



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

DIVISION OF  
INVESTMENT MANAGEMENT

January 27, 1994

Mr. David S. Butterworth  
Managing Director  
D.S. Butterworth & Co., Inc.  
1853 William Penn Way  
P.O. Box 10695  
Lancaster, PA 17605-0695

ACT ICIA of 1940  
SECTION \_\_\_\_\_  
RULE 17f-2  
PUBLIC \_\_\_\_\_  
AVAILABILITY 1/27/94

Re: Charter Funds, File No. 811-5411;  
Our Ref. No. 93-403

Dear Mr. Butterworth:

Your letter of July 2, 1993 requests our assurance that we would not recommend that the Commission take any enforcement action under Section 17(f) of the Investment Company Act of 1940 (the "1940 Act") if the Charter Funds (the "Trust") retains an affiliate, Charter Guaranty Company, Inc. ("Charter Guaranty"), as its custodian in the manner described in your letter.

The Trust proposes to retain Charter Guaranty as its administrator, shareholder servicing agent, and custodian. Charter Guaranty, in turn, will enter into sub-custodial agreements with various banks. 1/ Your letter states that Charter Guaranty is not a bank qualified under Section 26(a)(1) of the 1940 Act or a member of a national securities exchange. Your letter also states that David S. Butterworth owns both Charter Guaranty and the Trust's adviser.

Section 17(f) requires every management investment company to place its securities and similar investments in the custody of (1) a bank or banks qualified under Section 26(a)(1), 2/ (2) a

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- 1/ Your letter indicates that Charter Guaranty will enter into some of these sub-custodial agreements to take advantage of the book entry system of the Depository Trust Company ("DTC"). You should note that Rule 17f-4 imposes certain requirements on investment companies or qualified custodians who deposit some or all of a company's securities with a qualified depository, like DTC. See Mutual Investment Fund of Connecticut, Inc. (pub. avail. Nov. 20, 1986).
- 2/ Section 26(a)(1) provides that the trustee or custodian shall be a bank which has "at all times aggregate capital, surplus and undivided profits of a specified minimum amount, which shall be not less than \$500,000." Section 26 applies to unit investment trusts and is relevant to management investment companies, like the Trust, only to the extent

company that is a member of a national securities exchange, in accordance with Commission regulations, or (3) the investment company itself, in accordance with Commission regulations (*i.e.*, self-custody). Rule 17f-2 sets forth the conditions under which a registered management investment company may maintain custody of its securities and other assets.

The staff has interpreted Rule 17f-2 to apply to any arrangement between an investment company and its investment adviser where the adviser also serves as custodian or sub-custodian. 3/ The staff believes that the principal policy of Section 17(f) is to ensure that securities and other assets owned by the investment company are maintained in such a manner that they will be subject to adequate independent scrutiny and that this policy would be frustrated if an investment adviser rendering custodial services was not subject to additional safeguards such as those in Rule 17f-2, particularly the verifications required by paragraph (f). 4/ The staff has interpreted the rule to further include an arrangement where an investment company's adviser and custodian are wholly-owned subsidiaries of the same corporation, and the adviser and custodian share common directors and officers. 5/ We believe that the same concerns under Section 17(f) are present in your proposed arrangement where the investment adviser and custodian are both wholly-owned by the same individual.

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that Section 17(f) references the definition of bank in Section 26(a)(1). Your letter states that the Trust will comply with paragraphs (2) through (4) of Section 26(a); however, these provisions do not apply to management investment companies.

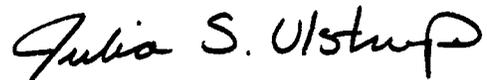
- 3/ See American National Growth Fund, Inc. (pub. avail. Oct. 4, 1991) (adviser served as custodian); The Mutual Fund Group (pub. avail. Dec. 12, 1989) (adviser served as sub-custodian); Mutual Investment Fund of Connecticut, Inc. (adviser served as custodian); Pegasus Income & Capital Fund, Inc. (pub. avail. Dec. 31, 1977) (adviser served as custodian).
- 4/ Paragraph (f) of Rule 17f-2 requires that an independent public accountant verify by complete examination the securities and similar investments held by a self-custodian at least three times annually.
- 5/ See IPI-Income & Price Fund (pub. avail. Dec. 12, 1980). See also Composite Group of Funds (pub. avail. Mar. 2, 1987) (Rule 17f-2 applied to arrangement where subsidiary of custodian served as investment adviser).

