

(b) The Schedule of Spreads will set forth rates of compensation to the Fund that are reasonable and fair and that are determined in light of those considerations set forth in the application.

(c) The Schedule of Spreads will be uniformly applied to all Borrowers of the Fund's portfolios securities, and will specify the lowest allowable spread with respect to a loan of securities to any Borrower.

(d) If a security is loaned to an unaffiliated Borrower with a spread higher than the minimum set forth in the Schedule of Spreads, all comparable loans to an Affiliated Broker-Dealer will be made at no less than the higher spread.

(e) The Fund's Program will be monitored on a daily basis by an officer of the Fund who is subject to section 36(a) of the Act. This officer will review the terms of each loan to an Affiliated Broker-Dealer for comparability with loans to unaffiliated Borrowers and conformity with the Schedule of Spreads, and will periodically, and at least quarterly, report his or her findings to the Fund's Board, including a majority of the Disinterested Directors.

5. The Fund's Board, including a majority of the Disinterested Directors, (a) will determine no less frequently than quarterly that all transaction with Affiliated Broker-Dealers effected during the preceding quarter were effected in compliance with the requirements of the procedures adopted by the Board and the conditions of the requested order and that such transactions were conducted on terms which were reasonable and fair; and (b) will review no less frequently than annually such requirements and conditions for their continuing appropriateness.

6. The Funds will maintain and preserve permanently in an easily accessible place a written copy of the procedures (and any modifications thereto) which are followed in lending securities and shall maintain and preserve for a period of not less than six years from the end of the fiscal year in which any loan occurs, the first two years in an easily accessible place, a written record of each loan setting forth the number of shares loaned, the face amount of the securities loaned, the fee received (or the rebate rate remitted), the identity of the Borrower, the terms of the loan and any other information or materials upon which the finding was made that each loan made to an Affiliated Broker-Dealer was fair and reasonable and that the procedures followed in making such loan were in accordance with the other undertakings set forth in the application.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-12133 Filed 5-12-00; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

First Allmerica Financial Life Insurance Company, et al.

May 5, 2000.

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

ACTION: Notice of application for an order of approval pursuant to Section 26(b) of the Investment Company Act of 1940 (the "Act") and an order granting exemptive relief pursuant to Section 17(b) of the Act.

Summary of Application: Applicants seek an order under Section 26(b) of the Act approving the proposed substitution of shares of the Investment Grade Income Fund of AIT for shares of the Select Income Fund of AIT and for shares of Strategic Income Portfolio of Fulcrum held by the First Allmerica Separate Accounts and the Allmerica Financial Life Separate Accounts to support certain variable life insurance contracts or variable annuity contracts (collectively, the "Variable Contracts") issued by First Allmerica or Allmerica Financial Life. Applicants also seek an order under Section 17(b) of the Act exempting them from Section 17(a) to the extent necessary to permit the Applicants, by means of in-kind redemptions and purchases, to carry out the above-referenced substitutions of securities.

Applicants: First Allmerica Financial Life Insurance Company ("First Allmerica"); Allmerica Select Separate Account, Allmerica Select Separate Account II, Fulcrum Separate Account, Group VEL Account, Inheritance Account, Separate Account VA-K and VEL II Account (collectively, the "First Allmerica Separate Accounts"); Allmerica Financial Life Insurance and Annuity Company ("Allmerica Financial Life"); Allmerica Select Separate Account, Allmerica Select Separate Account II, Fulcrum Separate Account, Fulcrum Variable Life Separate Account, Group VEL Account, Inheritance Account, Select Account III, Separate Account IMO, Separate Account VA-K, VEL Account, VEL II Account and VEL Account III (collectively, the "Allmerica Financial Life Separate Accounts"); Allmerica

Investment Trust ("AIT") and the Fulcrum Trust ("Fulcrum") (collectively, the "Applicants").

Filing Date: The application was filed on January 31, 2000, and amended and restated on May 3, 2000.

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 this application by writing to the SEC's Secretary and serving Applicants with a copy of the request, in person or by mail. Hearing requests must be received by the Commission by 5:30 p.m. on May 30, 2000 and must be accompanied by proof of service on the 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 may request notification of the date of a hearing by writing to the Secretary of the SEC.

ADDRESSES: Secretary, SEC, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Applicants, Richard M. Reilly, President, Allmerica Financial Life Insurance and Annuity Company, 440 Lincoln Street, Worcester, MA 01653, and copy to George M. Boyd, Esq., First Allmerica Financial Life Insurance Company, N-440, 440 Lincoln Street, Worcester, MA 01653.

FOR FURTHER INFORMATION CONTACT: Ann L. Vlcek, Senior Counsel, or Keith Carpenter, 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 may be obtained for a fee from the SEC's Public Reference Branch, 450 Fifth Street, N.W., Washington, DC 20549-0102.

Applicants' Representations

1. First Allmerica was organized under the laws of Massachusetts in 1844. Effective October 16, 1995, the company converted from a mutual life insurance company known as State Mutual Life Assurance Company of America to a stock life insurance company and adopted its present name. The company is a wholly-owned subsidiary of Allmerica Financial Corporation ("AFC").

2. Allmerica Financial Life is a life insurance company organized under the laws of Delaware in July 1974. Allmerica Financial Life is an indirect, wholly-owned subsidiary of First Allmerica, which in turn is a wholly-owned subsidiary of AFC.

