

retirement payments begin, or upon payment of a death benefit.

### Applicants' Legal Analysis

1. Applicants request an exemption pursuant to section 6(c) from sections 26(a)(2)(C) and 27(c)(2) to the extent necessary to permit the deduction from Fund BD II and Other Accounts of the Mortality and Expense Risk Charge. Sections 26(a)(2)(C) and 27(c)(2) of the Act, in relevant part, prohibit a registered unit investment trust, its depositor or principal underwriter, from selling periodic payment plan certificates unless the proceeds of all payments, other than sales loads, are deposited with a qualified bank and held under arrangements which prohibit any payment to the depositor or principal underwriter except a reasonable fee, as the Commission may prescribe, for performing bookkeeping and other administrative duties normally performed by the bank itself.

2. Section 6(c) of the Act authorizes the Commission to exempt any person from any provision of the Act or any rule or regulation thereunder, if and to the extent that 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.

3. Applicants also request relief with respect to Future Contracts that may be funded by Fund BD II and Other Accounts. Applicants represent that the terms of the relief requested with respect to any Future Contracts are consistent with the standards of section 6(c) of the Act. Without the requested relief, applicants represent that they would have to request and obtain exemptive relief for Future Contracts and any Other Account. Applicants represent that these additional requests for exemptive relief would present no issues under the Act not already addressed in this application, and that investors would not receive any benefits or additional protections thereby.

4. Applicants represent that the requested relief is appropriate in the public interest, because it would promote competitiveness in the variable annuity contract market by eliminating the need for applicants to file redundant exemptive applications, thereby reducing their administrative expenses and maximizing the efficient use of resources. The delay and expense involved in repeatedly seeking exemptive relief would reduce applicants' ability to effectively take advantage of business opportunities as they arise.

5. Applicants represent that the 1.02% mortality and expense risk charge for Contracts providing the standard death benefit is reasonable in relation to the risks assumed by TLAC under the Contracts and is within the range of industry practice for comparable annuity contracts. This representation is based on an analysis of publicly available information regarding similar contracts of other companies, taking into consideration such features as the charge levels, the benefits provided, and investment options under the contracts. TLAC will maintain at its home office, and make available to the SEC upon request, a memorandum setting forth in detail the products analyzed and the methodology and results of applicants' comparative review.

6. Applicants represent that the mortality and expense risk charge of 1.30% for Contracts providing the enhanced death benefit is reasonable in relation to the risks assumed by TLAC under the Contracts. Based on its analysis, TLAC determined that an additional mortality risk charge of .28% was a reasonable charge for the enhanced death benefit. TLAC will maintain at its home office, and make available to the SEC upon request, a memorandum setting forth in detail the methodology used in applicants review.

7. Applicants acknowledge that distribution expenses may in part be financed by profits derived from the mortality and expense risk charges. TLAC has concluded that there is a reasonable likelihood that the proposed distribution financing arrangement will benefit Fund BD II and investors in the Contracts. TLAC will maintain and make available to the Commission upon request a memorandum at its home office setting forth the basis of such conclusion.

8. The Accounts will invest in a management investment company that has adopted a plan pursuant to rule 12b-1 under the Act only if that company has undertaken to have such plan formulated and approved by its board of directors, a majority of whom are not "interested persons" of the company within the meaning of section 2(a) (19) of the Act.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Rel. No. IC-21174; 812-9132]

### Harris & Harris Group, Inc.; Notice of Application

June 29, 1995.

**AGENCY:** Securities and Exchange Commission ("SEC").

**ACTION:** Notice of Application for Exemption under the Investment Company Act of 1940 (the "Act").

**APPLICANT:** Harris & Harris Group, Inc.

**RELEVANT ACT SECTIONS:** Order requested pursuant to sections 6(c) and 61(a) granting an exemption from sections 18(d), 23(b), 61(a)(3)(B), and 61(b).

**SUMMARY OF APPLICATION:** Applicant is a closed-end registered investment company that intends to elect business development company ("BDC") status under the Act. Before becoming a registered investment company, applicant issued warrants that currently are held by two of its officers (the "Warrants") and issued stock options to certain officers and non-employee directors (the "Options"). Upon applicant's election of BDC status, the requested order would permit the Warrants and Options to remain exercisable pursuant to their terms as if they had been issued pursuant to an executive compensation plan conforming to section 61(a)(3)(B) of the Act.

