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SECTION 17(e)
RULE 17e-1
PUBLIC
AVAILABILITY 12/18/98

December 18, 1998
Our Ref. No. 98-17
Drinker Biddle & Reath LLP
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter dated December 17, 1998, requests our assurance that we would not recommend enforcement action to the Securities and Exchange Commission ("Commission") under Section 17(e) of the Investment Company Act of 1940 ("Act") if certain open-end management investment companies ("Funds") utilize a broker, who is an "affiliated person" under Section 2(a)(3) of the Act, of the Funds' investment adviser, and thereby is an "affiliated person of an affiliated person" of each Fund ("Affiliated Broker"), to effect foreign currency transactions in the Interbank market in the manner described in your letter.

FACTS

You represent that the Interbank foreign currency market is a highly liquid, global currency market that offers execution in over 50 currencies and operates on a 24-hour basis, five days a week. You state that some of the market's key participants are investment banks, commercial banks, central banks, corporations, and currency brokers and dealers. Unlike commodities exchanges, which trade foreign currency futures contracts and related futures options, Interbank market participants buy and sell currencies in forward and spot transactions, and can also trade currency options.¹ You state that, while the currency products that are traded in both markets are substantially similar, the Interbank market offers a number of advantages over foreign currency transactions that are executed on the commodities exchanges.²

In general, participants in the Interbank market that execute transactions for customers take a position in the market and earn a spread between the bid and asked currency prices. In contrast, you state that the Affiliated Broker would not charge a spread, but would instead charge its customers a separate, disclosed commission for each transaction.³ You state that these

¹ A forward currency transaction involves a contract to purchase or sell a specific currency at a future date and price agreed upon by the parties at the time that the contract is entered into. A spot currency transaction provides for the immediate or near-term settlement of the currency being bought or sold. A currency option involves the purchase or sale of the right, but not the obligation, to buy or sell a specified amount of a particular currency at a specified price within a certain time period.

² For example, you cite the ability of Interbank market participants to trade a greater number of different foreign currencies, to negotiate varying terms to meet the specific needs of the counterparties, and to execute trades on a 24-hour basis. You also state that the Interbank market is more liquid than the market for exchange-traded foreign currency futures and options.

³ The Affiliated Broker would charge commissions on either a "half-turn" or "round-turn" basis. Commissions paid on a half-turn basis involve a separate commission each time a transaction is either opened or closed, as opposed to round-turn commissions, which involve a

commissions are similar to the commissions charged by futures commission merchants ("FCMs") for exchange-traded currency futures contracts and options. You also state that for exchange-traded currencies, the Affiliated Broker would base its commissions on the same standard lot sizes that are used by FCMs. For currencies that are not exchange-traded, the Affiliated Broker would base its commissions on lot sizes specified in its customer fee schedule.

You believe that the Affiliated Broker may be able to provide the Funds with services that are superior to services provided by other Interbank market participants. According to your letter, under normal circumstances, market-making counterparties in the Interbank market generally charge a bid/asked spread of between 0.05% and 0.10% of the notional amount of the transaction for transactions in major currencies. This spread may be wider for less liquid currencies or during times when there is little trading activity. You state that because of the size of the Interbank market and the large number of participants, the prices that certain participants in the Interbank market are willing to pay may not be readily apparent to all participants. You also state that the Funds believe that the Affiliated Broker, in some cases, would be able to provide the Funds with increased market coverage and, consequently, better prices on an after-execution basis with respect to some foreign currency transactions.

Under the proposed arrangement, the Funds will have the option, but will not be required, to use the Affiliated Broker to effect Interbank foreign currency transactions. The Affiliated Broker will charge the Funds a per lot, dollar-based commission for each currency contract for Interbank transactions and will receive no other compensation in connection with those transactions. The Funds may use the Affiliated Broker only if the Funds' Boards of Trustees ("Trustees"), including a majority of the trustees who are not "interested persons," have approved certain procedures ("Section 17(e) Procedures") that are designed to protect the interests of the Funds and their shareholders. You state that the Section 17(e) Procedures will satisfy the requirements of Rule 17e-1 under the Act, and will provide safeguards in addition to those provided by that rule.⁴

single commission which is payable when the transaction is initially entered into and that covers both the opening and closing of the transaction.

⁴ You state that certain of the Section 17(e) Procedures are designed to ensure that the Funds' investment advisers ("Investment Advisers") meet their obligations to seek best execution for transactions effected on behalf of the Funds. You further state that among these, the Funds' Investment Advisers will be prohibited from using the Affiliated Broker in instances where doing so would be inconsistent with the Investment Advisers' obligations to seek best execution, e.g., where the Funds could deal directly with an Interbank participant on better terms than they could obtain by executing the transaction through the Affiliated Broker. You also represent that the Section 17(e) Procedures will allow the Funds to consider using the Affiliated Broker only when the price obtained for a foreign currency transaction, plus the Affiliated Broker's commission, is at least as favorable as the price contemporaneously quoted by an independent source previously selected by the Trustees. The Section 17(e) Procedures also will require that the Trustees review, at least annually, the Affiliated Broker's quality of execution for the Funds and overall responsiveness and performance. We take no position on whether these procedures satisfy the Investment Advisers' best execution obligations.

