Funds will not be subject to a sales load, redemption fee, distribution fee under a plan adopted in accordance with rule 12b–1 under the Act or service fee (as defined in rule 2830(b)(9) of the NASD's Conduct Rules), or if such shares are subject to any such fee, the Adviser will waive its advisory fee for each Investing Fund in an amount that offsets the amount of such fees incurred by the Investing Fund.

2. Before relying on the order, an Investing Fund will hold a meeting of the Board for the purpose of voting on the advisory contract under section 15 of the Act. Before approving any advisory contract for an Investing Fund, the Board, including a majority of the Independent Directors, taking into account all relevant factors, shall consider to what extent, if any, the advisory fees charged to the Investing Fund by Adviser should be reduced to account for reduced services provided to the Investing Fund by the Adviser as a result of the Uninvested Cash being invested in the Money Market Funds. In connection with this consideration, the Adviser will provide the Board with specific information regarding the approximate cost to the Adviser of, or portion of the advisory fee under the existing advisory contract attributable to, managing the Uninvested Cash of an Investing Fund that can be expected to be invested in the Money Market Funds. The minute books of the Investing Fund will record fully the Board's considerations in approving the advisory contract, including the consideration relating to fees referred to above.

3. Each Investing Fund will invest Uninvested Cash in, and hold shares of, the Money Market Funds only to the extent that the Investing Fund's aggregate investment of Uninvested Cash in the Money Market Funds does not exceed 25 percent of the Investing Fund's total assets. For purposes of this limitation, each Investing Fund will be treated as a separate investment company.

4. Investment of Cash Balances in shares of the Money Market Funds will be in accordance with each Investing Fund's respective investment restrictions, if any, and will be consistent with each Investing Fund's policies as set forth in its prospectus and statement of additional information.

5. Each Investing Fund and Money Market Fund that may rely on the order shall be shall be advised or, provided the Adviser manages Cash Balances, sub-advised by the Adviser.

6. No Money Market Fund whose shares are held by an Investing Fund shall acquire securities of any investment company in excess of the limits contained in section 12(d)(1)(A) of the Act.

7. Before a Fund may participate in Securities Lending Arrangements, a majority of the Board, including a majority of the Independent Directors, will approve the Fund's participation in Securities Lending Arrangements. The Board also will evaluate the Securities Lending Arrangements and their results no less frequently than annually and determine that any investment of Cash Collateral in the Money Market Funds is in the best interest of the shareholders of the Fund.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–19506 Filed 8–1–02; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Rel. No. IC–25687; File No. 812–12516]

The Phoenix Edge Series Fund, et al.

July 26, 2002.

AGENCY: The Securities and Exchange Commission (''SEC'' or ''Commission'').

ACTION: Notice of application for an order of exemption under Section 6(c) of the Investment Company Act of 1940, as amended (the ''1940 Act'') from the provisions of Sections 9(a), 13(a), 15(a), and 15(b) of the 1940 Act and Rules 6e-2(b)(15) and 6e-3(T)(b)(15) thereunder.

Summary of Application: Applicants seek an order to permit shares of the Phoenix Edge Series Fund (''Phoenix Fund'') or any other existing or future investment company that is designed to fund insurance products and for which the Advisors (as defined below) or any of their affiliates may serve as investment manager, investment advisor, sub-advisor, administrator, manager, principal underwriter or sponsor (the Phoenix Fund and such other investment companies being herein referred to, collectively, as the ''Fund''), or any current or future series of any Fund (a ''Portfolio'') to be sold to and held by: (1) Separate accounts funding variable annuity and variable life insurance contracts issued by both affiliated and unaffiliated life insurance companies (''Separate Accounts''); and (2) qualified pension and retirement plans outside of the separate account context (''Qualified Plans'' or ''Plans'').

Applicants: The Phoenix Fund, Phoenix Investment Counsel, Inc. (''PIC''), Phoenix-Aberdeen International Advisors, LLC (''PAIA''), Duff & Phelps Investment Management Co. (''DPIM'') and Phoenix Variable Advisors, Inc. (''PVA'') (collectively, ''Applicants'').

Filing Date: The application was filed on May 17, 2001 and amended and restated on April 17, 2002.

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 on the application by writing to the Secretary of the Commission and serving Applicants with a copy of the request, personally or by mail. Hearing requests must be received by the Commission by 5:30 p.m. on August 19, 2002 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 writer's interest, the reason for the request, and the issues contested. Persons may request notification of the date of the hearing by writing to the Commission's Secretary.

ADDRESSES: Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0690. Applicants, c/o Ruth S. Epstein, Esq., Dechert, 1775 Eye Street, NW., Washington, DC 20006–2401.

FOR FURTHER INFORMATION CONTACT: Harry Eisenstein, Senior Counsel, or Zandra Y. Bailes, Branch Chief, Office of Insurance Products, Division of Investment Management at (202) 942–0670.

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, 450 Fifth Street, NW., Washington, DC 20549–0102 (tel. 202–942–8090).

Applicants' Representations

1. The Phoenix Fund is a no-load, open-end, management investment company registered under the 1940 Act. The Phoenix Fund is organized as a Massachusetts business trust established pursuant to an Agreement and Declaration of Trust dated February 18, 1986. The Phoenix Fund is comprised of twenty-seven separate Portfolios, each of which has its own investment objectives and policies. Additional Portfolios may be added in the future.

2. Shares of the Phoenix Fund are currently offered to the Separate Accounts of Phoenix Home Life Mutual Insurance Company (''Phoenix''), PHL Variable Insurance Company (''PHL Variable''), and Phoenix Life and

Annuity Company (''PLAC''), which fund benefits under variable annuity and variable life insurance contracts issued by those companies. Shares of the Phoenix Fund are not sold directly to the public.

3. Phoenix Equity Planning Corporation (''PEPCO'') is registered as a broker-dealer under the Securities Exchange Act of 1934, as amended, and is a member of the National Association of Securities Dealers, Inc. PEPCO performs bookkeeping, pricing and administrative services for the Phoenix Fund. PEPCO also serves as principal underwriter for certain variable annuity and life insurance contracts. PEPCO is a subsidiary of Phoenix Investment Partners, Ltd. (''PXP''). PXP and PEPCO are each a subsidiary of the Phoenix Companies, Inc.

