

PUBLIC

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RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 93-167-CC
Alliance Capital
Management L.P.
File No. 801-32361

Your letter of April 5, 1993, requests our assurance that we would not recommend enforcement action to the Commission under Section 18(f)(1) of the Investment Company Act of 1940 (the "1940 Act") 1/ if registered open-end investment companies ("Funds") advised by Alliance Capital Management L.P. or by certain of its majority-owned subsidiaries borrow from certain foreign banks that have banking activities in the United States ("Banks") as described in your letter.

Each Fund proposes to borrow from one or more Banks. 2/ Each Bank will be a "high-quality" commercial bank, incorporated or organized under the laws of one of the foreign countries specified in your letter. The government or a governmental agency of a Bank's home country, or a political subdivision thereof, will regulate the Bank as a bank. Each Bank will be engaged substantially in commercial banking activity. 3/ A Bank will not be operated for the purpose of evading the 1940 Act. In addition, no Bank or Bank employee will be an "interested person"

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- 1/ Section 18(f)(1) permits a registered open-end investment company to borrow from a bank if immediately after the borrowing the company maintains an asset coverage of at least 300 percent for all of its borrowings. Section 2(a)(5) of the 1940 Act generally defines "bank" to include (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, or (C) any other banking institution or trust company doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks by the Comptroller of the Currency, and which is supervised and examined by State or Federal banking authorities having supervision over banks, and which is not operated for the purpose of evading the 1940 Act.
- 2/ A Fund may borrow from a Bank directly or from a syndicate of Banks. Each Fund's borrowing from a Bank will comply with the asset coverage limitation of Section 18(f)(1).
- 3/ Each Bank will be engaged regularly in, and derive a substantial portion of its business from, extending commercial and other types of credit, and accepting demand and other types of deposits, that are customary for commercial banks in its home country.

(as defined in Section 2(a)(19) of the 1940 Act) of a borrowing Fund or the Fund's investment adviser or principal underwriter.

Each Bank will do business in the United States through one or more state licensed branches or agencies or federal licensed branches. Each branch or agency will be subject to banking regulation that is substantially equivalent to that applied to a state-chartered or national bank, as the case may be. A substantial portion of the business of each branch or agency will consist of receiving deposits or exercising fiduciary powers similar to those of national banks. Federal, or state and federal, banking authorities will supervise and examine each branch or agency. No branch or agency will be operated for the purpose of evading the 1940 Act.

The state or federal banking authority that licenses the branch or agency will have the power, in proper circumstances, to request and obtain information concerning the condition of the entire Bank. For example, you state that the Comptroller of the Currency requires "parent" foreign banks of federal branches or agencies to provide information about the parent foreign banks' general affairs in connection with the Comptroller's supervision and regulation of the branches and agencies. 4/

A Bank's branches or agencies in the United States will have aggregate assets of at least \$500 million. Further, at the time a loan agreement is entered into, at least one of the Bank's branches or agencies (together with its predecessors) will have been in business in the United States for at least five years, and the Bank will have no present intention to cease its banking operations in the United States.

Each borrowing from a Bank will be for a specified term, and the lending Bank may not call a loan on demand. Each loan agreement will explicitly provide that a Bank may accelerate the loan only if the Fund defaults. 5/ In addition, each loan agreement will explicitly provide that the laws of a state of the United States govern the agreement. Accordingly, you state that a United States court should give the terms of a loan agreement with a Bank the same effect as it would the terms of a loan

4/ 12 C.F.R. § 28.101. You state that the Comptroller ordinarily requests extensive information from a parent foreign bank that applies for permission to create a federal branch or agency. Thereafter, the Comptroller requires the parent foreign bank to submit financial reports and other information periodically. Id.

5/ Under certain circumstances, however, the Fund could elect to prepay the loan, including when necessary to maintain the requisite asset coverage.

agreement with a domestic bank. You believe that the risk is minimal that a Bank seeking to call a loan in violation of the terms of the loan agreement would be able to obtain and execute a foreign judgment against the Fund (absent the Fund breaching the agreement).

Even if a Bank were able to obtain a judgment in its country for breach of the loan agreement in contradiction of the express terms of the loan agreement and could locate and seize any assets that the Fund maintained in the country in which the Bank was located, 6/ you maintain that it is unlikely that such assets would be sufficient to satisfy a judgment in the amount of the outstanding loan. As a result, the Bank likely would have to commence an action against the Fund in the United States to enforce the judgment. Moreover, in your view, the Uniform Foreign Money-Judgments Recognition Act, 7/ which governs the recognition of foreign money-judgments in New York and at least 21 other states, would not require a New York court to recognize a foreign money-judgment against the Fund under these circumstances. 8/

Each borrowing from a Bank will be an arm's length transaction and will not be conditioned on: (i) the Fund's purchase of securities that the Bank or any affiliate of the Bank issues or underwrites, or (ii) any other transaction or relationship between the Bank (or any of its affiliates) and the Fund (or any of its affiliates). Moreover, a Fund only will borrow from a Bank when (i) the borrowing is consistent with the Fund's borrowing policies, (ii) the Fund's adviser deems the borrowing to be in the best interests of the Fund and its shareholders, and (iii) the borrowing is otherwise consistent with the 1940 Act. The Fund's borrowing policies will be disclosed in the Fund's prospectus.

The Commission has taken the position that foreign banking institutions generally do not fall within the definition of

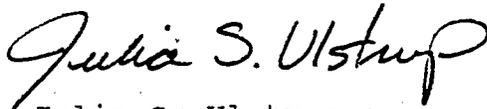
6/ Certain Funds maintain assets outside the United States through custodial or subcustodial arrangements under Rule 17f-5 of the 1940 Act. As a result, a Fund's assets may be located in the same country as a Bank that lends to the Fund. It is also possible that a Fund may borrow from its custodian or subcustodian.

7/ 13 U.L.A.: Civil Proc. & Rem. Laws 261 (1962).