ANALYSIS

Section 17(e)(1) of the Act generally prohibits any affiliated person of a registered investment company, or any affiliated person of such person, acting as agent, from accepting compensation for the purchase or sale of any property to or for such registered company, except in the course of such person's business as an underwriter or broker. Section 17(e)(2) limits the amount of remuneration which may be received by a person acting in reliance on the broker exception in Section 17(e)(1).⁵ Section 17(e) was designed to eliminate the potential for self-dealing that exists when persons affiliated with an investment company, acting as agents, receive compensation for purchases of property from and sales of property to the investment company.⁶ Instead of prohibiting such transactions for persons acting as brokers, Congress chose to deter abuses by limiting the amount of compensation as well as the circumstances under which brokers may receive compensation in connection with securities transactions effected on behalf of affiliated investment companies

You believe that, but for the Act's definition of "broker," the Affiliated Broker could avail itself of the broker exception contained in Section 17(e)(1). Because the definition of broker under Section 2(a)(6) of the Act is restricted to persons who effect transactions in "securities," and because Interbank transactions may not involve transactions in securities,⁷ Section 17(e) may not permit the Affiliated Broker to engage in Interbank transactions on behalf of the Funds. You attribute the limited scope of the broker exception to the fact that investment companies did not invest in currencies in 1940 when the Act was enacted. You believe that since then, global economies have become increasingly integrated, and foreign investments, and the use of foreign currency transactions to manage those investments, have become increasingly important. You believe that, in light of the importance of these transactions and the advantages that Interbank transactions have over exchange-traded foreign currency products, the Funds' use of the Affiliated Broker will further the interests of the Funds and their shareholders. Moreover, you believe that, in effecting Interbank foreign currency transactions pursuant to the Section 17(e) Procedures, the

⁵ Section 17(e)(2) limits the remuneration that any affiliated broker of a registered investment company may receive in connection with a securities transaction to (A) the usual and customary broker's commission for transactions effected on an exchange, (B) two percent of the sales price for secondary distributions, and (C) one percent for other purchases or sales. Rule 17e-1 defines when commissions or fees paid to securities brokers will be deemed not to exceed the usual and customary brokerage commission for purposes of Section 17(e)(2)(A).

⁶ See Hearings Before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 76th Cong., 3d Sess. 262 (1940); Hearings Before a House Subcommittee of the Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 98 (1940); U.S. v. Deutsch, 451 F.2d 98, 108 (1971), cert. denied, 404 U.S. 1019 (1972).

⁷ Section 2(a)(36) of the Act, which defines "security," does not include the terms "currency" or "currency contract." You state that the staff has issued letters which appear contradictory regarding whether currency and currency transactions fall within the Act's definition of security. For purposes of this letter, we assume, without deciding, that forward and spot currency contracts and currency options are not securities within the Act's definition.

Affiliated Broker will be acting in a manner that is not inconsistent with the intent of Section 17(e).⁸

You state that the Section 17(e) Procedures will satisfy the requirements of Rule 17e-1 under the Act, and thereby will extend to the Funds' Interbank foreign currency transactions the same protections, at a minimum, that apply to the Funds' securities transactions.⁹ Rule 17e-1 defines when commissions or fees paid to securities brokers will be deemed not to exceed the usual and customary brokerage commission as set forth in Section 17(e)(2)(A). Under the Section 17(e) Procedures, the Trustees will be responsible for ensuring that the Affiliated Broker's commissions are reasonable and fair as compared to the commissions received by other brokers in connection with comparable transactions involving similar currencies being purchased or sold during a comparable period of time.¹⁰ You also state that the Section 17(e) Procedures will include additional safeguards not contained within the provisions of Section 17(e) and Rule 17e-1. Among these, the Section 17(e) Procedures will cap the Affiliated Broker's total commission at 0.03% of the notional amount of each Interbank transaction.

We agree that it would not be inconsistent with the intent of Section 17(e) to permit the Affiliated Broker to receive commissions for effecting transactions in the Interbank foreign currency market for the Funds. We therefore would not recommend enforcement action to the Commission under Section 17(e) if the Funds utilize the Affiliated Broker in effecting such transactions. In taking this position, we rely particularly on your representations that (1) all transactions will be conducted in accordance with the Funds' Section 17(e) Procedures, which will satisfy the requirements of Rule 17e-1, and (2) the Affiliated Broker's commission will not exceed 0.03% of the notional amount of the particular currency transaction involved.

