

PUBLIC

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RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 95-151-CC
Templeton Russia
Fund, Inc.
File No. 811-8788

By letter dated March 9, 1995, you seek assurance that the staff would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act of 1940 (the "Investment Company Act") or Rule 17f-5 thereunder if Templeton Russia Fund, Inc. (the "Fund") invests in the equity securities of Russian issuers ("Russian Equities") and holds those securities in accordance with the custodial arrangements described in your letter.

You state that the Fund is a newly organized, non-diversified closed-end management investment company. Templeton Investment Management (Singapore) Pte. Ltd. (the "Investment Manager") will serve as the Fund's investment adviser. The Fund's investment objective is capital appreciation. The Fund will seek to achieve its objective by investing, under normal market conditions, at least 65% of the value of its total assets in the securities of Russian issuers. The Fund will enter into a custody agreement (the "Custody Agreement") with Chase Manhattan Bank, N.A. ("Chase") under which Chase will serve as the Fund's primary U.S. custodian bank. Chase, in turn, will enter into a sub-custody agreement with its recently organized, wholly owned, indirect Russian subsidiary Chase Manhattan Bank International ("Chase Moscow") to perform certain custody functions as Chase's delegatee.

The Russian Share Registration System

As more fully described in your letter, the Russian government recently privatized the ownership of approximately 15,000 companies. Russian companies do not issue share certificates. Instead, equity securities of Russian issuers are maintained in book-entry form by registrars. An estimated 3,000 registrars located throughout Russia carry out share registration services for Russia's 15,000 privatized companies. 1/ These services are provided pursuant to individual arrangements between each issuer and its registrar. In your letter, you state that, although certain laws and regulations have been enacted that

1/ According to your letter, entities that serve as registrars include Russian commercial banks, brokerage firms, wholly-owned subsidiaries of the issuer, and the issuers themselves.

apply to the share registration system, 2/ registrars currently are not subject to active government supervision, and the legal requirements do not appear to be regularly enforced. 3/

You believe that the Russian share registration system poses certain custodial risks to investors. For example, because the Russian legal system does not currently provide effective remedies for resolving commercial disputes, an investor may not be able to use this system to enforce liabilities imposed on a Russian registrar under the regulations. You believe, however, that the most significant risk of the Russian share registration system to the Fund and its shareholders is that by fraud, negligence or even mere mistake on the part of the registrar, the Fund could lose all or part of its holdings of an issuer through alteration of the share register. You believe that, while this risk exists in any book-entry system, it is magnified in Russia because of the large number and geographical dispersion of registrars, the absence of active government supervision, and a general lack of experience throughout the system. 4/

The Registration and Holding of Russian Equities

You state that Russian Equities purchased by the Fund will be registered to reflect the Fund's ownership in the following manner. A Chase Moscow employee or agent will present to the registrar in person the documentation necessary to effect the transaction, including information from the Fund's broker concerning the trade and a valid transfer instruction. The registrar will effect the re-registration of the shares to reflect the Fund's ownership and will issue to the Chase Moscow

2/ See, e.g., State Committee of the Russian Federation for the Management of State Property and the Commission on Securities and Stock Exchanges of the President of the Russian Federation, "Regulation on a Joint Stock Company Shareholder Register" (April 1994).

3/ For example, although Russian law requires a Russian corporation with more than 1,000 shareholders to use an independent registrar, you state that this obligation has not always been strictly enforced.

4/ You state that the Fund's prospectus will include extensive disclosure regarding the Russian share registration system and the risks to investors, including prominent disclosure on the cover page of the prospectus and in the Fund's shareholder reports. The Fund also represents that all advertisements or sales literature will prominently disclose this information, except for tombstone advertisements that do not include a general description of the Fund under Rule 134(a)(3)(iii).

employee or agent a share register "extract" reflecting the ownership of all the shares registered. 5/ Only after receiving this extract will the Fund pay for the securities.

According to your letter, Russian Equities generally will be held in the name of a Chase Moscow nominee or occasionally in the name of the Fund itself. Chase's nominees are merely "shell" entities established solely for the purpose of holding shares of Chase's clients and do not have separate employees. We understand that Chase Moscow will establish an omnibus account on the books of each registrar for the appropriate nominee. Under an omnibus account, all assets held in a nominee's name are maintained in a single account. Each omnibus account will contain only assets of Chase Moscow's customers. Ownership of shares by separate customers will be recorded on the books of Chase Moscow. To verify the holdings of its customers, Chase Moscow will compare the total shares held in the omnibus account according to the registrar with the total shown on the books of Chase Moscow.

Section 17(f) and Rule 17f-5

Section 17(f) sets forth the custodial requirements for registered management investment companies. 6/ Congress intended Section 17(f) to address two concerns. First, Section 17(f) is designed to prevent fund insiders and affiliates from misappropriating or misusing fund assets. 7/ Second, the language of Section 17(f) indicates that it was intended to ensure that custodial arrangements available to a registered investment company provide reasonable protections for the fund's assets. 8/

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- 5/ According to your letter, these extracts are not securities and cannot be used to transfer ownership. They may, however, be useful in establishing proper ownership if any dispute arises as to the Fund's ownership of certain shares.
- 6/ Section 17(f) permits four types of custodians: U.S. banks (and their foreign branches), and subject to the Commission's rules, members of U.S. securities exchanges, U.S. securities depositories and investment companies themselves.
- 7/ See Hearings on S. 3580 Before the Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. 264 (1940).
- 8/ See, e.g., Section 17(f)(1), which requires banks holding investment company assets to have \$500,000 of capital and be subject to government regulation.

With respect to foreign custodians, Rule 17f-5 attempts to address these concerns by requiring a fund's foreign custodial arrangements to meet certain minimum requirements. Under Rule 17f-5, a registered investment company may maintain assets outside the United States with certain categories of "eligible foreign custodians," including: foreign banks with more than \$200 million shareholders' equity; majority-owned subsidiaries of U.S. banks with more than \$100 million shareholders' equity; transnational foreign securities depositories and clearing agencies; and certain centralized securities depositories and clearing agencies.

Although Chase qualifies as an eligible custodian under Section 17(f), and Chase Moscow will be permitted to act as a foreign custodian pursuant to a Commission order, 9/ the Fund seeks no-action relief under Section 17(f) and Rule 17f-5 to address concerns raised by the Russian share registration system. You believe that the Division's position in ASX Settlement and Transfer Corporation Pty Ltd (pub. avail. Apr. 19, 1994) ("ASX Settlement") provides an appropriate basis for the staff to grant the requested relief. In that letter, the Division stated that a subregistry system that does not have any custodial role in relation to the securities recorded on the subregister is not a custodian subject to Rule 17f-5. You state that, like the subregistry system in ASX Settlement, the Russian registrars are limited participants in the custodial process, and the "custodian" should be viewed as being the entity in whose name the shares are held on the register (either Chase Moscow or the Fund itself). You acknowledge that, in ASX Settlement, no-action relief was granted to a single registrar that was a subsidiary of the Australian Stock Exchange and subject to government supervision. You believe, however, that the verification procedures and enhanced board oversight you propose will provide an appropriate substitute in Russia's multiple registrar system and provide sufficient protection against loss due to negligence or fraud by a registrar.

Procedures to Prevent Fund Insiders From Misusing Fund Assets

Under your proposal, when shares are held in the name of a Chase Moscow nominee, only a Chase Moscow representative or agent

9/ Because Chase Moscow does not meet the shareholder equity requirements necessary to qualify as an "eligible foreign custodian" under Rule 17f-5(c)(2), Chase has filed an application with the Commission seeking exemptive relief for Chase Moscow pursuant to Section 6(c) of the Investment Company Act. Investment Company Act Release No. 20969 (Mar. 28, 1995) (notice). Absent a request for a hearing on the application, an order granting the relief will be issued on April 24, 1995, pursuant to delegated authority.

will have the authority to instruct the registrar to transfer the Fund's portfolio holdings. When interests are recorded directly in the Fund's name, the Fund will instruct the registrar at the time the shares are purchased that Chase Moscow and its representatives will be the only persons authorized to act with respect to the Fund's portfolio holdings. You believe, therefore, that personnel of the Fund, the Investment Manager and other Fund affiliates effectively will not have access to or otherwise be able unilaterally to alter in any manner the Fund's portfolio holdings as reflected in the share registers.

