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October 18, 1988

Act I.C.A.-4
Section 18(f)
Rule
Public Availability 2/2/89

Office of the Chief Counsel, Division
of Investment Management
Securities and Exchange Commission
Washington, D.C. 20549

Re: Hutton Options Trading L.P.

Dear Sir or Madam:

I am writing on behalf of Hutton Options Corporation, a Delaware corporation ("Corporation") and Hutton Options Trading, L.P. (the "Fund") a Delaware limited partnership being formed by the Corporation. By letter dated October 21, 1987, the firm of Barrett Smith Schapiro Simon & Armstrong ("Barrett Smith") wrote to you requesting a no-action position concerning Section 18(f) of the Investment Company Act of 1940 with respect to certain proposed practices, including selling put options on specific common stocks, and selling and purchasing put and call options on stocks, stock indices and foreign currencies (copy enclosed).

As you may recall, Barrett Smith subsequently requested that you not reply to that request pending a determination by Hutton either to proceed with the Fund or formally to withdraw the request. As I explained in my conversation today with Clifford Kirsh, we now represent the Fund, and hereby request that you respond to the no-action request by writing to us. Also I am enclosing a copy of a letter which I have written to Jeremiah DeMichaelis, Branch Chief and Gregory Smith, Esq. requesting written comments on the Fund's registration statement, which was filed on November 17, 1987.

I look forward to an early response to the no-action request. If you have any questions on this matter please call me at 626-3332.

Sincerely,

Alan Rosenblat

Alan Rosenblat

AR/kak

cc: Jeremiah DeMichaelis, Esq.
Clifford Kirsh, Esq.
Gregory Smith, Esq.
Paul Roye, Esq.

Enclosure

LAW OFFICES OF
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October 18, 1988

Jeremiah J. DeMichaelis, Esq.
Branch Chief
Gregory Smith, Esq.
Securities and Exchange Commission
450 5th St., N.W.
Washington, D.C. 20549

Re: Hutton Options Trading L.P.

Gentlemen:

This confirms Paul Roye's conversation with Mr. DeMichaelis and my conversation with Mr. Smith today in which we stated that this firm now represents Hutton Options Trading L.P. (the "Fund"). As you know, the Fund filed a notification of registration on Form N-8A and a registration statement on Form N-1A on November 17, 1987 together with certain exhibits. As you also know, the firm of Barrett Smith Schapiro Simon & Armstrong ("Barrett Smith") formerly represented the Fund. Because Barrett Smith no longer represents the Fund, we hereby request that you send your written comments on the Fund's registration statement to us as soon as possible.

As you are also aware, by letter dated October 21, 1987 (copy enclosed), Barrett Smith wrote to Mary S. Podesta, Esq. then Chief Counsel of your Division, requesting a no-action letter concerning certain in a proposed investment practices, including selling put options on specific common stocks, and selling and purchasing put and call options on stocks, stock indices and foreign currencies. I am writing to the Office of Chief Counsel of your Division requesting that it provide us with a response to that request.

Finally this will confirm that we intend to file an additional application for exemption under Section 6(c) of the Investment Company Act of 1940 ("Act") with regard to issues raised under Sections 2(a)(19) and 22 of the Act. The exemptive relief requested will be of a nature routinely granted recently by the Commission and will concern the status of certain of the partners to the partnership as interested persons under

Section 2(a)(19), and the ability of the Fund to impose a contingent differed sales charge in light of Section 22 of the Act.

We look forward to receiving your comments and to bringing this registration to a successful conclusion. If you have any questions or comments on the foregoing, please call me at 626-3332.

Sincerely,

Alan Rosenblat

Alan Rosenblat

AR/kak

cc: Office of Chief Counsel, Division of Investment Management
Clifford Kirsch, Esq.
Paul Roye, Esq.