3. Each Applicant separate account is a "separate account" as defined by Rule 0-1(e) under the Act, and is registered under the Act as an investment trust. Each of the 19 Applicant separate accounts is a segregated asset account of the indicated Applicant insurance company. Each of the respective Applicant separate accounts is used by the Applicant insurance company of which it is a part to fund certain variable annuity or variable life contracts. Applicant insurance companies may issue additional variable contracts funded by Applicant separate accounts in the future. Certain sub-accounts of the respective Applicant separate accounts are dedicated to owning shares of one of the investment portfolios of AIT or one of the investment portfolios of Fulcrum (AIT and Fulcrum are sometimes referred to collectively herein as the "Underlying Funds"). Accordingly, each AIT or Fulcrum sub-account reflects the investment performance of that portfolio of AIT or Fulcrum in which the sub-account invests.

4. Each Applicant separate account is administered and accounted for as part of the general business of the Applicant insurance company of which it is a part. The income, gains or losses (realized or unrealized) of each Applicant separate account are credited to or charged against the assets of that separate account, without regard to income, gains or losses of such Applicant insurance company.

5. As noted above, each of the Applicant separate accounts serves as a funding vehicle for certain Variable Contracts. The terms and conditions, including charges and expenses, applicable to the respective Variable Contracts are described in separate registration statements relating to each Variable Contract. As the Variable Contracts are currently structured, holders of any of the Variable Contracts ("Contractholders") may select one or more of the investment options available under the Variable Contract held by the allocating premiums payable under such contracts to that sub-account of the relevant Applicant separate account that corresponds to the investment option desired. Thereafter, Contractholders accumulate funds, on a tax-deferred basis, based on the investment experience of the selected sub-account(s). Contractholders may, during the life of the contract, make unlimited transfers of accumulation values among the sub-accounts available under the Variable Contract held. Depending on the type of Variable Contract, the first six or twelve transfers in a contract year are guaranteed to be

free of any transfer charge. The Applicant insurance companies do not currently charge for additional transfers but reserve the right to do so. Applicants represent that the relief requested here will not affect any charge to which any Contractholder would otherwise be subject, or affect any right or privilege to which any Contractholder would otherwise be entitled (except for the substitution in the underlying investment options, as described herein).

6. AIT is a Massachusetts business trust that was established on October 11, 1984 and is registered under the Act as an open-end diversified investment company. AIT currently consists of 14 different Funds: Select Emerging Markets Fund, Select Aggressive Growth Fund, Select Capital Appreciation Fund, Select Value Opportunity Fund, Select International Equity Fund, Select Growth Fund, Select Strategic Growth Fund, Growth Fund, Equity Index Fund, Select Growth and Income Fund, Select Income Fund, Investment Grade Income Fund, Government Bond Fund and Money Market Fund (collectively, the "Funds," and each, a "Fund"). Currently, shares of each Fund are purchased only by the separate accounts established by First Allmerica or Allmerica Financial Life for the purpose of funding variable annuity contracts and variable life insurance contracts. Two AIT Funds are involved in the proposed substitutions discussed in this application.

7. The first AIT Fund involved in the proposed substitution is AIT's Investment Grade Income Fund ("IGIF").¹ IGIF seeks as high a level of total return, which includes capital appreciation as well as income, as is consistent with prudent investment management. To achieve its goal, the Fund invests in investments grade debt securities such as bonds and other corporate debt obligations; obligations issued or guaranteed by the U.S. Government, its agencies or instrumentalities; and market instruments, including commercial paper, bankers acceptances, and negotiable certificates of deposit. The Fund also may make investments in mortgage-backed and asset-backed securities. The Fund may invest up to 25% of its assets in foreign securities (not including its investments in American Depositary Receipts or ADRs) and up to 25% of its assets in debt obligations of supranational entities.

¹ Subject to the completion of the proposed substitutions, the name of this Fund will be changed to the Select Investment Grade Income Fund.

Investment techniques the Fund may employ include: entering into financial futures contracts and related options, forward commitments, purchasing options, repurchase agreements and stand-by commitments; investing in restricted securities, stripped mortgage-backed securities and when-issued securities; lending portfolio securities; and writing covered options.

8. The second AIT Fund involved in the proposed substitution is AIT's Select Income Fund ("SIF"), which seeks a high level of current income. SIF invests primarily in investment grade, fixed-income securities. Examples of the types of securities in which the Fund invests are corporate debt obligations such as bonds, notes and debentures, and obligations convertible into common stock; commercial paper; obligations issued or guaranteed by the U.S. Government, its agencies or instrumentalities; and debt securities backed by various types of financial assets. The Fund may also invest in mortgage-backed and asset-backed securities. The Fund's investments in corporate debt securities are not limited to any particular type of company or industry. The Fund may invest up to 25% of its assets in foreign securities (not including its investments in ADRs), up to 35% of its assets in money market instruments, and up to 25% of its assets in debt obligations of supranational entities. The Fund invests primarily (and in practice invests exclusively) in investment grade securities rated in the four highest grades by Moody's Investors Services or Standard & Poor's Rating Services or similar rating organizations, and in unrated securities. Investment techniques the Fund may employ include: entering into financial futures contracts and related options, forward commitments, forward contracts on foreign currencies, purchasing options, repurchase agreements and stand-by commitments; investing in high yield securities, restricted securities, stripped mortgage-backed securities and when-issued securities; lending portfolio securities; and writing covered options.

