830 of the Conduct Rules of the National
Association of Securities Dealers, Inc. (“NASD Conduct Rules”), if any, will only be charged at
the Fund of Funds level or at the Fund level, not both. With respect to other investments in a Fund
of Funds, any sales charges and/or service fees charged with respect to shares of the Fund of Funds
will not exceed the limits applicable to a fund of funds as set forth in Rule 2830 of the NASD
Conduct Rules. Further, applicants represent that each Fund of Funds will represent in the
Participation Agreement that no insurance company sponsoring a registered separate account
funding variable insurance contracts will be permitted to invest in the Fund of Funds unless the
insurance company has certified to the Fund of Funds that the aggregate of all fees and charges
associated with each contract that invests in the Fund of Funds, including fees and charges at the
separate account, Fund of Funds, and Fund levels, will be reasonable in relation to the services
rendered, the expenses expected to be incurred, and the risks assumed by the insurance company.

6. Applicants submit that the proposed arrangement will not create an overly complex
fund structure. Applicants note that no Fund will acquire securities of any investment company or
company relying on section 3(c)(1) or 3(c)(7) of the Act in excess of the limits contained in section
12(d)(1)(A) of the Act, except to the extent permitted by an exemptive order that allows the Fund
to purchase shares of an affiliated money market fund for short-term cash management purposes or
rule 12d1-1 under the Act. Applicants also represent that to ensure that the Funds of Funds comply
with the terms and conditions of the requested relief from section 12(d)(1)(A) of the Act, a Fund of
Funds must enter into a participation agreement between the Corporation, on behalf of the relevant
Fund, and the Funds of Funds (“Participation Agreement”) before investing in a Fund beyond the limits imposed by section 12(d)(1)(A). The Participation Agreement will require the Fund of Funds to adhere to the terms and conditions of the requested order. The Participation Agreement will include an acknowledgment from the Fund of Funds that it may rely on the requested order only to invest in the Funds and not in any other registered investment company. The Participation Agreement will further require each Fund of Funds that exceeds the 5% or 10% limitations in sections 12(d)(1)(A)(ii) and (iii) of the Act to disclose in its prospectus that it may invest in the Funds, and to disclose, in “plain English,” in its prospectus the unique characteristics of the Fund of Funds investing in the Funds, including but not limited to the expense structure and any additional expenses of investing in the Funds. Each Fund of Funds also will comply with the disclosure requirements concerning the costs of investing in Funds set forth in Investment Company Act Release No. 27399.

7. Applicants also note that a Fund may choose to reject a direct purchase of shares in Creation Units by a Fund of Funds. To the extent that a Fund of Funds purchases shares of a Fund in the secondary market, the Fund would still retain its ability to reject purchases of its shares through its decision to enter into the Participation Agreement prior to any investment by the Fund of Funds in excess of the limits of section 12(d)(1)(A).

B. Section 17(a)

1. Section 17(a) of the Act generally prohibits sales or purchases of securities between a registered investment company and any affiliated person of the company. Section 2(a)(3) of the Act defines an “affiliated person” of another person to include any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the other person.
2. Applicants seek relief from section 17(a) to permit a Fund that is an affiliated person of a Fund of Funds because the Fund of Funds holds 5% or more of the Fund’s shares to sell its shares to and redeem its shares from a Fund of Funds. Applicants believe that any proposed transactions directly between a Fund and Fund of Funds will be consistent with the policies of each Fund and Fund of Funds. The Participation Agreement will require any Fund of Funds that purchases shares from a Fund to represent that the purchase of shares from the Fund by a Fund of Funds will be accomplished in compliance with the investment restrictions of the Fund of Funds and will be consistent with the investment policies set forth in the Fund of Funds’ registration statement. 

3. Section 17(b) of the Act authorizes the Commission to grant an order permitting a transaction otherwise prohibited by section 17(a) if it finds that (i) the terms of the proposed transaction are fair and reasonable and do not involve overreaching on the part of any person concerned; (ii) the proposed transaction is consistent with the policies of each registered investment company involved; and (iii) the proposed transaction is consistent with the general purposes of the Act. Section 6(c) of the Act permits the Commission to exempt any person or transactions from any provision of the Act if such exemption is necessary or 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.

5 To the extent that purchases and sales of shares of a Fund occur in the secondary market and not through principal transactions directly between a Fund of Funds and a Fund, relief from section 17(a) would not be necessary. However, the requested relief would apply to direct sales of shares in Creation Units by a Fund to a Fund of Funds and redemptions of those shares. The requested relief is also intended to cover the in-kind transactions that would accompany such sales and redemptions as described in the application for the HealthShares™ Order.
4. Applicants submit that the proposed transactions satisfy the standards for relief under sections 17(b) and 6(c) of the Act. Applicants state that the terms of the transactions are reasonable and fair and do not involve overreaching. Applicants note that any consideration paid for the purchase or redemption of shares directly from a Fund will be based on the net asset value of the Fund. Applicants state that the proposed transactions will be consistent with the policies of each Fund of Funds and Fund and with the general purposes of the Act.