8/ Your letter focuses on how a New York court would apply the Uniform Foreign Money-Judgments Recognition Act because the investment activities of each Fund are centered in New York.

"bank" under Section 2(a)(5). 9/ The Commission also has stated, however, that the question of whether and under what conditions a foreign bank should be permitted to fulfill the important roles assigned to domestic banks under the 1940 Act "should be evaluated based upon the particular role involved." 10/ You state that each Fund's adviser believes that the Fund's ability to borrow from the Banks will permit increased competition among lenders to the Fund and result in potential savings and other benefits to the Fund and its shareholders.

On the basis of the facts and representations in your letter, and without necessarily agreeing with your legal analysis, we would not recommend enforcement action if the Funds borrow from the Banks in the manner described in your letter. Our response is limited to the proposed borrowings from Banks under Section 18; it does not express our opinion regarding a Bank's status as a "bank" for any purpose under the 1940 Act. You should note that any different facts or representations may require a different response. Further, this response only expresses the Division's position on enforcement action and does not purport to express any legal conclusions on the questions presented.



Julia S. Ulstrup
Senior Counsel

9/ See, e.g., Investment Company Act Rel. No. 18381 (Oct. 29, 1991) (adopting Rule 3a-6 which excepts foreign banks and foreign insurance companies from the definition of "investment company" under the 1940 Act); Investment Company Act Rel. No. 15314 (Sep. 17, 1986) at note 4 and accompanying text (proposing former Rule 6c-9 to exempt from the 1940 Act foreign banks or foreign bank finance subsidiaries that offer or sell debt securities and non-voting preferred stock); and Investment Company Act Rel. No. 12679 (Sep. 22, 1982) at note 17 and accompanying text (proposing amendments to former Rule 6c-1 to exempt from the 1940 Act certain finance subsidiaries of domestic and foreign issuers).

10/ Investment Company Act Rel. No. 18381 at note 9.

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Investment Company Act of 1940--
Section 18(f)(1)

April 5, 1993

*ADMITTED IN DISTRICT OF COLUMBIA

Thomas Harman, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Act	ICA 1940
Section	18(f)(1)
Rule	
Public Availability	4/7/93

Dear Mr. Harman:

On behalf of Alliance Capital Management L.P., an investment adviser registered under the Investment Advisers Act of 1940 (the "Advisers Act"), and each of its direct and indirect majority-owned subsidiaries that are registered as investment advisers under the Advisers Act (collectively and separately referred to as the "Adviser"), we hereby request confirmation that the staff of the Division of Investment Management (the "Division") would not recommend to the Commission enforcement action against the Adviser, any open-end investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act"), for which the Adviser is the investment adviser (each, a "Fund") or any Bank (as defined herein) if the Fund were to borrow pursuant to Section 18(f)(1) of the 1940 Act as described herein from a Bank incorporated under the laws of a foreign country that has banking activities in the United States.

Relevant Statutes

Section 18(f)(1) of the 1940 Act prohibits any registered open-end investment company from issuing any class of senior security, or selling any senior security of which it is the issuer, except that the investment company is permitted to borrow from any bank subject to a 300

percent asset coverage restriction contained in Section 18(f)(1). Section 2(a)(5) of the 1940 Act defines a "bank", for purposes of the 1940 Act, as:

. . . (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title. . . .

The Proposed Transactions

Subject to the asset coverage limitation of Section 18(f)(1), the Fund proposes to borrow from one or more foreign banks (each, a "Bank"), either directly or as a member of a syndicate of Banks that may include one or more domestic banks, when the borrowings (i) are consistent with the Fund's borrowing policies, (ii) are deemed by the Adviser to the Fund to be in the best interests of the Fund and its shareholders, and (iii) are otherwise consistent with the 1940 Act. Each borrowing from a Bank would be an arm's length transaction between the Bank and the Fund and would not be linked to, or conditioned upon, (i) the purchase by the Fund of securities issued or underwritten by the Bank or any affiliate of the Bank or (ii) any other transaction or relationship between the Bank (or any of its affiliates) and the Fund (or any of its affiliates).

The Fund's borrowing pursuant to Section 18(f)(1) would be disclosed in the Fund's prospectus. Among other things, the prospectus would disclose the effects of leveraging, including the possibility that sales of the Fund's portfolio securities might be required in order to permit the Fund to make the loan repayments necessary to maintain the asset coverage of outstanding borrowings required by Section 18(f)(1).

Each loan agreement would, by its terms, be governed by the laws of a state of the United States. Each

borrowing from a Bank would be for a specified term, would not be callable on demand by the lending Bank and could be accelerated by the Bank only upon an event of default with respect to the Fund as specified in the loan agreement. Under certain circumstances, however, the loan could be prepaid at the option of the Fund, including when necessary to maintain the asset coverage requirement of Section 18(f)(1).

Each Bank would be a high-quality commercial bank, incorporated or organized under the laws of one of the following countries: (i) the Western European countries of Austria, Belgium, Denmark, France, Germany, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom; (ii) Mexico and the South American countries of Argentina, Brazil and Chile; (iii) Japan, Korea, and Taiwan; (iv) Australia and New Zealand; (v) Canada; and (vi) Israel. Each Bank (i) would be regulated as a bank by the government or a governmental agency of its home country or by a political subdivision thereof, (ii) would be engaged substantially in commercial banking activity in that it would be engaged regularly in, and derive a substantial portion of its business from, extending commercial and other types of credit, and accepting demand and other types of deposits, that are customary for commercial banks in its home country, and (iii) would not be operated for the purpose of evading the provisions of the 1940 Act. No Bank or Bank employee would be an "interested person" (as defined in Section 2(a)(19) of the 1940 Act) of the Fund or of any investment adviser of, or principal underwriter for, the Fund.

