

**PUBLIC**

JUN 14 1995

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-638  
Benson White &  
Company  
File No. 801-46820

Your letter of May 10, 1995 requests assurance that we would not recommend enforcement action to the Commission against Benson White & Company ("Benson White") or its affiliates if they offer, and provide asset allocation services in connection with, the Life Cycle Mutual Funds Program (the "Program") without registering the Program under the Investment Company Act of 1940 ("Investment Company Act") or registering the participants' accounts under the Securities Act of 1933 ("Securities Act"). You also seek our assurance that we would not recommend enforcement action to the Commission under section 36(b) of the Investment Company Act if Benson White or its affiliates are paid a management fee as described in your letter.

1. The Program

Under the Program, a participant's assets would be allocated among two or more of the following four mutual fund portfolios:<sup>1</sup> Life Cycle Equity Fund (the "Equity Fund"); Life Cycle Bond Fund (the "Bond Fund"); Life Cycle Retirement Income Fund (the "Retirement Fund"); and Life Cycle Harvest Fund (the "Harvest Fund").<sup>2</sup> Assets would be allocated in accordance with predetermined age-based asset allocation ratios.<sup>3</sup> In the event

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<sup>1</sup>Each of the portfolios would be a registered investment company or would be a series of a registered investment company.

<sup>2</sup>The Equity Fund would consist mostly of stocks included in the Standard & Poor's 500 Stock Index. The Bond Fund principally would invest in U.S. government securities of between five and ten years in duration. The Retirement Fund would invest in the same type of securities as the Bond Fund, except that the securities generally would have longer durations to generate additional cash flow. The Harvest Fund primarily would consist of short-term U.S. government securities; its investment objective would be the preservation of capital.

<sup>3</sup>Specifically, under the program, a participant's asset allocation would be 80% in the Equity Fund and 20% in the Bond Fund until the participant reaches age 46. Thereafter, on each successive birthday, the participant's asset allocation would be adjusted automatically to reflect a deduction of holdings in the Equity Fund and an increase in holdings in either the Bond Fund for investors age 65 or younger, or in the Retirement Fund for investors over 65.

The asset allocation formula would be compulsory for all investors except those who invest \$1 million or more. Such persons may invest directly in the portfolios and determine

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SECTION 3(a)

BATTLE FOWLER LLP  
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A PROFESSIONAL CORPORATION  
FEDERAL EXPRESS

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Attention: Office of Chief Counsel  
Division of Investment Management

Office of Chief Counsel  
Division of Corporate Finance

Re: Benson White & Company's  
Life Cycle Mutual Funds (the "Funds")

Ladies and Gentlemen:

We represent Benson White & Company ("Benson White") in connection with its proposal to offer tax-qualified retirement plans and IRAs, and their participants the opportunity to invest in the Life Cycle Mutual Funds Program (the "Program"), which will consist of four mutual fund portfolios (the "Portfolios"). Under the Program, a potential investor is offered a recommended allocation among the Portfolios which is uniquely determined solely based on such investors age and, in certain very limited circumstances, on fund performance and market conditions.

On behalf of Benson White, we are writing to request that the Staff of the Securities and Exchange Commission (the "Commission") confirm that it will not recommend enforcement action be taken against Benson White, or its affiliates, if (i) they provide the asset allocation service for the Program described below without registering the Program under the Investment Company Act of 1940 (the "1940 Act"), (ii) they provide the services and establish shareholder accounts in the

Funds in connection with the Program described below without registering the accounts under the Securities Act of 1933 (the "1933 Act") and (iii) they are paid the Management Fee (as described herein) for providing both the Program services as described herein as well as the investment advisory services for the Portfolios.

Background.

A. Benson White. Benson White is a registered investment advisor that will serve as investment advisor to the Portfolios. In addition, Benson White will create the asset allocation model offered to Program participants, including the determination of the hurdle rate (all as described herein). Benson White is not otherwise a fiduciary with respect to existing retirement plans which may invest or permit investment in the Program.