Applicants’ Conditions:

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. The members of a Fund of Funds Advisory Group will not control (individually or in the aggregate) a Fund within the meaning of section 2(a)(9) of the Act. The members of a Fund of Funds Subadviser Group will not control (individually or in the aggregate) a Fund within the meaning of section 2(a)(9) of the Act. If, as a result of a decrease in the outstanding voting securities of a Fund, the Fund of Funds Advisory Group or the Fund of Funds Subadviser Group, each in the aggregate, becomes a holder of more than 25% of the outstanding voting securities of a Fund, it (except for any member of the Fund of Funds Advisory Group or Fund of Funds Subadviser Group that is a separate account) will vote its shares of the Fund in the same proportion as the vote of all other holders of the Fund’s shares. This condition does not apply to the Fund of Funds Subadviser Group with respect to a Fund for which the Fund of Funds Subadviser or a

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6 Applicants acknowledge that receipt of any compensation by (a) an affiliated person of a Fund of Funds, or an affiliated person of such person, for the purchase by the Fund of Funds of shares of a Fund or (b) an affiliated person of a Fund, or an affiliated person of such person, for the sale by the Fund of its shares to a Fund of Funds is subject to section 17(e) of the Act. The Participation Agreement also will include this acknowledgment.
person controlling, controlled by, or under common control with the Fund of Funds Subadviser acts as the investment adviser within the meaning of section 2(a)(20)(A) of the Act (in the case of an Open-end Fund) or as the Sponsor (in the case of a UIT Fund). A registered separate account will seek voting instructions from its contract holders and will vote its shares in accordance with the instructions received and will vote those shares for which no instructions were received in the same proportion as the shares for which instructions were received. An unregistered separate account will either (i) vote its shares of the Fund in the same proportion as the vote of all other holders of the Fund’s shares; or (ii) seek voting instructions from its contract holders and vote its shares in accordance with the instructions received and vote those shares for which no instructions were received in the same proportion as the shares for which instructions were received.

2. No Fund of Funds or Fund of Funds Affiliate will cause any existing or potential investment by the Fund of Funds in shares of a Fund to influence the terms of any services or transactions between the Fund of Funds or a Fund of Funds Affiliate and the Fund or a Fund Affiliate.

3. The board of directors or trustees of an Investing Management Company, including a majority of the Disinterested Trustees, will adopt procedures reasonably designed to assure that the Fund of Funds Adviser and any Fund of Funds Subadviser are conducting the investment program of the Investing Management Company without taking into account any consideration received by the Investing Management Company or a Fund of Funds Affiliate from a Fund or a Fund Affiliate in connection with any services or transactions.

4. Once an investment by a Fund of Funds in the securities of an Open-end Fund exceeds the limit in section 12(d)(1)(A)(i) of the Act, the board of trustees of the Open-end Fund (“Board”), including a majority of the Disinterested Trustees, will determine that any consideration
paid by the Open-end Fund to a Fund of Funds or a Fund of Funds Affiliate in connection with any services or transactions: (a) is fair and reasonable in relation to the nature and quality of the services and benefits received by the Open-end Fund; (b) is within the range of consideration that the Open-end Fund would be required to pay to another unaffiliated entity in connection with the same services or transactions; and (c) does not involve overreaching on the part of any person concerned. This condition does not apply with respect to any services or transactions between an Open-end Fund and its investment adviser(s), or any person controlling, controlled by, or under common control with such investment adviser(s).

5. No Fund of Funds or Fund of Funds Affiliate (except to the extent it is acting in its capacity as an investment adviser to an Open-end Fund or Sponsor to a UIT Fund) will cause a Fund to purchase a security in any Affiliated Underwriting.

6. The Board of an Open-end Fund, including a majority of the Disinterested Trustees, will adopt procedures reasonably designed to monitor any purchases of securities by the Open-end Fund in an Affiliated Underwriting once an investment by a Fund of Funds in the securities of the Fund exceeds the limit in section 12(d)(1)(A)(i) of the Act, including any purchases made directly from an Underwriting Affiliate. The Board of the Open-end Fund will review these purchases periodically, but no less frequently than annually, to determine whether the purchases were influenced by the investment by the Fund of Funds in the Open-end Fund. The Board of the Open-end Fund will consider, among other things, (i) whether the purchases were consistent with the investment objectives and policies of the Open-end Fund; (ii) how the performance of securities purchased in an Affiliated Underwriting compares to the performance of comparable securities purchased during a comparable period of time in underwritings other than Affiliated Underwritings or to a benchmark such as a comparable market index; and (iii) whether the amount of securities
purchased by the Open-end Fund in Affiliated Underwritings and the amount purchased directly from an Underwriting Affiliate have changed significantly from prior years. The Board of the Open-end Fund will take any appropriate actions based on its review, including, if appropriate, the institution of procedures designed to assure that purchases of securities in Affiliated Underwritings are in the best interests of shareholders.

