

PUBLIC

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RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 95-607-CC
Kavilco, Inc.
File No. 811-06027

Your letter dated October 9, 1995 requests our assurance that we would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act of 1940 ("1940 Act") 1/ if Kavilco, Inc. ("Kavilco"), a registered closed-end investment company, maintains a checking account in the manner described below.

Kavilco operates a checking account at West One Bank, from which it pays operating expenses and shareholder dividends and distributions. The account is funded with wire transfers from Kavilco's custodian, the Charles Schwab Trust Company ("CSTC"), which is a trust company registered under the laws of California. You represent that CSTC meets the definition of a bank in Section 2(a)(5) of the 1940 Act and has the qualifications prescribed in Section 26(a)(1) of the 1940 Act. 2/ Kavilco currently has only two officers, who are the only authorized signatories for checks drawn on that account: the Chief Financial Officer, who manages its Seattle, Washington office, and the President/Chief Executive Officer, who resides in Kasaan, Alaska. Kasaan is located in a remote part of the state, accessible only by float plane or boat. Kavilco states that it can take several weeks or longer under adverse conditions for mail or other deliveries to reach the President.

Section 17(f) provides in pertinent part that if an investment company employs a bank as custodian for its securities and similar investments then all of its cash assets must also be kept in the custody of a bank or banks. Section 17(f) also provides, however, that an investment company using a bank custodian may maintain bank checking accounts with an aggregate balance that does not exceed the amount of the company's fidelity bond maintained pursuant to Section 17(g) of the 1940 Act. The Commission has set forth guidelines that should be followed by an investment company that establishes and maintains a checking account. 3/ Those guidelines are intended to ensure that the

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- 1/ 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) of the 1940 Act, (2) a company that is a member of a national securities exchange, or (3) the investment company itself.
 - 2/ Telephone conversation between David Baca of Davis Wright Tremaine and Jana Cayne of the staff, April 3, 1996.
 - 3/ Investment Company Act Release No. 6863 (Jan. 29, 1972).

investment company can meet shareholders' expectations that cash held by the fund will be given a similar degree of protection to that given its portfolio securities.

Kavilco states that it will comply with all of those guidelines except, with respect to certain checks, the guideline that checks should include the signatures of at least two persons designated by resolution of the fund's board of directors. Kavilco maintains that if the President (the only employee who would be qualified to sign company checks besides the Chief Financial Officer) is required to sign each check, including checks for operating expenses, it will be impossible for Kavilco to regularly pay its operating expenses on a timely basis.

Kavilco proposes to revise its checking account agreement to require two signatures on checks that are written for an amount in excess of \$10,000, for dividends or distributions to shareholders, or under circumstances in which time constraints would not prohibit Kavilco from paying its expenses in a timely fashion. For all other checks, Kavilco proposes to obtain only one signature, that of the Chief Financial Officer, under the following procedures: a list identifying each check to be issued, indicating the payee, amount, and date of the check, would be sent to the President by facsimile transmission; the checks would be sent out only after the President reviews the list and faxes back his approval. 4/ In addition, Kavilco will provide to the President each month a list, prepared by the independent consultant responsible for reconciling Kavilco's bank statements, of all checks written against the checking account. Kavilco represents that it will maintain copies of the faxed approvals and monthly lists of checks pursuant to Rule 31a-2(a)(2) under the 1940 Act. 5/

On the basis of the facts and representations in your letter and in your telephone conversations with the staff, we would not recommend that the Commission take any enforcement action under Section 17(f) of the 1940 Act if Kavilco obtains one signature for certain checks in the manner described above. Because this

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- 4/ Telephone conversation between David Baca, and Robert Bagnall and Jana Cayne, January 3, 1996.
- 5/ Telephone conversation between David Baca, and Robert Bagnall and Jana Cayne, February 20, 1996. Rule 31a-2(a)(2) requires an investment company to preserve certain records for a period not less than six years from the end of the fiscal year in which the transaction occurred, the first two years in an easily accessible place.

position is based on the facts and circumstances set forth in your letter, you should note that any different facts or circumstances might require a different result.

Jana M. Cayne

Jana M. Cayne
Attorney

DAVIS WRIGHT TREMAINE

LAW OFFICES

2300 FIRST INTERSTATE TOWER · 1300 SW FIFTH AVENUE · PORTLAND, OR 97201-5682
(503) 241-2300 · FAX: (503) 778-5299

DAVID C. BACA
Direct Line: (503) 778-5306

ICA
Section 17(f)
Date October 9, 1995
Priority 4-4-96

REC'D MAIL
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SECTION

VIA UPS

Securities and Exchange Commission
Division of Investment Management
Office of the Associate Director-Chief Counsel
450 Fifth Street NW
Washington, D. C. 20549

Re: Kavalco, Inc.
Our File No. 25537\17

Ladies and Gentlemen:

We represent Kavalco, Inc. (the "Company"). The Company is an Alaskan native corporation, registered as a closed-end investment company under the Investment Company Act of 1940 (the "40 Act"). On behalf of the Company, we request your concurrence with our opinion that policies concerning a checking account maintained by the Company will satisfy the requirements of Section 17(f) of the 40 Act. In particular, we request your concurrence that, under the limitations set forth in this letter, certain checks drawn on the checking account must bear the signature of only one officer of the Company.