Enclosure

BARRETT SMITH SCHAPIRO SIMON & ARMSTRONG

1940 Act/18(f)

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CABLE ROOTBAR WASHIN

October 21, 1987

BY HAND

Mary S. Podesta, Esq.
Chief Counsel, Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Ms. Podesta:

We are writing on behalf of Hutton Options Corporation, a Delaware corporation (the "Corporation"), and Hutton Options Trading L.P. (the "Fund") which is a Delaware limited partnership being formed by the Corporation. This letter requests your advice that the Staff will not recommend enforcement action if the Fund engages, in the manner and subject to the limitations described below, in certain investment practices, which might otherwise raise issues under Section 18(f) of the Investment Company Act of 1940 (the "Act") with respect to the issuance of a "senior security". The practices to which such provisions of Section 18(f) might apply are:

1. Selling put options on specific common stocks.

2. As part of "spread" transactions, both selling and purchasing call options on stocks, stock indices and foreign currencies.

3. As part of "spread" transactions, both selling and purchasing put options on stocks, stock indices and foreign currencies.

The Nature Of The Fund

The Fund will be organized as a limited partnership and will be registered as a non-diversified, open-end management company. The Corporation will be the corporate general partner of the Fund. Five individuals will act as the individual general partners of the Fund. The Fund's investment objective will be to seek short-term capital appreciation. The Fund will seek to achieve this objective primarily by the purchase and sale of put and call options on stocks, stock indices and foreign currencies that are traded on national securities exchanges.1/ The Fund does not intend to hold a portfolio of equity securities. Consequently, options trading by the Fund may not be deemed a hedging technique. In this regard the Fund will differ from most, if not all, other funds that include investing in options as part of their investment strategies.

In furtherance of its investment objective, the Fund intends to invest in the following types of options:

Stock Options

The Fund intends to purchase and write put and call options on stocks that are traded on national securities exchanges and certain other foreign exchanges. A call option is a short-term contract (having a duration of less than one year) pursuant to which the purchaser, in return for a premium paid, has the right to buy a security underlying the option at a specified exercise price at any time during the term of the option. The writer of the call option, who receives the premium, has the obligation, upon exercise of the option, to deliver the underlying security against payment of the exercise price. A put option is a

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1/ The Fund may also effect options transactions on foreign exchanges to take advantage of extended trading hours. The Fund will use foreign exchanges only if they clear the option trades through The Options Clearing Corporation and if the option to be traded is also traded on a U.S. exchange.

similar contract which gives the purchaser, in return for a premium, the right to sell the underlying security at a specified price during the term of the option. The writer of the put, who receives the premium, has the obligation to buy the underlying security, upon exercise, at the exercise price.

If the writer of an option wishes to terminate the obligation, the writer may effect a "closing purchase transaction". This is accomplished by buying an option of the same series as the option previously written. The effect of the purchase is that the writer's position will be cancelled by The Options Clearing Corporation (the "Clearing Corporation"). However, the writer may not effect a closing purchase transaction after the writer has been notified of the exercise of an option. Likewise, an investor who is a holder of an option may liquidate the position by effecting a "closing sale transaction". This is accomplished by selling an option of the same series as the option previously purchased.

A profit may be realized on a closing transaction if the price of the transaction is less than the premium received from writing the option or is more than the premium paid to purchase the option; a loss will be realized on a closing transaction if the price of the transaction is more than the premium received from writing the option or is less than the premium paid to purchase the option.

Options on Stock Indices

The Fund intends to purchase and sell put and call options on stock indices that are traded on national securities exchanges and certain foreign exchanges. Options on stock indices are similar to options on stock except that, rather than the right to take or make delivery of stock at a specified price, an option on a stock index gives the holder the right to receive, upon exercise of the option, an amount of cash if the closing level of the stock index upon which the option is based is greater than, in a case of a call, or less than, in the case of a put, the exercise price of the option. This amount of cash is equal to the difference between the closing level of the index and the exercise price of the option, expressed in dollars times a specific multiple (the "multiplier"). The writer of the option is obligated, in return for the premium received, to make delivery of this amount. Unlike stock options, all settlements are in cash, and gain or loss depends on price movements in the stock market generally (or in a particular industry or segment of the market) rather than price movements in individual stocks.