B. Life Cycle Mutual Funds. The Life Cycle Mutual Funds will consist of four separate mutual fund portfolios: Life Cycle Equity Fund (the "Equity Fund"); Life Cycle Bond Fund (the "Bond Fund"); Life Cycle Retirement Income Fund (the "Retirement Fund"); and Life Cycle Harvest Fund (the "Harvest Fund").

The Equity Fund will reflect value orientation with an emphasis on enhancing the Portfolio's current income. Normally between 90% and 100% of the assets in the Equity Fund portfolio will be invested on a buy and hold basis in certain of the stocks comprising the S&P 500.

The Bond Fund will generally hold fixed income investments of between 5 and 10 years in duration. Normally at least 75% of the Bond Fund's portfolio will be invested in securities that are issued or guaranteed as to principal and interest payment by the United States government, its agencies or instrumentalities. The Bond Fund may also invest in high-grade corporate obligations, certificates of deposit of large banks and high grade commercial paper.

The Retirement Fund is targeted to investors over 65 years of age and will generally hold fixed income investments of between 10 and 15 years in duration. The Retirement Fund will invest in securities similar to the Bond Fund, with somewhat longer durations, with the purpose of generating cash flow to older shareholders in the form of interest and principal payments.

The investment objective of the Harvest Fund is the preservation of capital. The Harvest Fund's portfolio will include only fixed income securities with a duration under 7 years and will primarily consist of Treasury securities with a duration of no more than 5 years. The Harvest Fund will hold

profits in excess of the hurdle rate that have been harvested from the Equity Fund (see "Hurdle Rates" below).

C. Asset Allocation. The investment philosophy of Benson White is based upon the premise that the single most relevant factor in determining portfolio strategy for retirement assets is the age of the investor. Benson White rejects traditional strategies that focus on wealth, risk appetite and overall allocation between retirement assets and general savings. Therefore, the heart of this philosophy is highly individualized in that it relates to the participant's actual birthday. Under the Program, all initial and subsequent purchases made in the Portfolios will be allocated between the Equity Fund and either the Bond Fund (up to age 65) or Retirement Fund (over age 65) in accordance with age-based asset allocation ratios predetermined by Benson White. The age-based asset allocations will not be changed on an interim basis. Until age 46 a shareholder's asset allocation will be 80% in the Equity Fund and 20% in the Bond Fund. Thereafter on each successive birthday, Program participants will automatically authorize an asset conversion that gradually decreases their holding in the Equity Fund and increases their holding in the Bond Fund (up to age 65) or Retirement Fund (over age 65). For example, at age 50 all shareholders would hold 70% of their account in the Equity Fund and 30% in the Bond Fund whereas at age 65 they would hold 50% in each Portfolio. While investors may redeem shares in any Portfolio, at any time, in whole or in part, any shares that remain in any of the Portfolios after a partial redemption will be reallocated among all the Portfolios in accordance with the Program. Investors with holdings of \$1,000,000 or more may opt out of the Program and initially determine an asset allocation different than the Program. Further, they will have an annual right to adjust their own allocation mix which may differ from the parameters of the Program.

D. Hurdle Rates. The hurdle rate is a given rate of return determined by Benson White, which may vary over time based upon the overall equity market (the "Hurdle Rate") that is applied annually to shares of the Equity Fund. Whenever the annual total return on shares in the Equity Fund which represent appreciation is in excess of the Hurdle Rate then in effect for that particular shareholder's age, a portion of their shares held in the Equity Fund reflecting the excess value over the Hurdle Rate are automatically exchanged for shares in the Harvest Fund (up to age 65) or the Retirement Fund (over age 65). There would be no such exchange of shares for shareholders in those years in which the annual total return on shares in the Equity Fund does not appreciate in excess of their applicable Hurdle Rate. The application of the Hurdle Rate is a risk management discipline which is age based and market sensitized. A different Hurdle Rate is determined for shareholders by age and will generally be higher for younger shareholders than older shareholders, because

younger shareholders have more time to make up for losses sustained in the equity market than do older shareholders. The calculation and application of the appropriate Hurdle Rate will depend upon prevailing values in the equity markets as measured by such traditional measures of market valuation as dividend yields, price to book ratios, and dividend yield and bond yield ratios. The Hurdle Rate is calculated at the beginning of each year and is applied to each shareholder's Equity Fund share holdings on an ongoing basis. Harvest Fund shares received by shareholders are not re-exchanged for Equity Fund Shares unless the equity market enters into a range that offers a unique opportunity and is considered of more reasonable valuation relative to historic market values. The test of "reasonable valuation" is based upon market conditions and, as described above, tempered with age-based judgment. Shares exchanged from the Equity Funds to the Retirement Fund remain in the Retirement Fund.