1. Background.

The Company operates one checking account at West One Bank. The Company pays operating expenses and shareholder dividends and distributions out of the checking account. The account is funded with wire transfers from the Company's custodian, the Charles Schwab Trust Company.

An examination conducted by the Division of Investment Management, Examinations Branch found certain deficiencies with respect to the operation by the Company of the checking account. A copy of the July 31, 1994 letter from the Examinations Branch to the Company is enclosed for your reference. In particular, the examination raised concerns about the use of non-preprinted checks, the authority of a single officer of the Company to sign checks, the need to notify the depository bank of the Company's checking account guidelines, and the need for further precautions in separating the functions of reconciling the bank account from writing and signing checks.

The Company and its directors have agreed to remedy each of the deficiencies noted in the examination, other than strict adherence to the two-signature requirement. A copy of the Company's response, dated August 31, 1995, is enclosed for your reference.

The Company is unable to comply with one of the guidelines (the "Guidelines") contained in Investment Company Act Release No. 6863 (the "Release") concerning two signatures because of certain unique characteristics of the Company and its operations. The majority of the shareholders of the Company are Alaska natives or their descendants, and reside in locations scattered across Alaska.

The Company currently operates with only two officers; a Chief Financial Officer who manages the Company's office in Seattle, Washington, and the President/Chief Executive Officer of the Company, who resides in Kasaan, Alaska. Kasaan is located in a remote part of the state, accessible only by float plane or boat when the weather conditions permit. In practice, therefore, the ability of the Company to obtain the signature of both officers on checks is severely impaired. It can take several weeks or even longer under adverse conditions for mail or other deliveries to reach the President. A requirement that the President countersign every check, including all checks for operational expenses, would make it impossible for the Company to regularly pay its operating expenses on a timely basis. The company tried to implement a dual signature policy about 10 years ago. It was unable to pay its bills in a timely manner, and relations with entities providing services to the company were strained.

The Company's other two employees both work at the Company's principal office in Seattle. The employees are the Chief Financial Officer and his administrative assistant. The administrative assistant is charged with preparing checks for payment, and maintaining the checking accounts. After discussions with the Company's auditors, the Company believes it would be inappropriate and contrary to prudent internal control procedures for the administrative assistant to be a co-signatory on the checking account. The Company has discussed this situation with its auditors but has been unable to devise any system that would comply both with prudent internal control requirements and item 4 of the Guidelines.

2. Proposed Additional Precautions.

The Company is now in complete compliance with each of the other Guidelines. The Company proposes to revise its checking account agreement with West One to require two signatures on every

check in excess of \$10,000, and would undertake with the Division to obtain the signatures of two officers authorized by the directors on every check in excess of \$10,000, and on every check for dividends or distributions to shareholders. The Company would also undertake with the Division to obtain two signatures on all checks where time constraints would not prohibit the Company from paying its expenses in a timely fashion, and would further undertake to provide to the President each month a listing of all checks written on the checking accounts, prepared by the independent consultant responsible for reconciling the Company's bank statements.

The Company believes that with these safeguards in place, the board and other officer of the Company will be able to monitor actual expenditures from the Company's checking accounts, minimizing the possibility of a defalcation. These policies would further limit the risk to the Company to checks of smaller denomination and written within a relatively short period of time. The Company has discussed these procedures with its auditors, and believe that they comply with normal internal control procedures.

3. Legal Analysis.

We note that the Guideline 4 of the Release provides that "checks written on such an account should require the signatures of at least two persons designated by resolution of the board of directors" (emphasis added). While a two-signature requirement is under most circumstances good practice, and an appropriate way to comply with the Guidelines, we do not believe that the Guidelines by their terms impose an absolute requirement that two signatures be obtained on each check. Guideline 10 provides that each checking account should also include "other controls as are necessary in the circumstances of the particular company," and the Company believes that by adopting the policies and procedures outlined below will have enacted adequate controls and precautions to protect the shareholders of the Company, consistent with Guideline 10 and the Guidelines read as a whole.

4. Conclusion.

Based on the foregoing, we respectfully request your concurrence with our conclusion that enactment of the policies and guidelines referred to in this letter, assuming compliance with all other Guidelines contained in the Release, will constitute compliance with Section 17(f) of the Act, and that the Division will not recommend that any enforcement action be taken against the Company if it adopts these policies and operates the checking accounts as discussed.

Securities and Exchange Commission
October 9, 1995
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Seven additional copies of this letter are enclosed. If you have any questions or desire additional information, please contact me at (503) 778-5306. In addition, if the general counsel's office should reach a conclusion different from that set forth in this letter, we request the opportunity to confer with you prior to the transmission of a written response.

We would appreciate it if you would acknowledge receipt of this letter by returning a file stamped copy in the enclosed self-addressed return envelope.

Very truly yours,

DAVIS WRIGHT TREMAINE

A handwritten signature in black ink, appearing to read 'DWB' with a long horizontal flourish extending to the right.

David C. Baca

DCB:mg

Enclosures

c: Mr. Scott Burns

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