Each Bank would do business in the United States through one or more state licensed branches or agencies or federal licensed branches, a substantial portion of the business of which would consist of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency (each, a "Branch" or "Agency"). A Bank's Branches and Agencies in the United States would have aggregate assets of at least \$500 million and no Branch or Agency would be operated for the purpose of evading the provisions of the 1940 Act. Moreover, at the time of the loan agreement, at least one of the Bank's Branches or Agencies (together with its predecessors) would have been in business in the United States for at least five years and the Bank would have no present intention to cease its banking operations in the United States.

Each state licensed Branch or Agency would be supervised and examined by state and federal authorities having supervision over banks and would be subject to state and federal regulation that would be substantially equivalent to that applicable to a bank chartered in the state in which the Branch or Agency was licensed. Each federal licensed Branch would be supervised and examined by federal authorities having supervision over banks and would be subject to federal regulation that would be substantially equivalent to that applicable to a national bank. In each case, the state or federal licensing authority would have the power pursuant to its licensing and reporting powers to request and obtain information concerning the condition of the entire Bank in proper circumstances.¹

In addition, pursuant to the International Banking Act of 1978 (the "International Banking Act"), by virtue of maintaining a Branch or Agency in the United States, the Bank would be subject to various provisions of the Bank Holding Company Act of 1956 (the "BHCA"), including limitations on its non-banking activities in the United States and on its acquisition of securities of companies engaged directly or indirectly in United States activities, and would be required to file various reports with the Board of Governors of the Federal Reserve System (the "Board"). Among other things, a Bank would be required to file an annual report that included its financial statements and certain information on its direct and indirect non-banking activities in the United States. Each Bank also would be required to file an annual confidential report of operations

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1. For example, a 1979 policy statement outlining the responsibilities of the various federal regulators on the supervision of United States branches and agencies of foreign banks announced the agencies' intention to seek to assure themselves that the entire foreign bank was financially sound and that, to that end, the agencies planned to collect information on the consolidated operations of the foreign banks and to expand their contacts with senior management of the banks. Release and Policy Statement of the Federal Financial Institutions Examination Council (July 20, 1979). The regulations of the Comptroller of the Currency (the "Comptroller") governing federal branches and agencies and interpretations thereto explain that the Comptroller will require information from "parent" foreign banks concerning their general affairs and that extensive information will ordinarily be requested upon receipt of an initial application for a federal branch or agency. Thereafter, the foreign bank will be required to submit financial reports and certain other information periodically. 12 C.F.R. §28.101. Although state laws differ, banking authorities in most states have similar powers.

containing information concerning the Bank's earnings, loan loss experience and reserves and setting forth financial information concerning the Bank's foreign subsidiaries.

Through custodial or subcustodial arrangements, certain Funds maintain assets outside the United States. Those assets may be segregated or may be commingled by the custodian or subcustodian of a Fund with custodied assets of other entities and, accordingly, might not be maintained in a separate account in the name of the Fund. In those instances, the assets are not readily identifiable as assets of the particular Fund by persons and entities without knowledge of the custodial arrangement. It is possible that Fund assets would be maintained for the Fund by a custodian or subcustodian in the country in which the Bank that made the loan to the Fund, or that participated in a syndicate of banks that made the loan to the Fund, is located, and it is possible also that the Fund might borrow from a custodian or subcustodian. For the reasons discussed above, however, the Fund's assets would not necessarily be identifiable as Fund property. Moreover, in most cases, the Fund would not maintain enough assets in the foreign country to satisfy a judgment for the amount of the outstanding loan.

Commission's Position on Status of a Foreign
Bank as a "Bank" under Section 2(a)(5)

By its terms, Section 2(a)(5) of the 1940 Act requires that a "bank" be either (i) "organized under the laws of the United States" or a State thereof or (ii) "doing business under the laws of any State or of the United States" and supervised by United States banking authorities. The Commission and its staff have consistently taken the position that Section 2(a)(5) generally applies to domestic banks while recognizing, as discussed below, that a foreign bank may also qualify as a bank under certain circumstances if it is doing business under the laws of the United States.

The Commission's general position on foreign banks is exemplified by the 1982 release proposing amendments to Rule 6c-1 under the 1940 Act to exempt certain finance subsidiaries of foreign issuers from the 1940 Act. In that release, the Commission stated that, although pursuant to Section 3(c)(3) of the 1940 Act banks are excluded from the definition of investment company, "foreign banks do not fall within the definition of a bank, which includes only United States banks."²

2. Investment Company Act Release No. 12679, note 17 (Sept. 22, 1982).

In a 1986 release proposing Rule 6c-9, which was intended to exempt foreign banks and their finance subsidiaries from the registration requirement of the 1940 Act in connection with their issuance of certain debt securities and non-voting preferred stock in the United States, the Commission similarly concluded that a foreign bank may not rely on the exclusion for banks provided by Section 3(c)(3) of the 1940 Act (the "1986 Release").³

In the 1986 Release, however, the Commission also cited two instances in which the Commission (or the staff) had recognized that a foreign bank might be a "bank" for purposes of the 1940 Act if it were doing business in the United States and were adequately supervised by United States banking authorities. First, the Commission cited a 1984 release publishing revised proposed Rule 17f-5, which set forth an exemption from the custody requirements of the 1940 Act to permit investment companies to maintain assets with foreign custodians. In that release, the Commission stated that, while a foreign bank generally does not fall within the definition of a bank under Section 2(a)(5) of the 1940 Act, a foreign bank with a branch or branches in the United States might fall within the definition of a bank because, with the adoption of the International Banking Act in 1978, the primary responsibility for supervising and examining U.S. branches of foreign banks was assigned to United States federal and state banking regulators.⁴

Second, the 1986 Release cited a no-action letter dated July 28, 1976 involving an Israeli bank, Bank Leumi le-Israel B.M. ("Bank Leumi") (the "Bank Leumi Letter"). In that letter, the Division of Investment Management (the "Division") stated that, based on the representations in the incoming letter, it would not recommend that the Commission take enforcement action against Bank Leumi if it offered bonds issued by Bank Leumi and guaranteed by the Export-Import Bank of the United States in the United States without registering as an investment company under the 1940

3. Investment Company Act Release No. 15314 (Sept. 17, 1986). The Division of Investment Management also has issued letters in which it declined to grant favorable no-action positions on the grounds that a foreign banking organization was not a "bank" excluded from the definition of investment company under the 1940 Act. Continental Illinois Limited (pub. avail. Apr. 1, 1973); Bank of America Canada (pub. avail. July 25, 1983); CCBP International, Inc. (pub. avail. Dec. 1, 1987).