E. Market. The Funds are generally to be offered to tax-deferred retirement investors within the context of IRA, Keogh, SEP, 401(K), 403(b), 457, or other qualified tax-deferred investment mediums such as variable annuities. The decision to invest or to permit investment in the Portfolios through the Program will be made by independent fiduciaries of such retirement plans or by plan participants depending on the provisions of such plans.

F. Disclosure Documents. All shareholders will receive a standard mutual fund prospectus for each of the Portfolios prior to said purchase, describing the four individual Portfolios. Each prospectus will also include disclosure describing the automatic asset allocation based upon a shareholder's age and the use of the Hurdle Rate as a risk management technique. Each shareholder electing the Program will agree at the outset to allow Benson White to exchange shares among the Portfolios in accordance with the parameters set forth in the Program disclosure. The Program will not be available to shareholders who do not execute the fund exchange agreement (the "Exchange Agreement"), which grants Benson White the authority to exchange shares according to the Program. With the exception of investors of \$1,000,000 or more who are permitted to invest in the Portfolios directly and may opt out of the Program and choose their own allocation, each shareholder's shares will be allocated in accordance with the prospectus and Exchange Agreement. If the Program's recommended asset allocation is to be changed at any time subsequent to the initial subscription date, such revised investment allocation recommendation must be approved by the participant prior to its implementation with respect to their account. The shareholder will not be charged any loads or fees for exchanges among the Portfolios or for redemptions.

In addition, each shareholder will receive confirmations for each purchase or sale of shares as may be required by applicable laws or regulations and quarterly statements of such shareholder's account. Also, each shareholder will be provided with current prospectuses for each of the Portfolios, semi-annual and annual reports, proxy statements and all other information and disclosure required by any applicable laws or regulations. Finally, should shareholders have any questions or concerns regarding their investment, Benson White personnel will be reasonably available for consultation.

G. Beneficial Ownership. Under the Program, each shareholder retains beneficial ownership in their shares of the Portfolios and the records maintained by the Program will reflect the individual shareholder's ownership of shares. Payments by investors for their shares will be made directly to the Funds, not to Benson White. Each shareholder will be able to pledge and vote their shares in the Portfolios. As previously stated, shareholders may redeem their shares, in whole or in part, at any time. Finally, participation in the Program does not affect any available rights of each shareholder under appropriate federal and state securities laws to proceed directly against the issuer of any underlying security in its account and would not, because of participation in the Program, be obligated to join Benson White or any of its affiliates, or any other participant in the Program, as a condition precedent to proceeding against any issuer.

H. Distribution and Administration. Life Cycle Mutual Fund Distributors, a wholly-owned subsidiary of Furman Selz will act as distributor of the Portfolios. Furman Selz is not affiliated with Benson White. Furman Selz Incorporated will act as mutual fund administrator.

I. Fees, Expenses and Sales Load. Each Portfolio will have an initial front-end sales load of 4-1/4% payable to its distributor. In addition, each Portfolio's distribution plan pursuant to Rule 12b-1 under the 1940 Act will encompass a service fee of 25 basis points per year and an asset based sales charge for distribution assistance of 50 basis points per year. When available, a second class may be offered with no front-end load and a 1.00% 12b-1 fee. The Management Fee paid to Benson White, or its affiliates, for annual management and investment advisory services will be 75 basis points for each of the Portfolios. An investment in the Portfolios through the Program will not entail any additional or separate charges for the asset allocation services; however, Benson White reserves the right to assess an administrative account charge in connection therewith from the Program participants. Despite the differences in the Portfolios' investment objectives, a common advisory fee rate will eliminate the appearance that the advisor's allocation model may be affected by a particular Portfolio's advisory fee. Furman

Selz Incorporated, as administrator, will receive an annual administration fee of approximately 25 basis points per Portfolio. Other annual operating expenses, such as custodian charges and legal and audit fees are estimated to be 20 basis points per Portfolio. The sales charge will have a number of exemptions built into it to allow for the purchase of the Portfolios on a no-load basis and there will be break-points in the sales charge for volume purchases. This exemption would apply, for example, when selling to organized retirement plans such as 401(k)'s above a certain size.