⁸ In support of your argument, you cite instances in which the Division staff has agreed not to recommend enforcement action to the Commission under Section 17(e) if FCMs received compensation from affiliated investment companies for effecting futures transactions on commodities exchanges. You believe that, because Interbank foreign currency transactions are substantially similar to futures contracts and options traded on the commodity exchanges, similar relief is appropriate. See, e.g., Kidder, Peabody Government Income Fund, Inc. (pub. avail. Sept. 15, 1986) (stating that the staff would not recommend enforcement action under Section 17(e) or Rule 17e-1 if an FCM receives commissions for executing futures contracts on a commodities exchange on behalf of an affiliated investment company, provided that the arrangement complies with Section 17(e) and Rule 17e-1); Shearson Lehman Brothers, Inc. (pub. avail. Feb. 18, 1986) (same, except that Shearson agreed to comply with the limitations of Section 17(e)(2)(C) by capping brokerage commissions for financial futures and options transactions executed on a commodities exchange at 1% of the purchase price of the futures contract).

⁹ We take no position on whether the specific procedures described in your letter satisfy the requirements of Rule 17e-1.

¹⁰ In making this determination, you state that the Investment Advisers will compare the Affiliated Broker's commissions to those of (1) other currency brokers that charge commissions for transactions on the Interbank market, and (2) FCMs who execute foreign currency futures contracts and options trades on commodities exchanges.

Our position is based on the facts and circumstances set forth in your letter. Any different facts or circumstances may require different conclusions.

A handwritten signature in black ink, appearing to read 'E. Geldzahler', written in a cursive style.

Evan Geldzahler
Senior Counsel

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Investment Company Act of 1940:
Section 17(e)

Douglas J. Scheidt, Esq.
Associate Director and Chief Counsel
Division of Investment Management
Securities and Exchange Commission
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450 Fifth Street, N.W.
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Re: Interbank Transactions Under Investment Company Act Section 17(e)

Dear Mr. Scheidt:

We act as counsel to a number of open-end management investment companies ("Funds") registered under the Investment Company Act of 1940, as amended (the "Act"), that engage in foreign currency transactions in the Interbank market ("Interbank transactions"). We are writing to request the advice of the staff that it would not recommend that the Commission take action under Section 17(e) of the Act if a broker that is an "affiliated person," as defined in Section 2(a)(3) of the Act, of a Fund's investment adviser, and thereby is an "affiliated person of an affiliated person" of the Fund ("Affiliated Broker"), acts as a broker in connection with the Fund's Interbank transactions in the manner described in this letter.

1. Background.

The Interbank market is generally viewed as the most liquid market in the world for foreign currency trading. The market operates globally on a 24-hour basis, five days a week, with an estimated volume exceeding \$1.2 trillion daily. Key participants in the market include investment banks, commercial banks, central banks, corporations, currency brokers and dealers and speculators. Although there are thousands of market participants, commercial banks act as the core of the Interbank market and provide essential liquidity to the market.

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Participants in the Interbank market can buy and sell currencies in forward and spot transactions, and can also trade in currency options. A forward currency transaction involves a contract to purchase or sell a specific currency at a future date and price agreed upon by the parties at the time the contract is entered into. A contract counterparty may either accept or make delivery of the currency specified in the contract at the maturity of a forward contract or, prior to maturity, enter into a closing transaction involving the purchase or sale of an offsetting amount of currency. A spot currency transaction involves an obligation providing for immediate or near-term settlement of the currency being bought or sold. A currency option involves the purchase or sale (for a premium) of the right (but not the obligation) to buy or sell a specified amount of currency at a specified price within a specified time period.

Foreign currency contracts and options traded in the Interbank market have been viewed as being substantially similar to foreign currency futures contracts and related futures options that are traded on commodity exchanges. See, e.g., Philadelphia Stock Exchange, Inc. 1994 SEC No-Act. LEXIS 888 (October 18, 1994) (currency options listed on securities exchanges, options on foreign currency futures contracts, over-the-counter foreign currency options traded in the Interbank market and currency options traded on foreign exchanges said to be "functionally and economically equivalent"); Philadelphia Stock Exchange, Inc. 1991 SEC No-Act. LEXIS 880 (July 9, 1991) (analogous treatment given to foreign currency futures contracts and forward contracts to purchase or sell currencies justified for purposes of broker/dealer net capital rule because of the similarity of the two products and the high degree of correlation between a futures contract's settlement price and the corresponding forward contract's rate). Currency transactions in the Interbank market, however, can offer a number of advantages in comparison to exchange-traded futures contracts and options in that Interbank transactions can relate to a greater number of different foreign currencies, can include terms that are negotiated to meet the needs of the particular counterparties, can be executed during banking hours in many different time zones and can offer significantly greater liquidity.

