have to create and operate a variety of asset allocation funds at substantial additional expense, notwithstanding the fact that suitable Portfolios otherwise exist.

4. Section 12(d)(1) was intended to mitigate or eliminate actual or potential abuses which might arise when one investment company acquires shares of another investment company. These abuses include the acquiring fund imposing undue influence over the management of the acquired funds through the threat of large-scale redemptions, the acquisition by the acquiring company of voting control of the acquired company, the layering of sales charges, advisory fees, and administrative costs, and the creation of a complex pyramidal structure which may be confusing to investors.

5. Applicants believe that none of these potential or actual abuses are present in the structure of STAR. STAR does not exercise any influence over the management of the acquired Portfolios by the threat of redemptions. STAR does not hold out to investors that STAR is seeking to exercise investment judgment to time the market or to pick the "better" or "best" performing funds. Instead, STAR enables Vanguard to offer an asset allocation service to investors on a cost-effective basis. STAR currently, as a matter of fundamental policy, invests its assets solely in specified Portfolios within defined ranges. 5 Redemptions from the acquired Portfolios will result solely in the ordinary course of business as a result of STAR's receipt of net redemption requests from its shareholders. The acquired Portfolios, as a matter of policy and practice, are at all times at least 85% invested in liquid, publicly traded securities. Thus, they would have no reason to hold a higher than normal cash position to protect their other shareholders against potential redemptions by STAR. As well, the actual results of ten years of the STAR Portfolio's investments in the acquired Portfolios demonstrates that STAR's investments tend to reduce the redemption rates of the acquired Portfolios.6

6. The structure of STAR contains no layering of sales charges, advisory fees, or administrative costs. Neither STAR nor the Portfolios imposes any sales charges or fees pursuant to rule 12b-1. Although STAR may pay advisory fees at the level of the Vanguard Portfolios, it does not intend to pay an advisory fee at the STAR level for advisory services related to investments in any Vanguard Portfolios. Similarly, virtually all administrative fees are imposed at the Portfolio level, and shareholders of STAR will hear a portion of the fees only in proportion to their holdings of the Portfolios.

7. STAR does not have a complex structure that would make it difficult for a shareholder to determine the true value of his or her interest in the Portfolios. Indeed, the 10% limitation contained in the STAR Order operates to increase the complexity of the STAR Portfolio by requiring it to acquire shares of additional Portfolios which would not otherwise acquire, and of the LIFEStrategy Portfolios if they must invest directly in securities once they have reached the 10% limit with respect to the Vanguard Asset Allocation Fund.

8. In addition to not containing the actual and potential abuses which led to the enactment of section 12(d)(1)applicants believe that the structure of STAR provides a number of benefits to STAR and its shareholders, including: (a) An increase in the variety of investment options available to shareholders; (b) a simpler method for an investor to allocate his or her assets on a continuous basis without, at a minimum, the inconvenience of initiating the steps periodically to "rebalance" his or her portfolio; (c) a modest reduction in the investor's account maintenance costs, because an investor will not need to maintain two or more accounts to attain a desired allocation; and (d) the lower expense ratios and increased diversification which result from a new STAR Fund Portfolio's ability to take advantage of the existing asset base created by the acquired Funds.

9. The acquired Vanguard Portfolios benefit from the existence of STAR in four major respects: (a) The likely addition of assets from STAR will further reduce the expense ratios of the Portfolios; (b) to the extent many shareholders of STAR would otherwise open accounts with each of the Portfolios, the number of accounts maintained by the Portfolios in the aggregate, and the resulting transfer agency fees, will be reduced; (c) the costs of printing and mailing prospectuses, sales material, and periodic reports will be reduced because

The Vanguard Group can combine information concerning two or more funds in a single document; and (d) the Portfolios' redemption rates are likely to be lower due to the long-term nature of STAR's assets. As well, all of the Vanguard Funds are likely to benefit from the existence of STAR since increased distribution and the resulting addition of assets to The Vanguard Group produces cost savings and other benefits for all Funds even if they are not the acquired Funds.

## B. Section 17(a)

1. Section 17(a) makes it unlawful for an affiliated person of a registered investment company to sell securities to, or purchase securities from, the company. STAR and the acquired Vanguard Funds may be considered affiliated persons because they share common officers and/or directors/trustees. An acquired Fund's issuance of its shares to STAR may be considered a sale prohibited by section 17(a).

2. Section 17(b) provides that the SEC shall exempt a proposed transaction from section 17(a) if evidence establishes that: (a) The terms of the proposed transaction are reasonable and fair and do not involve overreaching; (b) the proposed transaction is consistent with the policies of the registered investment company involved; and (c) the proposed transaction is consistent with the general provisions of the Act. Applicants request an exemption under sections 6(c) and 17(b) to permit the Portfolios to sell their shares to STAR.

3. Applicants believe that the proposed transactions meet the standards of sections 6(c) and 17(b). All purchases and redemptions of shares of a Vanguard Portfolio will be effected at current net asset value. STAR's purchase and sale of shares of the Vanguard Portfolios is consistent with STAR's policy, as set forth in its registration statement. Applicants also believe that the proposed transactions are consistent with the general purposes of the Act.

## C. Section 17(d) and Rule 17d-1

1. Section 17(d) prohibits an affiliated person of the registered investment company, or an affiliated person of such person, acting as principal, from effecting any transaction in which such investment company is a joint, or joint and several, participant with such person in contravention of SEC rules and regulations. Rule 17d–1 provides that an affiliated person of a registered investment company or an affiliated person of such person, acting as principal, shall not participate in, or effect any transaction in connection

<sup>&</sup>lt;sup>5</sup> If the requested order is granted, STAR may seek shareholder approval to eliminate this limitation as a matter of fundamental policy. STAR would continue to disclose in its prospectus and other documents the Vanguard Funds in which it intends to invest

<sup>&</sup>lt;sup>6</sup> For each of the 10 years in which the STAR Portfolio has operated, the STAR Portfolio's redemption rates, with one exception, have been somewhat or substantially below the redemption rates of the Portfolios. In 1994, for example, the STAR Portfolio experienced a redemption rate of 7%, while the average redemption rate for the acquired Vanguard Portfolios was 19.7%.