

reorganization of a company (other than a plan devised for the purpose of evading section 12(d)(1) of the Act); or (ii) acquires (or is deemed to have acquired) securities of another investment company pursuant to exemptive relief from the Commission permitting such Underlying Fund to (a) acquire securities of one more affiliated investment companies for short-term cash management purposes, or (b) engage in interfund borrowing and lending transactions.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-7325 Filed 3-26-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Rel No. IC-25493; 812-12650]

First American Investment Funds, Inc., et al.; Notice of Application

March 21, 2002.

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

ACTION: Notice of application for an order under the Investment Company Act of 1940 (the "Act") under (i) section 6(c) of the Act granting an exemption from sections 18(f) and 21(b) of the Act, (ii) section 12(d)(1)(J) of the Act granting an exemption from section 12(d)(1) of the Act, (iii) sections 6(c) and 17(b) of the Act granting an exemption from sections 17(a)(1) and 17(a)(3) of the Act, and (iv) section 17(d) of the Act and rule 17d-1 under the Act to permit certain joint arrangements.

SUMMARY OF APPLICATION: Applicants request an order that would permit certain registered open-end management investment companies to participate in a joint lending and borrowing facility. The requested order would also amend a condition of a prior order ("Order").¹

Applicants: First American Investment Funds, Inc. ("FAIF"), First American Funds, Inc. ("FAF"), First American Strategy Funds, Inc. ("FASF"), First American Insurance Portfolios, Inc. (collectively, the "Investment Companies"), U.S. Bancorp Asset Management, Inc. ("USBAM") and all other open-end registered management

investment companies and their series that now or in the future are advised by USBAM or a person controlling, controlled by, or under common control with USBAM (together with the Investment Companies, the "Funds").²
Filing Dates: On September 28, 2001 and amended on March 19, 2002.

Hearing or Notification of Hearing: An order granting the requested relief will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on April 15, 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 the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

ADDRESSES: Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Applicants, c/o James D. Alt, Esq., 601 Second Avenue South, Minneapolis, Minnesota 55402.

FOR FURTHER INFORMATION CONTACT: Julia Kim Gilmer, Senior Counsel, at (202) 942-0528, or Janet M. Grossnickle, 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 may be obtained for a fee at the Commission's Public Reference Branch, 450 Fifth Street, NW., Washington, DC 20549-0102 (tel. 202-942-8090).

Applicants' Representations

1. Each Investment Company is registered under the Act as an open-end management investment company and is organized as a Maryland or a Minnesota corporation. USBAM is registered under the Investment Advisers Act of 1940 and serves as investment adviser to the Funds.

2. The Funds have obtained an order permitting each Fund to use its uninvested cash to purchase shares of one or more affiliated money market

funds that comply with rule 2a-7 of the Act (the "Money Market Funds").³ The Funds have also obtained an order permitting the Funds to invest cash on a joint basis through joint accounts ("Joint Accounts").⁴

3. Some Funds may lend money to banks or other entities by entering into repurchase agreements or by investing in other short-term instruments either directly or through Joint Accounts. Other Funds may borrow money from the same or other banks for temporary purposes to satisfy redemption requests or to cover unanticipated cash shortfalls such as a trade "fail" in which cash payment for a security sold by a fund has been delayed. Currently, the Funds have credit arrangements with their custodian (*i.e.*, overdraft protection).

4. If the Funds were to borrow money from their custodian under their current arrangements or from another bank, the Funds would pay a significantly higher interest rate than the rate that would be earned by other Funds on repurchase agreements and other short-term instruments. Applicants state that this differential represents the bank's profit for serving as middleman between a borrower and a lender.

5. Applicants request an order that would permit the Funds to enter into lending agreements under which the Funds would lend and borrow money for temporary purposes directly to and from each other through a credit facility ("Proposed Credit Facility"). Applicants believe that the Proposed Credit Facility would substantially reduce the Funds' potential borrowing costs and enable the Funds to earn higher rates of interest on cash balances they currently invest in Money Market Funds or repurchase agreements. Although the Proposed Credit Facility would substantially reduce the Funds' need to borrow from banks, the Funds would be free to establish a committed line of credit or other borrowing arrangements with banks. The Funds would also continue to maintain overdraft protection with their custodian.