4. PIC, PAIA, DPIM and PVA (each an ''Advisor'' and collectively, ''Advisors'') serve as the Phoenix Fund's investment advisors. Each is registered as an investment advisor under the Investment Advisers Act of 1940, as amended. PVA is a subsidiary of Phoenix. All of the outstanding stock of PIC is owned by PEPCO. PAIA is a joint venture jointly owned and managed by PM Holdings, Inc., a subsidiary of Phoenix, and Aberdeen Fund Managers, Inc., a subsidiary of Aberdeen Asset Management PLC. DPIM is a subsidiary of Phoenix.

5. The Fund intends to offer shares of the Portfolios to Separate Accounts of both affiliated and unaffiliated life insurance companies (''Participating Insurance Companies'') to serve as investment vehicles for various types of insurance products. These products may include, but are not limited to, variable annuity contracts, single premium variable life insurance contracts, scheduled premium variable life insurance contracts, modified single premium variable life insurance policies, and flexible premium variable life insurance contracts (collectively referred to herein as ''variable contracts'' or ''contracts'').[1] Participating Insurance Companies will be those insurance companies that purchase shares of the Fund for such purposes.

6. The Participating Insurance Companies will establish their own Separate Accounts and design their own variable contracts. Each Participating Insurance Company will have the legal obligation of satisfying all requirements applicable to such insurance company under both federal and state law. It is anticipated that Participating Insurance Companies, including Phoenix, PHL Variable, and PLAC, will rely on Rule 6e–2 or Rule 6e–3(T) under the 1940 Act, in connection with variable life insurance contracts, although some Participating Insurance Companies may rely on individual exemptive orders as well. The role of the Fund, so far as the federal securities laws are applicable, will be limited to that of offering its shares, as described below, to Separate Accounts of various insurance companies and to Qualified Plans, and fulfilling any conditions the Commission may impose upon granting the order requested in the application.

7. Each Participating Insurance Company will enter into a participation agreement with the applicable Fund on behalf of the Portfolios in which the Participating Insurance Company invests. The Separate Accounts of the Participating Insurance Companies will invest in shares of the Fund in accordance with allocation instructions received from contract owners.

8. The Fund intends to offer shares of the Portfolios directly to Qualified Plans outside of the separate account context. Qualified Plans may choose a Portfolio as the sole investment under the Qualified Plan or as one of several investments. Qualified Plan participants may or may not be given an investment choice depending on the Qualified Plan itself. Fund shares sold to such Qualified Plans would be held by the trustee(s) of said Qualified Plans as mandated by Section 403(a) of the Employee Retirement Income Security Act (''ERISA''). Certain Qualified Plans, including those described in Sections 403(b)(7) and 408(a) of the Internal Revenue Code of 1986, as amended (''Code''), may vest voting rights in Plan participants instead of Plan trustees. [2] Exercise of voting rights by participants in any such Qualified Plans, as opposed to the trustees of such Plans, cannot be mandated by Applicants. Each Plan must be administered in accordance with the terms of the Plan and as determined by its trustee or trustees.

Applicants' Legal Analysis

1. In connection with the funding of scheduled premium variable life insurance contracts issued through a separate account registered under the 1940 Act as a unit investment trust, Rule 6e–2(b)(15) provides partial exemptions from Sections 9(a), 13(a), 15(a), and 15(b).[3] Section 9(a) provides that it is unlawful for any company to serve as an investment advisor or principal underwriter of any registered open-end investment company if an affiliated person of that company is subject to a disqualification enumerated in Sections 9(a)(1) or (2). Rule 6e–2(b)(15)(i) and (ii) provides a partial exemption from Section 9(a) to the extent that such section would render a company ineligible to serve as investment advisor or principal underwriter of any registered open end management investment company, where an officer, director, employee or affiliated person of such company is subject to a disqualification enumerated in Section 9(a), but the individual subject to such disqualification does not participate directly in the management or administration of the underlying registered management investment company. Rule 6e–2(b)(15)(iii) provides a partial exemption from Sections 13(a), 15(a), and 15(b) to the extent those sections have been deemed by the Commission to require ''pass-through'' voting with respect to an underlying fund's shares. The exemptions granted to a separate account by Rule 6e–2(b)(15) are available only where all of the assets of the separate account consist of the shares of one or more registered management investment companies which offer their shares ''exclusively to variable life insurance separate accounts of the life insurer or of any affiliated life insurance company.'' Therefore, the relief granted by Rule 6e–2(b)(15) is not available with respect to a variable life insurance separate account that owns shares of a management company that also offers its shares to a variable annuity separate account of the same insurance company or any other insurance company. The use of a common underlying fund as the underlying investment medium for both variable annuity and variable life insurance separate accounts of the same life insurance company or of any affiliated life insurance company is referred to herein as ''mixed funding.''

2. In addition, the relief granted by Rule 6e–2(b)(15) is not available with respect to a scheduled premium variable life insurance separate account that owns shares of an underlying management company that also offers

[1] Some Separate Accounts to which the Fund may offer its Portfolio shares may be exempt from registration under the 1940 Act pursuant to Sections 3(c)(1) or 3(c)(7) thereof.

[2] Qualified Plans described in Sections 403(b)(7) and 408(a) of the Code may invest in mutual funds through custodial arrangements. Such custodial arrangements typically provide that shares held of record by the custodian are held for the benefit of the participant that beneficially owns such shares. Because of the limited role of custodians of those Plans, Applicants intend to treat each participant in those Plans as a separate Qualified Plan for purposes of the Application.

[3] The exemptions provided by Rule 6e-2 also are available to a separate account's investment advisor, principal underwriter, and sponsor or depositor.

its shares to separate accounts funding variable contracts of one or more unaffiliated life insurance companies. The use of a common underlying fund as the underlying investment medium for variable life insurance separate accounts of one insurance company and separate accounts funding variable contracts of one or more unaffiliated life insurance companies is referred to herein as ''shared funding.''

3. Moreover, because the relief under Rule 6e–2(b)(15) is available only where shares are offered exclusively to variable life insurance separate accounts, additional exemptive relief may be necessary if the shares of the Fund are also to be sold to Qualified Plans.

4. Accordingly, Applicants are requesting an order of the Commission granting exemptions from Sections 9(a), 13(a), 15(a), and 15(b) of the 1940 Act, and Rule 6e–2(b)(15) thereunder, to the extent necessary to permit shares of each Fund to be offered and sold to, and held by: (a) Separate Accounts funding variable annuity contracts and scheduled premium and flexible premium variable life insurance contracts issued by both affiliated and unaffiliated life insurance companies; and (b) Qualified Plans.