Even if the Trust complied with all of the requirements of Rule 17f-2, we do not have enough information about Charter Guaranty to determine whether Charter Guaranty can serve as the Trust's custodian. Paragraph (d) of Rule 17f-2 generally requires that access to the investment company's securities be limited to (1) certain officers or employees of the company, (2) certain officers or employees of the bank or other company in whose safekeeping the investments are placed, and (3) the independent public accountant for purposes of the verifications required by paragraph (f). Paragraph (b) of the rule generally requires that an investment company with self-custody place its investments in the safekeeping of "a bank or other company whose functions and physical facilities are supervised by Federal or State authority." As custodian, Charter Guaranty would have access to the Trust's securities. Your letter states that Charter Guaranty is not a bank; it does not address, however, whether Charter Guaranty falls within the meaning of "other company whose functions and physical facilities are supervised by Federal or State Authority" in Rule 17f-2(b). 6/

Finally, we question whether, under your proposed arrangement, Charter Guaranty properly can be characterized as the Trust's "custodian." It is not clear from your letter that Charter Guaranty will provide any custodial functions to the Trust.

Therefore, on the basis of the facts and representations in your letter, we cannot assure you that we would not recommend enforcement action to the Commission under Section 17(f) of the 1940 Act if the Trust retains Charter Guaranty as its custodian.

Sincerely,



Julia S. Ulstrup  
Senior Counsel

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6/ See American National Growth Fund, Inc. (registered broker-dealer affiliate as custodian under Rule 17f-2) and Composite Group of Funds (savings and loan affiliate as custodian under Rule 17f-2). See also Principal Preservation Portfolios (Aug. 15, 1988) (registered broker-dealer affiliate as safekeeping entity under Rule 17f-2(b)).

*D.S. Butterworth & Co., Inc.*  
Investment Management

July 2, 1993

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

Re: Charter Funds  
Registration No. 33-19369

Dear Mr. Harman:

D.S. Butterworth & Co. requests on behalf of the Charter Funds (the "Trust") that the staff of the Division of Investment Management (the "Staff") advise the Trust that it will not recommend any enforcement action to the Securities and Exchange Commission pursuant to Section 17(f) of the Investment Company Act of 1940, as amended (the "1940 Act"), if the Trust retains an affiliated non-bank, non-securities exchange member custodian, but otherwise complies with Section 26(a) of the 1940 Act.

The Trust intends to retain Charter Guaranty Company, Inc. ("Charter Guaranty") as its administrator and shareholder servicing agent; additionally, the Trust intends (pending the outcome of this request) to retain Charter Guaranty as its custodian. This firm is owned by David S. Butterworth, as are D.S. Butterworth & Co., the adviser, and Charter Securities Corp., the principal underwriter. The Trust, a "series" type fund, is closely affiliated with the adviser and is designed primarily to make the adviser's investment management services and reasonable diversification available to its smaller clients. These closely affiliated companies serve the Trust through what are believed to be very practical and inexpensive relationships, the services of which would not otherwise be economically feasible using larger non-affiliated firms.

The custodian agreement with Charter Guaranty provides that "no trustee, officer, employee or agent of the Trust, and no officer, director, employee or agent of the Custodian, shall have physical access to the assets of the Trust maintained by the Custodian or be authorized or permitted to withdraw any investments of the Trust, nor shall the Custodian deliver any assets of the Trust to any such person. No officer, director, employee or agent of the Custodian who holds any similar position with the Trust shall have