Procedures to Provide Reasonable Protections for the Fund's Assets

Monitoring

You propose that Chase Moscow will enter into a contractual arrangement with the registrar for each issuer whose securities will be held by the Fund. Each such arrangement will include substantially the following provisions:

(a) Regular Share Confirmations - each contract will establish Chase Moscow's right to conduct regular share confirmations on behalf of Chase Moscow's customers. In conducting these share confirmations, a Chase Moscow employee or agent will request either a duplicate share extract or some other sufficient evidence of verification and will determine if the extract reflects the same information as contained in Chase Moscow's records. 10/ For at least the first two years following Chase Moscow's first use of a registrar in connection with a Fund investment, Chase Moscow will conduct these share confirmations at least quarterly, although thereafter they may be conducted less frequently if the Board of Directors, in consultation with Chase Moscow, determines it appropriate. 11/ In no event,

10/ You state that if the registrar is unwilling to issue a duplicate extract, Chase Moscow intends to prepare a form document listing the name of the Chase employee or agent, the date and time of verification, and the number of shares in the nominee name or the Fund's name, as the case may be, as reflected in the register. This form will be signed and certified by the Chase Moscow employee or agent, and Chase Moscow will request the signature of an appropriate official of the registrar. This form then will be retained by Chase Moscow as if the form were a duplicate extract.

11/ According to your letter, the Board of Directors and Chase Moscow will consider a variety of factors in making this determination, including whether any share register alteration incidents have occurred; the length of time in
(continued...)

however, will the Fund continue to hold shares in any issuer where share confirmations of the registrar are conducted less frequently than annually;

(b) Prompt Re-registration - registrars will be obligated to effect re-registrations within 72 hours of receiving the necessary documentation;

(c) Use of Nominee Name - each contract will establish Chase Moscow's right to hold shares not held directly in the beneficial owner's name in the name of a Chase Moscow nominee;

(d) Auditor Verification - each contract will establish Chase Moscow's right to obtain direct access to the share register for the independent auditors of each Chase Moscow client; and

(e) Specification of the Registrar's Responsibilities and Liabilities - each contract will set forth the registrar's responsibilities as to distributions and other corporate actions; the registrar's liabilities as established under the regulations applicable to the share registration system; and the procedures for making a claim against and receiving compensation from the registrar in the event a loss is incurred.

In connection with the monitoring obligations and related rights described above in Paragraphs (a)-(e), the Fund represents the following:

(1) the Fund will not purchase the securities of any issuer whose registrar is unable or unwilling to enter into a contract with Chase Moscow that includes substantially the provisions described above;

(2) the Custody Agreement will incorporate Chase Moscow's obligation to seek to obtain the share confirmation and related rights described above;

(3) the Custody Agreement will require Chase Moscow to maintain custody of the share register extracts, and will incorporate the procedures and requirements regarding the use of the extract substitutes;

11/(...continued)

which no incidents have occurred; developments in the Russian government, such as increased enforcement authority and exercise thereof by government agencies over the securities markets; and the development of centralized settlement systems and their role in ensuring registrar conduct.

(4) Chase will be liable under the Custody Agreement to the extent that the Fund incurs a loss that results from the negligence or willful misconduct of Chase or Chase Moscow. Chase also will be liable under the Custody Agreement to the extent that the Fund incurs a loss that results from the negligence or willful misconduct of any agent retained by Chase or Chase Moscow for share registrations or share confirmations;

(5) Chase and/or Chase Moscow will be liable under the Custody Agreement for any Fund loss caused by the conduct of a nominee's directors, officers and employees; 12/ and

(6) Chase Moscow will maintain a list of registrars with which it has entered into contracts and make this information available to the Board of Directors and the Investment Manager upon request.

Enhanced Board Oversight

You state that, consistent with its obligation under Rule 17f-5, the Board of Directors will actively oversee the Fund's custodial arrangements. 13/ Under your proposal, however, the Board of Directors will subject the custodial arrangements to additional scrutiny.

You state that Chase Moscow will prepare for distribution to the Board of Directors a quarterly report identifying any concerns Chase Moscow has regarding the Russian share registration system that should be brought to the Board of Directors' attention. This report will include detailed information regarding the steps Chase Moscow has taken during the reporting period to ensure that the Fund's interests continue to be appropriately recorded. Chase Moscow also will maintain a

12/ Telephone conversation on March 9, 1995 between Alison Baur and Lawrence Stoller. You state that, if the Fund incurs a loss described in Paragraphs (4) and (5), the Fund could seek redress in the U.S. against Chase or directly against Chase Moscow as a third-party beneficiary of the sub-custody agreement between Chase and Chase Moscow.

13/ Rule 17f-5 requires a fund's board, among other things, to determine that maintaining the company's assets in a particular country or countries and with a particular foreign custodian is consistent with the best interests of the fund and its shareholders, and to establish a system to monitor foreign custody arrangements to ensure compliance with the conditions of the rule. The rule also requires the board to review and approve at least annually the continuance of these arrangements as consistent with the best interests of the fund and its shareholders.

cumulative list of all registrars that have been the subject of any of the events described below in Paragraphs (i)-(v), and will include this list in each report.

You represent that the Board of Directors will consider at its quarterly meetings (and at other times as may be necessary), among other things; the quarterly report described above (and any information provided by the Investment Manager), and will determine at each meeting that investment in Russian Equities through the use of the monitoring system continues to be appropriate. You undertake that, in the event the Board of Directors determines that, over the long-term, investment in Russian Equities is no longer consistent with the best interests of the Fund's shareholders, the Fund will promptly call a shareholder meeting to consider whether to change the Fund's name and investment policies, or to liquidate the Fund and distribute the proceeds, net of any liabilities, to the Fund's shareholders.

In addition, the Custody Agreement will require Chase Moscow promptly to advise the Board of Directors and the Investment Manager when one or more of the following events has occurred as to any registrar that serves in that capacity for any issuer in which the Fund holds shares or in which the Investment Manager has informed Chase Moscow it would like to purchase shares:

(i) a registrar, to Chase Moscow's actual knowledge, has eliminated the name of a shareholder from a register or otherwise altered the shareholder's interest and that shareholder alleges that such elimination or alteration was unlawful;

(ii) a registrar informs Chase Moscow that it no longer will be able materially to comply with the protective provisions of the contract between Chase Moscow and the registrar, or Chase Moscow has actual knowledge that a registrar has engaged in conduct that indicates it will not materially comply with these protective provisions;

(iii) Chase Moscow has actual knowledge that a registrar has refused to re-register shares in the name of a particular purchaser and the purchaser or seller alleges that such refusal was unlawful; 14/

14/ This situation could arise, for example, when a registrar has a close relationship with an issuer. If the issuer finds a particular potential investor to be undesirable, the issuer may instruct the registrar to refuse to re-register shares in that investor's name. In instances when the Fund is selling portfolio securities, this poses a risk that the Fund could face a delay in disposing of its holdings and could be exposed to potential loss on its investment. While
(continued...)

(iv) Chase Moscow has actual knowledge that a registrar holds for its own account shares of the issuer for which it serves as registrar; and

(v) Chase Moscow determines that a registrar has materially breached its registrar contract with Chase Moscow and has failed to cure such breach within a reasonable time.

You represent that, when Chase Moscow reports to the Board of Directors and Investment Manager any of the registrar events described above in Paragraphs (i)-(v), the Investment Manager will not purchase additional shares of an issuer served by that registrar, except with the specific approval of the Board of Directors.

You believe that the presence of Chase Moscow in the custodial arrangements, the monitoring functions Chase Moscow will perform, and the active oversight by the Board of Directors, provide reasonable protection against the risks of loss presented by the Russian system.

Based on the unique facts and representations in your letter, and without necessarily agreeing with your legal analysis, we would not recommend that the Commission take any enforcement action under Section 17(f) or Rule 17f-5 if the Fund invests in and holds Russian Equities in accordance with the custodial arrangements described in your letter. You should note that any different facts or representations may require a different conclusion. Further, this response expresses the Division's position on enforcement action only, and does not purport to express any legal conclusions on the questions presented.



Alison E. Baur
Senior Counsel

14/(...continued)

you do not believe that this presents a custody risk, you state that this risk will be disclosed in the Fund's prospectus.

ACT ICA of 1940
SECTION _____
RULE 17f-5
PUBLIC AVAILABILITY 4/18/95

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Section 17(f) of the Investment Company
Act of 1940 and Rule 17f-5 thereunder

March 9, 1995

By Federal Express

Jack W. Murphy, Associate Director and
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Settlement and Custody of Equity Securities of Russian Issuers Held
By Templeton Russia Fund, Inc.

Dear Mr. Murphy:

As counsel to Templeton Russia Fund, Inc. (the "Fund"), we are writing to seek assurance that the staff of the Division of Investment Management would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act of 1940 (the "1940 Act") or Rule 17f-5 thereunder if the Fund invests in the equity securities of Russian issuers ("Russian Equities") in accordance with the custodial arrangements discussed below. As set forth more fully below, we believe that the unique system used to maintain Russian Equities in book-entry form, in conjunction with the protective measures proposed by the Fund, is consistent with the policies and purposes underlying Section 17(f) and Rule 17f-5, and therefore believe that it would be appropriate for the Division staff to take the position requested.