4. Investment Company Act Release No. 13724 (January 24, 1984).

Act in reliance upon its counsel's opinion that it was a bank under Section 2(a)(5)(C) of the 1940 Act and thereby excluded from the registration requirements of the 1940 Act by virtue of Section 3(c)(3) thereof.

In Bank Leumi's incoming request letter, Bank Leumi's counsel represented that Bank Leumi had a subsidiary trust company in New York, a branch in Illinois and agencies in New York and California and was, therefore, subject to examination and supervision by the banking authorities in those states. Counsel also stated that, in connection with its establishment of its New York agency, Bank Leumi had been required to furnish detailed information about its Israeli banking operations, that the financial condition of the entire bank was reviewed at least annually by the New York banking authorities in connection with the agency's annual license renewals, and that the investigative power of the New York banking authorities in a proper case extended to the entire bank, both in New York and overseas. Bank Leumi's counsel further represented that, as a result of Bank Leumi's maintaining the trust company in New York, Bank Leumi was subject to the New York banking authorities' power to examine Bank Leumi when deemed necessary or advisable and was subject to the supervision of the Board pursuant to the provisions of the BHCA. Accordingly, because Bank Leumi met the other criteria set forth in Section 2(a)(5)(C) of the 1940 Act, counsel represented that Bank Leumi qualified as a "bank" as defined in Section 2(a)(5)(C) of the 1940 Act.⁵

Counsel for Bank Leumi further argued in the incoming letter that there were no supervening public policy considerations that would conflict with the no-action position requested. Counsel for Bank Leumi stated that, since Bank Leumi (i) was subject to banking regulation and supervision in Israel, (ii) was subject to examination and supervision by the banking authorities of New York, Illinois and California, and (iii) was, and for the past fifteen

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5. In support of the contention that Bank Leumi qualified as a "bank" as defined in Section 2(a)(5)(C) of the 1940 Act, counsel for Bank Leumi noted that the Commission staff had taken a favorable no-action position in a letter in 1969 with respect to a registration statement for IDB Bankholding Corporation Limited. Counsel for Bank Leumi stated that the staff's no-action position had been based on the opinion of counsel for Israel Discount Bank Limited ("IDB") that, based on IDB's operation of two branches in New York, IDB should be excluded from the definition of an investment company. IDB Bankholding Corporation Limited (November 7, 1969) (the "Israel Discount Bank Letter"), a copy of which is attached as Appendix A.

years had been, subject to the reporting requirements of the Securities Exchange Act, it was consistent with the protection of investors and purposes fairly intended by the policy and provisions of the 1940 Act for Bank Leumi to be excluded from the registration provisions of the 1940 Act.⁶

In 1990, the Commission codified the position it had taken in two prior 1988 no-action letters⁷ by issuing an interpretive release stating that a United States branch or agency of a foreign bank would be considered a "bank" as defined in Section 2(a)(5)(C) for the limited purpose of the issuance of securities in the United States by the branch or agency if, in addition to the requirements of Section 2(a)(5)(C), the nature and extent of the federal and state regulation and supervision of the particular branch or agency was substantially equivalent to that applicable to banks chartered under Federal or state law in the same jurisdiction (the "1990 Release").⁸ In the 1990 Release, the Commission cited the Bank Leumi Letter as being a letter from a branch or agency of a foreign bank requesting no-action advice on the status of United States branches and agencies of foreign banks under the 1940 Act. The Bank Leumi Letter was referred to in the 1990 Release as the only letter that the Division had received from a branch or agency on that subject as of the time Rule 6c-9 was adopted in October 1987.⁹

In a number of instances since the Bank Leumi Letter, the Commission and the staff have granted favorable relief to foreign banks having United States banking activities without expressly addressing whether or not the foreign banks could qualify as "banks" within the meaning of

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6. Note that the Commission staff had granted an earlier letter to Bank Leumi dated June 19, 1969 (the "1969 Bank Leumi Letter"), in which the staff also agreed not to recommend enforcement action to the Commission if Bank Leumi made a public distribution of its equity securities in the United States without registering as an investment company under the 1940 Act, provided Bank Leumi retained its license under New York Banking laws. Bank Leumi le-Israel B.M. (June 19, 1969), a copy of which is attached as Appendix B.
 7. See Bank Bumi Daya (pub. avail. June 8, 1988) and Bank Ekspor Impor Indonesia (pub. avail. July 15, 1988).
 8. Investment Company Act Release No. 17681 (Aug. 17, 1990).
 9. Note, however, that the Bank Leumi Letter was not limited to Bank Leumi's branches or agencies but extended to the entire bank. Note also the Israel Discount Bank Letter and the 1969 Bank Leumi Letter referred to above.