### Discussion.

We are of the view that the Program would not constitute an investment company and so need not be registered under the 1940 Act. In our opinion the Program does not create or constitute a separate security within the meaning of the 1933 Act. Finally, we feel that the total investment advisory fees paid to Benson White and its affiliates constitute no more than reasonable compensation when all the advisory service rendered by Benson White to Program participants are considered.

A. Investment Company Classification. The Program as structured raises several issues under the 1940 Act. Each of the Portfolios making up the Program will be required to register as an investment company under the 1940 Act. At the current time, it is envisioned that the Portfolios will be separate series within an umbrella fund. Certain other asset allocation programs generally similar to the Program have raised questions about the creation of a deemed investment company at the level where the asset allocation service is rendered. This can occur where the participants of the plan give complete discretion to the asset allocation manager and that manager applies that discretion to all participants on a non-individualized basis. Proposed Rule 3a-4 under the 1940 Act would provide a safe harbor from the classification of a discretionary asset allocation service as an investment company. We do not believe, however, that the asset allocation plan component of the Program to be administered by Benson White (the "Asset Allocation Plan") as set forth in this letter constitutes an investment company. Our conclusion is based upon first, that the Asset Allocation Plan is not susceptible to characterization as a pooled investment vehicle, and thus as an investment company and second, in the alternative, that if the Asset Allocation Plan is considered to create a pooled investment vehicle, we believe it is sufficiently "individualized" for each investor in the Program to satisfy the Commission's concerns in this area, and would satisfy the requirements of Proposed Rule 3a-4.

We submit that, at its essence, the claim that an asset allocation plan might be an investment company is the fact that an "issuer" of securities is created when the interests of

multiple investors reflect a co-mingled common investment selected by a discretionary advisor. It is our contention that the Asset Allocation Plan is a *nondiscretionary* investment management service. A discretionary advisory relationship involves the delegation to the advisor of the decision making power over the securities in a client portfolio. The Asset Allocation Plan is fully disclosed to the investor in advance of his/her decision to invest in the Portfolios. The investor and not Benson White decides whether to accept or reject Benson White's asset allocation recommendations as evidenced by executing the Exchange Agreement and subscribing for shares on the one hand or by not purchasing shares or by selling all or part of their shares at any time on the other hand. The Program at hand will result in each participant electing to invest in the offered allocation.

This element which highlights investor choice rather than advisor discretion, also reflects that the Asset Allocation Plan does not involve a "co-mingled" vehicle. The Program will result in different allocations for each investor depending upon their age. At worst, we would argue that separate investment companies will be created for each age bracket that reflects a different asset allocation. However, since the asset allocation model of the Program requires a shift in investment on the actual birthday of the participant, there will be no meaningful commonality of investment over the course of an entire year even for those in the same age bracket.

Additionally, investors with holdings of \$1,000,000 or more may opt out of the Program and purchase shares directly in the Portfolios and institute their own asset allocation plan - which is certainly not an investment company. Further, under the Program there is no pooling or co-mingling of investor accounts. Each investor would retain direct beneficial ownership in shares of the Portfolios and the records of the Funds would reflect such. Finally, the underlying premise of the Program is that the initial allocation is only adjusted automatically on the participant's birthday and does not involve continuing judgment by Benson White beyond the description of the Program as disclosed. We, therefore, submit that the Program doesn't present facts supporting a common investment susceptible to the characterization of a separate "issuer". Since the investment portfolios of the participants will not generally be identical this Program is more akin to a series of private non-discretionary accounts.