The multiplier for an index option performs a function similar to the unit of trading for a stock option. It determines the total dollar value per contract of each point in the difference between the exercise price of an option and the current level of the underlying index. A multiplier of 100 means that a one point difference will yield $100. Options on different indices may have different multipliers.

In most cases, the Fund will invest in "American" style options, which may be exercised at any time on or before their expiration dates. However, the Fund may also invest in certain "European" style stock index options, which may only be exercised on their expiration dates.

Foreign Currency Options

The Fund intends to purchase and sell put and call options on foreign currencies that are traded on national securities exchanges. Exchange-traded options on foreign currencies are based on the same principles as listed stock options. Like stock options, upon exercise, there is a right to receive or an obligation to deliver the underlying property, in this case, the foreign currency.

A put option on a foreign currency conveys to the purchaser, in return for a premium, the right to sell, during the term of the option, the underlying currency. The writer of the put, who receives the premium, has the obligation to buy the underlying currency, upon exercise, at the exercise price.

A call option on a foreign currency conveys to the purchaser, in return for a premium, the right to buy, during the term of the option, the underlying currency. The writer of the call option, who receives the premium, has the obligation, upon exercise of the option, to deliver the underlying currency against payment of the exercise price.

Specific Investment Strategies

Spreads

The Fund may invest in "spread" transactions involving puts or calls on stocks, on stock indices and on foreign currencies. In a spread transaction, the Fund will simultaneously purchase a call (or put) option on a stock, stock index or foreign currency and sell another call (or put) on the same stock, stock index or foreign currency. The option purchased typically has a different exercise price than the option sold, and both options typically have the same expiration date. The exception is in the case of calendar and time spreads which are discussed in detail below. The use of spread transactions is intended to reduce the risks of trading in options.

The "spread" transactions in which the Fund intends to engage may be sub-categorized as "debit" spreads and "credit" spreads:

Debit Spreads. In "debit" spread transactions, the option purchased will go "in the money" either prior to or at the same time as the option sold. Thus, a debit call spread is created when the option sold has an exercise price that is greater than or equal to the exercise price of the option purchased. For example, a debit call spread is created when a stock is trading at $50 a share, a call option with an exercise price of $45 a share is purchased, and a call option with an exercise price of $45 a share or more is sold. As for a debit put spread, the exercise price of the option sold would be less than or equal to the exercise price of the option purchased.

The Fund will enter into debit spreads when its investment adviser believes that the market will advance (in the case of a debit call spread) or decline (in the case of a debit put spread). Debit call spreads will be used to realize income from market price advances for a stock, stock index or foreign currency to a price, level or exchange rate in excess of the sum of the strike price of the call held plus the net premium paid. Debit put spreads will be used to realize income from market price declines to a price, level or exchange rate below the strike price minus the net premium paid.

As an example of a debit call spread, assume that XYZ stock is trading at $50 and the Fund purchases an XYZ July 50 call for a premium of $5 and writes an XYZ July 55 call for a premium of $3. The transaction would be entered into where the investment adviser believes that during the life of the July calls the price of XYZ stock will exceed $52 (the strike price plus the net premium). In the case of a debit put spread, assume again that XYZ stock is trading at $50, the Fund writes one XYZ July 45 put for a premium of $3 and buys one XYZ July 50 put at $5. The investment adviser will enter into such a transaction when it believes that during the life of the July puts the price of XYZ stock will decline below $48 (the strike price minus the net premium).

In the case of a debit call spread, the maximum potential profit is achieved by the Fund if, on expiration, the market price of the underlying security or the level of the underlying index or the exchange rate applicable to the underlying foreign currency is at or above the exercise price of the call sold. The Fund's maximum potential profit will be equal to the difference between the two exercise prices, less the net premium paid. If, on expiration, the market price of the underlying security or the level of the underlying index or the exchange rate of the underlying foreign currency is at or below the exercise price of the call purchased, the Fund will suffer a loss no greater than the net premium paid for the spread.