9. Overall management services are provided to AIT by Allmerica Financial Investment Management Services, Inc. ("AFIMS" and/or the "Manager"), an indirect, wholly-owned, subsidiary of AFC. AFIMS is an investment adviser registered under the Investment Advisers Act of 1940, as amended. Under the terms of a management agreement between AIT and AFIMS (the "Management Agreement"), AFIMS manages AIT's business affairs and has general responsibility for the management of the investments of the

Funds, subject to the control of the Board of Trustees of AIT.

10. AFIMS, at its expense, has contracted with investment sub-advisers to manage the investments of the Funds. Each sub-adviser has been selected on the basis of various factors including management experience, investment techniques and staffing, and is authorized to engage in portfolio transactions on behalf of the applicable Fund subject to such general or specific instructions as may be given by the trustees and/or AFIMS. Allmerica Asset Management, Inc. ("AAM") serves as sub-adviser for IGIF. Incorporated in 1993, AAM has approximately \$13 billion under management as of December 31, 1999. AAM serves as investment adviser to investment companies and affiliated insurance company accounts. Standish, Ayer & Wood, Inc. ("SAW") serves as sub-adviser for SIF. Founded in 1993, the firm had approximately \$44 billion in assets under management as of December 31, 1999. SAW manages portfolios for pension plans, financial institutions and endowment and foundation funds.

11. AFIMS is responsible for the payment of all fees to the sub-advisers. Other than the expenses specifically assumed by AFIMS under the Management Agreement, all expenses incurred in the operation of AIT are borne by AIT, including fees and expenses associated with the registration and qualification of AIT's shares under the Securities Act of 1933; other fees payable to the SEC; independent accountant, legal and custodian fees; association membership dues; taxes; interest; insurance premiums; brokerage commissions; fees and expenses of the trustees who are not affiliated with AFIMS; expenses for proxies, prospectuses and reports to shareholders; and Fund recordkeeping expenses and other expenses. A prospectus for AIT accompanies the prospectus of each of the Variable Contracts that offers one or more of the Funds as an investment option.

12. For its services, AFIMS is entitled to receive a fee from each Fund at AIT, based on the average daily net asset value of each Fund. In addition, AFIMS has voluntarily undertaken to reimburse each Fund for its fees and expenses that exceed the applicable expense limitation set for that Fund. The expenses which are subject to the voluntary expense limitations include management fees; independent accountant, legal and custodian fees; recordkeeping expenses; fees and expenses of the trustees who are not affiliated with AFIMS; association

membership dues and insurance; expenses for proxies, prospectuses and reports to shareholders; and fees associated with the registration of Fund shares. AFIMS has declared voluntary expense limitations for IGIF and SIF of 1.00% of each Fund's average daily assets. The expense limitations may be removed at any time after a Fund's first fiscal year of operations with notice to existing shareholders. Actual expenses have been well below such expense limitations for both Funds.

13. Fulcrum is a Massachusetts business trust that was established on September 8, 1993 and commenced operations on February 1, 1996. Prior to September 1, 1998, the Trust's name was "The Palladian Trust." Fulcrum is registered under the Act as an open-end diversified investment company and currently consists of five different portfolios; Global Interactive/Telecomm Portfolio, the International Growth Portfolio, the Growth Portfolio, the Value Portfolio and the Strategic Income Portfolio (collectively, the "Portfolios," and each, a "Portfolio").

14. The Fulcrum Strategic Income Portfolio ("SIP") is the only Fulcrum Portfolio involved in the proposed substitution discussed in this application. SIP seeks to make money for investors by investing for high current income and capital appreciation in a variety of fixed-income securities. SIP invests primarily in investment grade corporate debt securities and securities issued or guaranteed as to principal or interest by the U.S. Government or its agencies or instrumentalities; below investment-grade corporate debt securities; and foreign securities which include government debt of developed and emerging markets, corporate obligations of foreign companies, and debt obligations of supranational entities. Debt securities in which SIP may invest include bonds, notes, debentures, mortgage-backed and asset-backed securities, and other similar instruments. Although SIP may invest up to 50% of its assets in below investment grade securities, or junk bonds, SIP has generally invested most of its assets in investment grade securities. Investment techniques the Fund may employ include: commercial paper, indexed securities, securities of other investment companies, restricted securities, variable and floating rate securities and warrants; foreign currency transactions, futures contracts, repurchase agreements, reverse repurchase agreements, short sales against the box, and short sales; leveraging; purchasing options; and lending portfolio securities.