6. Applicants anticipate that the Proposed Credit Facility would enable the Funds to borrow for temporary purposes at a substantially reduced cost in the event of unexpected cash needs due to "failed" sales of securities or an unanticipated volume of redemption requests or for other reasons. Sales fails

¹ First American Strategy Funds, Inc., Investment Company Act Rel. Nos. 22173 (Aug. 26, 1996) (notice) and 22241 (Sept. 23, 1996) (order), amendment by First American Funds, Inc., Investment Company Act Rel. Nos. 22910 (Nov. 25, 1997) (notice) and 22950 (Dec. 23, 1997) (order).

² Each Fund that currently intends to rely on the requested order is named as an applicant. Any Fund that relies on the order in the future will do so in accordance with representations and conditions of application.

³ First American Funds, Inc., Investment Company Act Rel. Nos. 22910 (Nov. 25, 1997) (notice) and 22950 (Dec. 23, 1997) (order) ("Cash Sweep Order").

⁴ First American Investment Funds, Inc., Investment Company Act Rel. Nos. 22537 (March 3, 1997) (notice) and 22589 (March 28, 1997) (order).

may present a cash shortfall if the Fund has undertaken to purchase a security with the proceeds from the securities sold. In the event the Funds are unable to liquidate portfolio securities for immediate settlement to meet redemption requests, which normally are effected immediately, they will not receive payment in settlement for up to three days. The Proposed Credit Facility would provide a source of immediate, short-term liquidity pending settlement of the sale of portfolio securities.

7. While borrowing arrangements with banks will continue to be available to cover unexpected cash needs, under the Proposed Credit Facility a borrowing Fund would pay lower interest rates than those offered by banks on short-term loans and for overdraft protection with its custodian bank. In addition, Funds lending through the Proposed Credit Facility would earn interest at a rate higher than they otherwise could obtain from investing their cash balances in repurchase agreements or the Money Market Funds. Thus, applicants believe that the Proposed Credit Facility will benefit both borrowing and lending Funds.

8. The interest rate to be charged to the Funds on any loan made pursuant to the Proposed Credit Facility (the "Interfund Loan Rate") will be the average of the current overnight repurchase agreement rate available either directly or through the Joint Accounts (the "Repo Rate") and a single benchmark rate set for all Funds (the "Bank Loan Rate"). The Bank Loan Rate will be calculated by USBAM each day according to a formula established by each Fund's board of directors ("Board") to approximate the lowest interest rate at which bank loans would be available to the Funds. The formula will be based upon a publicly available rate (e.g., Federal Funds plus 25 basis points) and will vary with this rate so as to reflect changing bank loan rates. The initial Bank Loan Rate formula and any subsequent modifications to the formula will be subject to the approval of each Fund's Board. Each Fund's Board periodically will review the continuing appropriateness of reliance on the formula to determine the Bank Loan Rate, as well as the relationship between the Bank Loan Rate and current bank loan rates.

9. The Proposed Credit Facility will be administered by the Cash Sweep and Interfund Borrowing Committee of USBAM (the "Committee") and is composed of USBAM's chief executive officer, chief investment officer, chief operating officer, corporate counsel and head of compliance operations. The Proposed Credit Facility will be