Section 2(a)(5) of the 1940 Act. For example, the Commission has granted various orders under Section 6(c) of the 1940 Act exempting foreign banks from the provisions of the 1940 Act with respect to their issuance of equity securities in the United States based upon, among other things, representations by the banks that they would issue such securities only so long as they were supervised and examined by state and federal banking authorities in the United States.¹⁰ The Commission staff also has issued at least three no-action letters to foreign banks permitting them, without registering as investment companies, to offer securities to employees of their United States branches, agencies or subsidiaries in reliance on one of the limited offering exemptions from registration under the 1933 Act provided by Rule 505 or 701 of that Act, which exemptions are not available to investment companies.¹¹

More recently, in 1991 the Commission rescinded Rule 6c-9 and adopted new Rule 3a-6 under the 1940 Act,

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10. E.g., Australia and New Zealand Banking Group Limited, Investment Company Act Release No. 16537 (Aug. 26, 1988) and Investment Company Act Release No. 16510 (July 29, 1988). In proposing revisions to Rule 6c-9, however, to exempt equity offerings by foreign banks from the 1940 Act, the Commission determined not to make a United States "presence" a pre-condition to a foreign bank's reliance on the proposed exemptive rule. Investment Company Act Release No. 17682 (Aug. 17, 1990), text at note 17.
 11. In the first of these letters, counsel for several requesting German banks did not argue that the foreign banks would be "banks" within the meaning of Section 2(a)(5) of the 1940 Act, but rather argued that, in light of the limited nature of the offering to employees, the regulatory purposes of the 1940 Act would not be served by subjecting the foreign banks to regulation under the 1940 Act. Shaw, Pittman, Potts & Trowbridge (pub. avail. Apr. 14, 1988). In granting the no-action request, the Division noted "the unique facts, especially the nature of the offerings as part of employee stock purchase programs maintained by the Banks for the benefit of the employees of their Branches."

In two subsequent no-action letters, counsel for the requesting foreign banks argued that the foreign banks would be "banks" within the meaning of Section 2(a)(5)(C) of the 1940 Act because of the nature and extent of their United States operations and of their regulation by United States banking authorities. Canadian Imperial Bank of Commerce (pub. avail. Jan. 18, 1989); Union Bank of Finland Ltd. (pub. avail. March 14, 1990). In addition, counsel argued that, even if the foreign banks were not deemed to be "banks" under Section 2(a)(5)(C) of the 1940 Act, the proposed offerings to employees would not violate the spirit or purposes of the 1940 Act. In granting these no-action requests, the Division did not articulate its reasoning behind its position and stated that it was not expressing any legal conclusions on the questions presented.

which excludes foreign banks (whether or not they have United States banking activities) from the definition of investment company for all purposes under the 1940 Act. The stated purpose of that rule was to define a group of foreign entities that would be banks under the Act if those entities were organized under the laws of the United States or of a state¹² and to place such entities that are selling securities in the United States "on an equal footing under the [1940] Act with banks in like circumstances organized under the laws of the United States."¹³ The Commission expressly declined to include foreign banks within the definition of bank in Section 2(a)(5) of the 1940 Act, stating that: "The question of whether and under what conditions a foreign bank . . . should be permitted to fulfill the important roles assigned to domestic banks . . . under the Act should be evaluated based upon the particular role involved."¹⁴

We are unaware of any other instances in which the Commission or its staff has addressed the issue of whether a foreign bank doing business in the United States would be a "bank" within the meaning of Section 2(a)(5)(C) of the 1940 Act. We are also unaware of any instances in which the Commission or its staff has addressed this issue in the context of Section 18(f) of the 1940 Act.¹⁵

Analysis

Statutory Requirements

Following the rationale of the Bank Leumi Letter, we believe that a Bank, depending on the nature and extent

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12. Rule 3a-6 defines a foreign bank as a foreign banking institution that is (i) regulated as such by its home country's or subdivision's government or any agency thereof, (ii) engaged substantially in commercial bank activity, and (iii) not operated for the purpose of evading the 1940 Act. "Engaged substantially in commercial banking activity" is defined to mean engaging regularly in and deriving a substantial portion of its business from extending commercial and other credit, and accepting demand and other deposits, that are customary for commercial banks in the foreign bank's home country.
 13. Investment Company Act Release No. 18379 (Oct. 25, 1991), text at notes 13-14.
 14. Id. at note 9.
 15. Note, however, the 1960 exemptive order issued to Income Fund of Boston, Inc. and discussed below.

of its banking business in the United States and its regulation under state and federal laws, should be able to satisfy the requirements of Section 2(a)(5)(C) of the 1940 Act and thereby to qualify as a "bank" for purposes of Section 18(f)(1). In order to qualify as a "bank" under the definition set forth in Section 2(a)(5)(C) of the 1940 Act, a Bank would be required to satisfy the following four criteria set forth in that section: (i) the Bank must qualify as a banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, (ii) a substantial portion of the Bank's business must consist of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, (iii) the Bank must be supervised and examined by State or Federal authority having supervision over banks, and (iv) the Bank cannot be operated for the purpose of evading provisions of the 1940 Act.

Doing Business under the Laws of Any State or the United States. Each Bank would engage in domestic and international banking services and would be regulated as a banking institution in its home country. In the United States, the Bank would maintain and operate one or more state or federal-licensed branches or federal-licensed agencies in the United States and thereby conduct the business of banking under the laws of those states or of the United States, as the case may be.

Receiving Deposits or Exercising Fiduciary Powers. Since each Bank would be a commercial bank, it would be engaged regularly in, and derive a substantial portion of its business from, extending commercial credit and accepting demand and other types of deposits within the meaning of Rule 3a-6 under the Act. As the Commission recognized when adopting Rule 3a-6, such activities constitute the business of a bank within the meaning of Section 2(a)(5) of the 1940 Act. In addition, the Bank, through its Branch or Agency in the United States would receive deposits or exercise fiduciary powers similar to those permitted to national banks.

Supervision and Examination by State or Federal Banking Authority. As discussed above, a Bank's United States banking activities would be supervised and examined by federal, or state and federal, banking authorities and would be subject to state or federal banking regulation that is substantially equivalent to that applied to banks

chartered in those states or to national banks, as the case may be. As discussed at note one, supra, the applicable state or federal licensing authority would have the power pursuant to its licensing and reporting powers to request and obtain information concerning the condition of the entire Bank in proper circumstances. In addition, pursuant to the International Banking Act, the Bank would be subject to various provisions of the BHCA, including limitations on its direct and indirect non-banking activities in the United States, and would be required to file with the Board annual and other reports governing the Bank's overall financial condition.