15. AFIMS serves as overall manager of Fulcrum, and is responsible for managing Fulcrum's daily business and has general responsibility for the management of the investments of the Portfolios. Portfolio managers (the "Portfolio Managers") have been hired to handle the day-to-day investment management of the Portfolios. The Portfolio Managers' activities are subject to general oversight by the trustees and AFIMS. AAM serves as Portfolio Manager of SIP. For these services, each Portfolio pays an overall management fee, computed and accrued daily and paid monthly, based on its average daily net assets. The overall fee varies based on the performance of that Portfolio (after expenses) compared to that of an appropriate benchmark. The Portfolio Manager receives 80% of the fee, and AFIMS receives the remaining 20%. For the period beginning on the effective date of a Portfolio manager agreement with a new Portfolio Manager and ending with the last day of the twelfth full calendar month thereafter, each Portfolio pays a monthly advisory fee calculated at an annual rate of 0.80% of the Portfolio's average daily net assets. After the first 12 full calendar months with a new Portfolio Manager, as described above, each Portfolio pays a monthly advisory fee equal to a basic fee, plus or minus an incentive fee. The fee might be reduced if absolute performance is negative. The monthly basic fee equals one-twelfth of the annual basic fee rate of 2.0% multiplied by average daily net assets over the previous 12 months. The incentive fee ranges from -2.0% to +2.0% on an annual basis, depending on a comparison of the Portfolio's performance (reflecting a deduction of portfolio expenses) and the performance of a selected benchmark index over the past 12 months. The monthly incentive fee, like the monthly basic fee, is calculated by multiplying one-twelfth of the incentive fee rate on an annual basis by the average daily net assets over the previous 12 months. Accordingly, the total fee could range from 0.0% to an annual rate of 4.0%, depending on performance.

16. AFIMS has agreed to limit operating expenses and reimburse those expenses to the extent that each Portfolio's "other expenses" (*i.e.*, expenses other than management fees) exceed the expense limitations set for the Portfolios. AFIMS has guaranteed these expense limitations through June 30, 2000. For the two years following the date that the expense limitations end and subject to certain conditions, each Portfolio will reimburse AFIMS for

any Portfolio expenses it reimbursed pursuant to the expense limitations. The limitation on "other expenses" for SIP is an annual rate of 1.50% of average daily net assets.

17. In accordance with its authority under the Variable Contracts,² and subject to the approval of the Commission under Section 26(b) of the Act, Applicant insurance companies have approved a proposal to make certain substitutions of shares held in sub-accounts of the Applicant separate accounts. Applicants propose to substitute shares of IGIF for shares of SIF and for shares of SIP.

18. Applicants maintain that IGIF and SIF have similar investment objectives and seek to achieve these objectives by investing in similar types of fixed-income securities and utilizing comparable investment strategies. Applicants have concluded that the investment objectives and policies of IGIF are sufficiently similar to those of SIF that the essential objectives and risk expectations of Contractholders can continue to be met. Applicants believe that the proposed substitution of IGIF for SIF will benefit Contractholders in that (1) IGIF has a lower investment advisory fee schedule than SIF, (2) IGIF

has a better one- and five-year performance record than SIF, and (3) IGIF has a larger asset base than SIF which may provide certain economies of scale and lower expenses.

19. Applicants assert that, as a result of the proposed substitution, the Contractholders who currently invest in SIF will benefit from the lower investment advisory fee of IGIF. The current investment advisory fees paid by each Fund are listed in the following chart.

Investment Adviser and Sub-Adviser Fees

The Manager receives fees computed daily at an annual rate based on the average daily net asset value of each Fund as set forth below.

| | Investment grade income fund (percent) | Select income fund (percent) |
|--------------------|--|------------------------------|
| First \$50 million | 0.50 | 0.60 |
| Next \$50 million | 0.45 | 0.55 |
| Over \$100 million | 0.40 | 0.45 |

The Manager pays each sub-adviser fee computed at an annual rate based on

ANNUAL FUND OPERATING EXPENSES

[Expenses deducted from fund assets—as of 12/31/98]

| | Investment grade income fund (percent) | Select income fund (percent) |
|---------------------------------------|--|------------------------------|
| Investment advisory fees | .43 | .54 |
| Other expenses | .09 | .10 |
| Total operating expenses ¹ | .52 | .64 |

¹ Until further notice, the Manager has declared a voluntary expense limitation of 1.00% for the Select Income Fund and Investment Grade Income Fund.

23. For the foregoing reasons, Applicants submit that the proposed substitution of the shares of IGIF for shares of SIF is in the best interest of Contractholders.

24. Applicants maintain that IGIF and SIP have similar investment objectives and seek to achieve these objectives by investing in similar types of fixed-income securities and utilizing comparable investment strategies. Applicants have concluded that the investment objectives and policies of IGIF are sufficiently similar to those of SIP that the essential objectives and risk expectations of Contractholders can

continue to be met. Applicants believe that the proposed substitution of IGIF for SIP will benefit Contractholders in that (1) IGIF has a larger asset base than SIP which should provide certain economies of scale and lower expenses, and (2) IGIF has a better performance record than SIP.

25. Applicants believe that SIP has not grown to a size to allow it to operate efficiently. As shown in the table below, IGIF has a larger asset base than SIP, which should provide certain economies of scale, resulting in lower expenses, compared to SIP. After the proposed substitution, SIP would be

the average daily net asset value of each Fund as set forth below.

Investment Grade Income Fund: 0.20%.

Select Income Fund: 0.20%.

20. Applicants state that IGIF has a better performance record than SIF for the one- and five-year periods ended December 31, 1998.