available to Funds as lenders if the Fund would otherwise invest on any given day in the Money Market Funds pursuant to the Cash Sweep Order, or, in the case of Money Market Funds, if that Fund would otherwise invest in overnight repurchase agreements or other high quality short-term investments. Under the Proposed Credit Facility, the portfolio managers for each participating Fund, other than the Money Market Funds, may provide the Committee with instructions to participate as a borrower or lender. On each business day, the Committee will collect data on the uninvested cash balances and borrowing requirements of all participating Funds, other than the Money Market Funds, from the Funds' custodian. With respect to the Money Market Funds, the portfolio managers will inform the Committee of the amount of cash, if any, they wish to make available under the Proposed Credit Facility as a lender. The Money Market Funds typically would not participate as borrowers because they rarely need to borrow cash to meet redemptions. Once it determines the aggregate amount of cash available for loans and borrowing demand, the Committee will allocate loans among borrowing Funds. Applicants expect that there typically would be far more available uninvested cash for borrowing than borrowing demand. After the Committee has allocated cash for interfund loans, it will inform the Money Market Fund managers of the amount of loans, if any, made for the account of each Money Market Fund, so that the Fund managers may invest any remaining cash in other available short-term instruments. With respect to other participating Funds, the Committee will follow standing instructions from the portfolio managers to invest the remaining amounts daily in the Money Market Funds pursuant to the Cash Sweep Order.

10. The Committee will allocate borrowing demand and cash available for lending among the Funds on an equitable basis, subject to certain administrative procedures applicable to all Funds, such as the time of filing requests to participate, minimum loan lot sizes, and the need to keep the number of transactions and associated administrative costs to a minimum. To reduce transaction costs, each single loan normally will be allocated to minimize the number of participants necessary to complete the loan transaction. The method of allocation and related administrative procedures will be established by each Fund's Board, including a majority of directors

who are not "interested persons" of the Funds, as defined in section 2(a)(19) of the Act ("Independent Directors"), to ensure that both borrowing and lending Funds participate on an equitable basis.

11. USBAM will (a) monitor the interest rates charged and the other terms and conditions of the loans, (b) limit the borrowings and loans entered into by each Fund to ensure that they comply with the Fund's investment policies and restrictions, (c) ensure equitable treatment of each Fund, and (d) make quarterly reports to the Boards of the Funds concerning any transactions by the Funds under the Proposed Credit Facility and the interest rates charged. USBAM will administer the Proposed Credit Facility as part of its duties under its existing management agreement with each Fund and would receive no additional fee as compensation for its services.

12. Each Fund's participation in the Proposed Credit Facility will be governed by and be consistent with its organizational documents and fundamental investment restrictions. Each Fund currently has a non-fundamental investment restriction limiting borrowings to 10% of total assets and barring the Funds from borrowing for leverage purposes. In the event a Fund does not have an investment restriction that prohibits the Fund from borrowing for other than temporary or emergency purposes, that Fund's borrowings through the Proposed Credit Facility, as measured on the day when the most recent loan was made, will not exceed the greater of 125% of the Fund's total net cash redemptions or 102% of sales fails for the preceding seven calendar days. No Fund will be permitted to participate in the Proposed Credit Facility unless the Fund has fully disclosed all material information concerning the Proposed Credit Facility in its statement of additional information.

13. Applicants state that certain Funds operate in reliance on the Order. Applicants state that condition 2 of the Order provides that Underlying Portfolios, as defined in the Order, will not acquire securities of other investment companies in excess of the limits contained in section 12(d)(1)(A) of the Act. Applicants request that condition 2 of the Order be amended solely to the extent necessary to permit the Underlying Portfolios to engage in interfund borrowing and lending transactions through the Proposed Credit Facility.

14. Applicants seek an order pursuant to section 6(c) of the Act exempting them from sections 18(f) and 21(b) of the Act, pursuant to section 12(d)(1)(f) of

the Act exempting them from section 12(d)(1) of the Act, pursuant to sections 6(c) and 17(b) of the Act exempting them from sections 17(a)(1) and 17(a)(3) of the Act, and pursuant to section 17(d) of the Act and rule 17d-1 under the Act to permit certain joint arrangements. Applicants also seek an exemption under section 12(d)(1)(f) of the Act from sections 12(d)(1)(A) and (B) of the Act and under sections 6(c) and 17(b) of the Act from section 17(a) of the Act solely to the extent necessary to amend the Order.