**FILING DATES:** The application was filed on July 29, 1994 and amended on November 3, 1994 and June 29, 1995.

**HEARING OR NOTIFICATION OF HEARING:** An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the SEC's Secretary and serving applicant with a copy of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on July 24, 1995, and should be accompanied by proof of service on applicant, 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 the date of a hearing may request notification by writing to the SEC's Secretary.

**ADDRESSES:** Secretary, SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Applicant, One Rockefeller Plaza, New York, NY 10020.

**FOR FURTHER INFORMATION CONTACT:** Marianne H. Khawly, Staff Attorney, at (202) 942-0562, or C. David Messman, Branch Chief, at (202) 942-0564 (Division of Investment Management, Office of Investment Company Regulation).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application is available for a fee from the SEC's Public Reference Branch.

### Applicant's Representations

1. In 1981, applicant was incorporated under the laws of New York. In 1982, applicant first registered securities under the Securities Act of 1933. Also in 1982, applicant began filing periodic reports under the Securities Exchange Act of 1934. From its inception to 1984, applicant was primarily engaged in the breeding and syndication of thoroughbred horses. In 1985, applicant began developing its financial and consulting services and by November 1986 had no operations pertaining to the thoroughbred industry.

2. On September 25, 1985, applicant acquired a minority interest in a subsidiary by exchanging applicant's common stock and issuing Warrants to purchase common stock of applicant. On March 26, 1986, C. Richard Childress and Charles E. Harris, officers of applicant, purchased 149,965 and 335,657 of these Warrants (then due to expire in September 1989), respectively, from the holders of the Warrants in a negotiated transaction for cash. The exercise price of the Warrants was floating with the minimum exercise price equal to \$1.24 per share and the maximum exercise price equal to \$2.06 per share.

3. On August 3, 1989, applicant's shareholders approved modifications to the terms of the Warrants. The modifications decreased the number of shares subject to Mr. Childress's and Mr. Harris's Warrants to 106,158 and 237,605 shares, respectively, extended the expiration date to September 1999, and changed the exercise price to a flat \$2.06 per share. Currently, the shares subject to the Warrants constitute approximately 3.34% of applicant's outstanding voting securities.

4. Also on August 3, 1989, applicant's shareholders approved a proposal by the Board of Directors to institute applicant's Long-Term Incentive Compensation Plan (the "Plan"). The Plan provides for the grant of stock-based awards, including incentive stock options and non-qualified options to officers, directors, and employees, up to a maximum of 1,200,000 shares of applicant's common stock.

5. On July 31, 1992, applicant registered as a closed-end, non-diversified, investment company under the Act. Applicant was internally managed and its primary investment objective was long-term growth through capital appreciation.

6. On April 20, 1994, the Board determined that it would be in the best interests of the shareholders to elect to be regulated as a BDC under sections 55 through 65 of the Act.<sup>1</sup> Also on that date, in anticipation of electing BDC status, the Board adopted amendments to the Plan in order to increase the reserved shares and to otherwise conform the Plan to the requirements of section 61 of the Act (the "Amended Plan"). On June 30, 1994, applicant's shareholders approved the Amended Plan, with the continued existence of the outstanding Warrants and Options, and applicant's conversion to BDC status.

7. As of May 26, 1995, applicant and 10,304,542 shares of outstanding common stock and outstanding Options written on 531,349 shares of common stock. All outstanding Options are held by officers (191,349 shares) or non-employee directors (350,000 shares). The shares subject to the Options constitute approximately 5.16% of applicant's outstanding voting securities.

8. The Options expire 10 years from their date of issuance, except 173,349 Options issued to Mr. Harris that expire only five years after their issuance. All of the Options were immediately exercisable at the time of issuance, except 8,000 Options issued to Rachel Pernia, an officer, that vest over a five year period. Of those 8,000 Options, 4,800 Options currently are exercisable and the remaining 3,200 Options vest over the next two years.