21. Applicants maintain that, as shown in the table below, IGIF has a larger asset base than SIF which may provide certain economies of scale, resulting in lower expenses, compared to SIF. The net assets of each Fund as of September 30, 1999 were as follows:

| | Net assets (in millions) |
|------------------------------|--------------------------|
| Investment grade income fund | \$250.2 |
| Select income fund | \$176.9 |

22. Applicants state that the expense ratio for IGIF is significantly lower in comparison to SIF, which is due primarily to the difference in the level of investment advisory fees between the two Funds. The fees and expenses incurred for the fiscal year ended December 31, 1998 by each Fund are as follows:

dissolved. The net assets of SIP and IGIF as of September 30, 1999 are as follows:

| | Net assets (in millions) |
|------------------------------------|--------------------------|
| Fulcrum strategic income portfolio | \$2.4 |
| AIT investment grade income fund | 250.2 |

26. Applicants state that the expense ratio for IGIF is significantly lower in comparison to SIP. The fees and expenses incurred for the fiscal year ended December 31, 1998 by each Fund are as follows:

² Each of the Variable Contracts reserves to the issuing Applicant insurance company the right, subject to Commission approval, to substitute

shares of another management investment company held by a sub-account of the separate account issuer of the contract. This reservation of right is disclosed

in the registration statement relating to each Variable Contract.

ANNUAL FUND OPERATING EXPENSES

[Expenses deducted from fund assets *before* fee limitations—as of 12/31/98]

| | Investment grade in- come fund (percent) | Strategic in- come port- folio (per- cent) |
|--------------------------------|---|---|
| Investment advisory fees | .43 | ² .67 |
| Other expenses | .09 | ³ 6.49 |
| Total operating expenses | 1.52 | 7.16 |

¹ Until further notice, the investment adviser has declared a voluntary expense limitation of 1.00% for the Investment Grade Income Fund.² The Investment advisory fee for the Strategic Income Portfolio listed above was based on the performance of the portfolio during 1998 and can vary from 0% to 4.00%.³ The Manager has agreed to a voluntary expense limitation on the "other expenses" at an annual rate of 1.50% of the average daily net assets of the Strategic Income Portfolio. The expense limitation is guaranteed through June 30, 2000. Subject to certain conditions, the Strategic Income Portfolio will reimburse the Manager for any portfolio expenses it reimbursed pursuant to the expense limitation for the two years following the date that the expense limitation ends.

27. Set forth below are charts showing gross and net operating expenses, including investment advisory fees, for IGIF, SIP and SIF for the years ended December 31, 1996—December 31, 1999.

| | Year ended 12/31/99 (percent) | | Year ended 12/31/98 (percent) | | Year ended 12/31/97 (percent) | | Year ended 12/31/96 (percent) | |
|-------------------------------------|-------------------------------------|------|-------------------------------------|------|-------------------------------------|------|-------------------------------------|------|
| | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
| Investment Grade Income Fund | | | | | | | | |
| Management fees | 0.43 | 0.43 | 0.43 | 0.43 | 0.41 | 0.41 | 0.40 | 0.40 |
| Other expenses | 0.07 | 0.07 | 0.09 | 0.09 | 0.10 | 0.10 | 0.12 | 0.12 |
| Total operating expenses | 0.50 | 0.50 | 0.52 | 0.52 | 0.51 | 0.51 | 0.52 | 0.52 |
| Strategic Income Portfolio | | | | | | | | |
| Management fees | 0.35 | 0.23 | 0.67 | 0.47 | 0.41 | 0.41 | 0.80 | 0.80 |
| Other expenses | 3.26 | 1.27 | 6.49 | 1.71 | 6.27 | 1.20 | 11.5 | 6.57 |
| Total operating expenses | 3.61 | 1.50 | 7.16 | 2.18 | 6.68 | 1.61 | 12.3 | 7.37 |
| Select Income Fund | | | | | | | | |
| Management fees | 0.52 | 0.52 | 0.54 | 0.54 | 0.59 | 0.59 | 0.60 | 0.60 |
| Other expenses | 0.09 | 0.09 | 0.10 | 0.10 | 0.13 | 0.13 | 0.14 | 0.15 |
| Total operating expenses | 0.61 | 0.61 | 0.64 | 0.64 | 0.72 | 0.72 | 0.74 | 0.74 |

28. Applicants state that IGIF has a better performance record than SIP. Applicants have no reason to believe that, in the near term, the performance of SIP will match or exceed that of IGIF.

29. Applicants also believe that the substitution would provide Contractholders a more predictable advisory fee. IGIF's investment advisory fee is an annual rate of 0.50% of average daily net assets on the first \$50 million of assets, 0.45% on the next \$50 million of assets, and 0.40% on assets over \$100 million. SIP's advisory fee can vary from 0% to 4.00% depending on performance.

30. For the foregoing reasons, Applicants submit that the proposed substitution of the shares of IGIF for shares of SIP is in the best interest of Contractholders.

31. Applicant insurance companies will effect the substitutions as soon as practicable following the issuance of the requested order, as follows. As of the effective date of the substitutions ("Effective Date"), shares of SIF and SIP held by the various Applicant separate accounts will be redeemed by the Applicant insurance companies. The proceeds of such redemptions, which may be effected in-kind, will then be used to purchase the appropriate number of shares of IGIF. Since it is anticipated that the proposed substitution will be effected by in-kind transfer of assets, Contractholders will be fully invested at all times. The proposed substitutions will take place at relative net asset value with no charge in the amount of any Contractholder's account value, cash value or death

benefit or in the dollar value of his or her investment in any of the Applicant separate accounts. Contractholders will not incur any fees or charges as a result of the proposed substitutions, nor will their rights nor the Applicant insurance companies' obligations under the Variable Contracts be altered in any way. All expenses incurred in connection with the proposed substitutions, including legal, accounting and other fees and expenses, will be paid by the Applicant insurance companies. In addition, the proposed substitutions will not impose any tax liability on Contractholders. The proposed substitutions will not cause the Variable Contract fees and charges currently being paid by existing Contractholders to be greater after the proposed substitutions than before the

proposed substitutions. The proposed substitutions (and any transfer in advance of the substitution) will not be subject to a transfer charge and will not be counted toward any limit on transfers guaranteed not to be subject to a transfer charge.

