GLASS GREENBERG & IRWIN
COUNSELORS AT LAW

LEONARD R. GLASS
HAROLD GREENBERG
STEPHEN IRWIN
STUART M. PELLMAN

LORANCE HOCKERT
LEONARD N. FLAMM
ALAN PRESSMAN

540 MADISON AVENUE
NEW YORK, N.Y. 10022
TEL: (212) 838-6670
TELEX: 424366
CABLE: "GLEENWIN"

July 12, 1973

Act Investment Company Act
Section 17(f)
Rule
Public Availability 10/13/73

Alan Rosenblat, Chief Counsel
Division of Investment Management Regulation
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Gentlemen:

We are counsel to Norman F. Swanton Associates ("Associates"), a firm engaged in the business of arranging loans of securities owned by financial institutions to registered broker-dealers.

Associates wishes to expand its clientele of Lenders to include Mutual Funds which are registered under the Investment Company Act of 1940.

We have reviewed the published guidelines for the lending of portfolio securities by Mutual Funds, as contained in the exchange of correspondence between the Staff and the State Street Bank & Trust Co. (CCH par. 78,676; par. 79,056), in which the Staff has modified Guideline No. 5 to permit fees to be paid to custodians in connection with such securities loans made on a negotiated basis.

Since Associates is not a custodian of securities, we would appreciate your advice as to whether or not the Staff would take any action if a Mutual Fund compensated Associates in connection with arranging for the loan of its portfolio securities. Such securities loans would be collateralized by a deposit of cash with the lending institution equal to at least 100% of the market value of the securities loaned, and would follow the applicable statutes, the guidelines contained in the exchange of correspondence between the Staff and the State Street Bank & Trust Co. and the applicable rules and regulations of the New York Stock Exchange Inc.

As a fee for its services, Associates will be paid a negotiated percentage of the interest earned on the cash deposit held by the Lender as collateral for the securities loaned to the Borrower. In consideration of the Borrower granting a right of first refusal to Associates with respect to satisfying its block borrowing needs,

(a minimum market value of not less than $100,000), Associates will pay the Borrower a fee based upon a percentage of the value of any securities loan arranged through Associates. This compensation arrangement will be disclosed in writing to both the Borrower and the Lender.

In the alternative, Associates will arrange such loans of portfolio securities under terms in which the Lender remits to the Borrower a negotiated fixed percentage of the interest earned on the cash deposit held by the Lender. In this case the Borrower will compensate Associates on a negotiated fee basis.

The services performed by Associates in connection with these securities loan transactions include locating securities which the Borrower requires to complete open contracts; making daily computation of market values of the securities loaned for the purpose of adjusting the cash deposits based upon current market values; and providing daily reports of dividends or other income accruing to the securities on loan and following up to insure accuracy and timeliness of payment of such income by Borrowers to the Lenders.

All fees paid to Associates either by Lender or Borrower will be disclosed in advance in writing. In all instances Associates deals with a specific officer or partner of both the Lender and the Borrower and all agreements are subject to approval and clearance by counsel to the Lender, the Borrower and Associates. Associates makes no representation with respect to the financial ability of the Lender or the Borrower and requires that an independent investigation be made by both the Lender and the Borrower to insure compliance with applicable statutes and regulations covering such transactions.

Heretofore, a significant number of the securities loan programs in effect throughout the securities industry have been conducted in a manner which led to the abuses and irregularities recently disclosed by the Staff. Our client believes the public interest would be served if securities loan programs, which are a vital and effective tool in the securities industry, were conducted on a highly professional basis. It would appear that Mutual Funds should be afforded the opportunity available to others to utilize the services of firms engaged in the business of arranging securities loan transactions on a contractual fee basis.

Accordingly, we would appreciate your advice as to whether or not the Staff will take any action if Associates engages in the

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business of arranging securities loans for Mutual Funds which are subject to the Investment Company Act of 1940, under terms in which Associates will be paid a fee either by the Mutual Fund or the Borrower in accordance with the procedures set forth above.

As supplementary information we enclose herewith a copy of the proposed agreement to be executed between the Mutual Fund and the Borrower in each securities loan transaction.

Very truly yours,

LRG:rl

Sections 8, 13, and 36 of the Investment Company Act of 1940, taken together, impose upon the directors of a mutual fund a fiduciary duty to invest the fund's assets according to its stated investment goals. Lending the fund's portfolio securities creates some risks of forced sales upon default, but we have not objected to such arrangements if the safeguards set forth in our correspondence with State Street Bank & Trust Company are met, including the accrual of commensurate benefits to the fund in return for its assumption of these risks. Since lending portfolio securities may be unfamiliar to many mutual fund directors, we would not object to your client's charging a fee for arranging loans of portfolio securities (as explained above and supplemented by your letters of August 1 and August 27, 1973) provided that (1) your client discloses to its potential clients' directors in writing that it is possible to arrange for the fund's securities to be borrowed without paying any fee, (2) neither your client nor any of its affiliated persons is an affiliated person of the fund, its investment adviser or its principal underwriter (see Section 2(a)(3) of the Act for definition of affiliated person), and (3) your client receives a written representation from each mutual fund that its directors have determined that the fee is reasonable and based solely on the services rendered.

Alan Rosenblat

Alan Rosenblat, Chief Counsel
Division of Investment Management Regulation

September 12,1973 MB:mb