We have been asked whether a Fund's use of an Affiliated Broker for such transactions might be permissible under Section 17(e) of the Act under the following facts. Unlike many participants in the Interbank market, an Affiliated Broker's execution desk would not take a position in the market for its own account, and the Affiliated Broker would not earn a spread between bid and asked currency prices in transactions executed for a Fund. Rather, the Affiliated Broker would charge a Fund a separate, disclosed commission for its services on each transaction, which would be charged on either a "half-turn" basis (involving a separate commission each time a transaction is either opened or closed) or a "round-turn" basis (involving

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a single commission when a transaction is initially entered into that covers both the opening and closing of the customer's currency transaction). These commissions would be similar to the commissions charged by futures commission merchants on exchange-traded currency futures contracts and options, and the Affiliated Broker would base its commissions for currency contracts on the same standard lot sizes that are used by futures commission merchants (or substantial equivalents in the case of currencies that are not traded on commodities exchanges). For example, in spot and forward transactions in the Australian dollar, a currency that is also traded in the futures market, the Affiliated Broker would charge a flat, dollar-based commission based on the same standard lot size used by futures commission merchants. Similarly, in transactions in the Belgian franc, a currency that is not traded in the futures market, the Affiliated Broker would charge a flat, dollar-based commission based on a standard lot size set forth in the Affiliated Broker's customer fee schedule.

As discussed further below, the staff has previously stated that it would not recommend that the Commission take action under Section 17(e) of the Act in situations involving the payment of commissions to futures commission merchants by affiliated investment companies in connection with transactions in exchange-traded futures contracts and options, subject to certain conditions. We are unaware that the staff has previously addressed the payment of commissions by an investment company to an affiliated foreign currency broker in connection with transactions in the Interbank market. We believe, however, that the same considerations apply under Section 17(e) with respect to both Interbank transactions and transactions in foreign currency futures contracts and options in light of their substantial similarities. We also believe that a Fund's proposed use of an Affiliated Broker as described in this letter will further the interests of the Fund and its shareholders, and will be fully consistent with the policies of Section 17(e) of the Act and Rule 17e-1 thereunder, as well as the positions previously taken by the staff.

In particular, it should be noted that, as described further below, an Affiliated Broker's commissions from a Fund (a) will not exceed "the usual and customary broker's commission" as provided in Section 17(e)(2)(A) of the Act and Rule 17e-1 thereunder, (b) will otherwise comply with the provisions of Rule 17e-1, and (c) will not exceed 0.03% of the notional amount of any currency transaction. In addition, a Fund would use an Affiliated Broker for Interbank transactions only where the Affiliated Broker charges commissions to its other Interbank customers and the commissions charged to the Fund are no greater than the Affiliated Broker's normal commissions.

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We are, therefore, requesting the advice of the staff that it will not recommend that the Commission take action under Section 17(e) of the Act if an Affiliated Broker acts as a broker for a Fund in connection with Interbank transactions in the manner described in this letter.

2. Factual Situation.

Each Fund's investment adviser ("Investment Adviser") is responsible for decisions to buy and sell investments, including currencies, on behalf of the Fund, for the selection of brokers and dealers to execute the Fund's portfolio transactions, and for the negotiation of brokerage commissions, if any, in connection with such transactions. In placing orders for the purchase and sale of portfolio securities and other assets for the Funds, each Investment Adviser is responsible for seeking best execution in conformance with applicable law.

The Funds (with certain exceptions, such as Funds that are "money market funds" within the meaning of Rule 2a-7 under the Act and certain Funds that invest principally in U.S. Government or municipal securities) are permitted, under their stated investment policies, to buy and sell foreign currencies. These Funds may engage in both Interbank transactions and transactions in exchange-traded futures contracts and options. They frequently choose to engage in Interbank transactions because of the advantages described above. Market-making counterparties in the Interbank market quote and the Funds pay, under normal circumstances, a bid/asked spread of between five and ten "points" (0.05% and 0.10%) for major currencies. The bid/asked spread is generally affected by market liquidity so that the spread may widen, or the cost to a Fund may increase, for less widely traded currencies or during times when there is little trading activity in the market. In order to minimize their costs, the Funds generally attempt to execute with counterparties that quote the narrowest spread.

Because of the size of the foreign currency market and the large number of market participants, the prices that certain participants in the Interbank market are willing to pay (and the spreads they are willing to accept) may not always be known immediately by other market participants (including the Funds). Currently, Affiliated Brokers do not provide any Interbank brokerage services for the Funds we represent. Certain Funds believe, however, that in some cases an Affiliated Broker would be able to provide the Funds with increased market coverage and, consequently, better prices on an after-execution basis with respect to some of their foreign currency transactions.

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3. Proposed Use of Affiliated Brokers.