Potential profitability of debit put spreads is achieved by the reverse of the relationship of exercise price to market price. Accordingly, the maximum potential profit in a debit put spread is realized if, on expiration, the market price of the underlying security or the level of the underlying index or the exchange ratio applicable to the underlying foreign currency is at or below the exercise price of the put sold. The Fund's maximum potential profit will be equal to the difference between the two exercise prices, less the net premium paid. If, on expiration, the market price of the underlying security or the level of the underlying index or the exchange rate of the underlying foreign currency is at or above the exercise price of the put purchased, the Fund would suffer a loss no greater than the net premium paid for the spread.

Credit Spreads. In "credit" spread transactions, the option sold will always go "in the money" before the option purchased. In the case of a credit call spread, the exercise price of the option sold must be less than the exercise price of the option purchased. For example, a credit call spread is created when a stock is trading at $50 a share, a call option with an exercise price of $50 a share is sold, and a call option with an exercise price of $55 per share is purchased. With regard to credit put spreads, the exercise price of the option sold must be greater than the exercise price of the option purchased.

Credit spreads will be utilized by the Fund to realize income in the form of premiums. The investment adviser will direct the Fund to enter into credit spread transactions when it believes that the market price of the underlying security or the level of the underlying index or the exchange ratio applicable to the underlying foreign currency will decline, in the case of a credit call spread, or advance, in the case of a credit put spread. Using the same facts as set forth above for debit spreads, when XYZ stock is trading at $50, the Fund would buy the XYZ July 55 call with a premium of $3 and sell the XYZ July 50 call for a premium of $5, in anticipation of no movement or a decline in the price of XYZ stock. In the case of a credit put spread, the Fund would buy the XYZ July 45 put for a premium of $3 and write the XYZ July 50 put with a premium of $5 if its investment adviser believes the price of XYZ stock will remain at $50 or higher for the term of the options.

With respect to credit call spreads, the maximum potential profit is achieved by the Fund if the market price of the underlying security or the level of the underlying index or the exchange rate applicable to the underlying foreign currency is at or below the exercise price of the call sold. The Fund's maximum potential profit would be equal to the net premium received for the spread. If, on expiration, the market price of the underlying security or the level of the underlying index or the exchange rate applicable to the underlying foreign currency is at or above the exercise price of the call purchased, the Fund's loss would be equal to the difference between the two exercise prices less the net premium received for the spread.

In the case of a credit put spread, the Fund's maximum potential profit will be realized if the market price of the underlying security or the level of the underlying index or the exchange rate applicable to the underlying foreign currency is at or above the exercise price of the put sold. The Fund's profit would be equal to the net premium received for the spread. If, on expiration, the market price of the underlying security or the level of the underlying index or the exchange rate applicable to the underlying foreign currency is at or below the exercise price of the put purchased, the Fund's loss would be equal to the difference between the two exercise prices less the net premium received for the spread.

Calendar and Time Spreads. The Fund may, on occasion, utilize calendar and time spreads which involve purchasing an option with a later exercise date than the option sold. In a calendar spread, the option purchased and the option sold have the same exercise price. The basis for entering into such a transaction is that time will erode the value of the near-term option that was sold at a faster rate than the far-term option, causing the spread to widen with a potential for profit on the near-term expiration. In a time spread, both the exercise dates and the exercise prices are different.

Discussion

The purchase or sale of options creates contingent liabilities, but it does not constitute current indebtedness, there being no extension of credit. However, the Staff has stated that since options transactions involve potential leveraging, issues are raised under Section 18(f) of the Act.2/ Section 18(f) prohibits an open-end investment

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2/ See Dreyfus Strategic Investing and Dreyfus Strategic Income (available June 22, 1987). "Leverage is deemed to exist when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return." Investment Company Act Release No. 10666 at n.5 (April 18, 1979).

company from issuing any "senior security" (an obligation or instrument which constitutes a security and evidences indebtedness), except bank borrowings for which there is an asset coverage of at least 300 per centum.