32. Two of the Applicant separate accounts, the First Allmerica Inheritance Account and Allmerica Financial Life VEL Account III, currently have sub-accounts that invest in SIF and IGIF. Applicant insurance companies may in the future cause the First Allmerica Inheritance Account and Allmerica Financial Life VEL Account III to combine those sub-accounts that hold shares of IGIF. The combination of those subaccounts that hold shares of IGIF would not have any impact on the value of the Variable Contracts involved, the fees or rights of the Contractholders, or diminish in any way the obligations of the Applicant insurance companies under any Variable Contract. The Applicant insurance companies would bear the costs of any such combination, including any legal and/or accounting fees relating to them, and the Contractholders would not incur any fees or charges as a result of such combination. In addition, any such sub-account combination would not result in any adverse tax consequences to the Contractholders, or any change in the economic interest or contract values of any Contractholders.

33. By supplements to the various prospectuses for the Variable Contracts and Applicant separate accounts, all owners of the Variable Contracts will be notified of the Applicant insurance companies' intention to take the necessary actions, including seeking the order requested by this application, to substitute shares of the Underlying Funds as described herein. The supplements for the Applicant separate accounts will advise Contractholders that from the date of the supplement until the date of the proposed substitution, each owner may make one transfer of all amounts allocated to the SIF or SIP sub-account to another sub-account without that transfer being counted toward the limit on transfers guaranteed not to be subject to a transfer charge. The supplements also will inform Contractholders that the Applicant insurance companies will not exercise any rights reserved under any of the Variable Contracts to impose additional restrictions on transfers until at least 30 days after the proposed substitutions. With these supplements, Contractholders will also receive a current prospectus relating to IGIF (unless the Contractholders has already received that prospectus).

34. In addition to the prospectus supplements distributed to owners of Variable Contracts, within five days after the proposed substitutions, and Contractholders who were affected by the substitutions will be sent a written notice informing them that the substitutions were carried out and that they may make one transfer of all account value under a Variable Contract invested in any one of the affected sub-accounts on the date of the notice to another sub-account available under their Variable Contract without that transfer counting as one of the number of transfers per year guaranteed to be free of charge. The notice will also reiterate the fact that the Applicant insurance companies will not exercise any rights reserved by either under any of the Variable Contracts to impose additional restrictions on transfers until at least 30 days after the proposed substitutions. The notice as delivered in certain states also may explain that, under the insurance regulations in those states, Contractholders who are affected by the substitutions may exchange their Variable Contracts for fixed-benefit life insurance contracts or annuity contracts, as applicable, issued by the Applicant insurance companies (or one of their affiliates) during the 60 days following the proposed substitutions.

35. The Applicant insurance companies are also seeking approval of the proposed substitutions from any state insurance regulators whose approval may be necessary or appropriate.

Applicants' Legal Analysis

1. Section 26(b) states that it "shall be unlawful for any depositor or trustee of a registered unit investment trust holding the security of a single issuer to substitute another security for such security unless the Commission shall have approved such substitution. The Commission shall issue an order approving such substitution if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title." The purpose of Section 26(b) is to protect the expectation of investors in a unit investment trust that the unit investment trust will accumulate the shares of a particular issuer and to prevent unscrutinized substitutions which might, in effect, force shareholders dissatisfied with the substituted security to redeem their shares, thereby possibly incurring either a loss of the sales load deducted from initial purchase payments, an additional sales load upon reinvestment of the redemption proceeds, or both. Section

26(b) affords this protection to investors by preventing a depositor or trustee of a unit investment trust holding the shares of one issuer from substituting for those shares the shares of another issuer, unless the Commission approves that substitution.

2. Applicants request that the Commission issue an order pursuant to Section 26(b) of the Act approving the substitutions by the Applicant insurance companies of shares held by the Applicant separate accounts as follows: (1) shares of IGIF for shares of SIF; and (2) shares of IGIF for shares of SIP.

3. Applicants state that the Variable Contracts expressly reserve for the Applicant insurance companies the right, subject to compliance with applicable law, to substitute shares of another investment company for shares of an investment company held by a separate account or a sub-account of a separate account. Applicants maintain that the prospectuses for the Variable Contracts and the separate accounts contain appropriate disclosure of this right. Applicants note that the Applicant insurance companies each reserved this right of substitution both to protect themselves and their Contractholders in situations where either might be harmed or disadvantaged by circumstances surrounding the issuer of the shares held by one or more of their separate accounts and to afford the opportunity to replace such shares where to do so could benefit itself and Contractholders.