physical access to the assets of the Trust". Additionally, in complying with Section 26(a) of the 1940 Act, the Trust through Charter Guaranty ultimately designates custody of its portfolio securities with "(1)...one or more trustees or custodians, each of which is a bank...(2) provides, in substance, (A) that during the life of the trust the trustee or custodian, if not otherwise remunerated, may charge...for its expenses as are provided for in such instrument; (B) that no such charge or collection shall be made except for services theretofore performed or expenses theretofore incurred; (C) that no payment to the depositor of or a principal underwriter for such trust, or to any affiliated person or agent of such depositor or underwriter, shall be allowed the trustee or custodian as an expense (except that provision may be made for the payment to any person of a fee, not exceeding such reasonable amount as the Commission may prescribe as compensation for performing bookkeeping and other administrative services, of a character normally performed by the trustee or custodian itself); and (D) that the trustee or custodian shall have possession of all securities and other property in which the funds of the trust are invested, all funds held for such investment, all equalization, redemption, and other special funds of the trust, and all income upon, accretions to, and proceeds of such property and funds, and shall segregate and hold the same in trust [subject only to the charges and collections allowed under clauses (A), (B), and (C)] until distribution thereof to the security holders of the trust; (3) provides, in substance, that the trustee or custodian shall not resign...(4) provides, in substance, (A) that a record will be kept by the depositor or an agent...; and (B) that whenever a security is deposited..." , as this Section states in its entirety.

The distinction to be made, however, is that Charter Guaranty contracts with such bank custodian(s) for these services and not the Trust directly. Any administrative services that can be delegated by the bank custodian, such as securities trading, affirming transactions with the Depository Trust Company ("DTC"), relaying settlement instructions to brokers, etc., are handled by Charter Guaranty. This also facilitates better communication, electronic data transfer, and coordination of activities between what may eventually be multiple advisers and multiple bank custodians through one entity, Charter Guaranty.

Under the Trust's previous plan of business a custodian, Dauphin Deposit Bank and Trust Company ("Dauphin"), was to be retained. Their capabilities were not extraordinary, except for the fact that they are recognized as one of Central Pennsylvania's finest banking institutions and as custodian of the Trust's Pennsylvania tax-exempt income portfolio their daily pricing of local municipal securities could prove beneficial in determining the portfolio's NAV. There really are no similar benefits afforded to the Trust's other portfolios and in such cases Dauphin is simply one more layer

adding to their incremental costs. In fact, Dauphin contracts with the Northern Trust Company ("Northern") in Chicago for computer systems and physical/non-DTC eligible securities custody; Northern in-turn then provides Dauphin with access to the Depository Trust Company's book-entry-only securities depository and the National Securities Clearing Corp. settlement and clearance system. The Trust is better served by Charter Guaranty being able to directly contract with DTC agent banks in certain instances, placing itself in the line-up as the first intermediary (and in doing so reduce the Trust's costs), while alternately contracting with select local bank custodians when the benefits of their services are truly worthwhile from a value-added standpoint.

The objective of the previous explanation of a custodian and its attendant duties is to show that in reality it is not a sole-source relationship, but actually multiple layers with the ultimate "custodian" being (with some exceptions) the Depository Trust Company. The safeguards intended in Section 17(f) of the 1940 Act for the custody of investment company assets seem to be clearly met through the DTC book-entry-only system and/or through DTC agent banks (being one layer removed) and further by restricting access to such assets by affiliated persons otherwise responsible for administering the Trust's activities.

In all instances the Trust will, by contract with Charter Guaranty and their contract(s) with one or more banks, have custody of its portfolio securities maintained within the requirements of Section 26(a) of the 1940 Act. The Trust's custodian agreement with Charter Guaranty will be "approved by the vote of a majority of the outstanding voting securities...precisely [describing] all compensation to be paid thereunder...shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of [trustees] or by vote of a majority of the outstanding voting securities of [the Trust]" and will provide that "...such contract or agreement and any renewal thereof [shall be] approved by the vote of a majority of [trustees], who are not parties to such contract or agreement or interested persons of any such party...", as required of investment advisory and underwriting contracts in Section 15 of the 1940 Act.

The Trust seeks relief from disclosing individually each of the underlying bank custodians in its prospectus while avoiding any interpretation by the Staff of Section 17(f) of the 1940 Act that could arise in naming Charter Guaranty as custodian whereby such action is construed as creating a self-custodian relationship under subsection 17(f)(3) due to their affiliation; and, therefore, causing the Trust to be required to retain independent accountants to perform the three verifications of their portfolio securities as required by subsection (f) of Rule 17f-2 of the 1940 Act.

Thomas Harman, page 4.

July 2, 1993

If you should have any questions or require further information concerning this request, please call me. Thank you.

Sincerely,

A handwritten signature in cursive script that reads "David S. Butterworth". The signature is written in dark ink and is positioned above the typed name.

David S. Butterworth  
Managing Director