Investment Company Act Release No. 10666 (April 18, 1979) ("Release 10666") and Investment Company Act Release No. 7221 (June 9, 1972) ("Release 7221") provide for methods by which potential leveraging may be eliminated in option transactions -- segregation of assets and the covering of a position by purchasing an option on the same underlying security as the option written.3/

In Dreyfus Strategic Investing and Dreyfus Strategic Income (available June 22, 1987) ("Dreyfus Strategic Investing"), the Staff stated:

> We agree that, if a fund meets the segregation requirements, a "senior security" would not be present and, therefore, the 300-percent asset-coverage requirement of Section 18(f) would not apply. In addition, if a fund has "covered" positions so as to eliminate any potential leveraging, as described above, the 300-percent asset-coverage requirement of Section 18(f) would not apply. [Footnote omitted]

The Fund intends to use both segregation of assets and covering as contemplated by Release 10666 and in Release 7221 in connection with its trading of options. In this regard, the Fund believes that the principles espoused in Dreyfus Strategic Investing support its position that no senior security would be created by the investment strategies

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3/ Although Release 10666 deals with reverse repurchase agreements, firm commitments and standby commitments, the Commission stated therein that it would "view from a similar analytical posture" any other security issued by an investment company which might have an analogous effect on the corporate structure of the investment company.

described herein, provided that the Fund applies such segregation and covering techniques to its investment strategies in the manner set forth below, including the use of such techniques in combination.

Accordingly, the Fund will implement its investment strategies only in compliance with the following limitations:

Put Options on Common Stocks. In accordance with the provisions of Release 7221, put options on common stocks written by the Fund may be effected only if the Fund establishes a segregated account with its custodian consisting of cash or high-grade short-term obligations in an amount equal to the exercise price of the put.

Debit Spreads. Under Release 7221 a call or a put option written is covered if the writer purchases a call or a put, as the case may be, on the same securities at the same price at the time of the sale. A debit spread by definition involves the writing of a call or a put that is covered by the purchase of a call or a put on the same stock, stock index or foreign currency as the call or put written.

In the case of a debit call spread, the exercise price of the call purchased will be equal to or less than the exercise price of the call written. Thus, the option written in a debit call spread is fully covered. See Dreyfus Strategic Investing, supra, and Putnam Option Income Trust II (available September 23, 1985). In Dreyfus Strategic Investing, the Staff stated that a call is covered if the call purchased has "a strike price no higher than" that of the call sold.

In the case of a debit put spread, the exercise price of the put purchased will be equal to or greater than the put written. Hence, the short position in debit put spreads should be deemed to be fully covered in the same manner as the short position in debit call spreads. Although not specifically addressed, the same modification to the language of Release 7221 set forth in Dreyfus Strategic Investing, supra, should apply to puts. To analogize to Dreyfus Strategic Investing, a put is covered by holding a separate put option on the same securities with a strike price no lower than the strike price of the put option sold.

Credit Spreads. Credit spreads are similar to debit spreads in that they involve a simultaneous purchase and sale of an option. However, due to the fact that in credit spreads the option sold will go "in the money" before the option purchased, or be "deeper in the money" than the option purchased, the cover does not fully meet the requirements of Release 7221. The imperfection in coverage is equivalent to the difference between the exercise price of the option purchased and the exercise price of the option sold.

The Fund is of the opinion that, by providing for a combination of "coverage" and "segregation", the objectives enunciated in Release 7221 will be achieved. The maximum potential economic risk in a credit spread is equal to the differential in exercise prices, minus the net premium received. Therefore, so long as the Fund segregates with its custodian an amount of cash or highgrade short-term obligations equal to the difference in exercise prices, the credit spreads in which the Fund invests should be considered fully covered.4/

Calendar and Time Spreads--American Style. "American" style calendar and time spreads, which may be exercised at any time, have the same risk considerations as spreads where the options have the same exercise date. Thus, the coverage and segregation requirements for these investments are the same as discussed above under Debit Spreads or Credit Spreads, as applicable.