7. The Open-end Fund will maintain and preserve permanently in an easily accessible place a written copy of the procedures described in the preceding condition, and any modifications to such procedures, and will maintain and preserve for a period of not less than six years from the end of the fiscal year in which any purchase in an Affiliated Underwriting occurred, the first two years in an easily accessible place, a written record of each purchase of securities in Affiliated Underwritings once an investment by a Fund of Funds in the securities of the Open-end Fund exceeds the limit in section 12(d)(1)(A)(i) of the Act, setting forth from whom the securities were acquired, the identity of the underwriting syndicate’s members, the terms of the purchase, and the information or materials upon which the determinations of the Board of the Open-end Fund were made.

8. Before investing in a Fund in excess of the limits in section 12(d)(1)(A), the Fund of Funds and the Fund will execute a Participation Agreement stating, without limitation, that their boards of directors or trustees and their investment advisers, or Sponsors and trustees, as applicable, understand the terms and conditions of the order and agree to fulfill their responsibilities under the order. At the time of its investment in shares of an Open-end Fund in excess of the limit in section 12(d)(1)(A)(i), a Fund of Funds will notify the Open-end Fund of the investment. At such time, the Fund of Funds will also transmit to the Open-end Fund a list of the names of each Fund of Funds Affiliate and Underwriting Affiliate. The Fund of Funds will notify
the Open-end Fund of any changes to the list of the names as soon as reasonably practicable after a change occurs. The Fund and the Fund of Funds will maintain and preserve a copy of the order, the agreement and, in the case of an Open-end Fund, the list with any updated information for the duration of the investment and for a period of not less than six years thereafter, the first two years in an easily accessible place.

9. Before approving any advisory contract under section 15 of the Act, the board of directors or trustees of each Investing Management Company, including a majority of the Disinterested Trustees, will find that the advisory fees charged under such advisory contract are based on services provided that will be in addition to, rather than duplicative of, the services provided under the advisory contract(s) of any Open-end Fund in which the Investing Management Company may invest. These findings and their basis will be recorded fully in the minute books of the appropriate Investing Management Company.

10. A Fund of Funds Adviser or trustee or Sponsor of an Investing Trust will waive fees otherwise payable to it by the Fund of Funds in an amount at least equal to any compensation (including fees received pursuant to any plan adopted by an Open-end Fund under rule 12b-1 under the Act) received from a Fund by the Fund of Funds Adviser, trustee, or Sponsor of the Investing Trust, or an affiliated person of the Fund of Funds Adviser, trustee or Sponsor of the Investing Trust, other than any advisory fees paid to the Fund of Funds Adviser, trustee or Sponsor of the Investing Trust or its affiliated person, by an Open-end Fund, in connection with the investment by the Fund of Funds in the Fund. Any Fund of Funds Subadviser will waive fees otherwise payable to the Fund of Funds Subadviser, directly or indirectly, by the Investing Management Company in an amount at least equal to any compensation received from a Fund by the Fund of Funds Subadviser, or an affiliated person of the Fund of Funds Subadviser, other than any advisory fees
paid to the Fund of Funds Subadviser or its affiliated person by an Open-end Fund, in connection
with the investment by the Investing Management Company in the Fund made at the direction of
the Fund of Funds Subadviser. In the event that the Fund of Funds Subadviser waives fees, the
benefit of the waiver will be passed through to the Investing Management Company.

11. With respect to registered separate accounts that invest in a Fund of Funds, no sales
load will be charged at the Fund of Funds level or at the Fund level. Other sales charges and
service fees, as defined in Rule 2830 of the NASD Conduct Rules, if any, will only be charged at
the Fund of Funds level or at the Fund level, not both. With respect to other investments in a Fund
of Funds, any sales charges and/or service fees charged with respect to shares of the Fund of Funds
will not exceed the limits applicable to a fund of funds as set forth in Rule 2830 of the NASD
Conduct Rules.

12. No Fund will acquire securities of any investment company or company relying on
section 3(c)(1) or 3(c)(7) of the Act in excess of the limits contained in section 12(d)(1)(A) of the
Act, except to the extent permitted by an exemptive order that allows the Fund to purchase shares
of an affiliated money market fund for short-term cash management purposes or rule 12d1-1 under
the Act.

For the Commission, by the Division of Investment Management, pursuant to delegated
authority.

Florence E. Harmon
Deputy Secretary