Not Operated for Purposes Of Evading the 1940 Act.

Neither the Bank nor its Branches or Agencies would be operated for the purpose of evading the 1940 Act.

Based on the above, each Bank would have United States banking operations that would qualify as a "bank" for purposes of Section 2(a)(5)(C) of the 1940 Act as set forth in the 1990 Release. Moreover, following the rationale of the Bank Leumi Letter, the language of the statute is broad enough to conclude that the Bank itself, not just its United States banking operations, would be a "bank" under Section 2(a)(5)(C) of the 1940 Act since, by acting through its branches and agencies in the United States, the Bank does business under the laws of various states and is supervised and examined by state and federal banking authorities within the meaning of Section 2(a)(5)(C) of the 1940 Act.

Under the foregoing analysis, the extent to which United States federal and state regulation extends beyond the Bank's activities in the United States to reach activities outside the United States is not relevant. While we believe that there is a valid basis for arguing that the regulation of the Bank's United States activities alone is sufficient to constitute the Bank a bank for purposes of Section 18(f)(1) of the 1940 Act, we note that United States regulation would extend to activities and operations of the Bank beyond those of its Branch or Agency. Both of these approaches appear to have been considered in the Bank Leumi Letter.

As with Bank Leumi, the Bank would be a commercial bank organized under the laws of a foreign jurisdiction, would be subject to regulation as a bank under the laws of its home country, and would conduct banking activities (including deposit-taking or fiduciary activities) under the

laws of the United States, or a state thereof, through a branch or agency in the United States. There are only limited distinctions between the Bank Leumi Letter and the Bank's situation. Although Bank Leumi represented that it had a New York-chartered trust company subsidiary that subjected both the domestic and overseas operations of Bank Leumi, as an affiliate, to the power of examination by New York State banking authorities, a Bank might not have a bank subsidiary. A Bank, therefore, might not be expressly subject to the same power of examination under New York law that exists in relation to such a subsidiary but, as discussed above, would be subject to investigation by state or federal banking authorities in connection with the licensing and reporting powers of those authorities. In addition, a Bank, unlike Bank Leumi, might not be subject to the reporting requirements of the Securities Exchange Act of 1934 (the "1934 Act").

Although it is unclear to what extent these factors may have been significant to the staff's position at the time of the Bank Leumi Letter, we do not believe that the differences between a Bank today and Bank Leumi in 1976 should be viewed as significant in light of the authority over the Bank retained by the relevant state or federal licensing authority. Moreover, since the adoption of the International Banking Act in 1978, a Bank with either a state or federal licensed Branch or Agency would be subject to the same degree of federal banking regulation as Bank Leumi was in 1976 by virtue of its trust company subsidiary, which as described above includes the authority of federal banking authorities to investigate the condition of the entire Bank and to require both publicly-available and confidential reports concerning the Bank.

Policy Considerations

Note also that the Bank Leumi Letter was issued in connection with the issuance of securities in the United States without Bank Leumi being required to register as an investment company while the current proposed transactions relate to whether a registered investment company may borrow from a Bank without violating Section 18(f) of the 1940 Act. We believe that the policies underlying Section 18(f)(1) of the 1940 Act do not require the Commission to interpret the term "bank" as used in Section 18(f)(1) of the 1940 Act as excluding a Bank and that, even if a Bank were not deemed a "bank" within the meaning of Section 2(a)(5) of the 1940

Act, permitting the borrowings from a Bank as proposed would not violate the policies of Section 18(f)(1).

Section 18(f) was enacted in response to a lack of regulation which permitted investment companies (i) to establish complex capital structures in which the control exercised by junior classes of securities was diluted and their investment risk increased and (ii) to engage in speculative leveraged investing. Section 18(f)(1) addressed both practices by limiting the ability of open-end investment companies to issue senior securities and restricting investment companies from borrowing other than from banks and in compliance with a 300 per centum asset coverage requirement.

In enacting Section 18(f), Congress sought to prevent investment companies from engaging in, or acting as conduits for investors to engage in, the same types of speculative practices regulated by the Board's Regulations T and U, both of which were adopted under the 1934 Act prior to the enactment of the 1940 Act. Regulation T was adopted to "regulate extensions of credit by and to brokers and dealers" and to "impose . . . initial margin requirements and payment rules on securities transactions".¹⁶ Regulation U was adopted to "impose credit restrictions upon 'banks' . . . that extend credit for the purpose of buying or carrying margin stock" ("purpose loan").¹⁷

When the 1940 Act was enacted, borrowings by an entity (other than a broker-dealer subject to Regulation T) from an entity other than a domestic bank (or broker-dealer) were not subject to any margin restrictions. Since 1940, however, the Board has adopted Regulations G and X. Regulation G imposes margin restrictions in connection with "purpose" loans extended by certain lenders that are not domestic banks or broker-dealers. Regulation X applies the requirements of Regulation G to loans obtained abroad from a foreign lender that is not subject to Regulations G, T or U.

As a result of the promulgation of Regulation G, a purpose loan to a United States investment company by a non-bank, non-broker-dealer domestic lender is subject to essentially the same margin restrictions as a similar loan from a domestic bank subject to Regulation U. As a result

16. 12 C.F.R. 220.1(a).

17. 12 C.F.R. 221.1(a).

of the promulgation of Regulation X, a purpose borrowing by a United States investment company from a foreign lender is subject to the same requirements as a purpose borrowing from a Regulation G lender.

In Section 18(f), Congress established two levels of protection against excessive speculation by investment companies. First, by restricting investment companies to borrowing from banks, Congress ensured that investment companies could borrow for the purpose of purchasing margin stock only in compliance with Regulation U. Second, by imposing an asset coverage requirement, Congress limited the overall amount of leverage an investment company could use in borrowing for any purpose.