Even if the Asset Allocation Plan were considered to qualify as an issuer and entail discretionary services, we contend that these services are provided on an individualized basis since each participant can (i) decide to enter the Program offered by Benson White or not, and (ii) redeem all or part of

their Portfolio shares at any time\*. Most importantly, the individualized nature of the service is further evidenced by the fact that each participant's account will reflect an allocation sensitive to their particular birthdate and differ among all investors. Benson White's retirement investment philosophy, as has been previously discussed, uniquely looks to the investor's age as the cornerstone of the strategy for that investor's retirement portfolio. While this emphasis may not be a traditional one, we submit that a birthday based strategy is clearly individualized to that investor. While the Asset Allocation Plan does not require regular review with the client, it is no less individualized merely because its thrust, by definition, does not require periodic adjustment because of facts that may sometimes fluctuate but rather is focused on an equally individualized (but not varying) fact-one's birthdate.

The Commission has decided against adopting a rule defining which investment management services must register as investment companies under the 1940 Act and by not formally adopting the Rule 3a-4 safe harbor since its original proposal in 1980. It was the view of the Advisory Committee on Investment Management Services for Individual Investors (the "Advisory Committee") that, whether or not individualization is afforded, an investment company is not created where clients retain all the incidents of ownership of securities in their portfolios, and there is no pooling of assets in the conventional sense. The Advisory Committee recommended that clients of those services not subject to Securities Act registration receive an information statement disclosing material facts concerning the services offered. Investment Company Act of 1940 Release No. 11391 (October 10, 1980). As we have previously stated, under the Program there is no pooling or co-mingling of investor accounts. The Fund prospectuses will include the type of information recommended by the Advisory Committee.

B. 1933 Act. As described above, we believe that the Asset Allocation Plan and participation in the Program do not create a separate issuer. Therefore, it is our opinion that shareholders will not be investing in any other security other than their shares of the Funds. Shares of the Funds will, of course, be registered under the 1933 Act. Even if the Asset Allocation Plan were considered to be a "discretionary" account, the Commission's Division of Corporate Finance has indicated that "if proposed rule 3a-4 were adopted, the Division would take the view that discretionary advisory arrangements meeting the requirements of the rule should not be regarded themselves as

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\* In addition, investors of \$1,000,000 or more may decide to buy the Portfolios in accordance with their own asset allocation model and/or change their asset allocation on an annual basis.

securities for purposes of the [1933] Securities Act". Investment Company Act of 1940 Release No. 11391 (October 10, 1980) at note 15. Regarding a number of managed account programs which have been considered in prior no-action letters, the Commission has consistently stated that it would not recommend enforcement action under either the 1933 Act or the 1940 Act provided that each investor would retain beneficial ownership in their investment company shares. See United Missouri Bank of Kansas City, n.a. (available January 23, 1995), Westfield Consultants Group (available December 13, 1991) and Fidelity Managed Accounts (available December 13, 1988). As previously described herein, investors in the Program would retain all indicia of ownership in the shares of the Portfolio. and the records of the Funds would reflect such beneficial ownership.

C. Fee Structure. Section 36(b) of the 1940 Act imposes a fiduciary duty upon an investment adviser and its affiliates with respect to the receipt of compensation for services, and authorizes lawsuits by the Commission or shareholders for breach of this duty. The leading authorities on the evaluation of the amount of compensation received by an investment adviser are Gartenberg v. Merrill Lynch Asset Management, Inc., 528 F. Supp. 1038 (S.D.N.Y. 1981), aff'd, 694 F.2d 923 (2d Cir. 1982), cert. denied, 461 U.S. 906, 103 S. Ct. 1877 (1983) ("Gartenberg I"), Gartenberg v. Merrill Lynch Asset Management, Inc., 573 F. Supp. 1293 (S.D.N.Y. 1983), aff'd, 740 F.2d 190 (2d Cir. 1984) ("Gartenberg II") and Schuyt v. Rowe Price Prime Reserve Fund, Inc., 663 F. Supp. 962 (S.D.N.Y. 1987), aff'd, 835 F.2d 45 (2d Cir. 1987), cert. denied, 108 S. Ct. 1594 (1988). Gartenberg I, Gartenberg II and Schuyt were tried on the merits and dismissed and these dismissals have been affirmed. The reasoning of these opinions were reaffirmed in Krinsk v. Fund Asset Management, Inc., 875 F.2d 404 (2d Cir. 1989), cert. denied, 110 S. Ct. 281 (1989) and in Kalish v. Franklin Advisers, Inc., 742 F. Supp. 1227 (S.D.N.Y. 1990), aff'd, on other grounds, 928 F.2d 590 (2d Cir. 1991).