Applicants' Legal Analysis

1. Section 17(a)(3) generally prohibits any affiliated person, or affiliated person of an affiliated person, from borrowing money or other property from a registered investment company. Section 21(b) generally prohibits any registered management investment company from lending money or other property to any person if that person controls or is under common control with the company. Section 2(a)(3)(C) of the Act defines an "affiliated person" of another person, in part, to be any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that the Funds may be under common control by virtue of having USBAM as their common investment adviser and having the same Board.

2. Section 6(c) provides that an exemptive order may be granted where an 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. Section 17(b) authorizes the Commission to exempt a proposed transaction from section 17(a) provided that the terms of the transaction, including the consideration to be paid or received, are fair and reasonable and do not involve overreaching on the part of any person concerned, and the transaction is consistent with the policy of the investment company as recited in its registration statement and with the general purposes of the Act. Applicants believe that the proposed arrangements satisfy these standards for the reasons discussed below.

3. Applicants submit that sections 17(a)(3) and 21(b) of the Act were intended to prevent a person with strong potential adverse interests and some influence over the investment decisions of a registered investment company from causing or inducing the investment company to engage in lending transactions that unfairly inure to the benefit of that person and that are detrimental to the best interests of the

investment company and its shareholders. Applicants assert that the Proposed Credit Facility transactions do not raise these concerns because (a) USBAM will administer the program as a disinterested fiduciary, (b) all interfund loans will consist only of uninvested cash balances the lending Fund would have invested in short-term repurchase agreements or other short-term instruments either directly or through a Money Market Fund, (c) the interfund loans will not involve a greater risk than other similar investments, (d) the lending Funds will receive interest at a rate higher than it could otherwise receive for similar short-term investments, and (e) the borrowing Funds will pay interest at a rate lower than otherwise available to them under bank loan agreements. Moreover, applicants believe that the other conditions in the application will effectively preclude the possibility of any Fund obtaining an undue advantage over any other Fund. For the same reasons, applicants believe that the proposed amendment of the Order satisfies the standards of section 17(b) of the Act.

4. Section 17(a)(1) generally prohibits an affiliated person of a registered investment company, or an affiliated person of an affiliated person, from selling any securities or other property to the company. Section 12(d)(1) of the Act generally makes it unlawful for a registered investment company to purchase or otherwise acquire any security issued by any other investment company except in accordance with the limitations set forth in that section. Applicants believe that the obligation of a borrowing Fund to repay an Interfund Loan may constitute a security under sections 17(a)(1) and 12(d)(1). Section 12(d)(1)(f) provides that the Commission may exempt persons or transactions from any provision of section 12(d)(1) if and to the extent such exception is consistent with the public interest and the protection of investors. Applicants contend that the standards under sections 6(c), 17(b) and 12(d)(1) are satisfied for all the reasons set forth above in support of their request for relief from sections 17(a)(3) and 21(b), and from 17(a) to amend the Order, and for the reasons discussed below.

5. Applicants state that section 12(d) was intended to prevent the pyramiding of investment companies in order to avoid duplicative costs and fees attendant upon multiple layers of investment companies. Applicants submit that the Proposed Credit Facility does not involve these abuses. Applicants note that there would be no duplicative costs or fees to the Funds or

shareholders, and that USBAM would receive no additional compensation for its services in administering the Proposed Credit Facility. Applicants also note that the purpose of the Proposed Credit Facility is to provide economic benefits for all the participating Funds. Applicants further state that for all of the above reasons, the requested amendment of the Order does not implicate any of the concerns behind section 12(d)(1) of the Act.

6. Section 18(f)(1) prohibits open-end investment companies from issuing any senior security except that a company is permitted to borrow from any bank, if immediately after the borrowing, there is an asset coverage of at least 300 percent for all borrowings of the company. Under section 18(g) of the Act, the term "senior security" includes any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness. Applicants request exemptive relief from section 18(f)(1) to the limited extent necessary to implement the Proposed Credit Facility (because the lending Funds are not banks).