Treating a Bank as a "bank" for purposes of Section 18(f) (1) would preserve the protections against securities speculation on margin that Regulation U provides in the case of loans by domestic banks and, accordingly, would be consistent with the bi-level protection scheme established by Congress in that Section. Because the term "bank" in Regulation U utilizes the 1934 Act definition of bank, which is virtually identical to the 1940 Act definition, an argument can be made that a foreign bank with a branch or agency in the United States should be deemed a bank subject to Regulation U in connection with a "purpose loan" made in the United States. If the 1934 Act definition of bank were not construed sufficiently broadly to reach such a bank, however, a "purpose loan" from a foreign bank to an investment company would still be subject to substantially the same restrictions as those imposed by Regulation U as a result of the application to the loan of Regulations G and X.¹⁸

In addition, the source of an investment company's borrowing, whether a United States bank, a foreign bank or a non-bank, would not affect the application of the 300 per centum asset coverage test or diminish the protections it provides against speculative activities. In this regard, to

18. "Regulation X, adopted November 1, 1971, provides that, if credit is obtained abroad from a foreign lender not subject to Regulations G, T, or U, then the borrower's loan is required to conform with Regulation G as though the lender were subject to that Regulation." Staff Op. of November 1, 1973, FRRS Securities Credit Transaction Handbook, 5-989. Regulation G, adopted March 11, 1968, imposes margin requirements on persons not covered by Regulations T and U who extend credit in connection with the purchase or carrying of margin stock.

the extent that Section 18(f) was designed to protect debt holders of an investment company from speculative practices by the investment company, a Bank making a loan to a Fund should require no greater protection under the 1940 Act than should a domestic bank.

Moreover, in permitting foreign banks with United States branches or agencies to be treated as banks for purposes of issuing and selling securities in the United States, as in the Bank Leumi Letter, the Commission staff seems to have made a more difficult policy judgment than that required to permit similar entities to be treated as banks for purposes of Section 18(f)(1) of the 1940 Act. Purchasers of securities are subject to the risk of default by the issuer, in the case of debt securities, or the risk of the issuer's insolvency in the case of preferred and equity securities. A borrower, on the other hand, is subject to little, if any, risk growing out of the lender's condition or activities.

Upon loaning funds to a borrower, a lender completes his obligations in connection with the loan while the obligation of performance (i.e., the repayment of the loan) rests with the borrower. The lender assumes the risk of nonperformance by the borrower and may be required to enforce his rights under the loan agreement. These rights typically include the right to accelerate the repayment of the loan upon the occurrence of specified events of default. In the event of nonpayment by the borrower, it is the lender that is required to take action against the borrower for the return of funds.

In the context of a loan by a Bank, the Fund would not be in the position of having to reach the Bank's assets. Rather it is the Bank that would be in the position of having to enforce its rights against the Fund. Since the Fund would be a United States person and the loan agreement would be governed by United States law, the terms of the loan agreement should be given effect in any United States court to the same extent as the terms of a loan from a domestic bank. By its terms, the loan would be repayable only upon maturity or upon an event of default by the Fund. Accordingly, absent a default by the Fund, a Bank could not expect to call the loan prior to maturity and expect to obtain a judgment in a United States court against the Fund for the Fund's failure to repay the loan at the time of the call.

We also believe the risk is minimal that, absent a breach by the Fund, a Bank seeking to call the loan in clear violation of the terms of the loan agreement would be able to obtain and execute a foreign judgment against the Fund.¹⁹ New York, which is the jurisdiction in which the investment activities of each Fund are centered, and at least 21 other states have adopted the Uniform Foreign Money-Judgments Recognition Act (the "Uniform Act"), which governs the circumstances under which foreign country judgments are to be given recognition. In general, a foreign country judgment is not given recognition under the Uniform Act if (i) the judgment was rendered under a system which does not provide impartial tribunals or procedures compatible with the requirements of due process of law or (ii) the foreign court did not have personal jurisdiction over the subject matter. In addition, the Uniform Act permits a court in its discretion, to refuse to recognize a foreign judgment in a number of other circumstances.

In our view, the Uniform Act would not require a New York court to recognize a foreign judgment under the circumstances described above. First, we believe it would be self-evident, and could readily be demonstrated to a New York court, that a foreign court that rendered a judgment against a Fund for breach of contract for the Fund's refusal to comply with a Bank's acceleration demand, in direct contradiction of the express terms of the agreement under which the loan sought to be accelerated was made, was not an impartial tribunal.

Second, we do not believe it is likely that the foreign court would be considered to have personal jurisdiction over the Fund. None of the bases of personal jurisdiction expressly recognized by the Uniform Act would

19. We are unable to provide a legal analysis concerning the prospective actions of foreign governments and their court systems in each of the foreign countries in which a Bank might be organized. However, even if a Bank, through the intervention of its government or otherwise, were able to obtain a judgment in a court in its country for breach of the loan agreement in contradiction of the express terms of the loan agreement and could locate and seize any assets that might be maintained by the Fund in the country in which the Bank was located, it is unlikely such assets would be sufficient to satisfy a judgment in the amount of the outstanding loan. Accordingly, the Bank likely would have to commence an action against the Fund in the United States in order to enforce the judgment.

apply to the Fund.²⁰ Although the Uniform Act permits a court to recognize other bases of personal jurisdiction, such as whether the Fund has a sufficient presence in the foreign country or has committed the types of acts specified in New York's "long-arm" statute,²¹ we believe it unlikely that the instant circumstances would be found to constitute a valid basis of personal jurisdiction under New York law since the loan agreement would be negotiated and executed in New York and the Fund's main business activities -- the investment in securities subject to the investment manager's discretion -- would not be conducted in the foreign country.