5. In connection with the funding of flexible premium variable life insurance contracts issued through a separate account registered under the 1940 Act as a unit investment trust, Rule 6e–3(T)(b)(15) provides partial exemptions from Sections 9(a), 13(a), 15(a), and 15(b). The exemptions granted to a separate account by Rule 6e–3(T)(b)(15) are available only where all of the assets of the separate account consist of the shares of one or more registered management investment companies which offer their shares ''exclusively to separate accounts of the life insurer, or of any affiliated life insurance company offering either scheduled contracts or flexible contracts, or both; or which also offer their shares to variable annuity separate accounts of the life insurer or of an affiliated life insurance company.'' Therefore, Rule 6e–3(T) permits mixed funding with respect to a flexible premium variable life insurance separate account, subject to certain conditions.[4] However, Rule 6e–3(T) does not permit shared funding because the relief granted by Rule 6e–3(T)(b)(15) is not available with respect to a flexible premium variable life insurance separate account that owns shares of an underlying fund that also offers its shares to separate accounts (including variable annuity and flexible premium and scheduled premium variable life insurance separate accounts) of unaffiliated life insurance companies.

6. Applicants state that the relief provided by Rule 6e–3(T) is not relevant to the purchase of shares of the Fund by Qualified Plans. However, because the relief granted by Rule 6e–3(T)(b)(15) is available only where shares of the underlying fund are offered exclusively to separate accounts, or to life insurers in connection with the operation of a separate account, additional exemptive relief may be necessary if the shares of the Fund are also to be sold to Qualified Plans.

7. Accordingly, Applicants are requesting an order of the Commission granting exemptions from Sections 9(a), 13(a), 15(a), and 15(b) of the 1940 Act, and Rule 6e–3(T)(b)(15) (and any comparable permanent rule) thereunder, to the extent necessary to permit shares of each Portfolio to be offered and sold to, and held by: (a) Separate Accounts funding variable annuity contracts and scheduled premium and flexible premium variable life insurance contracts issued by unaffiliated life insurance companies; and (b) Qualified Plans.

8. In its most recent release adopting amendments to Rule 6e–3(T), the Commission stated that shared funding arrangements presented ''a very new and somewhat complicated area from a regulatory perspective'' (Investment Company Act Release No. 15651 (March 30, 1987)). In the context of mixed funding, the Commission noted in this same Release that ''it would prefer to see any evolvement in this area * * * take place in the context of the application process.''

9. Applicants state they believe that the reason the Commission did not grant greater relief in the area of mixed and shared funding when it adopted Rule 6e–3(T) is because of the Commission's uncertainty in this area with respect to such issues as conflicts of interest. Applicants believe that any Commission concern in this area is not warranted in the context of the application. If and when a material irreconcilable conflict between the Separate Accounts arises in this context or between Separate Accounts on the one hand and Qualified Plans on the other hand, the Participating Insurance Companies and Qualified Plans must take whatever steps are necessary to remedy or eliminate the conflict, including eliminating the Portfolios as eligible investment options. Applicants state they have concluded that the inclusion of Qualified Plans as eligible shareholders should not increase the risk of material irreconcilable conflicts among shareholders. However, Applicants further assert that even if a material irreconcilable conflict involving the Qualified Plans arose, the Qualified Plans, unlike the Separate Accounts (which are subject to Section 26(c) of the 1940 Act with respect to substitutions), can simply redeem their shares and make alternative investments. Applicants argue that allowing Qualified Plans to invest directly in the Fund should not increase the opportunity for conflicts of interest.

10. Applicants state that the Commission has previously granted exemptive orders permitting open-end management investment companies to offer their shares directly to Qualified Plans as well as to separate accounts of affiliated or unaffiliated insurance companies that issue variable annuity contracts and variable life insurance contracts.

11. Applicants request relief under Section 6(c) of the 1940 Act for the class consisting of the Fund and the Portfolios; life insurance companies (*i.e.,* Participating Insurance Companies) and their Separate Accounts that invest or in the future will invest in the Fund and the Portfolios; and, to the extent necessary, investment managers, investment advisors, sub-advisors, administrators, managers, principal underwriters or sponsors of Separate Accounts that currently invest or in the future will invest in the Fund and the Portfolios. Applicants assert that there is ample precedent, in a variety of contexts, for granting exemptive relief not only to Applicants in a given case, but also to members of the class not currently identified that may be similarly situated in the future. In the context of mixed and shared funding, Applicants note that the Commission has previously granted exemptions covering a class composed of registered investment companies designed to fund variable contracts for which a named party to the exemptive application or, in some instances, an affiliate thereof, would serve in one or more of the following capacities: investment manager, investment advisor, sub-advisor, administrator, manager, principal underwriter or sponsor.

12. Section 6(c) of the 1940 Act authorizes the Commission to exempt any person, security, or transaction or any class or classes of persons, securities, or transactions from any provision or provisions of the 1940 Act and/or of any rule thereunder if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the

[4] The exemptions provided by Rule 6e–3(T) also are available to a separate account's investment advisor, principal underwriter, and sponsor or depositor.

protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act. For the reasons stated below, Applicants believe that the requested exemptions are appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

13. Section 9(a) of the 1940 Act provides that it is unlawful for any company to serve as investment advisor or principal underwriter of any registered open-end investment company if an affiliated person of that company is subject to a disqualification enumerated in Sections 9(a)(1) or (2). Rules 6e–2(b)(15)(i) and (ii) and Rules 6e–3(T)(b)(15)(i) and (ii) provide exemptions from Section 9(a) under certain circumstances, subject to the limitations discussed above on mixed and shared funding imposed by the 1940 Act and the rules thereunder. These exemptions limit the application of the eligibility restrictions to affiliated individuals or companies that directly participate in the management of the underlying management company.

14. Applicants state that Rules 6e–2(b)(15)(i) and 6e–3(T)(b)(15)(i) provide, in effect, that the fact that an individual disqualified under Section 9(a)(1) or Section 9(a)(2) is an officer, director, or employee of an insurance company, or any of its affiliates, would not, by virtue of Section 9(a)(3), disqualify the insurance company or any of its affiliates from serving in any capacity with respect to an underlying investment company, provided that the disqualified individual did not participate directly in the management or administration of the underlying investment company.

15. Applicants state that Rules 6e–2(b)(15)(ii) and 6e–3(T)(b)(15)(ii) provide, in effect, that the fact that any company disqualified under Section 9(a)(1) or Section 9(a)(2) is affiliated with the insurance company would not, by virtue of Section 9(a)(3), disqualify the insurance company from serving in any capacity with respect to an underlying investment company, provided that the disqualified company did not participate directly in the management or administration of the investment company.