4/ These proposed Fund practices are identical to the methods utilized by Prudential-Bache Option Growth Fund, Inc. with regard to certain option investments. See PRUDENTIAL-BACHE OPTION GROWTH FUND, INC., PROSPECTUS at 3 (July 31, 1986) (subsection entitled "Investment Objectives and Policies -- Stock Options); STATEMENT OF ADDITIONAL INFORMATION at B-3 (July 31, 1986) (subsection entitled "Investment Objective and Policies -- Limitations on Purchase and Sale of Stock Options, Options on Stock Indices, Stock Index Futures and Options on Stock Index Futures).

Calendar and Time Spreads--European Style. In "European" style calendar and time spreads5/, the option purchased has a later expiration date than the option sold. The inability to exercise the option held before its exercise date creates a theoretical increase in the risk of the transaction. Nevertheless, the Fund is of the view that the existence of a liquid secondary market in "European" style options on stock indices effectively limits the risk exposure on the transaction to the difference between the exercise prices. The Fund need only effect a closing sale transaction of the option purchased if the option sold is exercised.

However, since there can be no guarantee that such a liquid secondary market will continue to exist, the Fund will only enter into such European style calendar and time spreads so long as it deposits in a segregated account with its custodian cash and cash equivalents equal in value to the amount by which the option sold is in the money times the multiplier times the number of contracts (less any amounts that may have been deposited with the custodian if the spread is of the "credit" type). Such amounts will be adjusted daily to reflect changes in the amount by which the "European" style option sold is in the money.

In summary, the Fund believes that regardless of whether it is possible to effect a closing sale transaction of the option purchased, the special segregation arrangements discussed above effectively eliminate all potential leverage exposure arising by reason of the inability to exercise the option purchased until after the expiration of the option sold.

* * *

The Staff of the Division has previously indicated that it would not recommend enforcement action for investment company use of options trading for speculative purposes where the investment company either segregated

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5/ At present, the only European style options are certain options on stock indices.

fund assets or provided for cover. See Dreyfus Strategic Investing, supra. It has also addressed options trading in Putnam Option Income Trust II, supra; Bartlett Management Trust (available May 17, 1985); and Koenig Tax Advantaged Liquidity Fund, Inc. (available March 27, 1985).

Conclusion

On the basis of the foregoing, we believe that the options trading strategies the Fund intends to use with the limitations set forth herein will not present the potential for leverage that Section 18(f) seeks to avoid. Accordingly, we request the advice of the Division that it will not recommend to the Commission that it take action against the Fund in respect of any claimed issuance of senior securities in violation of Section 18(f) of the Act by virtue of its transactions in purchasing and selling options as described herein.

If you have any questions, please call (collect) the undersigned at (212) 422-8180 or Mahlon M. Frankhauser of this firm at (202) 393-5024.

Very truly yours,

/s/ Thomas C. Meriam

Thomas C. Meriam

FEB 2 1989

Our Ref. No. 88-695-CC
Hutton Options
Trading L.P.
File No. 811-5391

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

By letter dated October 18, 1988, you request our assurance that we would not recommend any enforcement action to the Commission under Section 18(f) of the Investment Company Act of 1940 ("1940 Act") if Hutton Options Trading L.P. ("Fund"), an open-end investment company, engages in certain trading strategies involving the purchase and sale of put and call options on stocks, stock indexes, and foreign currencies ("Underlying Instruments"). These strategies will include debit spreads, credit spreads, calendar spreads, and time spreads. In addition, the Fund proposes to implement these strategies using both American-style and European-style options. 1/

According to your letter, when the Fund engages in debit and credit spreads, the Fund simultaneously sells and purchases options having the <u>same</u> expiration date on the <u>same</u> Underlying Instrument. 2/ In a debit call spread, the Fund will sell a call

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1/ An American-style option may be exercised at any time from the day on which it is purchased until the last trading day prior to expiration. A European-style option can be exercised only during a specified period, often limited to the last trading day prior to expiration.