Under the proposed arrangement, the Funds will have no obligation to use an Affiliated Broker for any currency transactions. Rather, as explained further below, a Fund will use an Affiliated Broker only after it has demonstrated to the satisfaction of a Fund's Board of Trustees that its commission is reasonable and fair and only when the price obtained by an Affiliated Broker for a particular Interbank transaction, plus the Affiliated Broker's commission, is at least as favorable as the price contemporaneously quoted by another independent source previously selected by the Board. As stated above, in these transactions the Affiliated Broker's execution desk will not take a position in the market for its own account. Rather, the Affiliated Broker will be acting as broker on behalf of the Funds, and the only compensation the Affiliated Broker will receive in connection with the transactions will be paid by the Funds. This compensation will consist of a flat, dollar-based commission that is based on specified lot sizes. In no event will an Affiliated Broker earn a spread on a Fund's currency transactions. The confirmation statements provided by an Affiliated Broker to a Fund will show that the Affiliated Broker is acting as broker and will set forth the commission rate. The Funds will not be required to deposit assets or post margin with an Affiliated Broker in connection with their currency transactions.¹

More specifically, under the proposed arrangement, all Interbank transactions handled by an Affiliated Broker for a Fund will be subject to procedures (the "Section 17(e) Procedures") adopted by the Fund's Board of Trustees, including a majority of its trustees who are not "interested persons" thereof (the "Independent Trustees"). These Procedures will satisfy the requirements of Section 17(e) of the Act and Rule 17e-1 thereunder (insofar as such Procedures relate to Interbank transactions, rather than exchange-traded securities, as described herein), as well as the additional safeguards described in this letter, to ensure that the interests of the Funds and their shareholders are fully protected and that the Congressional policies expressed in Section 17(e) are satisfied. In particular, the Section 17(e) Procedures will require that (1) each Interbank transaction must be appropriate for, and consistent with the policies of, the Fund involved, and (2) the commission, fee or other remuneration received by an Affiliated Broker for its services in connection with the transactions (a) must not exceed the usual and customary

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1. The Funds will, of course, segregate assets with their custodians or sub-custodians, or will otherwise cover their currency transactions, when and as required under Section 18 of the Act.

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broker's commission,² (b) must be no greater than its normal customer commission, and (c) must not exceed 0.03% of the notional amount of the particular currency transaction involved. In each

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2. Consistent with Rule 17e-1, the commission, fee or other remuneration received by an Affiliated Broker will be deemed as not exceeding "the usual and customary broker's commission" if it is reasonable and fair as compared to the remuneration received by other, unaffiliated firms in connection with comparable transactions involving similar currencies being purchased and sold during a comparable period of time. To establish the reasonableness and fairness of an Affiliated Broker's commissions, a Fund's Investment Adviser will be directed by the Fund to use reasonable efforts to obtain information on the fees of other currency brokers that charge commissions on Interbank transactions. In addition, an Affiliated Broker's commissions may be compared to those charged by futures commission merchants on exchange-traded currency futures contracts and options.

We believe that, for purposes of this analysis, comparison of an Affiliated Broker's commissions with the commissions of futures commission merchants is appropriate for several reasons. First, futures commission merchants and an Affiliated Broker would compete in the foreign currency markets. Investors generally have the choice of entering into foreign currency contracts on either a futures exchange or in the Interbank market. In both cases these contracts permit investors to assume or shift the risk of changes in foreign currency exchange rates in accordance with their business objectives. The services provided to these investors by futures commissions merchants and an Affiliated Broker are similar – to execute currency contracts for customers at favorable rates in a highly developed and liquid market. Second, because of the similarities between Interbank and futures transactions, an important consideration to investors is the comparative costs of these transactions. Like futures commission merchants, an Affiliated Broker would charge commissions instead of spreads on currency transactions. In addition, like futures commission merchants, an Affiliated Broker would base its commissions on standard lot sizes used for foreign currency futures transactions.

For these reasons, we believe that the comparisons with the fees charged by other Interbank foreign currency brokers and futures commission merchants will be more than adequate to enable the Trustees to determine independently whether an Affiliated Broker's commissions are fair and reasonable. In addition, the reasonableness and fairness of an Affiliated Broker's commissions will be otherwise demonstrated by the

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Interbank transaction placed with an Affiliated Broker, all contract terms (including price) for the Fund and the counterparty located by an Affiliated Broker will be identical, and an Affiliated Broker's only compensation will be its stated commission from the Fund as described above.

In this manner, the Section 17(e) Procedures will be designed to effectuate the purposes of Section 17(e) and protect the Funds against any potential overreaching by (1) establishing a limit on the amount of compensation that an Affiliated Broker can receive in connection with a Fund's Interbank transactions, which is substantially lower than the limitation in Section 17(e)(2)(C), and (2) limiting an Affiliated Broker's remuneration to its normal commission, which must be reasonable and fair as compared to the remuneration charged by other firms.