Jack W. Murphy, Esq.
March 9, 1995
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BACKGROUND

The Fund

The Fund is a newly organized, non-diversified closed-end management investment company. The Fund filed its notification of registration on Form N-8A and its Registration Statement on Form N-2 with the Commission on September 30, 1994. Templeton Investment Management (Singapore) Pte. Ltd. (the "Investment Manager") will serve as the Fund's investment adviser. The Investment Manager currently is in the process of organizing and staffing an affiliated office in Moscow, Russia. Templeton Global Investors, Inc. (the "Business Manager") will serve as the Fund's business manager. A group of underwriters led by Merrill Lynch, Pierce, Fenner & Smith Incorporated, A.G. Edwards & Sons, Inc., Nomura Securities International, Inc. and Prudential Securities Incorporated (the "Underwriters") will serve as the Fund's underwriters. The Fund's investment objective is capital appreciation. The Fund will seek to achieve its objective by investing, under normal market conditions, at least 65% of the value of its total assets in the securities of Russian issuers.

The Fund will enter into a custody agreement with The Chase Manhattan Bank, N.A. ("Chase") pursuant to which Chase will serve as the Fund's custodian. Chase has advised the Fund that Chase will enter into a sub-custody agreement with its recently organized, wholly owned, indirect Russian subsidiary, Chase Manhattan Bank International ("Chase Moscow") to perform certain custody functions as delegatee. Because Chase Moscow does not meet the shareholder equity requirements necessary to qualify as an "eligible foreign custodian" under Rule 17f-5(c)(2), Chase has filed an application with the Commission seeking exemptive relief for Chase Moscow pursuant to Section 6(c) of the 1940 Act.

Russian Securities Markets

Privatization and Voucher Program

In October 1992, Russia launched the largest mass privatization program ever. Privatization vouchers were distributed at a nominal cost to approximately 144 million eligible Russians. Voucher holders could bid for the shares of the 15,000 medium and large companies that were being privatized, exchange the vouchers for shares in voucher investment funds, which were established to provide diversification and ongoing investment management, or sell the vouchers in the newly developed secondary market. Since the conclusion of the voucher privatization program in June 1994, the Russian government has begun a series of cash auctions in which an additional 15% to 20% of Russian enterprises are being offered to the highest bidders. The cash auctions are intended to attract foreign investment and foreign expertise into the Russian economy.

Secondary Securities Market Trading

Immediately after the launch of the privatization program, a secondary market for shares and vouchers emerged, with at least twelve organized exchanges and over 100 small exchanges. Although developing rapidly, even the largest of Russia's stock exchanges remain in a relatively primitive state compared to Western stock exchanges. The actual volume of exchange-based trading in Russia is low and active trading generally occurs only in the shares of a few companies. Moreover, to the extent that secondary market trading occurs, it is generally done through over-the-counter trading facilitated by a growing number of licensed brokers.

Custody and Clearing Services

While Russian corporate law authorizes Russian corporations (called "joint stock companies" in Russia) to issue share certificates, and the use of share certificates also is incorporated into the regulations applicable to the share registration system, as a practical matter Russian corporations do not issue share certificates and Russian Equities are maintained in book entry form only.¹ Ownership of Russian Equities is reflected by entries in a share register, and transfer of title does not take place until appropriate entries have been made in the register. No central share registration system, however, exists in Russia. Instead, Russian corporations enter into individual share registration arrangements generally by contracting with a third party to maintain the corporation's share register. These "registrars," which are called "register holders" in the Russian regulations, perform services similar to those provided by a transfer agent. It is estimated that share registration services are carried out by up to 3,000 registrars located throughout Russia. A registrar generally is physically located near the company whose share register it maintains. Share registers are generally maintained in a computer format, although registers may be maintained in paper form only for some of the smaller Russian companies.

A Russian corporation with more than 1,000 shareholders is required by law to contract out the maintenance of its shareholder register to an independent entity that meets certain criteria, including those set forth in the regulations applicable to registrars and the share registration system.² Section 5.2 of the regulations prohibits natural persons from

¹ The practice of using book-entry form only may have been reinforced by, among other things, the collapse and fraud involved with Russian investment funds that issued bearer securities, including the highly publicized MMM debacle.

² See State Committee of the Russian Federation for the Management of State Property and the Commission on Securities and Stock Exchanges of the President of
(continued...)

serving as a register, i.e., the registrar must be organized as a joint stock company or some other legal entity. Section 5.2 also prohibits a company that is a shareholder (whether a record or beneficial owner) in the underlying issuer, or that has control over any shares, from serving as a registrar to that company. Section 5.3 of the regulations provides that the rights and duties of the issuer and the registrar shall be established in a contract between the entities. This Section also provides that a joint stock company shall contract only with one registrar. Section 5.7 indicates that a registrar may not unilaterally assign its contract with an issuer to another registrar. Section 5.8 states that a registrar must ensure the issuer and record owners (or the beneficial owner if there is no separate record owner) access to the share register data, submit to the issuer a shareholder list no less frequently than once per year, and conduct a monthly check of the number of classes of issued shares and transactions during the period.

We understand that in practice the requirement that larger Russian corporations use independent registrars has not always been strictly enforced and in certain cases the registrar may be a subsidiary of the company whose share register it maintains or have other close relationships to the issuer. In these cases, the management of a Russian corporation may be able to influence who can become a shareholder by instructing the registrar to refuse to re-register shares in the name of a potential purchaser.³ We also understand that some Russian registrars hold for their own account shares of the issuer for which they serve as registrar, even though this practice is prohibited by the regulations.

Entities that serve as registrar include Russian commercial banks, brokerage firms, the issuer (if less than 1,000 shareholders), and wholly-owned subsidiaries of the issuer. A single registrar may provide registration services to more than one Russian corporation,

²(...continued)
the Russian Federation, "Regulation on a Joint Stock Company Shareholder Register" (April 1994).

³ This situation may arise should management of the company not wish to have any more foreign shareholders or, for whatever reason, find a particular potential investor to be undesirable. While this may affect the Fund's performance by precluding the Investment Manager from investing in a company that meets the Investment Manager's criteria, it does not create any risk of loss in the custody of the Fund's portfolio holdings. No custody risk arises until the securities actually become assets of the Fund and this will not occur (and the Fund will not physically pay for Russian Equities) until the share settlement and registration process has been completed and the Chase Moscow employee or agent has taken the steps necessary to cause the securities to be registered in the name of Chase Moscow (through its nominee) or the Fund.

but each Russian corporation's share register is maintained by a single registrar only. Therefore, there is no risk that investors would have competing claims on the same securities by virtue of discrepancies among two or more registrars maintaining a share register with respect to the same securities. In the case of certain large corporations with many shareholders, a registrar may sub-contract out with one or more other registrars to maintain a certain portion of the share register. For example, a registrar may employ a "sub-registrar" to maintain the share register for shareholders in the first half of the alphabet and the direct registrar would maintain the register for shareholders in the second half of the alphabet. Because, in these cases, the registers maintained by the registrar and the sub-registrar will not overlap, there would continue to be no risk that investors would have competing claims on the same securities. Share registers maintained by sub-registrars also will be subject to share confirmations by Chase Moscow and the use of sub-registrars, therefore, will not affect the share confirmation process (discussed below) in any material respect.

Overview of the Registration System

If the Fund's Investment Manager determines that investment in a particular Russian company is appropriate, it will simultaneously instruct the broker and custodian to take the necessary steps to effect this transaction and to have the shares re-registered to reflect the Fund's ownership. This will generally occur as follows: Chase Moscow will be instructed to prepare the necessary documentation, which will include information from the broker concerning the trade, a valid transfer instruction, a document evidencing that the transaction tax, which may be as large as 6%, imposed on a re-registration has been paid,⁴ and a notarized confirmation that Chase Moscow is authorized to act on behalf of the Fund. These are the basic documents that will be used, although certain registrars may request additional documentation as well. A Chase Moscow employee or agent will present these forms and documentation to the registrar in person.⁵ Given the fact that companies are

⁴ Although not its intended purpose, the Investment Manager believes that the transaction tax also serves as a significant deterrent to preventing an unauthorized representative of Chase Moscow or the Fund from fraudulently obtaining the Fund's interest in a portfolio holding. Given the likely size of the Fund's portfolio holdings, the person attempting to commit the fraud would need to expend a significant sum of money to pay the tax and to have the shares re-registered in another name.

⁵ As discussed more fully on page 14 of this request, Chase Moscow intends to use its own employees in re-registering shares for the benefit of the Fund, although Chase Moscow may employ agents to carry out this process. The custody contract will provide that Chase Moscow will be responsible for any direct Fund loss (or any portion thereof) caused by the registration conduct of these agents to the same extent as if a Chase Moscow employee had performed this function.

Jack W. Murphy, Esq.
March 9, 1995
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widely dispersed throughout Russia and that registrars are located near the companies for which they maintain share registers, this means that it may take up to 10 days or more from the time the Fund determines that investment is appropriate until the Fund's investment is recorded on that company's share register.