2/ The term "debit" in debit spreads refers to the fact that the Fund will pay a higher premium for the option it purchases than it receives for the option it writes. As more fully explained in pages 5 and 6 of your letter, the Fund hopes to realize income from favorable market price movements in relation to the exercise price of the option it holds. The Fund's maximum potential profit would be equal to the difference between the two exercise prices, less the net premium paid. The Fund's maximum potential loss would be limited to the net premium paid for the spread.

The term "credit" in credit spreads refers to the fact that the Fund will receive more in premiums for the option it writes than it will pay for the option it purchases. As more fully explained in pages 7 and 8 of your letter, the Fund hopes to realize income in the form of premiums. The Fund's maximum potential profit would be equal to the net premium received for the spread. The Fund's maximum potential loss would be limited to the difference between the two exercise prices, less the net premium received.

option on an Underlying Instrument with a certain exercise price and simultaneously purchase a call option on the same Underlying Instrument with an exercise price that is no greater than that of the call option sold. 3/ In a debit put spread, the Fund will sell a put option on an Underlying Instrument with a certain exercise price and simultaneously purchase a put option on the same Underlying Instrument with an exercise price that is no lower than that of the put option sold. 4/ In these two situations, we would deem the option purchased and held by the Fund to "cover" the option written by the Fund and, therefore, would not deem the Fund to be in violation of Section 18(f). 5/ In addition, we believe the Fund would not violate Section 18(f) of the 1940 Act if the Fund uses American-style or European-style options to implement these debit call spreads and debit put spreads, as long as an American-style option is used to cover the position.

In a credit call spread, the Fund will sell a call option on an Underlying Instrument and simultaneously purchase a call option on the same Underlying Instrument having the same expiration date as the call option sold. However, in contrast to a debit call spread, the exercise price of the purchased call option will be greater than the exercise price of the call option sold. 6/ In a credit put spread, the Fund will sell a put option on an Underlying Instrument with a certain exercise price and simultaneously purchase a put option on the same Underlying Instrument having the same expiration date, but with an exercise

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3/ For example, the Fund might sell a June XYZ call option with a $50 exercise price and purchase a June XYZ call option with a $45 exercise price.

4/ For example, the Fund might sell a June XYZ put option with a $50 exercise price and purchase a June XYZ put option with a $60 exercise price.

5/ See, e.g., Dreyfus Strategic Investing and Dreyfus Strategic Income (pub. avail. June 22, 1987) ("Dreyfus"); Guide 9 of Guidelines for Form N-1A; Investment Company Act Rel. No. 7221 (June 9, 1972) ("Release 7221").

6/ For example, the Fund might sell a June XYZ call option with a $50 exercise price and purchase a June XYZ call option with a $55 exercise price.

price lower than that of the put option sold. 7/ In these cases, in addition to holding the purchased call or put option, the Fund proposes to set aside cash and high-grade short-term obligations in a segregated account with its custodian equal to the difference between the exercise prices of the two options. 8/ In our opinion, the Fund would not violate Section 18(f) if the Fund uses American-style or European-style options to implement these credit call spreads and credit put spreads, as long as an American-style option is used in combination with the segregation of assets to cover the position as described in this paragraph.

According to your letter, when the Fund engages in calendar spreads, the Fund sells a call (or put) option on an Underlying Instrument with a certain expiration date and simultaneously purchases a call (or put) option on the same Underlying Instrument with the same exercise price but having a later expiration date. 9/ We believe that the Fund would not violate Section 18(f) if the Fund uses American-style options to engage in calendar spreads so long as at all times prior to the expiration date of the option sold by the Fund, the Fund also holds an option on the same Underlying Instrument with the same exercise price as the option the Fund sold. However, if the Fund uses European-style options in calendar spreads, we do not believe that the option held by the Fund would necessarily "cover" the option sold by the Fund. For this reason, we believe

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7/ For example, the Fund might sell a June XYZ put option with a $50 exercise price and purchase a June XYZ put option with a $40 exercise price.