7. Applicants believe that granting relief under section 6(c) is appropriate because the Funds would remain subject to the requirement of section 18(f)(1) that all borrowings of the Fund, including combined interfund and bank borrowings, have at least 300% asset coverage. Based on the conditions and safeguards described in the application, applicants also submit that to allow the Funds to borrow from other Funds under the Proposed Credit Facility is consistent with the purposes and policies of section 18(f)(1).

8. Section 17(d) and rule 17d-1 generally prohibit any affiliated person of a registered investment company, or affiliated person of an affiliated person, when acting as principal, from effecting any joint transaction in which the company participates, unless the transaction is approved by the Commission. Rule 17d-1 provides that in passing upon applications for exemptive relief from section 17(d), the Commission will consider whether the participation of a registered investment company in a joint enterprise on the basis proposed is consistent with the provisions, policies, and purposes of the Act and the extent to which the company's participation is on a basis different from or less advantageous than that of other participants.

9. Applicants submit that the purpose of section 17(d) is to avoid overreaching by and unfair advantage to investment company insiders. Applicants believe that the Proposed Credit Facility is consistent with the provisions, policies

and purposes of the Act in that it offers both reduced borrowing costs and enhanced returns on loaned funds to all participating Funds and their shareholders. Applicants note that each Fund would have an equal opportunity to borrow and lend on equal terms consistent with its investment policies and restrictions. Applicants believe that each Fund's participation in the Proposed Credit Facility will be on terms which are no different from or less advantageous than that of other participating Funds.

Applicants' Conditions

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. The interest rate to be charged to the Funds under the Proposed Credit Facility will be the average of the Repo Rate and the Bank Loan Rate.

2. On each business day, the Committee will compare the Bank Loan Rate with the Repo Rate and will make cash available for interfund loans only if the Interfund Loan Rate is (a) more favorable to the lending Fund than both the Repo Rate and the then-current yield on the highest-yielding Money Market Fund in which the lending Fund could invest under the Cash Sweep Order, and its investment policies and restrictions, and (b) more favorable to the borrowing Fund than the Bank Loan Rate.

3. If a Fund has outstanding borrowings, any interfund loans to the Fund (a) will be at an interest rate equal to or lower than any outstanding bank loan of the Fund, (b) will be secured at least on an equal priority basis with at least an equivalent percentage of collateral to loan value as any outstanding bank loan that requires collateral, (c) will have a maturity no longer than any outstanding bank loan (and in no event over seven days), and (d) will provide that, if an event of default by the Fund occurs under any agreement evidencing an outstanding bank loan to the Fund, that event of default will automatically (without need for action or notice by the lending Fund) constitute an immediate event of default under the interfund loan agreement entitling the lending Fund to call the interfund loan (and exercise all rights with respect to any collateral) and that such call will be made if the lending bank exercises its right to call its loan under its agreement with the borrowing Fund.

4. A Fund may make an unsecured borrowing through the Proposed Credit Facility if its outstanding borrowings from all sources immediately after the interfund borrowing total less than 10% of its total assets, provided that if the

Fund has a secured loan outstanding from any lender, including but not limited to another Fund, the Fund's interfund borrowing will be secured on at least an equal priority basis with at least an equivalent percentage of collateral to loan value as any outstanding loan that requires collateral. If a Fund's total outstanding borrowings immediately after interfund borrowing would be greater than 10% of its total assets, the Fund may borrow through the Proposed Credit Facility only on a secured basis. A Fund may not borrow through the Proposed Credit Facility or from any other source if its total outstanding borrowings immediately after the interfund borrowing would be more than 33⅓% of its total assets.