In addition, a Fund's Section 17(e) Procedures will provide other protections additional to those contained in Section 17(e) and Rule 17e-1. As previously stated, each Investment Adviser is responsible for seeking best execution in connection with a Fund's investment transactions in conformance with applicable law. To provide independent assurance that best execution is being achieved, the Procedures will provide for both the testing of each transaction placed with an Affiliated Broker as well as periodic reviews by a Fund's Board of Trustees, including its Independent Trustees, of an Affiliated Broker's execution services.

In particular, the Procedures will require that a Fund may use an Affiliated Broker only when the price obtained by an Affiliated Broker for a particular Interbank transaction, plus the Affiliated Broker's commission, is at least as favorable as the price contemporaneously quoted by another independent source previously selected by the Board and its Independent Trustees. In addition, the Section 17(e) Procedures will specifically provide that the Board of Trustees of a Fund, including a majority of the Independent Trustees, will review, prior to the implementation of the arrangement described in this letter and thereafter at least annually, an Affiliated Broker's quality of execution for the Fund and overall responsiveness and performance. In connection with this review, the Board and its Independent Trustees will consider not only the reasonableness of the Affiliated Broker's commissions, but also other relevant factors such as the nature of the Interbank market, the Affiliated Broker's ability to provide efficient access to that market, the Affiliated Broker's experience and reputation, the

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requirement that the price of each transaction handled by the Affiliated Broker (including an Affiliated Broker's commission) must be independently tested as described above.

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timeliness of the Affiliated Broker's execution services, its ability to place difficult trades and its success in obtaining favorable prices. In this regard, the Procedures will specifically provide that a Fund's Investment Adviser will not use an Affiliated Broker in situations where such use could be inconsistent with the Investment Adviser's undertaking to seek best execution (such as where there is only one dealer in a particular currency with whom a Fund can deal directly on better terms than it could obtain from an Affiliated Broker after including its commission).³

The Section 17(e) Procedures will also require the Board of Trustees of a Fund, including a majority of its Independent Trustees, to determine no less frequently than quarterly that all Interbank transactions handled by an Affiliated Broker during the preceding quarter were executed in compliance with the Procedures. In this connection, the Procedures will require a Fund's Investment Adviser to record and retain the information necessary for the Board to make these determinations, and to present this information at the Board's quarterly meetings. Among other things, this information will show for each transaction executed through an Affiliated Broker: (1) the date and time a currency trade was placed with an Affiliated Broker; (2) the identity and amount of the currency involved and the settlement date; (3) the price of the traded currencies; (4) the amount of the Affiliated Broker's commission (which the Affiliated Broker will represent, in each instance, was no greater than its normal customer commission); (5) the commissions charged by other unaffiliated firms in connection with comparable transactions involving similar currencies being purchased and sold during a comparable period of time; and (6) the price obtained contemporaneously to verify the competitiveness of the price obtained by the Affiliated Broker. The Section 17(e) Procedures will provide further for the maintenance and preservation of the Procedures and of written records with respect thereto in conformance to the provisions of paragraph (c) of Rule 17e-1 under the Act and the representations in this letter.

4. Section 17(e) of the Act.

Section 17(e)(1) of the Act makes it unlawful for an affiliated person of a registered investment company, or an affiliated person of such person, acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any

3. Please note, however, that while the Section 17(e) Procedures will address an Investment Adviser's obligation to seek best execution, we are not requesting the staff's views on whether adherence to the Procedures will, in fact, satisfy that obligation.

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controlled company thereof, except in the course of such person's business as an underwriter or broker.

Section 17(e)(2) sets forth a specific statutory limitation on the remuneration a broker can receive when effecting securities transactions for a registered investment company. That sub-section provides in relevant part that it is unlawful for an affiliated person of a registered investment company, or an affiliated person of such person:

Acting as broker, in connection with the sale of securities to or by such registered company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds (A) the usual and customary broker commission if the sale is effected on a securities exchange, or (B) two per centum of the sales price if the sale is effected in connection with a secondary distribution of such securities, or (C) one per centum of the purchase or sale price of such securities if the sale is otherwise effected unless the Commission shall, by rules and regulations or order in the public interest and consistent with the protection of investors, permit a larger commission.

Section 17(e) was designed to prevent affiliates of an investment company, who act as agents, from personally profiting through commissions and other payments from sales and purchases of property by that investment company. However, Section 17(e)(1) specifically permits affiliated persons to receive commissions in a transaction that involves an affiliated investment company if they receive such commissions in the course of their business as underwriters or brokers.