16. Applicants state that the partial relief granted in Rules 6e–2(b)(15) and 6e–3(T)(b)(15) from the requirements of Section 9, in effect, limits the amount of monitoring necessary to ensure compliance with Section 9 to that which is appropriate in light of the policy and purposes of Section 9. These Rules recognize that it is not necessary to apply the provisions of Section 9(a) to individuals in a large insurance company complex, most of whom will have no involvement in matters pertaining to investment companies in that organization. These Rules further recognize that it is also unnecessary to apply Section 9(a) to individuals in various unaffiliated insurance companies (or affiliated companies of Participating Insurance Companies) that may utilize the Fund as a funding medium for variable contracts.

17. Applicants believe that there is no regulatory purpose in extending the Section 9(a) monitoring requirements because of mixed or shared funding. The Participating Insurance Companies are not expected to play any role in the management or administration of the Fund. Those individuals who participate in the management or administration of the Fund will remain the same regardless of which Separate Accounts or insurance companies use the Fund. Applicants maintain that, therefore, applying the monitoring requirements of Section 9(a) because of investment by Separate Accounts of other insurers would be unjustified and would not serve any regulatory purpose. Applicants also state that, furthermore, the increased monitoring costs would reduce the net rates of return realized by contract owners and Plan participants.

18. Applicants submit that the relief requested herein from Section 9(a) in no way will be affected by the proposed additional use of the shares of the Fund in connection with Qualified Plans. The insulation of the Fund from those individuals who are disqualified under the 1940 Act remains in place. Since the Qualified Plans are not investment companies and will not be deemed to be affiliated solely by virtue of their shareholdings, no additional relief from Section 9(a), with respect to Qualified Plans, is necessary.

19. Rules 6e–2(b)(15)(iii) and 6e–3(T)(b)(15)(iii) provide exemptions from the pass-through voting requirement with respect to several significant matters, assuming the limitations discussed above on mixed and shared funding are observed. Rules 6e–2(b)(15)(iii)(A) and 6e–3(T)(b)(15)(iii)(A) provide that the insurance company may disregard the voting instructions of its contract owners with respect to the investments of an underlying fund, or any contract between a fund and its investment advisor, when required to do so by an insurance regulatory authority (subject to the provisions of paragraphs (b)(5)(i) and (b)(7)(ii)(A) of Rules 6e–2 and 6e–3(T)). Rules 6e–2(b)(15)(iii)(B) and 6e–3(T)(b)(15)(iii)(A) provide that, with respect to registered management investment companies whose shares are held by a separate account of an insurance company, the insurance company may disregard voting instructions of contract owners if the contract owners initiate any change in such investment company's investment policies, principal underwriter, or any investment advisor (provided that disregarding such voting instructions is reasonable and subject to the other provisions of paragraphs (b)(5)(ii), (b)(7)(ii)(B), and (b)(7)(ii)(C) of Rules 6e–2 and 6e–3(T)).

20. Applicants state that Rule 6e–2 recognizes that a variable life insurance contract, as an insurance contract, has important elements unique to insurance contracts and is subject to extensive state regulation of insurance. Applicants believe that, in adopting Rule 6e–2(b)(15)(iii), the Commission expressly recognized that state insurance regulators have authority, pursuant to state insurance laws or regulations, to disapprove or require changes in investment policies, investment advisors, or principal underwriters. The Commission also expressly has recognized that state insurance regulators have authority to require an insurer to draw from its general account to cover costs imposed upon the insurer by a change approved by contract owners over the insurer's objection. The Commission, therefore, deemed such exemptions necessary "to assure the solvency of the life insurer and performance of its contractual obligations by enabling an insurance regulatory authority or the life insurer to act when certain proposals reasonably could be expected to increase the risks undertaken by the life insurer." [5] Applicants conclude that, in this respect, flexible premium variable life insurance contracts are identical to scheduled premium variable life insurance contracts. Therefore, the corresponding provisions of Rule 6e–3(T) (which apply to flexible premium insurance contracts and which permit mixed funding) undoubtedly were adopted in recognition of the same considerations as the Commission applied in adopting Rule 6e–2.

21. Applicants state that these considerations are no less important or necessary when an insurance company funds its separate accounts in connection with mixed and shared funding. Such mixed and shared funding does not compromise the goals of the insurance regulatory authorities or of the Commission. Applicants assert that, while the Commission may have

[5] Investment Company Act Release No. 9104 (Dec. 30, 1975) (proposing Rule 6e–2).

wished to reserve wide latitude with respect to the once unfamiliar variable annuity product, that product is now familiar and there appears to be no reason for the maintenance of prohibitions against mixed and shared funding arrangements. Applicants note that, by permitting such arrangements, the Commission eliminates needless duplication of start-up and administrative expenses and potentially increases an investment company's assets, thereby making effective portfolio management strategies that are easier to implement and promoting other economies of scale.

22. Applicants state that the Fund's sale of shares to Qualified Plans will not have any impact on the relief requested herein in this regard. Shares of the Fund sold to Qualified Plans would be held by the trustees of such Plans. With respect to the Qualified Plans, which are not registered as investment companies under the 1940 Act, Applicants state that there is no requirement to pass through voting rights to Plan participants. Indeed, to the contrary, applicable law expressly reserves voting rights associated with certain types of Plan assets to certain specified persons. For example, under Section 403(a) of ERISA, shares of a fund sold to a Qualified Plan must be held by the trustee(s) of the Plan. Section 403(a) also provides that the trustee(s) must have exclusive authority and discretion to manage and control the Plan with two exceptions: (a) When the Plan expressly provides that the trustee(s) are subject to the direction of a named fiduciary who is not a trustee, in which case the trustee(s) are subject to proper directions made in accordance with the terms of the Plan and not contrary to ERISA; and (b) when the authority to manage, acquire or dispose of assets of the Plan is delegated to one or more investment managers pursuant to Section 402(c)(3) of ERISA. Unless one of the above two exceptions stated in Section 403(a) applies, Plan trustee(s) have the exclusive authority and responsibility for voting proxies.

23. Applicants note that, if a named fiduciary to a Qualified Plan appoints an investment manager, the investment manager has the responsibility to vote the shares held unless the right to vote such shares is reserved to the trustees or the named fiduciary. Applicants further note that the Qualified Plans may have their trustee(s) or other fiduciaries exercise voting rights attributable to investment securities held by the Qualified Plans in their discretion. Certain Qualified Plans, however, may provide for the trustees(s) or another named fiduciary to exercise voting rights in accordance with instructions from participants.