In analyzing Section 36(b), the Court of Appeals in Gartenberg I took cognizance of the fact that the relationship between an investment company and its investment adviser is such that the forces of arm's-length bargaining will not work in the mutual fund industry in the same manner as they do in other sectors of the American economy. The Court noted that, under Section 36(b), "the test is essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." 694 F.2d at 928. The Court further stated that "[t]o be guilty of a violation of §36(b), therefore, the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length

bargaining. . . . To make this determination all pertinent facts must be weighed." 694 F.2d at 928.

The Court of Appeals then offered the following interpretation of the meaning of Section 36(b):

Congress, however, recognized that because of the potentially incestuous relationships between many advisers and their funds, other factors [in addition to comparative fees] may be more important in determining whether a fee is so excessive as to constitute a 'breach of fiduciary duty.' These include the adviser-manager's cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager. The legislative history of §36(b) makes clear that Congress

'intended that the court look at all the facts in connection with the determination and receipt of such compensation, including all services rendered to the fund or its shareholders and all compensation and payments received, in order to reach a decision as to whether the adviser has properly acted as a fiduciary in relation to such compensation.' S. Rep. No. 91-184, [1970] U.S. Code Cong. & Ad. News at 4910. (Emphasis added).

694 F.2d at 929-930.

Accepting the "guidance" of the Court of Appeals opinion in Gartenberg I as to collateral benefits, the District Court in Gartenberg II evaluated the fee from the standpoint of "benefits actually and constructively attained" by the advisor and in light of "the realization of constructive side benefits to [the advisor]." 573 F. Supp. at 1298. Therefore, the District Court abandoned the free market theory that it had espoused in its Gartenberg I decision and not only accepted profitability as a relevant factor but assessed it in the sense of the total economic analysis theory advanced by the Second Circuit. The total economic analysis theory advanced by the Second Circuit in the Gartenberg decisions was followed by the Second Circuit in Krinsk where the Court stated:

The following factors are to be considered in applying this standard: (a) the nature and quality of services provided to fund shareholders; (b) the profitability of the Fund to the adviser-manager; (c) fall-out benefits; (d) economies of scale; (e) comparative fee structures;

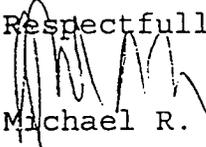
and (f) the independence and conscientiousness of the trustees. Krinsk, 875 F.2d at 409.

Giving consideration to the overall nature and quality of the services to be provided to the Program and its shareholders by Benson White, including but not limited to, investment advisory and management services to the individual Portfolios, determination of the Asset Allocation Plan and determination of the Hurdle Rate, we believe that the total fees paid to Benson White and its affiliates constitute no more than reasonable compensation. The fees paid to Benson White should be judged in the context of the comprehensive bundle of services which Benson White provides not merely to the individual Portfolios themselves but to the Program participants. Fund investors will be well informed of the nature of services provided to Program participants as well as the cost of those services. All fees associated with the Program will be disclosed to each investor in one document, namely the prospectus, in one place. We submit that as a matter of law, the value of the asset allocation service provided to all investors in the Program should be weighed under the Section 36(b) analysis.

Conclusion.

Based on the foregoing, it is our view that (i) the Program will neither constitute an investment company nor involve securities other than the shares of the underlying Portfolios and (ii) in light of the comprehensive bundle of services being provided, the total fees to be paid to Benson White and its affiliates are not excessive. Accordingly, we therefore request confirmation that the staff would not recommend any enforcement action under the Act. Please feel free to call the undersigned or Gary Rawitz (at (212) 856-6877), collect, at any time, if you have any questions regarding this matter.

Respectfully submitted,

  
Michael R. Rosella