An Affiliated Broker could clearly avail itself of the provisions of Section 17(e) in connection with the transactions described in this letter except for the definition of "broker" in Section 2(a)(6) of the Act, which limits the term to securities brokers. An Affiliated Broker may not be acting as a "broker" as so defined because at least certain types of currency transactions may not involve transactions in "securities" as that term is defined in Section 2(a)(36) of the

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Act.⁴ For this reason, Section 17(e)(2) may not permit the Funds' use of an Affiliated Broker in connection with Interbank transactions in compliance with the provisions of that Section. The failure to expressly include currency transactions within the types of transactions that are permitted under Section 17(e)(2), however, is undoubtedly attributable to the fact that registered investment companies generally did not invest in foreign securities and currencies in 1940 when the Act was enacted. Since then, however, the global economies have become increasingly integrated and co-dependent, registered investment companies that invest part or all of their assets in foreign securities have become common, and the use of foreign currency transactions in connection with the management of foreign investments has become ever more important. Moreover, in light of the investment purposes for which currency transactions are used, and the size and liquidity of the Interbank market, an investment company should be permitted to use an affiliated broker in Interbank transactions pursuant to the standards and procedures described in this letter that are comparable to, and exceed, those required under Section 17(e)(2) and Rule 17e-1.

In particular, we note that the Funds' proposed Section 17(e) Procedures will incorporate the protections and procedures of both Section 17(e) of the Act and Rule 17e-1 thereunder, and will thereby provide the Funds with the same safeguards for their transactions in Interbank transactions as those provided for the Funds' transactions in securities through an Affiliated Broker. Section 17(e)(2)(C) limits the remuneration an Affiliated Broker can receive to 1% of the purchase or sale price when a securities sale is not effected on a securities exchange

4. Section 2(a)(6) of the Act provides that "[b]roker means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." The definition of "security" in Section 2(a)(36) of the Act does not mention "currency" or "currency contracts." In Fidelity Management & Research Company 1988 SEC No-Act. LEXIS 809 (June 13, 1988), it was assumed, for purposes of applying Rule 17a-7 under the Act, that currency itself was not a "security" as defined in the Act. On the other hand, in Currency Fund 1986 SEC No-Act. LEXIS 2759 (September 25, 1986), the staff was unable to concur that a "forward currency contract" or "foreign currency contract" was not a security for purposes of the Act, and in Davidson & Associates, P.C. 1992 SEC No-Act. LEXIS 717 (May 7, 1992), the staff stated that "[a] forward contract on a foreign currency may be a security under Section 2(a)(36) of the 1940 Act."

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or in connection with a secondary distribution of securities. Rule 17e-1 provides that for sales effected on a securities exchange, a commission, fee or other remuneration paid to an Affiliated Broker will be deemed as not exceeding the usual and customary broker's commission, if:

(a) The commission, fee, or other remuneration received or to be received is reasonable and fair compared to the commission, fee or other remuneration received by other brokers in connection with comparable transactions involving similar securities being purchased or sold on a securities exchange during a comparable period of time;

(b) The board of directors, including a majority of the directors of the investment company who are not interested persons thereof: (1) has adopted procedures which are reasonably designed to provide that such commission, fee or other remuneration is consistent with the standard described in paragraph (a) of this rule; (2) makes and approves such changes as the board deems necessary; and (3) determines no less frequently than quarterly that all transactions effected pursuant to this rule during the preceding quarter were effected in compliance with such procedures; and

(c) The investment company (1) shall maintain and preserve permanently in an easily accessible place a written copy of the procedures (and any modification thereto) described in paragraph (b)(1) of this rule; and (2) shall maintain and preserve for a period not less than six years from the end of the fiscal year in which any transactions occurred, the first two years in an easily accessible place, a written record of each such transaction setting forth the amount and source of the commission, fee or other remuneration received or to be received, the identity of the person acting as broker, the terms of the transaction, and the information or materials upon which the findings described in paragraph (b)(3) of this rule were made.

As noted above, the only compensation an Affiliated Broker will receive in connection with the Funds' Interbank transactions will be a commission that, under the proposed Section 17(e) Procedures, (1) cannot exceed 0.03% of the notional amount of any transaction, (2) must be reasonable and fair as compared to the commissions, fees or other remuneration received by other unaffiliated firms in connection with comparable transactions involving similar

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currencies being purchased and sold during a comparable period of time, and (3) cannot exceed the Affiliated Broker's normal customer commission. In addition, the Section 17(e) Procedures will provide additional protections not prescribed by either Section 17(e) or Rule 17e-1. Under the Procedures, reports showing that these requirements have been met will be presented to a Fund's Board of Trustees, including its Independent Trustees, no less frequently than quarterly. Furthermore, the Procedures will provide for annual Board review of an Affiliated Broker's overall performance as broker. In this manner, the Section 17(e) Procedures will provide adequate assurance that the commissions paid by the Funds to an Affiliated Broker in Interbank transactions are reasonable and fair and, in addition, that the prices paid by the Funds in their transactions are competitive.

