

NATIONAL DEFERRED COMPENSATION, INC.

Investment Company Act of 1940 -- Section 3(a), 206

Aug 31, 1987

TOTAL NUMBER OF LETTERS: 2

**SEC-REPLY-1:
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
July 31, 1987**

**RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT
Our Ref. No. 87-339-CC
National Deferred Compensation, Inc.
File No. 132-3**

In your letter of June 12, 1987, you request our assurance that we would not recommend any enforcement action to the Commission under the Investment Company Act of 1940 ("1940 Act") if National Deferred Compensation, Inc ("NDC") and related entities establish and administer certain employer-sponsored payroll reduction or deduction plans without registration of these arrangements under the 1940 Act. NDC will act as the investment adviser, Bank One of Columbus, N.A. ("Bank One") will act as custodian, and Bank One Compensation Services, Inc. ("BOCS") will perform transaction processing services. According to your letter, NDC will provide individualized advice to participants, participants' accounts will be separately and individually maintained by Bank One, and each participant will retain the right to withdraw, hypothecate, vote, or pledge the securities in his account. You conclude that this proposed arrangement meets the conditions discussed in prior Commission releases and no-action letters n1 and, therefore, should not be considered an investment company. We would not recommend any enforcement action under the 1940 Act if NDC and its related entities implement the arrangement described in your letter without registration under the 1940 Act. Our position is based on the facts and representations made in your letter, particularly that, except for Bank One's limited discretion to redeem mutual fund shares to pay expenses, neither NDC, Bank One, nor BOCS will have discretion to make initial investments or to change investments. n2

Your letter also raises certain issues under the Investment Advisors Act of 1940 ("Advisers Act"). According to your letter, NDC may assess a surrender fee if a participant's account withdraws from the advisory services of NDC or if a mutual fund investment is changed to an insurance company investment. In our opinion, the imposition of this surrender fee may violate Section 206 of the Advisers Act. In SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963), the Supreme Court stated that an investment adviser is a fiduciary. As such, an adviser is held to the highest standards of conduct and must act in the best interest of the client. An adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service n3 or if it imposes an additional fee on a client for choosing to change his investment.

Your letter also states that all purchases and sales of mutual fund shares will be made through Mollman & Associates Securities, Inc. ("MASI") a broker-dealer affiliated with NDC. You should note that, as a fiduciary, NDC would have a duty to seek best execution of clients' transactions and a duty to disclose its affiliation with MASI and potential conflicts of interest resulting from this affiliation. n4

Footnotes

n1 E.g., Investment Company Act Rel. No. 11391 (Oct. 10, 1980); No-Load Timing Service, Inc. (pub. avail. Nov. 28, 1983); Shearson/American Express, Inc. (pub. avail. July 13, 1983).

n2 See Baillett, Blackstock & Stearns, Inc. (pub. avail. Aug. 19, 1987) (staff refused to grant no-action relief under the 1940 Act in a situation where an adviser exercised discretion over, and provided

substantially similar advice to, several accounts that would invest in mutual funds).

n3 Cf. Robert D. Brown Investment Counsel, Inc. (pub. avail. July 19, 1984) (staff stated that it may violate Section 206 if a contract for investment supervisory services contained a provision restricting a client's ability to terminate the contract or forcing the client to forfeit a portion of prepaid fees in the event of termination).

n4 See John Terwilliger (pub. avail. June 27, 1977); Investment Advisers Act Rel. No. 770 (Aug. 13, 1981).

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June 12, 1987

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

Re: National Deferred Compensation, Inc.

Dear Ms. Podesta:

On behalf of National Deferred Compensation, Inc. ("NDC") and its related entities, we request that you advise us that the Division will not recommend enforcement action to the Commission in the event that NDC and its related entities establish and administer employer sponsored payroll reduction or deduction plans, including deferred compensation arrangements, under Internal Revenue Code § 401(k), 403(b) and 457, without registration of such under the Investment Company Act of 1940, as amended (the "Investment Company Act").