4. Applicants state that, in the case of the proposed substitution of shares of IGIF for shares of SIF, SIF would be replaced by a Fund with a similar investment objective but which has a lower investment advisory fee, a better long-term performance record, and a larger asset base, potentially resulting in lower expenses. Applicants maintain that, in the case of the proposed substitution of shares of IGIF for shares of SIP, the interests of Contractholders will be better served primarily because SIP would be replaced by a Fund with similar investment objectives but which has a larger asset base, potentially resulting in lower expenses, and a better performance record.

5. Applicants generally submit that the proposed substitutions meet the standards that the Commission and its staff have applied to similar substitutions that have been approved in the past.

6. Applicants anticipate that Contractholders will be at least as well off with the proposed array of separate accounts and sub-accounts after the proposed substitutions as they have

been with the array of separate accounts and sub-accounts offered prior to the substitutions. Applicants maintain that the proposed substitutions retain for Contractholders the investment flexibility which is a central feature of the Variable Contracts. Applicants represent that, if the proposed substitutions are carried out, all Contractholders will be permitted to allocate purchase payments and transfer account values between and among the same number of separate accounts or sub-accounts as they could before the proposed substitutions.³

7. Applicants submit that neither of the proposed substitutions is of the type that Section 26(b) was designed to prevent and that, unlike traditional unit investment trusts where a depositor could only substitute an investment security in a manner which permanently affected all the investors in the trust, the Variable Contracts provide each Contractholder with the right to exercise his or her own judgment and transfer account values into other sub-accounts. Applicants state that, moreover, the Variable Contracts will offer Contractholders the opportunity to transfer amounts out of the affected sub-accounts into any of the remaining sub-accounts without cost or other disadvantage. Applicants contend, therefore, that the proposed substitutions will not result in the type of costly forced redemption which Section 26(b) was designed to prevent.

8. Applicants state that the proposed substitutions also are unlike the type of substitution which Section 26(b) was designed to prevent in that, by purchasing a Variable Contract, Contractholders select much more than a particular investment company in which to invest their account values. Applicants explain that Contractholders may also select the specific type of insurance coverage offered by either or both of the Applicant insurance companies under their Variable Contract as well as numerous other rights and privileges set forth in the Variable Contract. Applicants also believe that Contractholders may have considered each or both Applicant insurance companies' size, financial condition, type and reputation for service in selecting their Variable Contract. Applicants represent that these factors will not change as a result of the proposed substitutions.

9. Applicants request an order of the Commission pursuant to Section 26(b)

of the Act approving the proposed substitutions by the Applicant insurance companies. Applicants submit that, for all of the reasons stated above, the proposed substitutions are consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

10. Applicants request an order pursuant to Section 17(b) of the Act exempting them from the provisions of Section 17(a) of the Act to the extent necessary to permit them to effect (i) the substitutions proposed in this application by means of in-kind redemptions and purchases of shares and (ii) any subsequent consolidation of sub-accounts of the Applicant separate accounts as discussed in this application.

11. Sections 17(a)(1) and (2) of the Act, in relevant part, prohibit any affiliated person of a registered investment company, or any affiliated person of such a person, or any principal underwriter for such company (collectively, "Transaction Affiliates"), acting as principal, from knowingly selling to or purchasing from that registered investment company any security or other property.

12. Section 2(a)(3) of the Act defines the term "affiliated person of another person" in relevant part as: (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more the outstanding voting securities of such other person; (B) any person 5 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; and (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person.

13. Applicants submit that they may be deemed to be Transaction Affiliates of one another based upon this definition. Applicants state that, because the proposed substitutions may be affected by means of an in-kind redemption and a subsequent purchase of shares, also in an in-kind transaction, the substitutions may be deemed to involve on or more purchases or sales of securities or property between Transaction Affiliates. Applicants state that, because the Applicant separate accounts (as well as other separate accounts of the Applicant insurance companies) are registered collectively with the Commission as a single unit investment trust of which the Applicant insurance companies are the depositors, the Applicant separate accounts are affiliates persons of each other. Applicants further state that, because all

of the Applicant separate accounts are under the common control of the Applicant insurance companies, they are all affiliated persons of each other.

14. Applicants assert that, while they do not concede that Section 17(a) applies to the proposed substitutions, the combining of sub-accounts under the Applicants separate accounts, because it could be deemed to involve the transfer of assets from one entity to another, arguably would involve these entities, acting as principal, in buying and selling securities or other property from one to another in contravention of Section 17(a).

15. Section 17(b) of the Act provides that the Commission may, upon application, grant an order exempting any proposed transaction from the provisions of Section 17(a) if the evidence establishes that (1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned; (2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under the Act; and (3) the proposed transaction is consistent with the general purposes of the Act.

16. Applicants submit that, to the extent that the substitutions and any subsequent combination of sub-accounts that hold identical securities are deemed to involve principal transactions among Transaction Affiliates, the manner in which such substitutions and any combinations are to be implemented is sufficient to assure that such transactions do not involve overreaching on the part of any Applicant or other person, and are fair and reasonable and consistent with the policies and purposes underlying the Act. Applicants further submit that the facts and procedures recited in their application demonstrate that neither the Underlying Funds nor any of the Applicant separate accounts will be participating in the substitutions or any subsequent combination on a basis less advantageous than that of any other participant. Finally, Applicants state that, but for the fact that the substitutions may be effected by means of in-kind redemption and purchase transactions, rather than in cash, the procedures described in their application would comply with all of the conditions of Rule 17a-7 under the Act.⁷

⁷ Applicants note that Rule 17a-7 under the Act is not available to them in connection with the

³ No sub-accounts will be combined at the time the proposed substitution is effected. The number of underlying investment options for each of the 19 Applicant separate accounts currently varies from six to 24.