9. All Warrant and Option holders have executed an undertaking stating that the Warrants and Options are deemed to have been issued pursuant to the Amended Plan and are governed by the terms of the Amended Plan in accordance with section 61(a)(3)(B) of the Act.

10. Applicant's non-employee directors hold quarterly meetings, set general policy, review with management proposed and current investment ideas and prospects, and either approve or disapprove the expenditures of applicant's assets in such ventures. The Board expects the non-employee directors to continue to function in the same manner after election of BDC status. Applicant's non-employee directors receive nominal cash

<sup>1</sup> Section 2(a)(48) defines a BDC to be any closed-end investment company that operates for the purpose of making investments in securities described in sections 55(a)(1) through 55(a)(3) and makes available significant managerial assistance with respect to the issuers of such securities. Such issuers are small, nascent companies whose securities typically are illiquid. Certain of the regulatory restrictions of the Act are relaxed for BDCs.

compensation and benefits as salaries for their services.

### Applicant's Legal Analysis

1. Applicant states that due to the outstanding Warrants and Options, its capital structure did not comply with section 18 at the time of its registration as an investment company.<sup>2</sup> A company whose capital structure does not comply with section 18 may register, however, as an investment company without changing its capital structure.<sup>3</sup>

2. Section 61(b) requires that a BDC shall comply with the provisions of section 61 at the time it becomes subject to sections 55 through 65, as if it were issuing a security of each class which it has outstanding at such time. Thus, absent exemptive relief, applicant cannot have a non-conforming capital structure at the time it elects BDC status.

3. Applicant requests an order under sections 6(c) and 61(a) exempting it from the provisions of sections 18(d), 23(b), 61(a)(3)(B), and 61(b) of the Act. Upon Applicant's election of BDC status, the requested order would permit the Warrants, currently held by two executive officers, and the Options, currently held by officers and non-employee directors, to remain exercisable pursuant to their terms as if they had been issued pursuant to an executive compensation plan under section 61(a)(3)(B) of the Act.

4. Section 61(a)(3)(B) states that a BDC may issue to its directors, officers, employees, and general partners, warrants, options, and rights to purchase its voting securities pursuant to an executive compensation plan, provided that: (a) Such warrants, options, and rights, expire by their terms within ten years, have an exercise price that is not less than the current market value of the underlying securities at the date of issuance, and are not transferable except for dispositions by gift, will or intestacy; (b) the proposal to issue such warrants, options, and rights is authorized by the BDC's shareholders; (c) no investment adviser of the BDC receives any compensation described in section

<sup>2</sup> Section 18(a) limits the ability of a registered, closed-end investment company to issue senior securities, and section 18(d) prohibits a registered, closed-end investment company from issuing warrants unless they expire within 120 days of issuance.

<sup>3</sup> Although section 18 clearly reflects Congressional concern with the dilutive effect on an investment company's common stock of senior securities in general, and long-term warrants in particular, the SEC staff has taken the position that the statute only prohibits an investment company from issuing certain securities concurrent with or subsequent to its registration. See *Surfcastle* (pub. avail. Mar. 14, 1988); *The South America Fund N.V.* (pub. avail. Sept. 2, 1993).

205(1) of the Investment Advisers Act of 1940, except to the extent permitted by clause (A) or (B) of that section; and (d) the BDC does not have a profit-sharing plan as described in section 57(n) of the Act. In addition, Commission approval is required if warrants, options, and rights are to be issued to directors who are not officers or employees of the BDC.

5. The Warrants and Options expire by their terms within ten years and their issuance was approved by shareholders. Applicant is internally managed and does not have a profit-sharing plan. The Options are not transferable except for dispositions by gift, will or intestacy. While the Warrants are transferable, each Warrant holder has executed an undertaking agreeing that the Warrants will not be transferred except for dispositions by gift, will or intestacy.