After the registrar is satisfied that the documents are in proper order and that the tax has been paid, it is anticipated that the registrar will effect the re-registration to reflect the Fund's ownership of these shares and also will issue to the Chase Moscow representative or agent a share extract indicating the Fund's ownership of the Russian Equities. These extracts, which in many cases physically resemble share certificates, may serve as some evidence of an investor's holdings of a company's shares at a particular time. These extracts, however, are not securities and cannot be used to transfer ownership. We understand from discussions with Russian counsel that, although it is unclear whether the extract could have any evidentiary value, Chase Moscow's possession of the extract may be useful in establishing proper ownership if any dispute arises as to the Fund's ownership of certain shares. Although not required by the 1940 Act, the Fund and Chase have agreed that the custody agreement will include a provision that requires Chase Moscow to maintain custody of the Fund's share register extracts. Payment by the Fund in respect of a securities purchase will only be effected after the Chase Moscow employee or agent has taken the necessary steps to cause the Fund's interest to be recorded in the share register and the extract has been issued.

Sales of Russian Equities by the Fund will occur in much the same manner. The burden, however, will be on the purchaser of the securities to ensure that shares sold by the Fund are properly re-registered in the purchaser's name and therefore that its interest is properly recorded. While not a custody risk, in instances when the Fund is selling portfolio securities there is a risk that a registrar will refuse to re-register the shares in the name of a particular purchaser for the reasons discussed in note 3 and the accompanying text. If this did occur, the Fund could face a delay in disposing of Russian Equities, which may expose the Fund to potential loss on the investment. This risk, of course, will be disclosed in the Fund's Prospectus. Assuming the Fund's interest has continued to be appropriately recorded, however, any delay in the sale of a portfolio holding does not raise any custody issues under Section 17(f) or Rule 17f-5.⁶

⁶ Further, this potential delay does not affect the ability of the Fund's Board to conclude that "beneficial ownership for the company's assets will be freely transferable without the payment of money or value other than for safe custody or administration," as required by paragraph (a)(1)(iii)(C) of Rule 17f-5. Although we are unaware of any source indicating the Commission's intent regarding this provision, we believe the provision may be designed to address two potential concerns. First,

(continued...)

There are detailed regulations applicable to registrars and the share registration system. Section 2.12 of the regulations provides an important protection by requiring a registrar to date and time stamp each document the registrar receives. Section 3 of the regulations provides the procedures for obtaining share extracts. Section 4 of the regulations sets forth detailed provisions regarding the transfer of interests and the procedures pursuant to which this must occur. Section 5 of the regulations sets forth the duties and obligations of the registrar. Section 5.4 of the regulations imposes liability on the registrar for violating the terms of the agreement between the issuer and the registrar, for making mistakes in maintaining the register, and for unlawfully refusing to make entries. Section 5.6 sets forth the procedures to be followed in the event of loss of the share register data. This Section requires the registrar to notify the Russian Commission on Securities and Stock Exchanges (which recently was replaced by the Federal Commission on Securities and Stock Exchanges) within one day of the loss, to publish an announcement in the mass media informing investors of the loss and the need to prove their shareholder status and to re-register the shares, and to restore the share register fully within ten days without suspending the ability to enter transactions in the share register. Section 5.8 obligates the registrar to permit record owners (or the beneficial owner if there is no separate record owner) access to the register to verify their share holdings.

Notwithstanding the existence of these regulations, we understand that registrars are not subject to active government supervision or enforcement of the regulatory requirements. We also have been informed that, because the Russian system for resolving commercial disputes is, in many respects, in its infancy and is not perceived as providing effective remedies, it is unlikely that an investor in Russian Equities currently would seek to use the Russian legal system to enforce any liabilities imposed on a Russian registrar

⁶(...continued)

the provision could be designed to preclude funds from investing in markets that impose de facto systemic restrictions on the transfer of securities between investors, such as a requirement that the government grant prior approval of all securities transfers. While a particular registrar may refuse to recognize a proposed transfer to a particular investor, this would not be equivalent to a systemic restriction on securities transfers. Second, the provision also could be intended to prevent a foreign custodian from conditioning the transfer of securities upon the payment of any fee other than any customary fees charged by the foreign custodian. To the best of our knowledge, this is not the case in Russia. We do not believe this provision is designed to address what amounts merely to local market conditions that might affect the speed with which a fund can sell portfolio securities. If that were the case, then fund boards would be unable to make the requisite determination with respect to many emerging markets, where limited liquidity could result in significant delays in disposing of portfolio securities.

pursuant to the regulations. If a Russian registrar refuses to make the Fund whole, the Investment Manager or Chase Moscow, at the direction of the Fund, would bring the registrar's conduct to the attention of the appropriate government agencies, including the Ministry of Finance, the Federal Commission on Securities and Stock Exchanges, and the Russian Privatization Ministry, each of which has jurisdiction over the share registration system.⁷ Given the strong support for capital markets that these agencies have expressed, and the recognition that the registrar's actions could drastically affect the willingness of foreign and even domestic investors to inject much needed capital, it is expected that these agencies would attempt politically to pressure the registrar to honor its obligations.

The most significant risk of the Russian share registration system to the Fund and its shareholders is that by fraud, negligence or even mere mistake the Fund could lose all or part of its interest in a particular portfolio holding through disappearance or alteration of Chase Moscow's or the Fund's holdings as recorded in the share register. This risk, of course, exists in any book-entry system and is not necessarily unique to investment in Russia. A book-entry system is only as accurate as the people and equipment used to manage and operate the system and either of these variables could malfunction in any market. Further, all book-entry systems share the characteristic that a custodian cannot physically hold negotiable share certificates that provide the best evidence of an ownership claim and permit the owner to transfer ownership rights to a third party without having first to change the registration on the issuer's books.⁸ The risks associated with book-entry systems are magnified in Russia, however, because of the large number and geographical dispersion of registrars, and the absence of active government supervision and a base of experience.

To the best of our knowledge, there has only been a single reported instance in which an institutional shareholder's name has been removed from a share register. It has been reported that a registrar removed the name of a London-based investor from the share register of a Russian aluminum company.⁹ The investor reportedly learned of the alleged tampering when it attended a shareholder meeting.¹⁰ Although the circumstances behind this situation are not entirely clear, the Russian aluminum company contends that the

⁷ The Russian Privatization Ministry generally has authority over the entire privatization process. In certain cases, another Russian agency also may have authority to supervise a registrar. For example, banks also are subject to the supervision of the central bank.

⁸ See Securities Exchange Act Rel. No. 35038 (Dec. 1, 1994) (citing E. Guttman, Modern Securities Transfers, p. 1-2 (1987)).

⁹ See Financial Times at page 1 (Nov. 16, 1994).

¹⁰ Id.

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investor's name should never have been included on the share register because the investor had apparently not complied with the conditions applicable to purchase of the subject securities and that the company was only taking action to correct the register.¹¹ We understand that the matter has been referred to the Federal Commission on Securities and Stock Exchanges for review.

Role of Chase Moscow

Russian Equities generally will be held in the name of a Chase Moscow nominee. We have been advised that certain registrars and issuers may require that shares be held directly by the beneficial owner and therefore that positions occasionally will be recorded in the name of the Fund. Chase Moscow, through its nominee, will hold Russian Equities on behalf of the Fund in an omnibus account and Chase Moscow will establish an omnibus account for each of its nominees. Each omnibus account will contain only assets of Chase Moscow's customers. Chase Moscow will then employ a sub-accounting system in Russia to track the interests of the Fund and each investor for which Chase Moscow serves as custodian.

Chase's nominees are organized under the laws of various jurisdictions (e.g., in the United States and the United Kingdom). Nominees are used to comply with the requirement that a custodian segregate assets belonging to a client from those belonging to the custodian. From an administrative standpoint, the use of a nominee also facilitates the transfer of record ownership of securities on behalf of the custodian's clients. In fact, most securities depositories would be unwilling to transact business with custodians through the use of the many accounts that would be required if shares were held directly in each customer's name. Further, and perhaps most important, the use of nominees also serves to ensure that shares held by a custodian on behalf of its customers are not subject to the claims of the custodian's creditors. Chase's nominees, however, are merely "shell" entities established solely for the purpose of holding shares of Chase's clients. Although the nominees have a separate legal existence, as a practical matter they do not have any tangible existence. The nominees, for example, have no separate employees.¹² Therefore, Chase Moscow's use of nominees should not have any effect on the analysis of the compliance with the 1940 Act's custodial requirements. It should also be noted that the practice of using nominees is widely accepted throughout the world, including in the United States.

¹¹ Id.

¹² All directors, officers and employees of a nominee also will be directors, officers and/or employees of Chase or Chase Moscow. Given their dual status, Chase and/or Chase Moscow will be liable for any direct Fund loss (or any portion thereof) caused by the conduct of a nominee's directors, officers or employees.