24. If a Qualified Plan does not provide participants with the right to give voting instructions, Applicants do not see any potential for material irreconcilable conflicts of interest between or among variable contract owners and Plan participants with respect to voting of the respective Portfolio's shares. Accordingly, unlike the case with insurance company separate accounts, the issue of the resolution of material irreconcilable conflicts with respect to voting is not present with respect to such Qualified Plans because the Qualified Plans are not entitled to pass-through voting privileges.

25. Applicants further note that there is no reason to believe that participants in Qualified Plans that provide participants with the right to give voting instructions generally, or those in a particular Plan, either as a single group or in combination with participants in other Qualified Plans, would vote in a manner that would disadvantage variable contract owners. Applicants, therefore, assert that the purchase of shares of the Portfolios by Qualified Plans that provide voting rights does not present any complications not otherwise occasioned by mixed or shared funding.

26. Applicants submit that the prohibitions on mixed and shared funding might reflect concern regarding possible different investment motivations among investors. Applicants note that when Rule 6e–2 was adopted, variable annuity separate accounts could invest in mutual funds whose shares also were offered to the general public. At the time of the adoption of Rule 6e–2, therefore, the Commission staff contemplated underlying funds with public shareholders, as well as with variable life insurance separate account shareholders. Applicants state that the Commission staff may have been concerned with the potentially different investment motivations of public shareholders and variable life insurance contract owners. There also may have been some concern with respect to the problems of permitting a state insurance regulatory authority to affect the operations of a publicly available mutual fund and to affect the investment decisions of public shareholders.

27. Applicants state that, for reasons unrelated to the 1940 Act, however, Internal Revenue Service Revenue Ruling 81–225 (Sept. 25, 1981) effectively deprived variable annuities funded by publicly available mutual funds of their tax-benefited status. The Tax Reform Act of 1984 codified the prohibition against the use of publicly available mutual funds as an investment medium for variable contracts (including variable life contracts). Section 817(h) of the Code, in effect, requires that the investments made by variable annuity and variable life insurance separate accounts be "adequately diversified." If a separate account is organized as a unit investment trust that invests in a single fund or series, then the separate account will not be diversified. Applicants note that in this situation, however, Section 817(h) of the Code and the regulations promulgated thereunder, in effect, provide that the diversification test will be applied at the underlying fund level, rather than at the separate account level, but only if "all of the beneficial interests" in the underlying fund "are held by one or more insurance companies (or affiliated companies) in their general account or in segregated asset accounts * * *"[6] Applicants state that, accordingly, a unit investment trust separate account that invests solely in a publicly available mutual fund will not be adequately diversified. In addition, Applicants state that any underlying mutual fund, including any fund that sells shares to separate accounts, in effect, would be precluded from selling its shares to the public. Applicants conclude that, consequently, there will be no public shareholders of the Fund.

28. Applicants state that shared funding by unaffiliated insurance companies does not present any issues that do not already exist where a single insurance company is licensed to do business in several or all states. Applicants state that a particular state insurance regulatory body could require action that is inconsistent with the requirements of other states in which the insurance company offers its policies. Applicants maintain that the fact that different insurers may be domiciled in different states does not create a significantly different or enlarged problem.

29. Applicants submit that shared funding by unaffiliated insurers, in this respect, is no different than the use of the same investment company as the funding vehicle for affiliated insurers, which Rules 6e–2(b)(15) and 6e–3(T)(b)(15) permit. Affiliated insurers

[6] U.S. Department of the Treasury Regulation 1.817–5, which established diversification requirements for such funds, specifically permits, among other things, investment company managers, insurance company general and separate accounts and "qualified pension or retirement plans" to share the same underlying management investment company.

may be domiciled in different states and be subject to differing state law requirements. Affiliation does not reduce the potential, if any exists, for differences in state regulatory requirements. Applicants assert that, in any event, the conditions discussed below are designed to safeguard against, and provide procedures for resolving, any adverse effects that differences among state regulatory requirements may produce.

30. Rules 6e–2(b)(15) and 6e–3(T)(b)(15) give the insurance company the right to disregard the voting instructions of the contract owners. Applicants state that this right does not raise any issues different from those raised by the authority of state insurance administrators over separate accounts. Under Rules 6e–2(b)(15) and 6e–3(T)(b)(15), an insurer can disregard contract owner voting instructions only with respect to certain specified items. Affiliation does not eliminate the potential, if any exists, for divergent judgments as to the advisability or legality of a change in investment policies, principal underwriter, or investment advisor initiated by contract owners. The potential for disagreement is limited by the requirements in Rules 6e–2 and 6e–3(T) that the insurance company's disregard of voting instructions be reasonable and based on specific good-faith determinations.

31. Applicants note, however, that a particular insurer's disregard of voting instructions, nevertheless, could conflict with the majority of contract owner voting instructions. The insurer's action possibly could be different than the determination of all or some of the other insurers (including affiliated insurers) that the voting instructions of contract owners should prevail, and either could preclude a majority vote approving the change or could represent a minority view. If the insurer's judgment represents a minority position or would preclude a majority vote, then the insurer may be required, at the affected Fund's election, to withdraw its Separate Account's investment in the Fund and no charge or penalty will be imposed as a result of such withdrawal.

32. Applicants state that there is no reason that the investment policies of the Fund would or should be materially different from what these policies would or should be if the Fund funded only variable annuity contracts or variable life insurance policies, whether flexible premium or scheduled premium policies. Each type of insurance product is designed as a long-term investment program. Similarly, the investment strategy of Qualified Plans (*i.e.,* long-term investment) coincides with that of variable contracts and should not increase the potential for conflicts.

33. Applicants do not believe that the sale of shares of the Fund to Qualified Plans will increase the potential for material irreconcilable conflicts of interest between or among different types of investors. In particular, Applicants see very little potential for such conflicts beyond that which would otherwise exist between variable annuity and variable life insurance contract owners. Applicants submit that either there are no additional conflicts of interest or there exists the ability by the affected parties to resolve any such conflicts without harm to the contract owners in the Separate Accounts or to the participants under the Qualified Plans.