6. Applicant requests relief from section 61(b) to permit the Warrants and Options to remain outstanding at their current exercise prices after applicant elects BDC status. Applicant states that at the time the Warrants and Options were granted, applicant was not subject to the Act and did not expect to become subject to the Act. Applicant asserts that Congress intended section 61(b) to require that a company have an appropriate capital structure if it sought to take advantage of the more liberal provisions of the Act applicable to BDCs. Congress stated that "a highly leveraged company" could not elect to be subject to sections 55 through 65 until it had a capital structure that conformed to the leverage limitations established by section 18. Applicant states that it does not have any leverage because it has not issued any debt securities. Thus, applicant asserts that it does not fall within the category of "a highly leveraged company" that Congress sought to cover and therefore should not be required to cancel the Warrants and Options and reissue them with current market prices when it elects BDC status.

7. Section 18(d) of the Act makes it unlawful for any registered management investment company to issue any warrant or right to subscribe to or purchase a security of which such company is the issuer, except in the form of warrants or rights to subscribe expiring not later than 120 days after their issuance and issued exclusively to a class or classes of such company's security holders. Section 61(a) makes section 18(d) applicable to BDCs, subject to certain modifications not applicable here. Thus, applicant requests exemptive relief from section 18(d) because the Warrants expire more than 120 days after their issuance.

8. Section 23(b) states that no registered closed-end investment company shall sell any common stock of which it is the issuer at a price below the current net asset value of such stock. Section 63 makes section 23(b) applicable to BDCs, subject to certain exceptions. Section 63(3) provides that a BDC may sell any common stock of which it is the issuer at a price below the current net asset value of such stock upon the exercise of any warrant, option, or right issued in accordance with section 61(a)(3). Applicant contends that since the relief sought hereby would treat the Warrants and Options as if they had been issued pursuant to an executive compensation plan under section 61(a)(3)(B), the Warrants and Options should be excluded from section 23(b) by reason of section 63(3).

9. Section 61(a)(3)(B)(iv) states that the amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 25% of the outstanding voting securities of the BDC, except that if the amount resulting from the exercise of outstanding warrants, options, and rights issued pursuant to any executive compensation plan meeting the requirements of section 61(a)(3)(B) would exceed 15% of the outstanding voting securities, then the total amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance shall not exceed 20% of the outstanding voting securities. Applicant states that it meets the requirements of section 61(a)(3)(B)(iv). As of May 26, 1995, the aggregate amount of applicant's voting securities that would result from the exercise of all options issued or issuable under the Amended Plan and the exercise of all outstanding Warrants would be 1,543,763 shares, or approximately 14.98%, of the 10,304,542 shares of applicant's common stock outstanding. Applicant has no other options or rights outstanding other than those granted to its officers and non-employee directors as part of the Amended Plan and no other warrants outstanding other than those granted to Mr. Childress and Mr. Harris.

10. Applicant believes that its proposal addresses the major concerns of the Small Business Investment Incentive Act of 1980 ("SBIIA"). The SBIIA established BDCs and provided an alternative system of regulation for such companies that is modelled on, but less restrictive than that applicable to, registered closed-end investment companies. Applicant asserts that it

would be unfair to the holders of the Warrants or Options to ask them to exercise early. Premature exercise deprives the Warrant or Option holder of an element of value. Applicant contends that early exercise of the Warrants and Options could have adverse consequences on applicant's shareholders. First, nearly fifty percent of the shares received on exercise might have to be sold promptly in the market to raise cash and pay taxes due on exercise. Given the relatively low levels of trading volume in applicant's stock, such sales could have an adverse effect on the market prices of applicant's stock. Second, requiring early exercise would increase the pool of outstanding shares thereby increasing the number of shares available for grant under employee stock option plans and the potential dilution to shareholders pursuant to these plans. As of May 26, 1995, applicant's net asset value was \$3.52. Applicant asserts that if all the Warrants and Options (875,112 shares, collectively) were exercised, the pro-forma net asset value would equal \$3.41, a dilution of \$0.11 per share, or 3.13%.

11. Applicant further asserts that because the Warrants and Options are currently "in the money" and exercisable, failure to obtain the requested exemptive order would not reduce the potential dilution to shareholders. Because employee and director Warrants and Options do not adversely affect cash flow, applicant contends that they are a more favorable form of compensation. Specifically, because applicant is able to continue investing the cash it would otherwise have been required to spend on employee and director cash compensation programs during the Option period, applicant believes it will be able to produce higher returns for shareholders that if it must increase the cash compensation of its directors.