5. Before any Fund that has outstanding interfund borrowings may, through additional borrowings, cause its outstanding borrowings from all sources to exceed 10% of its total assets, the Fund must first secure each outstanding interfund loan by the pledge of segregated collateral with a market value at least equal to 102% of the outstanding principal value of the loan. If the total outstanding borrowings of a Fund with outstanding interfund loans exceeds 10% of its total assets for any other reason (such as a decline in net asset value or because of shareholder redemptions), the Fund will within one business day thereafter: (a) Repay all its outstanding interfund loans, (b) reduce its outstanding indebtedness to 10% or less of its total assets, or (c) secure each outstanding interfund loan by the pledge of segregated collateral with a market value at least equal to 102% of the outstanding principal value of the loan until the Fund's total outstanding borrowings cease to exceed 10% of its total assets, at which time the collateral called for by this condition (5) shall no longer be required. Until each interfund loan that is outstanding at any time that a Fund's total outstanding borrowings exceed 10% is repaid or the Fund's total outstanding borrowings cease to exceed 10% of its total assets, the Fund will mark the value of the collateral to market each day and will pledge such additional collateral as is necessary to maintain the market value of the collateral that secures each outstanding interfund loan at least equal to 102% of the outstanding principal value of the interfund loan.

6. No Fund may lend to another Fund through the Proposed Credit Facility if the loan would cause its aggregate outstanding loans through the Proposed Credit Facility to exceed 15% of its net assets at the time of the loan.

7. A Fund's interfund loans to any one Fund shall not exceed 5% of the lending Fund's net assets.

8. The duration of interfund loans will be limited to the time required to receive payment for securities sold, but in no event more than seven days. Loans effected within seven days of each other will be treated as separate loan transactions for purposes of this condition.

9. Each interfund loan may be called on one business day's notice by the lending Fund and may be repaid on any day by the borrowing Fund.

10. A Fund's participation in the Proposed Credit Facility must be consistent with its investment policies and limitations and its organizational documents.

11. Except as set forth in this condition, no Fund may borrow through the Proposed Credit Facility unless the Fund has a policy that prevents the Fund from borrowing for other than temporary or emergency purposes. In the case of a Fund that does not have such a policy, the Fund's borrowings through the Proposed Credit Facility, as measured on the day when the most recent loan was made, will not exceed the greater of 125% of the Fund's total net cash redemptions or 102% of sales fails for the preceding seven calendar days.

12. The Committee will calculate total Fund borrowing and lending demand through the Proposed Credit Facility, and allocate interfund loans on an equitable basis among the Funds. The Committee will not solicit cash for the Proposed Credit Facility from any Fund or prospectively publish or disseminate loan demand data to portfolio managers. The Committee will invest amounts remaining after satisfaction of borrowing demand in accordance with standing instructions from portfolio managers or return remaining amounts for investment directly by the portfolio managers of the Money Market Funds.

13. USBAM will monitor the interest rates charged and the other terms and conditions of the interfund loans and will make a quarterly report to the Boards of the Funds concerning the participation of the Funds in the Proposed Credit Facility and the terms and other conditions of any extensions of credit thereunder.

14. Each Fund's Board, including a majority of the Independent Directors: (a) Will review no less frequently than quarterly the Fund's participation in the Proposed Credit Facility during the preceding quarter for compliance with the conditions of any order permitting the transactions, (b) will establish the Bank Loan Rate formula used to

determine the interest rate on interfund loans and review no less frequently than annually the continuing appropriateness of the Bank Loan Rate formula, and (c) will review no less frequently than annually the continuing appropriateness of the Fund's participation in the Proposed Credit Facility.

15. In the event an interfund loan is not paid according to its terms and the default is not cured within two business days from its maturity or from the time the lending Fund makes a demand for payment under the provisions of the interfund loan agreement, USBAM will promptly refer the loan for arbitration to an independent arbitrator selected by the Board of each Fund involved in the loan who will serve as arbitrator of disputes concerning the interfund loans.⁵ The arbitrator will resolve any problem promptly, and the arbitrator's decision will be binding on all Funds involved. The arbitrator will submit, at least annually, a written report to the Boards setting forth a description of the nature of any dispute and the actions taken by the Funds to resolve the dispute.