5. Prior No-Action Letters.

We believe that the proposed arrangements described in this letter regarding the Funds' use of an Affiliated Broker as broker in Interbank transactions are substantially similar to the arrangements considered by the staff in the past involving the use of futures commission merchants by affiliated investment companies in connection with transactions in exchange-traded futures contracts and options. See Prudential-Bache Government Plus Fund, Inc. and Prudential-Bache Securities, Inc. 1985 SEC No-Act. LEXIS 2519 (September 3, 1985); Shearson Lehman Brothers, Inc. 1986 SEC No-Act. LEXIS 2274 (February 18, 1986); Drexel Burnham Lambert 1986 SEC No-Act. LEXIS 2556 (July 28, 1986); and Kidder, Peabody Government Income Fund, Inc. 1986 SEC No-Act. LEXIS 2731 (September 15, 1986).⁵ In those letters, although the staff believed that a futures commission merchant did not appear to be within the definition of "broker" contained in Section 2(a)(6) of the Act, the staff also believed that it would not be inconsistent with the intent of Sections 17(e)(1) and 17(e)(2) and Rule 17e-1 to permit a futures commission merchant to receive commissions from affiliated investment companies, as long as the conditions expressed in the letters were met.

As noted above, foreign currency contracts and options traded in the Interbank market are substantially similar to foreign currency futures contracts and options traded on commodity exchanges. In addition, the conditions of the aforementioned letters are substantially incorporated into the proposed arrangement. A Fund's Section 17(e) Procedures will require that

5. Cf. Investors Syndicate of America, Inc. 1977 SEC No-Act. LEXIS 1393 (May 19, 1977) (payment in connection with the origination of mortgages by affiliate that were purchased by investment company permitted subject to the limitations of Section 17(e)(2)(C)).

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(1) each Interbank transaction must be appropriate for, and consistent with the policies of, the Fund involved, and (2) the commission, fee or other remuneration received by an Affiliated Broker for its services in connection with the transactions (a) must not exceed 0.03% of the notional amount of the particular currency transaction involved, (b) must be reasonable and fair as compared to the remuneration received by other, unaffiliated firms in connection with comparable transactions involving similar currencies being purchased and sold during a comparable period of time, and (c) must be no greater than an Affiliated Broker's normal customer commission. The Section 17(e) Procedures will require a Fund's Board of Trustees, including a majority of its Independent Trustees, to determine no less frequently than quarterly that all Interbank transactions handled by an Affiliated Broker during the preceding quarter complied with the Procedures, and will also provide for the maintenance and preservation of the Procedures and appropriate written records with respect thereto. In addition, the Procedures will provide that at least annually a Fund's Board of Trustees, including its Independent Trustees, will review an Affiliated Broker's quality of execution for the Fund and overall responsiveness and performance, and will approve the independent sources that are used to test the competitiveness of the prices quoted by an Affiliated Broker.

The Section 17(e) Procedures will also ensure that a Fund's Board of Trustees receives adequate information to evaluate independently whether the requirements of the Procedures have been met. Under the conditions stated in this letter, the oversight by the Board of Trustees of the use of an Affiliated Broker in connection with Interbank transactions pursuant to the Section 17(e) Procedures will provide an effective safeguard against the abuses that might otherwise be inherent in a transaction between affiliated parties.

6. Conclusion.

We believe that the ability to use an Affiliated Broker will benefit the Funds and their shareholders by providing the Funds the opportunity to increase their coverage of the Interbank market and thereby obtain better prices for their Interbank transactions. The commissions paid by the Funds to an Affiliated Broker will never exceed 0.03% of the notional amount of any Interbank transaction and, therefore, will always be substantially less than the maximum amount permitted by Section 17(e)(2)(C) of the Act. In addition, the proposed standards for using an Affiliated Broker will not only satisfy the requirements of Section 17(e) and Rule 17e-1, but will also provide substantial additional protections. An Affiliated Broker's proposed currency transactions for the Funds will, therefore, be fully consistent with the intent and purposes of Section 17(e). In addition, we believe that the Funds' proposed use of an Affiliated Broker in connection with Interbank transactions is substantially similar to the use of

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affiliated futures commissions merchants which was previously considered by the staff in the letters cited above, and should be treated by the staff in a similar manner.

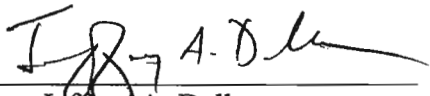
For the foregoing reasons, we respectfully request the staff's advice that it will not recommend enforcement action to the Commission under Section 17(e) of the Act if the Funds use an Affiliated Broker, and the Affiliated Broker receives commissions, in connection with the Funds' Interbank transactions as described herein.

Please do not hesitate to call Jeffrey A. Dalke at (215) 988-2607 or Daniel A. Moonay of this office at (215) 988-2670 with any questions regarding the matters discussed in this letter.

If, for any reason, the staff believes it will be unable to give the assurance requested, we ask for the opportunity to speak with you, or another member of your staff, prior to the issuance of any formal letter. Thank you for your consideration.

Very truly yours,

DRINKER BIDDLE & REATH LLP

By: 
Jeffrey A. Dalke

JAD:sc