Immobilized shares held by the Depository Trust Company ("DTC"), for example, are held in the name of a nominee, Cede & Co., which was established by the DTC solely for this purpose.

It must be emphasized that neither Chase nor Chase Moscow will be liable for the acts or omissions of the registrars. However, to seek to protect against the risk that the Fund's interest in a Russian issuer, as reflected in a share register, is improperly altered or eliminated, the Fund will not invest in an issuer of Russian Equities unless Chase Moscow has entered into a contract with that issuer's registrar. The Fund has instructed Chase Moscow that, in order for the Fund to invest, the contractual arrangement with each registrar must contain substantially these protective conditions:

1. Regular Share Confirmations -- Each contract will establish Chase Moscow's right to conduct regular share confirmations on behalf of Chase Moscow's customers.¹³ These confirmations are intended to limit the risk that the Fund and Chase Moscow's other clients may lose some or all of their interests in a portfolio holding because of the disappearance or alteration of the holding in the share register. In conducting these share confirmations, Chase Moscow will request either a duplicate share extract or some other sufficient evidence of verification and will determine if Chase Moscow's records correlate with those of the registrar, i.e., that the extract reflects the same information concerning the Fund's share position as contained in Chase Moscow's records.¹⁴ For at least the first two years following Chase Moscow's first use of a registrar in connection with a Fund investment, and subject to

¹³ As indicated above, Section 5.8 of the Russian regulations obligates the registrar to "ensure access to the data of the shareholder register" for record owners (or beneficial owner if there is no separate record owner).

¹⁴ It is our understanding that a registrar occasionally may be unwilling to issue an additional duplicate extract. In these cases, Chase Moscow will attempt to obtain some other indicia of the Fund's holding. Chase Moscow has indicated that it intends to prepare a form document listing the name of the Chase employee or agent, the date and time of verification, and the number of shares the Fund owns in the Russian issuer, as reflected in the register. This form will then be signed and certified by the Chase Moscow employee or agent, and Chase Moscow will request the signature of an appropriate official of the registrar. This form will then be retained by Chase Moscow as if the form were a duplicate extract. As with the extract itself, the legal value of the form is unclear. These procedures and requirements regarding the use of an extract substitute also will be incorporated into the Fund's custody agreement with Chase.

the cooperation of the registrar, Chase Moscow will conduct these share confirmations on at least a quarterly basis, although thereafter they may be conducted on a less frequent basis if the Fund's Board of Directors, in consultation with Chase Moscow, determine it appropriate.¹⁵ The Fund's Board and Chase Moscow will consider a variety of factors in determining whether these share verifications can, consistent with the best interests of the Fund and its shareholders, be conducted less frequently, including whether any share register alteration incidents have occurred, the length of time in which no incidents have occurred, developments in the Russian government, such as increased enforcement authority and exercise thereof by government agencies over the securities markets, and the development of centralized settlement systems and their role in ensuring registrar conduct.¹⁶ The Fund represents, however, that in no event will it continue to hold shares in any issuer where share confirmations of the registrar are conducted less than annually.

2. Prompt Re-registrations -- Registrars will be obligated to effect re-registrations within 72 hours of receiving the necessary documentation. This will seek to ensure that the Fund will be able both to acquire and dispose of shares in a timely fashion.¹⁷

3. Use of Nominee Name -- As indicated above, to comply with certain legal requirements and to ensure that shares held on behalf of its clients are not subject to the claims of Chase Moscow's creditors, each contract will

¹⁵ This two-year period will be applied on a registrar-by-registrar basis. Thus, the frequency of share confirmations will not be reduced as to any particular registrar with which Chase Moscow has had less than two years of experience.

¹⁶ Obviously, to the extent that these verifications can be performed less frequently, this could serve to reduce the Fund's custody costs.

¹⁷ This 72 hour period is the time requirement imposed on registrars by Section 4.6 of the Russian regulations applicable to the share registration system. While the Fund does not believe that Russian registrars will agree to abide by any re-registration period that is shorter than the regulatory requirement, Chase Moscow will reasonably attempt to ensure that re-registrations are recorded as quickly as possible. The calculation of this time limitation will not begin to run until the registrar accepts the suitability of the Fund as a purchaser and, if the Fund is selling securities, the suitability of the entity to which the securities will be sold. Thus, the 72 hour time period is designed to address the administrative process involved in re-registering securities and not issues involving investor acceptability.

establish Chase Moscow's right to hold shares not held directly in the beneficial owner's name in the name of a Chase Moscow nominee.

4. Auditor Verification -- In connection with their certification of the Fund's annual financial statements, the Fund's independent public accountants will verify the Fund's portfolio holdings in accordance with generally accepted auditing standards. While normally this will be accomplished by Chase Moscow providing to the Fund's independent public accountants share extracts evidencing the Fund's interest in a company as of the relevant date,¹⁸ there may be situations in which the Fund's independent public accountants may wish to have direct access to a share register for verification or other purposes. Consequently, each contract will establish the right of Chase Moscow to obtain direct access to the share register for the independent auditors of each Chase Moscow client.

5. Specification of Registrar's Responsibilities and Liabilities -- In addition to setting forth the registrar's responsibilities with regard to corporate actions and other distributions, the registrar's liabilities, as established under the regulations applicable to the share registration system, will be specified. The contract also will delineate the procedures for making a claim against and receiving compensation from the registrar in the event a loss is incurred.

Obviously, given the large number of registrars, the exact details of each contract will be subject to negotiation and may vary by registrar. Chase Moscow will maintain a list of registrars with which it has entered into contracts and make this information available to the Fund's Board and the Investment Manager upon request. The Fund represents that Chase Moscow's obligation to seek to obtain the share confirmation and related rights referred to in paragraphs 1 through 5 on pages 10 through 12 will be incorporated into the Fund's custody agreement with Chase.

It is important to note that, while it is the Fund's intention to obtain the safeguards described above, given that Russian markets are still in their earliest stages of development, there can be no assurance that Chase Moscow actually will be able to achieve this objective or that a registrar will comply with the contract. For example, with respect to the share confirmations specified above, although Chase Moscow may have a contractual right to conduct these verifications and the Russian regulations require the registrars to provide access to the register, a registrar may still refuse Chase Moscow's request for access

¹⁸ Independent public accountants have the option under Section 30(e) of the 1940 Act of verifying assets owned by a registered investment company by receiving confirmation from the company's custodian.

to the register. Further, as indicated above, the Russian system for resolving commercial disputes cannot be relied upon to provide an effective remedy. Therefore, although Chase Moscow currently has no reason to believe it will not be able to conduct these share confirmation and other monitoring functions, Chase Moscow cannot give any assurances as to its ability to perform these duties.

As indicated above, the Fund has advised Chase Moscow that it will not purchase the securities of any issuer if the registrar associated with that issuer is unable or unwilling to enter into a contract that includes substantially the provisions listed in paragraph numbers 1 through 5 on pages 10 through 12. Further, as will be reflected in the Fund's custody agreement with Chase, Chase Moscow will be required to monitor each registrar's contractual performance on an on-going basis and promptly to advise the Fund's Board and the Investment Manager when one or more of the following has occurred with respect to any registrar that serves in that capacity for any issuer the shares of which are held by the Fund or of which the Investment Manager has informed Chase Moscow it would like to purchase:¹⁹

1. a registrar, to Chase Moscow's actual knowledge, has eliminated the name of a shareholder from a register or otherwise altered the shareholder's interest and that shareholder alleges that such elimination or alteration was unlawful;
2. a registrar informs Chase Moscow that it will no longer be able materially to comply with the protective provisions of the contract between Chase Moscow and the registrar, or Chase Moscow has actual knowledge that a registrar has engaged in conduct that indicates it will not materially comply with these protective provisions;
3. Chase Moscow has actual knowledge that a registrar has refused to re-register shares in the name of a particular purchaser, and the purchaser or seller alleges that such refusal was unlawful;

¹⁹ Chase Moscow's obligation to advise the Fund concerning the activities of registrars for issuers in which the Fund has not invested will be limited. Chase Moscow and the Fund may agree from time-to-time that Chase Moscow will, as part of the Fund's determination of whether to invest in a given issuer, review whether Chase Moscow would be willing to enter into a contract with that issuer's registrar. Only where Chase Moscow has agreed to perform such a review will it be obligated to inform the Fund if it has or acquires actual knowledge of any of the five matters set forth in the text below with respect to a registrar for an issuer in which the Fund has invested.

4. Chase Moscow has actual knowledge that a registrar holds for its own account shares of the issuer for which it serves as registrar; and
5. Chase Moscow determines that a registrar has materially breached its registrar contract with Chase Moscow and has failed to cure such breach within a reasonable time.

Based on the foregoing, the Fund's Board at its next meeting may determine no longer to invest in, or to liquidate its holdings of, securities of issuers served by that registrar. The Fund represents that, when Chase Moscow reports an incident listed in paragraphs 1 through 5 on pages 13 through 14 to the Fund's Board and the Investment Manager, the Investment Manager will not purchase any additional shares of an issuer served by that registrar except with the specific approval of the Fund's Board.