34. Applicants note that Section 817 of the Code is the only section where separate accounts are discussed. Section 817(h) imposes certain diversification standards on the underlying assets of variable annuity contracts and variable life insurance contracts held in the portfolios of management investment companies. The Code provides that a variable contract shall not be treated as an annuity contract or life insurance for any period (and any subsequent period) for which the investments, in accordance with regulations prescribed by the Treasury Department, are not adequately diversified. On March 2, 1989, the Treasury Department issued regulations (Treas. Reg. 1.817–5) (the ''Treasury Regulations'') that established diversification requirements for the investment portfolios underlying variable contracts. The Treasury Regulations provide that, in order to rely on certain look-through provisions of the diversification requirements, all of the beneficial interests in the underlying investment company must be held by the segregated asset accounts of one or more insurance companies. The Treasury Regulations, however, also contain certain exceptions to this requirement, one of which allows shares in the investment company to be held by the trustee of a qualified pension or retirement plan without adversely affecting the ability of shares in the same investment company also to be held by insurance company separate accounts (Treas. Reg. 1.817–5(f)(3)(iii)). Applicants assert, therefore, that neither the Code nor the Treasury Regulations or revenue rulings thereunder present any inherent conflicts of interest if Qualified Plans, variable annuity Separate Accounts, and variable life insurance Separate Accounts all invest in the same management investment company.

35. Applicants state that the promulgation of Rules 6e–2(b)(15) and 6e–3(T)(b)(15) under the 1940 Act preceded the issuance of the Treasury Regulations that made it possible for shares of an investment company to be held by the trustee of a Qualified Plan without adversely affecting the ability of shares in the same investment company also to be held by the separate accounts of insurance companies in connection with their variable contracts. Applicants submit that the sale of shares of the same investment company to Separate Accounts and to Qualified Plans could not have been envisioned at the time of the adoption of Rules 6e–2(b)(15) and 6e–3(T)(b)(15), given the then-current tax law.

36. Applicants state that while there are differences in the manner in which distributions are taxed for variable annuity contracts, variable life insurance contracts, and Qualified Plans, these differences will have no impact on the Fund and, therefore, the tax consequences of distributions from variable contracts and Qualified Plans do not raise any conflicts of interest with respect to the use of the Fund. When distributions are to be made, and the Separate Account or the Qualified Plan cannot net purchase payments to make the distributions, the Separate Account or the Qualified Plan will redeem shares of the affected Fund at its net asset value. The Qualified Plan then will make distributions in accordance with the terms of the Qualified Plan. The life insurance company will surrender values from the Separate Account into the general account to make distributions in accordance with the terms of the variable contract. Distributions and dividends will be declared and paid by the Fund without regard to the character of the shareholder.

37. Applicants state that with respect to voting rights, it is possible to provide an equitable means of giving such voting rights to separate account contract owners and to Qualified Plans. The transfer agent for each Fund will inform each Participating Insurance Company of its share ownership in each Separate Account, as well as inform the trustees of Qualified Plans of their holdings. The Participating Insurance Company will then solicit voting instructions in accordance with Rules 6e–2 and 6e–3(T).

38. Applicants maintain that the ability of the Fund to sell its shares directly to Qualified Plans does not create a ''senior security'' with respect to any variable annuity or variable life contract owner as opposed to a participant under a Qualified Plan. The

term ''senior security'' is defined under Section 18(g) of the 1940 Act to include ''any stock of a class having priority over any other class as to distribution of assets or payment of dividends.'' As noted above, regardless of the rights and benefits of participants under the Qualified Plans, or contract owners under variable contracts, the Qualified Plans and the Separate Accounts, respectively, have rights only with respect to their respective shares of the Fund. The Qualified Plans and the Separate Accounts can redeem such shares of the Fund only at the net asset value of the shares. No shareholder of a Fund will have any preference over any other shareholder of such Fund with respect to distribution of assets or payment of dividends.

39. Applicants maintain that various factors have kept more insurance companies from offering variable annuity and variable life insurance contracts than currently offer such contracts. These factors include the costs of organizing and operating a funding medium, the lack of expertise with respect to investment management (principally with respect to stock and money market investments), and the lack of name recognition by the public of certain insurers as investment experts with whom the public feels comfortable entrusting their investment dollars. For example, some smaller life insurance companies may not find it economically feasible, or within their investment or administrative expertise, to enter the variable contract business on their own. Use of the Fund as a common investment medium for variable contracts, as well as for Qualified Plans, would reduce or eliminate these concerns. Mixed and shared funding also should provide several benefits to variable contract owners by eliminating a significant portion of the costs of establishing and administering separate funds. Applicants assert that Participating Insurance Companies and Qualified Plans will benefit not only from the investment and administrative expertise of the responsible advisors and their affiliates, but also from the cost efficiencies and investment flexibility afforded by a large pool of funds. According to Applicants, mixed and shared funding, including the sale of shares of a Fund to Qualified Plans, also would permit a greater amount of assets available for investment by such Fund, thereby promoting economies of scale, by permitting increased safety through greater diversification, and by making the addition of new Portfolios to a Fund more feasible. Applicants maintain that making the Fund available for mixed and shared funding will therefore encourage more insurance companies to offer variable contracts, and this should result in increased competition with respect to both variable contract design and pricing, which can be expected to result in more product variation and lower charges.

40. Applicants submit that, regardless of the type of shareholder in a Fund, the responsible Advisor will continue to manage a Portfolio's investments solely and exclusively in accordance with each such Portfolio's investment objectives and restrictions as well as with any guidelines established by the board of trustees or directors, as applicable, of the Fund. Applicants state that individual Portfolio managers work with a pool of money and do not take into account the identity of the shareholders and that, thus, the Fund is managed in the same manner as any other mutual fund. According to Applicants, if shareholders are not pleased with a mutual fund's investment results, or the manner in which the mutual fund is being operated, these shareholders may redeem their shares. Applicants state that it is the duty of the management of a mutual fund to keep shareholders informed through updated prospectuses and annual and semi-annual reports. Applicants believe that these periodic communications to shareholders function as these communications are intended. Qualified Plans, as well as contract owners, thus, will be given up-to-date information necessary for them to make informed investment decisions.

Applicants' Conditions

Applicants consent to the following conditions:

1. A majority of the Board of Trustees or Board of Directors (''Board'') of each Fund shall consist of persons who are not ''interested persons'' of the Fund, as defined by Section 2(a)(19) of the 1940 Act and the rules thereunder and as modified by any applicable orders of the Commission, except that if this condition is not met by reason of the death, disqualification, or bona fide resignation of any trustee or director, then the operation of this condition shall be suspended: (a) For a period of 90 days if the vacancy or vacancies may be filled by the Board; (b) for a period of 150 days if a vote of shareholders is required to fill the vacancy or vacancies; or (c) for such longer period as the Commission may prescribe by order upon application.