17. Accordingly, Applicants request an order of the Commission pursuant to Section 17(b) of the Act to permit the substitutions and related transactions described in this application. Applicants submit the proposed substitutions are consistent with the policies of each of the Applicant separate accounts and the Underlying Funds and with the general purposes of the Act.

18. Applicants assert that the Commission, in recent years, has issued several orders pursuant to Sections 17(b) and 26(b) of the Act under circumstances similar to those presented in their application, each of which provides substantial precedent for the relief requested by this application. Applicants submit that these orders involved transactions in which registered separate accounts that serve as funding vehicles for variable contract were permitted to substitute, by means of in-kind redemptions and subsequent purchases, shares of one mutual fund for shares and another affiliated mutual fund. Applicants state that certain of the transactions also were followed by a consolidation of the underlying sub-accounts. Applicants maintain that these orders were conditioned on certain representations by the respective applicants, which they believe appear to fall into five categories:

(i) The funds to be substituted have objectives, policies and restrictions sufficiently similar to the objective of the replaced funds so that the policy owners objectives can continue to be met;

(ii) Variable contract owners would be given sufficient notice of information about the substitutions and an opportunity to "opt out" of the substitution and transfer their policy values, without charge, to any other investment option available under the policy held;

(iii) Substitutions would take place at relative net asset value and without the imposition of any additional expense or charge, such that no change in the amount of any variable contract owners's investment or expenses would result;

(iv) Neither the rights of variable contract owners, nor the obligations of applicant insurance companies under the variable contract would be altered as a result of the substitutions; and

substitutions because: (i) affiliations among the Applicants do not rise solely by reason of having common investment advisers, director and/officers; and (ii) the contemplated redemptions and subsequent purchases of shares of IGIF may be effected in-kind and not for cash.

(v) All necessary regulatory requirements would be satisfied prior to the effective date of the substitutions, including compliance with applicable insurance law and the issuance of the Commission's order approving the substitution.

Applicants represent that the facts and circumstances underlying their application meet each of the conditions listed in (i) through (v) above and are sufficient to assure that the substitutions and any subsequent account combination will be carried out in a manner that is consistent with Sections 17(b) and 26(a) of the Act.

19. Applicants request that the Commission issue an order pursuant to Section 17(b) of the Act exempting them from the provisions of Section 17(a) of the Act to the extent necessary to permit the Applicant insurance companies to carry out the substitution transactions described herein. The Applicants represent that, for all the reasons stated above, the terms of the proposed substitutions as set forth herein, including any consideration to be paid and received, are reasonable and fair and do not involve overreaching on the part of any person concerned. Furthermore, the Applicants represent that the proposed substitutions will be consistent with the policies of the Applicant insurance companies and the Underlying Funds as stated in the current registration statement and reports filed under the Act by each and with the general purposes of the Act.

Conclusion

Applicants submit that for the reasons and upon the facts set forth above, the requested order of approval pursuant to Section 26(b) and the requested order granting exemptive relief pursuant to Section 17(b) should be granted.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-12132 Filed 5-12-00; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42769; File No. SR-OCC-00-01]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving a Proposed Rule Change Relating to Exercise Settlement Values for Expiring Index Options

May 9, 2000.

On January 19, 2000, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange

Commission ("Commission") a proposed rule change (File No. SR-OCC-00-01) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and on March 14, 2000, amended the proposed rule change.¹ Notice of the proposal was published in the **Federal Register** on March 31, 2000.² No comments letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The proposed rule change adds new subparagraph (3) to Article XVII, Section 4 of OCC's By-Laws³ to allow OCC to establish the exercise settlement value for expiring index options in conformity with the establishment of the final settlement value for related index futures and options on index futures when the primary market(s) for one or more component securities of the index is closed on the last trading day before expiration.⁴ OCC's current method for setting the exercise settlement amount for an underlying index when the primary market(s) for securities representing a substantial portion of the value of the index are closed on the last trading day before expiration is to use the reported level of the underlying index at the close of trading on the last preceding day for which a closing index level was reported.⁵

However, the valuation method that would be used by the Chicago Mercantile Exchange ("CME") is to set the settlement value for index futures whenever the primary market for a single component stock of the index is closed the last trading day before expiration. In such a situation, CME would determine the settlement value of the index by using the reported opening values for index stocks affected by the closing when the primary market(s) for such stocks reports.⁶ The use of

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 42575 (March 24, 2000), 65 FR 17328.

³ Section 4 sets forth OCC's procedures for establishing the exercise settlement value for an index option when the current value for the index is unavailable or inaccurate.

⁴ The rule change will only apply to series of index options introduced after the later of: (1) The date of the Commission's approval of this rule filing or (2) the date specified in a new Options Disclosure document or supplement thereto that discloses the substance of this rule change.

⁵ OCC By-laws, Article XVII, Section 4(a)(2).

⁶ For example, CME Rule 4003 states, "[I]f the New York Stock Exchange (NYSE) does not open on the day scheduled for the determination of the Final Settlement Price [of S&P 500 index futures], then the NYSE-stock component of the Final Settlement Price shall be based on the next opening prices of NYSE stocks."