16. Each Fund will maintain and preserve for a period of not less than six years from the end of the fiscal year in which any transaction by it under the Proposed Credit Facility occurred, the first two years in an easily accessible place, written records of all such transactions setting forth a description of the terms of the transaction, including the amount, the maturity, and the rate of interest on the loan, the rate of interest available at the time on short-term repurchase agreements and bank borrowings, the yield on the Money Market Funds and such other information presented to the Fund's Board in connection with the review required by conditions 13 and 14.

17. USBAM will prepare and submit to the Funds' Boards for review an initial report describing the operations of the Proposed Credit Facility and the procedures to be implemented to ensure that all Funds are treated fairly. After commencement of operations of the Proposed Credit Facility, USBAM will report on the operations of the Proposed Credit Facility at the Boards' quarterly meetings. In addition, for two years following the commencement of the Proposed Credit Facility, the independent public accountant for each Fund shall prepare an annual report that evaluates USBAM's assertion that it has established procedures reasonably

designed to achieve compliance with the conditions of the order. The report shall be prepared in accordance with the Statements on Standards for Attestation Engagements No. 3 and it shall be filed pursuant to Item 77Q3 of Form N-SAR. In particular, the report shall address procedures designed to achieve the following objectives: (a) That the Interfund Loan Rate will be higher than the Repo Rate and, if applicable, the yield on the highest yielding Money Market Fund in which a lending Fund is permitted to invest, but lower than the Bank Loan Rate; (b) compliance with the collateral requirements as set forth in the application; (c) compliance with the percentage limitations on interfund borrowing and lending; (d) allocation of interfund borrowing and lending demand in an equitable manner and in accordance with procedures established by the Boards; and (e) that the interest rate on any interfund loan does not exceed the interest rate on any third party borrowings of a borrowing Fund at the time of the interfund loan.

After the final report is filed, the Funds' external auditors, in connection with their Fund audit examinations, will continue to review the operation of the Proposed Credit Facility for compliance with the conditions of the application and their review will form the basis, in part, of the auditor's report on internal accounting controls in Form N-SAR.

18. No Fund will participate in the Proposed Credit Facility upon receipt of requisite regulatory approval unless it has fully disclosed in its statement of additional information all material facts about its intended participation.

Applicants also agree that condition number 2 to the Order will be modified as follows:

No Underlying Portfolio will 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 that an Underlying Portfolio has obtained exemptive relief from the Commission permitting it to (i) purchase securities of an affiliated money market fund for short-term cash management purposes, or (ii) engage in interfund borrowing and lending transactions.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-7326 Filed 3-26-02; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-25490; File No. 812-12714]

Integrity Life Insurance Company, et al.; Notice of Application

March 20, 2002.

AGENCY: Securities and Exchange Commission ("SEC or "Commission")

ACTION: Notice of application for an order pursuant to section 26(c) of the Investment Company Act of 1940 (the "Act"), approving substitution of shares of one registered management investment company with shares of another registered management investment company.

SUMMARY OF APPLICATION: Applicants seek an order approving the proposed substitution of shares of the Touchstone High Yield Fund for shares of the Morgan Stanley High Yield Portfolio (the "Substitution").

APPLICANTS: Integrity Life Insurance Company ("Integrity"), Separate Account II of Integrity Life Insurance Company ("Integrity Separate Account"), National Integrity Life Insurance Company ("National Integrity"), Separate Account II of National Integrity Life Insurance Company ("National Integrity Separate Account") and Touchstone Advisors, Inc. ("Touchstone") (collectively, the "Applicants").

FILING DATE: The application was filed on December 7, 2001 and amended and restated on March 18, 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 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 April 15, 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 the requester's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Secretary of the Commission.

ADDRESSES: For the Commission: Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. For Applicants: P.O. Box 740074, Louisville, Kentucky, 40202-3319.

FOR FURTHER INFORMATION CONTACT: Alison Toledo, Senior Counsel, or Lorna

⁵ If the dispute involves Funds with separate Boards, the directors of each Fund will select an independent arbitrator that is satisfactory to each Fund.