2. Each Board will monitor the respective Fund for the existence of any material irreconcilable conflict among and between the interests of the contract owners of all Separate Accounts, Plan participants, and Qualified Plans investing in that Fund, and determine what action, if any, should be taken in response to such conflicts. A material irreconcilable conflict may arise for a variety of reasons, including: (a) An action by any state insurance regulatory authority; (b) a change in applicable federal or state insurance, tax, or securities laws or regulations, or a public ruling, private letter ruling, no-action or interpretative letter, or any similar action by insurance, tax, or securities regulatory authorities; (c) an administrative or judicial decision in any relevant proceeding; (d) the manner in which the investments of any Portfolio are being managed; (e) a difference in voting instructions given by variable annuity contract owners, variable life insurance contract owners, Plan trustees, or Plan participants; (f) a decision by a Participating Insurance Company to disregard the voting instructions of contract owners; or (g) if applicable a decision by a Qualified Plan to disregard the voting instructions of Plan participants.

3. Any Qualified Plan that executes a fund participation agreement upon becoming an owner of 10% or more of the assets of a Fund, any Participating Insurance Company (collectively, ''Participating Entities'') and the relevant Advisor or its affiliate will report any potential or existing conflicts to the Board. The relevant Advisor and each of the Participating Entities will be responsible for assisting the Board in carrying out the Board's responsibilities under these conditions by providing the Board with all information reasonably necessary for the Board to consider any issues raised. This includes, but is not limited to, an obligation by each Participating Insurance Company to inform the Board whenever it has determined to disregard contract owner voting instructions and, if pass-through voting is applicable, an obligation by each Qualified Plan that is a Participating Entity to inform the Board whenever it has determined to disregard Plan participant voting instructions. The responsibility to report such information and conflicts and to assist the Board will be a contractual obligation of all Participating Entities investing in a Fund under their agreements governing participation in the Fund, and such agreements shall provide that such responsibilities will be carried out with a view only to the interests of the contract owners or, if applicable, Plan participants.

4. If it is determined by a majority of the Board of a Fund, or a majority of its disinterested trustees or directors, that a

material irreconcilable conflict exists, the relevant Participating Entities shall, at their expense and to the extent reasonably practicable (as determined by a majority of the disinterested trustees or directors), take whatever steps are necessary to remedy or eliminate the material irreconcilable conflict, up to and including: (a) Withdrawing the assets allocable to some or all of the Separate Accounts from the affected Fund or any Portfolio and reinvesting such assets in a different investment medium, including another Portfolio; (b) in the case of Participating Insurance Companies, submitting the question of whether such segregation should be implemented to a vote of all affected contract owners and, as appropriate, segregating the assets of any appropriate group (*i.e.*, variable annuity contract owners or variable life insurance contract owners of one or more Participating Insurance Companies) that votes in favor of such segregation, or offering to the affected contract owners the option of making such a change; (c) withdrawing the assets allocable to some or all of Qualified Plans that are Participating Entities from the affected Fund or any Portfolio and reinvesting such assets in a different investment medium, including another Portfolio; and (d) establishing a new registered management investment company or managed separate account. If a material irreconcilable conflict arises because of a Participating Insurance Company's decision to disregard contract owner voting instructions and that decision represents a minority position or would preclude a majority vote, the Participating Insurance Company may be required, at the Fund's election, to withdraw its Separate Account's investment in the Fund, and no charge or penalty will be imposed as a result of such withdrawal. If a material irreconcilable conflict arises because of the decision of a Qualified Plan that is a Participating Entity to disregard Plan participant voting instructions, if applicable, and that decision represents a minority position or would preclude a majority vote, the Qualified Plan may be required, at the election of the Fund, to withdraw its investment in the Fund, and no charge or penalty will be imposed as a result of such withdrawal. The responsibility to take remedial action in the event of a Board determination of a material irreconcilable conflict and to bear the cost of such remedial action shall be a contractual obligation of all Participating Entities under their agreements governing participation in the Fund, and these responsibilities will be carried out with a view only to the interests of the contract owners or, as applicable, Plan participants.

For the purposes of this Condition 4, a majority of the disinterested members of the Board shall determine whether or not any proposed action adequately remedies any material irreconcilable conflict, but in no event will the Fund or the Advisors or their affiliates, as relevant, be required to establish a new funding medium for any variable contract. No Participating Insurance Company shall be required by this Condition 4 to establish a new funding medium for any variable contract if an offer to do so has been declined by vote of a majority of contract owners materially adversely affected by the material irreconcilable conflict. No Qualified Plan that is a Participating Entity shall be required by this Condition (4) to establish a new funding medium for such Qualified Plan if (a) a majority of Plan participants materially and adversely affected by the material irreconcilable conflict vote to decline such offer or (b) pursuant to governing Plan documents and applicable law, the Plan makes such decision without a Plan participant vote.

5. The Board's determination of the existence of a material irreconcilable conflict and its implications shall be made known promptly in writing to all Participating Entities and the relevant Advisor or its affiliate.

6. Participating Insurance Companies will provide pass-through voting privileges to all variable contract owners for so long as the Commission continues to interpret the 1940 Act as requiring pass-through voting privileges for variable contract owners. Accordingly, such Participating Insurance Companies will vote shares of each Portfolio held in their registered separate accounts in a manner consistent with voting instructions timely received from such contract owners. Each Participating Insurance Company will vote shares of each Portfolio held in its registered Separate Accounts for which no timely voting instructions are received, as well as shares attributable to the Participating Insurance Company, in the same proportion as those shares for which voting instructions are received. Participating Insurance Companies shall be responsible for assuring that each of their registered Separate Accounts investing in a Fund calculates voting privileges in a manner consistent with all other Participating Insurance Companies. The obligation to vote a Fund's shares and to calculate voting privileges in a manner consistent with all other registered Separate Accounts investing in a Fund shall be a contractual obligation of all Participating Insurance Companies under their agreements governing participation in the Fund. Each Plan will vote as required by applicable law and governing Plan documents.

7. A Fund will notify all Participating Insurance Companies and Qualified Plans that disclosure regarding potential risks of mixed and shared funding may be appropriate in prospectuses for any of the Separate Accounts and in Plan documents. Each Fund will disclose in its prospectus that: (a) Shares of the Fund are offered to insurance company Separate Accounts that fund both variable annuity and variable life insurance contracts, and to Qualified Plans; (b) due to differences of tax treatment or other considerations, the interests of various contract owners participating in the Fund and the interests of Qualified Plans investing in the Fund might at some time be in conflict; and (c) the Board will monitor the Fund for any material conflicts and determine what action, if any, should be taken.