NDC is in the process of becoming an investment adviser registered under the Investment Advisers Act of 1940. NDC presently administers deferred compensation plans for certain public employees in the states of Ohio and Kentucky. NDC has entered into an arrangement with Bank One of Columbus, NA ("Bank One") whereby the two companies have formed and own Bank One Compensation Services, Inc. ("BOCS") with Bank One maintaining 80 percent of the voting control. NDC proposes to act as the investment adviser and proposes that BOCS will perform the transaction processing for such deferred compensation arrangements to be established with various public and private employers (including state, city and county governments, boards of education, etc.). The employer will agree to withhold from a participating employee's regular wages an amount specified by the employee. The withheld amounts will be paid directly to Bank One as custodian and will not be held by NDC or BOCS at any time.

A participating employee ("participant") will have the option of investing his deferred compensation in various insurance and securities products, more specifically fixed annuity contracts, variable annuities or no-load mutual funds. These options will be explained to each employee by NDC and its affiliate, Mollman & Associates Securities, Inc. ("MASI"), a broker-dealer registered under the Securities Exchange Act of 1934. If a participant elects to invest in fixed annuity contracts or variable annuities,

Bank One will forward the funds directly to the insurance carrier. No commissions will be charged directly to the participant, but commissions will be paid from the insurance carrier to MASI for variable annuities or to Financial Information Services Agency, Inc. ("FISA"), an affiliate of NDC and an insurance agency, for annuity and other insurance contracts. BOCS will administer the plan, track the contributions and investments and will receive a fee for its transactional and recordkeeping charges.

If a participant elects to invest in mutual funds, the participant will choose the fund(s) from a group of no-load mutual funds chosen and listed by NDC as approved funds. NDC will be responsible for continually reviewing the list of funds to determine whether additional funds should be added or certain funds deleted from the approved list. The participant will have the sole discretion, however, of choosing the desired fund from among those on the list. All purchases and sales of mutual fund shares will be made through MASI. Each participant will execute a subscription agreement setting forth specific instructions to BOCS as to the mutual fund(s) in which to invest and will direct Bank One, the custodian, to directly transfer the deferred wages to the appropriate fund. Neither NDC nor BOCS will have discretionary authority to make initial investments or to change the investments. Bank One will have limited discretion solely for the purpose of redeeming mutual fund shares as appropriate to pay transactional costs to BOCS and Bank One and to pay investment advisory fees to NDC.

NDC will conduct an initial meeting with each participant and will provide investment consultation with respect to the amount of wages to be deferred, the tax consequences of such deferral, and the various investment options available under the plan that are appropriate for the participant. NDC will provide follow-up advice to each participant concerning that participant's financial circumstances, designated investment goals, degree of risk and other relevant items. NDC will at all times be reasonably available to participants for consultation regarding that participant's investment account. Each participant will have access to an 800 telephone number to contact a representative of NDC to discuss his investment. At the request of the participant, representatives of NDC will be available at specified times and locations to meet and discuss that person's financial condition and goals. NDC will provide each participant with an annual statement as to the status of his or her account with an annual statement as to the status of his or her account and will include a questionnaire to be returned to NDC requesting updated information about the participant's financial condition and goals.

Although it is likely that participants in many cases will be treated similarly, it is anticipated that the individual requests, financial situation, needs and instructions to NDC will result in differing treatment. While NDC does propose to manage in similar ways those participants whose financial conditions, goals and risk-taking philosophies are similar, this will be subject to variations in treatment required by the individual needs and goals of different participants.

NDC, through BOCS, will send certain notifications and reports to participants. Confirmations will be sent to the participants at the initial investment in a mutual fund and upon any change by the participant between funds or withdrawal from a fund. In addition, quarterly confirmation of the total of all transactions by the participant will be provided to such participant. NDC will provide to each participant quarterly statements of his account, including a request to the participant to advise NDC of any changes in financial position or investment goals. NDC will also provide each employee with an annual statement concerning the status of the employee's account.