In addition, because it will maintain a local affiliated office in Moscow, the Investment Manager will be able to monitor Chase Moscow's activities and to report independently to the Fund's Board of Directors if the Investment Manager learns that Chase Moscow is not carrying out these functions appropriately.

Chase Moscow intends to use its own employees to re-register shares initially for the benefit of the Fund and to carry out the share confirmations specified in paragraph 1 on pages 10 through 11, although Chase Moscow has advised the Fund that it may employ agents to assist it in carrying out its responsibility to conduct these activities. If Chase Moscow does use these agents, it has indicated that it may employ local law offices, although Chase Moscow has reserved the right to use other organizations. Chase Moscow will be responsible for any Fund loss caused by the share registration and share confirmation conduct of these agents to the same extent as if a Chase Moscow employee had performed this function.²⁰ In that connection, as discussed in more detail in footnote 14, there can be

²⁰ As used throughout this request, Chase's liability to the Fund for the conduct of any Chase or Chase Moscow employee or agent will be limited only to direct damages and Chase will not be liable for any indirect or consequential damages. In addition, Chase's liability for direct damages shall not exceed the value of the securities on the date the Fund becomes aware of the loss. Chase Moscow, of course, will not assume responsibility for any registrar conduct that results in a loss to the Fund. In addition, apart from the share registration and share confirmation function, Chase Moscow's responsibility for the performance of any agent shall be as set forth in the Fund's custody agreement with Chase. This contract will provide that, outside the context of share registration and share confirmation, Chase Moscow will be liable for the performance of an agent only where the appointment of the agent by Chase Moscow constituted negligence or bad faith.

no assurance of registrar cooperation in the share confirmation process including as to their willingness to provide duplicate share extracts or the signing of other documents indicating the Fund's holdings.

As indicated above, the Fund will enter into a custody agreement with Chase. This agreement will address the question of Chase's liability with respect to a Fund loss (or any portion thereof) caused by Chase Moscow's failure to perform share registrations or the share confirmations described in paragraph 1 on pages 10 and 11, and the monitoring functions discussed in paragraphs 1 through 5 of pages 13 through 14. Chase will be liable thereunder to the extent that the Fund incurs a loss (or any portion thereof) caused by the negligence or willful misconduct of Chase or Chase Moscow, or, in respect of share registrations and share confirmations, by any agent retained by Chase or Chase Moscow to the same extent as if a Chase Moscow employee had performed this function. If the Fund incurs such a loss, the Fund could seek redress in the United States against Chase or directly against Chase Moscow as a third-party beneficiary of the sub-custody agreement between Chase and Chase Moscow. It is the Fund's current intention that, if this did occur, the Fund would bring an action in the United States against Chase. It is important to emphasize, however, that Chase Moscow cannot guarantee or otherwise assure that a registrar (or any other market participant) will perform its duties or that no loss due to a registrar's conduct (or that of any other market participant) will occur. Of course, Chase Moscow will not assume responsibility for any registrar conduct (or that of any other market participant) that results in a loss to the Fund.

Role of the Fund's Board of Directors

Rule 17f-5 sets forth the conditions under which a registered investment company may maintain custody of its assets outside the United States. The Rule requires a registered investment company's board to play an active role in supervising and monitoring these non-United States custody arrangements. Among other things, Rule 17f-5 requires a board to (i) determine that maintaining the company's assets in a particular country or countries is consistent with the best interests of the fund and its shareholders; (ii) determine that maintaining the company's assets with a particular foreign custodian is consistent with the best interests of the fund and its shareholders; (iii) establish a system to monitor the foreign custody arrangements to ensure compliance with the conditions of the rule; and (iv) review and approve at least annually the continuance of these arrangements as consistent with the best interests of the Fund and its shareholders.

The notes to the Rule indicate that the board also should make a number of determinations regarding the country in which the fund's assets will be held, including whether foreign law will restrict the access of the fund's independent public accountants to the books and records held by the foreign custodian, whether foreign law will restrict the fund's ability to recover its assets in the event of the foreign custodian's bankruptcy, whether

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foreign law would restrict the fund's ability to recover assets that are lost while under the control of a foreign custodian and the likelihood of expropriation, nationalization, freezes or confiscation of the fund's assets. Further, the notes also state that the board should consider the relevant aspects of the particular foreign custodian, including the custodian's financial strength, general reputation and standing, the custodian's ability to provide services efficiently and in a cost-effective manner, whether the foreign custodian provides a level of safeguards for maintaining the fund's assets not materially different from that provided by the fund's United States custodian in maintaining its United States assets, whether the foreign custodian has offices in the United States for purposes of asserting jurisdiction over and enforcement of judgments upon the foreign custodian and, in the case of a foreign securities depository, the number of participants in and operating history of the depository.

The Fund, through its Investment Manager and Business Manager, represents that it will provide its Board of Directors with detailed information for the Board to make these determinations and to meet the monitoring requirements of the Rule. Of course, the Fund will not invest in Russian Equities unless the Board of Directors is able to make these determinations.

Chase Moscow has advised the Fund that it will prepare for distribution to the Fund's Board of Directors a quarterly report identifying any concerns it has regarding the Russian share registration system that should be brought to the attention of the Directors. Chase and Chase Moscow have authorized us to represent on their behalf that this report will include detailed information regarding the steps Chase Moscow has taken during the reporting period to ensure that the Fund's interests continue to be appropriately recorded. In addition, Chase Moscow has indicated that it will maintain a cumulative list of any of the registrar events indicated in paragraphs 1 through 5 on pages 13 through 14, and will include this cumulative list in each report it provides to the Fund's Board. As indicated above, the Investment Manager will maintain an affiliated office in Moscow, and the Investment Manager has represented that it will, if necessary, prepare an independent report to the Board of Directors if the Investment Manager believes that Chase Moscow is not performing its duties adequately.

Consistent with its obligation under Rule 17f-5, the Fund's Board of Directors will actively oversee the Fund's Russian custodial arrangements. Among other things, the Board will consider at its quarterly meetings (and at other times as may be necessary) the quarterly report to be prepared by Chase Moscow (and any information provided by the Investment Manager) and will determine at each meeting that investment in Russian Equities through the use of the monitoring system described herein continues to be appropriate. In the event the Board determines that, over the long-term, investment in Russian Equities is no longer consistent with the best interests of the Fund's shareholders, the Fund undertakes promptly to call a shareholder meeting for the purpose of considering whether to change the Fund's name and investment policies, or to liquidate the Fund and

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distribute the proceeds, net of any liabilities, to the Fund's shareholders. The Fund, of course, will provide sufficient disclosure to investors in its Prospectus of this potential course of action.

Disclosure to Investors

The Fund's Prospectus, as currently reflected in Pre-Effective Amendment No. 1 to the Fund's Registration Statement, filed on October 20, 1994, includes disclosure regarding the risks of the Russian share registration system, including disclosure on the cover page of the Prospectus. The Fund undertakes to provide prominent, clear and sufficiently detailed disclosure regarding the share registration system and its risks to investors. Further, the Fund's Investment Manager and the Underwriters recognize that Russia's unique share registration system could entail risks that may not be appropriate for all investors. The Fund undertakes, therefore, to include the following prominent (bolded) disclosure on the cover page of its Prospectus:

Russia's system of share registration creates certain risks of loss that are not normally associated with investments in other securities markets. These risks are discussed more fully on pages __ and __ of this Prospectus, and investors should read these sections in detail.

The Fund represents that all advertisements and sales literature will prominently disclose this information, except for "tombstone" advertisements that do not include a general description of the Fund under Rule 134(a)(3)(iii). In addition, the Fund represents that it will include in its shareholder reports disclosure regarding the risks of the Russian share registration system.

Investment Restrictions That May Limit the Extent of Loss

The Fund is classified as a "non-diversified" company for purposes of Section 5(b) of the 1940 Act. This means that the Fund is not limited by the 1940 Act in the extent to which the Fund's assets can be invested in any one issuer. However, the Fund intends to qualify as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986 (the "Code"). In order to so qualify, the Fund must, among other things, diversify its holdings so that, at the end of each quarter of the Fund's taxable year, at least 50% of the value of its total assets is represented by cash, cash items, United States Government securities, securities of other regulated investment companies, and other securities, with such other securities limited in respect of any one issuer to an amount not greater in value than 5% of the Fund's total assets and to not more than 10% of the outstanding voting securities of the issuer. While there is, of course, no guarantee that the Fund will so qualify under Subchapter M, the Fund will not obtain "pass-through" tax treatment without Subchapter M qualification. Further, the Fund's Board of Directors has

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adopted a non-fundamental policy under which the Fund will not invest more than 10% of its assets in the securities of any one issuer.