8. All reports received by the Board of potential or existing conflicts, and all Board action with regard to determining the existence of a conflict, notifying Participating Entities and any Advisor and its affiliates of a conflict, and determining whether any proposed action adequately remedies a conflict, will be properly recorded in the minutes of the Board or other appropriate records, and such minutes or other records shall be made available to the Commission upon request.

9. If and to the extent Rule 6e–2 and Rule 6e–3(T) under the 1940 Act are amended, or Rule 6e–3 is adopted, to provide exemptive relief from any provision of the 1940 Act or the rules thereunder with respect to mixed or shared funding on terms and conditions materially different from any exemptions granted in the order requested in the application, then each Fund and/or the Participating Insurance Companies, as appropriate, shall take such steps as may be necessary to comply with Rule 6e–2 and Rule 6e–3(T), as amended, and Rule 6e–3, as adopted, to the extent such rules are applicable.

10. Each Fund will comply with all provisions of the 1940 Act requiring voting by shareholders (which, for these purposes, shall be the persons having a voting interest in the shares of that Fund), and in particular each Fund will either provide for annual meetings (except insofar as the Commission may interpret Section 16 of the 1940 Act not to require such meetings) or comply

with Section 16(c) of the 1940 Act (although the Fund is not one of the trusts described in Section 16(c) of the 1940 Act) as well as with Section 16(a) of the 1940 Act and, if and when applicable, Section 16(b) of the 1940 Act. Further, each Fund will act in accordance with the Commission's interpretation of the requirements of Section 16(a) of the 1940 Act with respect to periodic elections of directors (or trustees) and with whatever rules the Commission may promulgate with respect thereto.

11. The Participating Entities and the relevant Advisor or its affiliate shall at least annually submit to the Board of a Fund such reports, materials or data as the Board may reasonably request so that it may fully carry out the obligations imposed upon it by the conditions contained in the application and said reports, materials and data shall be submitted more frequently, if deemed appropriate, by the Board. The obligations of Participating Entities to provide these reports, materials and data to the Board of the Fund when it so reasonably requests, shall be a contractual obligation of all Participating Entities under their agreements governing participation in each Fund.

12. If a Qualified Plan should become an owner of 10% or more of the assets of a Fund, the Fund shall require such Plan to execute a participation agreement with such Fund which includes the conditions set forth herein to the extent applicable. A Qualified Plan will execute an application containing an acknowledgment of this condition upon such Plan's initial purchase of the shares of any Fund.

Conclusion

Applicants submit, based on the grounds summarized above, that the exemptions requested are 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 1940 Act.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–19533 Filed 8–1–02; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–46272; File No. SR–ISE–2002–11]

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change, and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1 and 2 Relating to a Market Maker Inactivity Fee

July 26, 2002.

I. Introduction

On April 16, 2002, the International Securities Exchange LLC (''ISE'') filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to impose a Competitive Market Maker (''CMM'') inactivity fee. On May 6, 2002, the Exchange's rule proposal was published for comment in the **Federal Register**.[3] The Commission received two comment letters on the proposal.[4] On April 30, 2002 and June 19, 2002, ISE submitted Amendment Nos. 1 and 2 to the proposal, respectively. [5] On June 19, 2002, the ISE submitted a response to comments.[6] This order approves the proposed rule change, publishes notice of Amendment Nos. 1 and 2 to the proposed rule change, and grants accelerated approval of Amendment Nos. 1 and 2.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 45816 (April 24, 2002), 67 FR 30406.

[4] *See* letters to Jonathan G. Katz, Secretary, Commission, from Henry Swartz, Principal, Equity Financial Products, Banc of America Securities, LLC, (''Banc of America'') dated May 23, 2002 (''Banc of America Letter''), and Matthew D. Wayne, Chief Legal Officer, Knight Financial Products LLC, (''Knight'') dated April 30, 2002 (''Knight Letter'').

[5] *See* letters from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated April 29, 2002 (''Amendment No. 1'') and June 18, 2002 (''Amendment No. 2''). In Amendment No. 1, the ISE made a technical change to the rule text. In Amendment No. 2, the ISE clarified the application of the fee between lessors and lessees, changed terminology to reflect the fact that the ISE has ''demutualized'' and that trading rights are now reflected in shares of Class B Common Stock, removed obsolete language from the Primary Market Maker (''PMM'') inactivity fee regarding the effective date of that fee, and extended the proposed effective date from July 1, 2002 to August 1, 2002.

[6] *See* letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Jonathan G. Katz, Secretary, Commission, dated June 18, 2002 (''ISE Response'').

II. Description of the Proposed Rule Change

The Exchange proposes to adopt a fee that would allow it to charge $25,000 per month to inactive CMM memberships, effective August 1, 2002.[7] The fee would apply to the owner of an inactive CMM membership except with regard to an owner that entered into a lease prior to August 1, 2002. In that case, the fee would apply to the lessee, if the lessee has been approved to operate the membership.

The fee would not apply to a member that holds an inactive CMM membership in a group of securities in which it also is operating the PMM membership pursuant to a lease. In that case, the member cannot operate both the PMM and CMM membership, and the member reasonably may want to retain control of the CMM membership so that it can operate the membership when its PMM lease expires. The proposal also would authorize the Exchange staff to grant exemptions if a member holds multiple inactive CMM memberships. In that situation, the Exchange could grant exemptions for all but one such membership as long as the member presents a business plan establishing that trading will begin in the inactive memberships over a reasonable time period.

The Exchange represents that it based the amount of the fee on conservative estimates of the revenues lost due to an inactive CMM membership. In addition, the Exchange represents that it would periodically reevaluate this fee to maintain the relationship between the amount of the fee and the lost revenue being recouped.

III. Comments Received

The Commission received comments on the proposal from Banc of America and Knight.[8] Banc of America objected to the proposal for several reasons. In particular, Banc of America argued that no precedent supports the proposed fee; the proposal improperly targets owners that do not operate their memberships, and that owners could not always rely on leasing to avoid the fee because seats would unlikely be leased continually and the proposed effective date would not provide enough time for owners to lease their seats; the fee would add to the start-up costs for market makers which may result in a barrier to entry to the exchange; and to require

[7] *See* Amendment No. 2, *supra* note.

[8] *See* Banc of America Letter and Knight Letter, supra note.