BOCS' primary responsibility will be to provide accounting and recordkeeping of the investments in each participant's account. The mutual fund shares will be held by Bank One or its nominee, as custodian for the plan, and BOCS will be responsible to maintain a record of the beneficial ownership of the shares. BOCS will have no discretionary authority with respect to any investments and at no time will have possession of any participant's funds. Bank One will be responsible for the distribution of any funds in the event of termination, retirement, or like event, and for liquidating or redeeming shares of the mutual funds in order to provide payment to NDC for advisory services or to BOCS for transaction fees. Each participant will specifically authorize such share redemptions in the subscription agreement signed at the outset by the participant. Bank One and BOCS will be responsible for sending proxy information to the participant or having the proxy information sent directly to the participant from each mutual fund. Bank One will not vote any of the mutual fund shares on behalf of the participants.

Each participant will maintain all indicia of ownership of the mutual fund shares except that the shares will be held by Bank One as beneficial owner and custodian for the participant. The participants'

accounts will be separately and individually maintained and will not be "pooled" by Bank One. However, Bank One may aggregate the contemporaneous buy or sell orders for the same securities in order to obtain lower per share brokerage costs, if appropriate. Each participant will retain the right to withdraw, hypothecate, vote or pledge the securities and each participant may terminate his or her investment or instruct Bank One to refrain from specific investments or transactions, subject to the plan requirements and Internal Revenue Service restrictions related to deferred compensation plans.

NDC will receive from each participant for its investment advisory services a fee equal to 1% of the total assets under management on an annual basis. This would include only the value of those assets which are invested in the no load mutual fund alternative. In addition, NDC may assess a surrender fee which will apply to any participant's account where that account is withdrawn from under the advisory services of NDC. This would include withdrawals for distribution in the event of termination of the plan or a change from the mutual fund investment to an insurance contract investment. No surrender fee will be charged in the event of any changes from one mutual fund to another approved mutual fund or for a change within a family of approved mutual funds. The surrender fee will be computed under a first-in, first-out method of accounting and will be equal to 5% of the value of the total assets if the contract is terminated within the first year of investment, 4% after the first year, 3% after the second year, 2% after the third year, and 1% after the fourth year and no surrender after the fifth year. This will be computed on a "rolling five-year basis" and will accrue or be reduced on a calendar quarter-by-quarter basis for all new investments during each quarter. BOCS will receive as a fee a fixed amount per month and/or per transaction and/or per participant fee (i.e. one dollar per month per participant). This fee will be assessed against all participating employees, whether investing in mutual funds, fixed contracts or variable annuities. Bank One will receive as compensation, its normal and customary fees for acting as custodian.

NDC will discuss with each participant the size of its charges in relation to services rendered and will disclose the possibility that similar or more comprehensive services may be available at lower cost from other advisers. The fact that the mutual funds themselves have retained investment advisers whose services are being paid for by the funds, and thus out of the participant's account, will also be disclosed. Each participant will be advised that NDC's services do not guarantee results.

We believe that the services proposed to be offered by NDC and its affiliates do not create an investment company required to be registered under the Investment Company Act. We rely for this position on the following authorities: (i) proposed Rule 3a-4, promulgated under the Investment Company Act; (ii) Investment Company Act Release No. 11391 (1980), Fed. Sec. L. Rep. (CCH) P82,662 (October 1980); (iii) No-Load Timing Service, Inc., SEC No-Action Letter of November 28, 1983; (iv) Shearson/American Express, Inc., SEC No-Action Letter of July 13, 1983; and (v) Paley & Ganz, Inc., SEC No-Action Letter of December 6, 1982. We believe that the plan proposed by NDC differs in insignificant respects from those proposed in the above no-action letters and the proposed Rule.

Based on the foregoing, it is our view that the plan described above should not be deemed to establish an investment company under the Investment Company Act. We therefore request confirmation that this staff will not recommend any enforcement action against NDC or its affiliates if they implement the proposed plan described herein without registration under the Investment Company Act of 1940.

Please telephone the undersigned of this firm (614/462-5400) if you have any questions regarding the foregoing request or require any additional information.

Sincerely,
Jack A. Bjerke