12. In addition, applicant does not seek relief to permit future issuances of options to non-employee directors pursuant to the Amended Plan. Thus, applicant contends that because the Options already issued to non-employee directors have been approved by both applicant's shareholders and directors the risks of management self-dealing, embezzlement, and abuse of trust that the Act is designed to prevent are significantly reduced.

13. Section 6(c) provides, in relevant part, that the SEC may, conditionally or unconditionally, by order, exempt any person or class of persons from any provision of the Act or from any rule thereunder, if such exemption is necessary or appropriate in the public

interest, consistent with the protection of investors, and consistent with the purposes fairly intended by the policy and provisions of the Act. Applicant submits that its request satisfies this standard, does not involve any overreaching, and is fair and reasonable.

For the SEC, by the Division of Investment Management, under delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-35913; File No. SR-Amex-95-22]

**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the American Stock Exchange, Inc. Relating to the Entry of Market-at-the-Close Orders Through AMOS**

June 28, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 5, 1995, the American Stock Exchange, Inc. ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Amex proposes to amend Exchange Rule 109, Commentary .02, to correct an error in SR-Amex-95-09<sup>3</sup> regarding entry of market-at-the-close ("MOC") orders<sup>4</sup> through the Post Execution Reporting ("PER") or Amex Options Switching ("AMOS") systems.<sup>5</sup>

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 35660 (May 2, 1995), 60 FR 22592.

<sup>4</sup> A market-at-the-close order is a market order that is to be executed at or as near to the close as practicable. See *American Stock Exchange Guide*, Rule 131(e), (CCH) ¶ 9281.

<sup>5</sup> The PER system provides member firms with the means to electronically transmit equity orders, up to volume limits specified by the Exchange, directly to the specialist's post on the trading floor of the Exchange. Securities Exchange Act Release No. 33486 (Jan. 18, 1994), 59 FR 54016. Similarly, the AMOS system is a computerized order routing system that provides member firms with the means to electronically transmit option orders directly to the trading floor of the Exchange. Securities

The text of the proposed rule change is as follows:

[new text is italicized; deleted text is bracketed]:

**Rule 109**

\* \* \* \* \*

**Commentary**

\* \* \* \* \*

.02 Members entering market-at-the-close orders through the PER [or AMOS] system[s] must do so no later than 3:50 p.m. The foregoing shall not limit or restrict the entry of market-at-the-close orders (or their cancellation) other than via such system[s].

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

**A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

**1. Purpose**

The Commission recently approved an amendment to Exchange Rule 109, Commentary .02, that imposed a 3:50 p.m. deadline for the entry, cancellation, or reduction of MOC orders through the PER or AMOS systems.<sup>6</sup> The Exchange, however, did not intend to apply the 3:50 p.m. deadline to options orders and, therefore, the reference to the AMOS system in its rule filing was incorrect. The disruptions that have resulted from MOC equity orders entered through PER have not been a concern with respect to option orders entered through AMOS. Therefore, the restriction on MOC orders in options is unnecessary. Although there are very few MOC option orders entered through AMOS, the 3:50 p.m. deadline is inconvenient to both member organizations and to the Exchange. Moreover, no other options exchange imposes such a restriction.

Exchange Act Release No. 34869 (Oct. 20, 1994), 59 FR 4293.

<sup>6</sup> Securities Exchange Act Release No. 35660 (May 2, 1995), 60 FR 22592.

**2. Statutory Basis**

The proposed rule change is consistent with Section 6(b)<sup>7</sup> of the Act in general and furthers the objectives of Section 6(b)(5)<sup>8</sup> in particular in that it is designed to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

The Exchange believes the proposed rule change will impose no burden on competition.

**C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

The Exchange has neither solicited nor received written comments on the proposed rule change.

**III. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the American Stock Exchange. All submissions should refer to File No. SR-Amex-95-22 and should be submitted by July 27, 1995.

**IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change**

The Commission has reviewed carefully the Amex's proposed rule change and believes, for the reasons set forth below, the proposal is consistent with the requirements of Section 6 of

<sup>7</sup> 15 U.S.C. 78f.

<sup>8</sup> 15 U.S.C. 78f(b)(5).