Therefore, even though the Fund is non-diversified under the 1940 Act, both the Code and the Fund's non-fundamental policy impose on the Fund certain diversification requirements. Although they will not prevent the Fund from incurring a loss, these diversification requirements should serve to limit the extent of any loss that could occur.

DISCUSSION AND ANALYSIS

Section 17(f) sets forth the requirements regarding the custody of a registered investment company's assets. As originally enacted in 1940, Section 17(f) permitted three types of custodians: banks, and subject to the Commission's rules, members of national securities exchanges and investment companies themselves. Congress modified Section 17(f) to expand the universe of custodians by permitting securities owned by investment companies to be kept in a central clearing system subject to the Commission's rules. In 1978, the Commission adopted Rule 17f-4 under the 1940 Act permitting clearing agencies registered with the Commission under the Securities Exchange Act of 1934 (the "1934 Act") to serve as investment company custodians under certain conditions.

Prior to adopting Rule 17f-5, funds were restricted in their use of foreign custodians. A bank is defined in Section 2(a)(5) of the 1940 Act to include only a United States bank and Rule 17f-4 requires an eligible securities depository custodian to register under Section 17A of the 1934 Act. Thus, in the absence of individual exemptive relief, a fund either had to maintain its assets in the overseas branch of a United States bank, or if none existed in that country, transfer assets out of the country to a proximate overseas branch of a United States bank. Recognizing the limitations of this system, in 1984 the Commission adopted Rule 17f-5, which permits a registered investment company to maintain its securities outside of the United States under certain conditions. Since its adoption, Rule 17f-5 has continued to be refined interpretively both by the Commission and the staff.

Rule 17f-5 provides that a registered investment company may maintain its non-United States assets with one of four categories of "eligible foreign custodians." These include certain foreign banks, certain majority-owned subsidiaries of United States banks, and certain foreign securities depositories or clearing agencies. The Rule, however, is premised on the existence of share certificates, even if the certificates only are stored in a central depository and book-entry trading is then conducted. Because Russian Equities are issued and traded in book-entry form on a completely dematerialized basis, the Russian system, and the registrars in particular, fit only awkwardly, if at all, into the Rule 17f-5 framework.

The staff previously has concluded that, in the context of a completely dematerialized book-entry system, an entity that performs only transfer agency functions, such as a Russian registrar, and does not serve a custodial function should neither be entitled to rely on nor be governed by Rule 17f-5.²¹ We believe that this provides an appropriate basis for the staff to grant the requested relief. Under this theory, because the registrars are limited participants in the custodial process, the staff need not consider their status under Section 17(f) and Rule 17f-5. Instead, the custodian should be viewed as the entity in whose name shares are held in the register, i.e., Chase Moscow (through its nominees) or, occasionally, the Fund. Granting relief pursuant to this theory is consistent with the staff's favorable no-action position in ASX Settlement. We note that in ASX Settlement there was a single registrar that was a subsidiary of the Australian Stock Exchange, and therefore subject to government supervision, but we believe that the proposed verification procedures that Chase Moscow will seek to employ and the oversight of the Fund's Board provide an appropriate substitute in Russia's multiple registrar system.

In the alternative, it is our opinion that the staff need not be limited solely to the confines and framework of Rule 17f-5 with respect to Russia's unique share registration system, and therefore need not consider the registrars' status under Rule 17f-5, if the policies and purposes underlying Section 17(f) are met. Instead, we believe it is possible to view the registrars as limited participants in the custodial process. Although Chase would not view the registrars as sub-custodians of Chase Moscow, and as described above would not be liable for acts or omissions of a registrar, nevertheless for the purposes of Section 17(f) it is reasonable to view the Fund's portfolio securities as within a "chain" of custody extending through the registrars. As discussed below, it is our view that the proposed protective measures that will be employed within this chain of custody adequately address the Section 17(f) concerns and therefore that the staff can grant the requested relief on this basis without separately considering the Rule 17f-5 status of the Russian registrars.

Congress intended Section 17(f) to address two concerns. First, Section 17(f) is designed to prevent fund insiders and affiliates from misappropriating or misusing fund assets.²² Second, the statutory language itself indicates that Section 17(f) is intended to

²¹ See ASX Settlement and Transfer Corporation Pty Ltd (pub. avail. Apr. 19, 1994); Reserve Bank of New Zealand (pub. avail. May 24, 1993).

²² The legislative history of the 1940 Act makes a number of references to the theft and misappropriation of investment company assets by those with access to them. See, e.g., Hearings on S. 3580 Before the Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. 264 (1940). See also 7 Securities and Exchange Commission Annual Report 15 (1940); 10 Securities and Exchange (continued...)

ensure that custodial arrangements available to a registered investment company provide a certain minimum level of systemic integrity. As discussed below, we believe that each of these concerns is adequately addressed.

A. Because of the protective measures described herein, the Investment Manager and other Fund affiliates will not be able to misappropriate or misuse the Fund's assets.

The legislative history of Section 17(f) indicates that Congress was concerned about the ability of persons affiliated with a fund to misappropriate or otherwise misuse the fund's assets. One means of ensuring that this concern is met is to establish various measures that protect a fund's assets. If a fund's investment adviser and other affiliates are unable to permeate these protections, this should serve to ensure the separation of the fund's assets from fund affiliates. The Commission itself has employed this approach in adopting rules under Section 17(f), such as Rule 17f-4, which permits a fund custodian to use certain securities depositories and clearing agencies.

It is our view that similar protections will exist between Chase Moscow, which itself will be an eligible foreign custodian for purposes of Section 17(f) and Rule 17f-5, and each registrar. Since shares generally will be held in the name of Chase Moscow (through its nominee), only a Chase Moscow representative or agent will have the authority to instruct the registrar to transfer the Fund's portfolio holdings. By establishing these safeguards, personnel of the Fund, the Investment Manager and other Fund affiliates effectively will not have access to or otherwise be able unilaterally to alter in any manner the Fund's portfolio holdings as reflected in the share registers.

Further, even though certain Russian issuers and/or registrars occasionally may require that shares be recorded on a register in the name of the Fund as beneficial owner, this will not undermine the applicable safeguards. The Russian share registration regulations incorporate the concept of an "authorized representative" acting on behalf of a beneficial owner. Section 1.2 of the regulations defines an authorized representative as a "person with respect to which there is a written instruction on the part of a registered person or registered lienholder that the said person should act on behalf of and in the interests of that other person." Section 2.6 of the regulations requires the registrar to open a personal account in the name of each record owner of shares of the issuer (or beneficial owner if there is no separate record owner), and to include in each personal account, among other things, the name and other relevant information relating to any authorized representative. Further,

²²(...continued)

Commission Annual Report 169 (1944) (purpose of Section 17(f) is to protect investment companies against theft and embezzlement by affiliated persons).

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Section 4.6.2 of the regulations requires that a transfer instruction relating to a transaction in Russian Equities be signed by "a registered person effecting the transfer of shares or by his authorized representative and may also be signed by a person to whom the shares are transferred or by his authorized representative." This Section further provides that a "transfer instruction may be submitted to the [registrar] by a person in whose name the shares are registered or by his authorized representative."

The Fund represents that, when interests are recorded directly in the Fund's name, the Fund will appoint Chase Moscow as its "authorized representative" pursuant to the above regulations. The Fund further represents that, at the time shares are re-registered in the Fund's name, the Fund, in addition to instructing the registrar as to Chase Moscow's appointment as an authorized representative, will instruct the registrar that Chase Moscow and its representatives will be the only persons authorized to act with respect to the Fund's portfolio holdings. No representatives of the Fund, the Investment Manager or any other affiliate of the Fund, therefore, will be authorized to instruct a registrar to take any actions in connection with interests recorded directly in the Fund's name.

Further, the Fund represents that positions held directly in its name will be treated in the exact manner as positions held in the name of Chase Moscow's nominee. These positions will be subject to the contracts between Chase Moscow and the registrars. The Fund will inform each registrar for which shares are registered directly in the name of the Fund that Chase Moscow shall be permitted access to the share register and shall receive appropriate assurances from the registrar for purposes of verifying the Fund's holdings as would be afforded to the Fund as record owner.

In this manner, although interests may be registered directly in the name of the Fund, the Fund's actions will have the effect of taking the Fund out of the chain of custody so that as a practical matter there will be no difference between interests recorded directly in the name of the Fund and those recorded in the name of Chase Moscow's nominee. There will be no breach, therefore, of the safeguards for portfolio holdings recorded in the Fund's name and these should be treated for purposes of the 1940 Act's custody requirements in the same manner as portfolio holdings recorded in the name of a Chase Moscow nominee.

- B. The presence of Chase Moscow, which will be an eligible custodian, the monitoring functions that Chase Moscow intends to perform, and the oversight of the Fund's Board will provide a level of systemic integrity that is consistent with Section 17(f).