We further believe that the risk of a foreign government, or a Bank acting under express or implied authority of its government, simply seizing the assets of a Fund in a foreign country is small. First, it is highly unlikely that a Fund would maintain significant assets in, or borrow from a Bank organized under the laws of, a jurisdiction whose government was likely to seize assets without justification. Second, as the staff is aware, pursuant to Rule 17f-5 adopted under the 1940 Act, the directors of a Fund are required to determine that maintaining the Fund's assets in a particular country is in the best interests of the Fund and its shareholders. That requirement insures that the level of expropriatory risk involved in leaving Fund assets with custodians in a foreign jurisdiction is reviewed. Accordingly, in light of the review associated with a Fund's Rule 17f-5 determination, whether made by the Fund's directors (as is required currently) or by some other person (as may be required if the Division's recommendations contained at pages 270 and 271 of its May 1992 report are adopted), it is unlikely that the Fund would have substantial assets custodied in jurisdictions that would permit unjustified seizures of the Fund's assets.

Moreover, because the Bank would have one or more Branches or Agencies with substantial assets in the United

20. These include personal service in the foreign state, voluntary appearance in the foreign proceedings, prior agreement to submit to foreign jurisdiction, being domiciled or incorporated in the foreign jurisdiction, and having a business office in the foreign jurisdiction out of which the cause of action arose.

21. New York's "long-arm" statute provides a basis for personal jurisdiction over a defendant who in person or through an agent does business or possesses real property in the state or commits a tortious act in the state.

States, a Fund could commence an action against the Bank in the United States for breach of contract and conversion of the Fund's assets if the Fund's assets custodied in a foreign country were seized in violation of the loan agreement.²²

For the above reasons, the Fund's repayment obligation (and, therefore, Fund's assets) should not be subject to, or dependent upon, the financial condition or activities of the Bank and there should be no greater risk to the Fund in borrowing from a foreign bank than from a domestic bank. Accordingly, as long as a borrowing complies with the asset coverage requirements of Section 18(f)(1), there appears to be substantially less of a policy basis for precluding borrowing from foreign banks with United States branches or agencies than there would have been for restricting sales in the United States of securities issued by those entities.

A further indication that the policies underlying Section 18(f)(1) of the 1940 Act should not be violated if the Bank were deemed to be a "bank" for purposes of Section 18(f) of the 1940 Act is the Commission's grant in 1960 of an order under Section 6(c) of the 1940 Act exempting an open-end investment company registered under the 1940 Act ("Applicant") from the requirements of Section 18(f)(1) of the 1940 Act to the extent necessary to permit the applicant to borrow from foreign banks provided such borrowings were consistent with the Applicant's borrowing policy, were otherwise consistent with the 1940 Act, and could be obtained on more favorable terms than domestic banks (the "18(f)(1) Order").²³

In connection with its application, Applicant argued that an exception to Section 18(f)(1) was made to permit borrowings to be made from a bank "apparently for the reason that the practical difficulties in maintaining adequate asset coverage for a security senior to a fully redeemable common stock would not raise problems adverse to the interest of investors in the case of bank borrowings."²⁴

22. The Fund might also have a cause of action against any global custodian for which the Bank was acting as subcustodian when it seized the assets.

23. Income Fund of Boston, Inc., Investment Company Act Release No. 3043 (June 10, 1960).

24. Income Fund of Boston, Inc., Investment Company Act Release No. 3037 (May 26, 1960).

Applicant stated that there appeared to be no reason to distinguish between banks and foreign banking firms in implementing this policy.

Consistent with the 18(f)(1) Order, borrowings from a Bank would be made only in arm's length transactions when they were deemed by the Fund to be in the best interests of the Fund and its shareholders and otherwise consistent with the 1940 Act and the Fund's borrowing policies. As with other bank borrowings, loans by a Bank could be prepaid by the Fund when necessary to satisfy the asset coverage requirements of Section 18(f)(1). Under these circumstances, as in the 18(f)(1) Order, there appears to be no reason to distinguish between borrowings from a domestic bank and borrowings from a Bank.

The treatment of a Bank as a bank for purposes of Section 18(f)(1) of the 1940 Act is also consistent with the United States national policy of supporting competitive equality between domestic and foreign banks²⁵ and with other actions taken by the Commission and its staff to provide equitable treatment for foreign banks under the 1940 Act in light of the increasing internationalization of today's economy.

Conclusion

Based on the foregoing, we believe that a Bank should be treated as a bank for purposes of Section 18(f)(1) of the 1940 Act and that the Fund should be permitted to borrow from a Bank pursuant to Section 18(f)(1) as proposed above. As discussed above, we believe the language of Section 2(a)(5)(C) is broad enough to include a Bank by virtue of its doing business in the United States through its Branches or Agencies. Moreover, even if a Bank is not deemed a "bank" within the meaning of Section 2(a)(5)(C), we believe the treatment of a Bank as a bank for purposes of Section 18(f)(1) would not conflict with any policies under the 1940 Act. Lastly, the Adviser to the Fund believes that the ability to borrow from the Banks would permit increased competition among lenders to the Fund and would result in potential savings and other benefits to the Fund and its shareholders.

25. This policy was recognized by Congress, for example, when enacting the International Banking Act. S. Rep. No. 1073, 95th Cong., 2d Sess. 2 (1978); H.R. Rep. No. 910, 95th Cong., 2d Sess. 5-7 (1978).

Thomas Harman, Esq.

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April 5, 1993

Accordingly, we request that the Division confirm that it would not recommend enforcement action against the Adviser, the Fund or any Bank if the Fund were to borrow from a Bank pursuant to Section 18(f)(1) of the 1940 Act as described herein. If it appears that the staff is unable to concur with our views expressed herein, we would appreciate the opportunity to discuss the matter with you further prior to the issuance of a response to our request. If you have any further questions concerning our request, please contact me or Janet R. Zimmer at (202) 737-8833.

Very truly yours,



Anthony C.J. Nuland

VIA HAND DELIVERY