8/ For example, if the Fund sold a call option with an exercise price of $50 and purchases a call option with an exercise price of $55, the Fund would segregate cash or high-grade short-term obligations equal to $5 (times the appropriate multiplier for that particular option). Similarly, if the Fund sells a put option with an exercise price of $50 and purchases a put option with an exercise price of $40, the Fund will segregate cash or high-grade short-term obligations equal to $10 (times the appropriate multiplier for that option).

9/ For example, the Fund may sell a June XYZ call (or put) option with a $50 exercise price and simultaneously purchase a September XYZ call (or put) option with a $50 exercise price.

that, in a calendar spread involving European-style options, the Fund would have to "cover" the option sold by segregating with its custodian cash or other liquid assets marked to market daily in the manner set forth in prior staff positions. 10/

When the Fund engages in time spreads, the Fund sells and purchases options with different exercise prices and different expiration dates. For example, in a debit call time spread, the Fund would sell a call option on an Underlying Instrument with a certain exercise price and expiration date and simultaneously purchase a call option on the same Underlying Instrument with an exercise price no greater than that of the call option sold and having an expiration date later than that of the call option sold. In a debit put time spread, the Fund would sell a put option on an Underlying Instrument with a certain exercise price and expiration date and simultaneously purchase a put option on the same Underlying Instrument with an exercise price that is no lower than that of the put option sold and having an expiration date later than that of the put option sold. If the Fund uses American-style options to implement the debit time spreads described in this paragraph, we would consider the option purchased and held by the Fund to "cover" the option sold by the Fund and, therefore, would not deem the Fund to be in violation of Section 18(f). However, if the Fund uses European-style options to implement debit time spreads, we do not believe that the option held by the Fund would necessarily "cover" the option sold by the Fund. Therefore, the Fund would have to "cover" the European-style options sold by segregating cash or other liquid assets with its custodian marked to market daily in the manner set forth in prior staff positions.

In a credit call time spread, the Fund would sell a call option on an Underlying Instrument at a certain exercise price and with a certain expiration date and simultaneously purchase a call option on the same Underlying Instrument with an exercise price that is greater than that of the call option sold and with an expiration date later than that of the call option sold. In a credit put time spread, the Fund would sell a put option on an Underlying Instrument at a certain exercise price and with a certain expiration date and simultaneously purchase a put option on the same Underlying Instrument with an exercise price that is lower than that of the put option sold and with an expiration date later than that of the put option sold. In these cases, in

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10/ See, e.g., supra, note 5. See, also, Investment Company Act Rel. No. 10666 (April 18, 1979) for a discussion of segregated accounts. In that Release, the Commission stated that only liquid assets, such as cash, U.S. government securities or other appropriate high-grade debt obligations, should be placed in such segregated accounts.

addition to holding the purchased put or call option, the Fund proposes to set aside cash or high-grade short-term obligations in a segregated account with its custodian equal to the difference between the exercise prices of the two options. 11/ In our opinion, the Fund would not violate Section 18(f) if the Fund uses American-style options to implement credit time spreads and segregates cash or other liquid assets as described in this paragraph. 12/ However, if the Fund uses European-style options to implement credit time spreads, we do not believe that the option held by the Fund would necessarily "cover" the option sold by the Fund. 13/ Therefore, the Fund would have to "cover" the European-style options sold by segregating cash or other liquid assets with its custodian marked to market daily in the manner set forth in prior staff positions.

L. Hope Lewis

L. Hope Lewis
Attorney

11/ See supra note 8.

12/ We believe that the use of American-style options would not raise potential leverage issues because if an option sold by the Fund were exercised, the Fund would have the right to immediately exercise the option it held. This ability to exercise the option immediately, coupled with the segregation of cash or other liquid assets in the case of credit time spreads, would eliminate potential leverage.

13/ Because European-style options may be exercised only during a specified period near expiration and, in the case of calendar spreads and time spreads, the exercise dates of the two options will be different, we believe the Fund's proposed use of European-style options to implement calendar spreads and time spreads would not necessarily eliminate the potential for leverage that Congress sought to prohibit by enacting Section 18(f) of the 1940 Act.