

will cause more than 10% of the acquired company's voting stock to be owned by investment companies.

2. Section 6(c) provides that the SEC may exempt persons or transactions 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. Applicants request an order under section 6(c) exempting them from section 12(d)(1) (A) and (B) to permit the Cardinal Funds to invest in shares of the Underlying Funds in excess of the percentage limitations of section 12(d)(1).

3. Applicants state that the Cardinal Funds have been created to function as an asset allocation mechanism. Applicants believe that the Cardinal Funds provide professional investment management for those investors who wish to diversify their mutual fund investments, but desire professional management to decide which mutual funds to select, how much of their assets to commit to each Fund, and when to reallocate their investments.

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 their proposed fund of funds structure. Applicants assert that the structure of the Cardinal Funds will not result in excessive fees for Cardinal Fund shareholders. Although SBMFM is considering charging an advisory fee to the Cardinal Funds, advisory fees charged to the Cardinal Funds and the Underlying Funds would not be duplicative. If SBMFM determines to charge an advisory fee for such allocation services, or to increase any advisory fee charged to a Cardinal Fund, such fees, in accordance with the conditions to the requested order, would only be for services that augment, rather than duplicate, advisory services provided to the Underlying Funds.

6. Applicants also assert that their proposed fund of funds structure does not present any danger of excessive sales charges. Although applicants have

reserved the right to have different sales charge structures in the future, which may include the payment of sales charges or service fees at both the Cardinal Fund and Underlying Fund level, applicants assert that such structures would not result in excessive or duplicative sales charges. In the event that a Cardinal Fund would invest in shares of an Underlying Fund that also bears sales charges or service fees, it would do so only in accordance with the conditions to the requested order, which require that any such sales charges or service fees, in the aggregate, be within the limitations set forth in section 26 of Article III of the National Association of Securities Dealers ("NASD") Rules of Fair Practice.²

7. Applicants assert that the Cardinal Funds would pose no threat of excessive control over the Underlying Funds. The shares of any Underlying Fund held by a Cardinal Fund will be voted either in proportion to the vote of all other holders of the securities of that Underlying Fund, or by pass-through voting by the shareholders of the Cardinal Funds. As well, applicants assert that redemption threats and a concomitant risk of lost advisory fees are not a problem in the context of a fund of funds structure in which all of the funds are members of the same fund family. The Cardinal Funds will only acquire shares of other Smith Barney Funds. Because Smith Barney affiliates are the advisers to the Smith Barney Funds and SBMFM will be the adviser to the Cardinal Funds, a redemption from one Smith Barney Fund will simply lead to the placing of the proceeds into another Smith Barney Fund. For these reasons, applicants submit that the requested order exempting applicants from section 12(d)(1) to the extent described in the application meets the standards of section 6(c).

B. Section 17(a)

1. Section 17(a) makes it unlawful for an affiliated person of a registered investment company, or an affiliated person of such person, to sell securities to, or purchase securities from, the company. The Cardinal Funds and the Underlying Funds may be considered affiliated persons because the funds may be deemed to be controlled by their advisers, who are under the common control of Smith Barney. Thus, an Underlying Fund's issuance of its shares

to a Cardinal Fund may be considered a sale prohibited by section 17(a).

2. Section 17(b) provides that the SEC shall exempt a proposed transactions from section 17(a) if evidence establishes that: (a) the terms of the proposed transactions are reasonable and fair and do not involve overreaching; (b) the proposed transactions 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 Underlying Funds to sell their shares to the Cardinal Funds.³ Applicants believe that the proposed transactions meet the standards of sections 6(c) and 17(b).

Applicants' Conditions

Applicants agree that the order granting the required relief shall be subject to the following conditions:

1. The Cardinal Funds and each Underlying Fund will be part of the same "group of investment companies" as defined in paragraph (a)(5) of rule 11a-3 under the Act.

2. The Cardinal Funds will not invest in an Underlying Fund unless that Fund may not acquire securities of any other investment company in excess of the limits contained in section 12(d)(1)(A) of the Act, except to the extent permitted by section 12(d)(1)(D).

3. At least a majority of each Cardinal Fund's directors will not be "interested persons," as defined in section 2(a)(19) of the Act ("Independent Directors"), and the selection of Independent Directors necessary to fill any vacancies on the board of directors, as well as the nomination of those persons to be recommended by the board of directors in connection with any shareholder vote, will be committed to the discretion of such Independent Directors.

4. Prior to approving any advisory contract under section 15 of the Act, the directors of each Cardinal Fund, including a majority of the Independent Directors, shall find that the advisory fees charged under such contract, if any, are based on services provided that are in addition to, rather than duplicative of, services provided under the advisory contract of any Underlying Fund in which a Cardinal Fund may invest. These findings and their basis will be recorded fully in the minute books of the Cardinal Fund.

³ Section 17(b) applies to specific proposed transactions, rather than an ongoing series of future transactions. See *Keystone Custodian Funds*, 21 S.E.C. 295, 298-99 (1945). Section 6(c) frequently is used to grant relief from section 17(a) to permit an ongoing series of future transactions.

² As multiple class funds, the Cardinal Funds will apply the NASD restrictions on a class-by-class basis to ensure that no investor would pay excessive sales charges.