The statutory provisions of Section 17(f) also indicate that Congress was concerned about the systemic integrity of the custody arrangements used by a registered investment company. Thus, for example, Congress required that investment company assets

only be maintained by United States banks that meet certain size requirements and are subject to government supervision. This concern is embodied in Rule 17f-5, which requires that foreign custodial arrangements generally meet certain minimum conditions before they are available for use by a registered investment company. While the Russian registrars alone may not currently satisfy these systemic integrity concerns, we believe that the presence of Chase Moscow, which will be an eligible custodian,²³ in the custodial arrangements, the monitoring functions that Chase Moscow will perform, and the oversight of the Fund's Board instill in the collective custody provisions a level of systemic integrity that is consistent with Section 17(f) and Rule 17f-5.

As indicated above, Russian Equities in which the Fund invests generally will be recorded on a share register in the name of Chase Moscow (through a Chase Moscow nominee). Since the Fund's interests will be registered in the name of a Chase Moscow nominee, no personnel from the Fund, the Fund's Investment Manager, or any other affiliate should be in a position to effect unauthorized transactions or otherwise to affect adversely the Fund's holdings in the normal course of their business.²⁴

Further, the Fund will not invest in the securities of an issuer unless that issuer's registrar has entered into a contract with Chase Moscow authorizing Chase Moscow to conduct the share confirmation and related functions discussed above, which are designed to help assure that the Fund's interests continue to be appropriately recorded. The regular share confirmations that will be conducted by the Chase Moscow representatives or agents are intended to provide appropriate protection against the possibility that a Fund's interest in a Russian company will disappear from a share register or otherwise be altered. While the confirmation in and of itself will not prevent this from occurring, the fact that the Fund will promptly be aware of any inappropriate changes to the Fund's interests should improve the Fund's chances of having its interests fully and properly restored or otherwise being made whole. Further, these regular confirmations may serve to deter fraudulent or reckless

²³ Although Chase Moscow will not be an "eligible foreign custodian" as this term is defined in Rule 17f-5, upon the issuance of an exemptive order, Chase Moscow will have been determined by the Commission to be an eligible custodian for purposes of Section 17(f).

²⁴ While a representative of the Fund, the Investment Manager or another affiliate could fraudulently attempt to have the Fund's holdings re-registered in another name, such as by impersonating a representative of Chase Moscow, this risk exists in any custodial arrangement, including those in the United States, and therefore should not be a factor in the consideration of the Russian share registration system. Moreover, as discussed in note 4, Russia's transaction tax should significantly deter this type of fraud.

behavior by a person associated with a registrar, since the associated person is likely to be aware that the fraudulent or reckless conduct may well be discovered promptly during the next regular confirmation.

Although the exact legal status of a share extract is unclear, we also believe it significant that Chase Moscow, which will be an eligible custodian, will maintain custody of an instrument (i.e., the share extract) that arguably can be viewed as a partial surrogate for a physical certificate. While not itself negotiable, the extract may serve as evidence that the holder has Russian Equities registered in its name on that date. Although the evidentiary value of the extract is unclear, in the event that any dispute arose concerning the Fund's ownership of particular Russian Equities, Chase Moscow's possession of the extract may be useful in establishing proper ownership.

Moreover, in adopting Rule 17f-5, the Commission has acknowledged that investment company boards can judge and monitor, and therefore, must play a role in ensuring the systemic integrity of, foreign custody arrangements. The Commission has recognized that, without the flexibility to maintain a fund's foreign assets outside of foreign branches of United States banks, Section 17(f) might make it difficult or even impossible for funds to make certain investments that they find desirable.²⁵ Further, the Commission has recognized that investment company "directors should be in a position to evaluate objectively whether foreign custodial arrangements are consistent with the best interests of the company" and that fund directors and management "can, consistent with their fiduciary duties, make foreign custody arrangements and monitor them as developments occur in a manner which protects shareholders."²⁶ Without this flexibility, registered investment companies and the Fund in particular will find their investment opportunities curtailed. We believe that, given the protective measures proposed, permitting the Fund's Directors to judge and monitor the use of the Russian registrars, and to play a role in ensuring the systemic integrity of the share registration system, is consistent with Section 17(f) and Rule 17f-5.

Finally, we recognize that even if the contemplated safeguards are fully implemented there can be no assurance that a loss through the share registration system cannot occur. However, Congress did not intend that Section 17(f) and the Rules thereunder provide a level of systemic integrity that affords absolute protection from loss. The Commission's recognition of this principle is embodied in note 3 to Rule 17f-5, which states that a fund's exposure to loss and the potential effect upon shareholders should be disclosed, if material, in the fund's prospectus. The systemic integrity concerns of Section

²⁵ See Investment Company Act Rel. No. 12354 (Apr. 5, 1982).

²⁶ Id.

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17(f) and its accompanying Rules only require that reasonable safeguards be put in place to prevent custodial loss. We believe that the procedures and safeguards we have proposed provide a level of systemic assurance that is consistent with the requirements of Section 17(f).

CONCLUSION

Although Section 17(f) and the rules thereunder were not intended to prohibit investment company purchases of particular securities or to prohibit the purchase of all securities publicly traded in a particular country, subjecting Russian registrars to a strict interpretation of Rule 17f-5 could effectively prevent the Fund and other registered investment companies from investing in Russian Equities. Unlike the situation in which an investment company has the ability to opt out of a depository or book-entry system and have its custodian or the fund itself take possession of the securities, the use of book-entry share registration systems maintained by the Russian registrars is the only means of ownership available to investors seeking to purchase Russian Equities.

We believe that the staff could conclude, consistent with its favorable no-action position in ASX Settlement, that granting the requested relief is appropriate because the Russian registrars perform no custodial function and therefore their status under Section 17(f) and Rule 17f-5 need not be considered. Instead, the custodian would be viewed as the entity in whose name shares are held in the register, i.e., Chase Moscow (through its nominees) or, occasionally, the Fund.

In the alternative, it is our opinion that the staff need not be limited solely to the confines and framework of Rule 17f-5 with respect to Russia's unique share registration system if the policies and purposes underlying Section 17(f) are met. Instead, we believe the staff can consider the proposed arrangements between Chase Moscow, which will be an eligible custodian, and each registrar as a sufficient safeguard. As discussed above, it is our view that the proposed protective measures that will be employed adequately address the Section 17(f) concerns and therefore that the staff can grant the requested relief on this basis without separately considering the Rule 17f-5 status of the Russian registrars.

We note that Russia's share registration system and the protective measures we have proposed are in many respects unique. In that regard, we believe that any favorable no-action relief the staff may grant will have limited utility outside of the Russian system.

While we do not believe that the staff need consider the status of the registrars under Rule 17f-5, we believe the remaining provisions of the Rule, in conjunction with the protective measures discussed above, provide an appropriate framework to address the custody of Russian Equities. The custody of Fund assets will be subject to close monitoring

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by the Fund's agents and review by the Fund's Board of Directors. The Fund's independent public accountants will be provided with confirmation of the contents of or direct access to each registrar's records upon request. Moreover, in connection with the Commission's examination and surveillance program, the Fund undertakes to furnish to the staff upon request share register extracts evidencing the Fund's ownership of these equity securities, and any other documents or information the staff reasonably may request. In addition to providing copies of the share extracts, the Fund, the Investment Manager and Chase Moscow undertake to facilitate on-site examinations in Russia by the Division staff of the books and records of the Investment Manager and Chase Moscow, including making available to the staff both in the United States and at the relevant offices overseas an authorized representative of the Fund, the Investment Manager and/or Chase Moscow competent to explain any books and records furnished to the staff.

In addition, the Fund's Prospectus will include prominent and detailed disclosure regarding the risks of the Russian share register system. Risk disclosure also will be provided in the Fund's shareholder reports. In this manner, investors will be able to determine for themselves whether investment in the Fund is appropriate notwithstanding these risks.

Finally, given the important role that Chase Moscow, the eligible custodian, will serve in the Russian share registration system, the Fund represents that it will not rely on any relief the staff grants pursuant to this request until the Commission issues an exemptive order qualifying Chase Moscow as an eligible custodian.

Therefore, for the reasons discussed above, we respectfully request that the Division staff assure us it would not recommend enforcement action to the Commission under Section 17(f) or Rule 17f-5 if the Fund invests in Russian Equities pursuant to the custodial arrangements discussed above.

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In accordance with Securities Act Rel. No. 6269 (Dec. 5, 1980), I have enclosed seven additional copies of this no-action request. Please do not hesitate to contact Allan S. Mostoff at (202) 626-3310, William Goodwin at (212) 326-3550, or me at (212) 326-3575 if you have any questions or concerns regarding this request.

Sincerely yours,

A handwritten signature in cursive script that reads "Lawrence B. Stoller".

Lawrence B. Stoller

cc: Thomas M. Mistele, Senior Vice President
Templeton Global Investors, Inc.

John A. MacKinnon, Esq.
Brown & Wood

Richard Samuel
The Chase Manhattan Bank, N.A.