



STATE STREET BANK and TRUST COMPANY  
BOSTON, MASSACHUSETTS 02101

RICHARD J. DELMAR  
VICE PRESIDENT

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TELEPHONE 466-4843

April 7, 1972

Mr. Alan Rosenblatt, Chief Counsel  
Division of Corporate Regulation  
Securities and Exchange Commission  
500 North Capitol Street, N. W.  
Washington, D. C. 20549

SECURITIES AND EXCHANGE COMMISSION  
**RECEIVED**

APR 10 1972

Re: Loaning of Portfolio Securities by  
Registered Investment Companies

DIVISION OF CORPORATE REGULATION

Dear Mr. Rosenblatt:

This letter is intended to answer the points raised in your December 27, 1971, reply to my letter of November 3, 1971, on the above referenced subject. It is our understanding that if these conditions are met, that the Staff would not recommend any action to the Commission should one of our investment company clients enter into such a program.

Pursuant to our discussions and exchange of correspondence, we propose to meet your guidelines as follows:

1. To insure a minimum of 100% collateralization of the loan at all times and to minimize the need for adjustment in the amount of cash collateral, the Bank would suggest an initial cash collateral of 105% of the market value of the securities loaned. The market price would be monitored daily and additional collateral would be required if the price rose to a point where the collateral amounted to only 100% of the then current market value of the securities. This would, we presume, insure compliance with your first and second guidelines.
2. In answer to your requirement that the Fund be permitted to terminate the loan at any time, it is to be a condition that the lender may so terminate, with the borrower then having the normal settlement time within which to redeliver to the lender the borrowed securities.

Act	1CA-46
Section	17(f)
File	
Public Availability	9/29/72

Mr. Alan Rosenblatt, Chief Counsel

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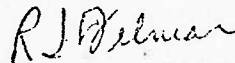
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3. The guideline that the Fund receive reasonable interest on such a loan would appear to us to be met by the availability of the cash collateral for short-term investment by the Fund. You have indicated that it would be mandatory to have such investments made in sufficiently liquid securities to provide for repayment to the borrower on his demand. It was also your suggestion that such investments be segregated from other short-term securities of the Fund. We shall incorporate both of these points in any program which we might suggest to any of our customers.
4. We have included as Exhibit A two alternative fee proposals which the Bank could offer to its customers. While we acknowledge that there are four basic transactions which are automatically involved in each loan, there is also the continuing responsibility to monitor the collateral and process additional transactions whenever there is a collateral adjustment. Thus, a loan of a security for five weeks which required four increases in cash collateral and investment of such cash requires eight separate transactions rather than the basic four. Additionally, the determination and collection of income is a continuing and separate responsibility during the term of the loan. Your further comment on this problem would be of assistance.
5. Our approach as to voting rights would be to terminate all loans prior to any record date involving proxy action. However, we understand that you may determine that this matter may be left to negotiation between the borrower and lender.

Your assistance in the formulation of this proposal is appreciated. We shall pursue the matter further with the other appropriate regulatory authorities. Should any of our customers wish to pursue this program, the Staff would, we assume, receive changes to the Registration Statement of Fund and would have further opportunity to comment at that time.

Any additional comment which you could make at this time would be helpful.

Very truly yours,



Richard J. Delmar  
Vice President

JRT:dcw

ALTERNATE FEE PROPOSALS

Fee Proposal 1.

- . Deliver loaned securities; receive and deposit loan collateral )
- . Receive, pay for and safekeep short term instrument) \$60/loan
- . Deliver short term instrument; receive and deposit collateral ) - \$100.
- . Receive and vault returned securities; return collateral to borrower ) APR 10 1972
- . Process collateral changes ) \$10/change
- . Administer loan i.e., monitor collateral, determine and collect income on loaned securities ) \$2/day

Fee Proposal 2.

- . 10% of interest on collateral with \$50 minimum and \$250 maximum for services shown in fee proposal 1.

Discussion

Assuming a \$300M loan for 40 days, with no marks to market, proposal 1. would call for a fee of \$140 (\$60 round trip charge plus 40 days at \$2 per day). Thus the fund's earnings would be \$1558 (\$1698 interest on \$300M at 5% for 40 days less \$140).

Assuming similar conditions, the fee under proposal 2. would be \$170, and the fund's earnings would be \$1528 (\$1698 less \$170).

Recommendation

State Street Bank recommends fee proposal number 1. as being most equitable to all parties concerned.

\* \* \* \*

Mr. Richard J. Delmar, Vice President  
State Street Bank and Trust Company  
Boston, MA 02101

The following is a clarification of my interpretation dated December 27, 1971, as well as a further interpretation as to whether the Investment Company Act of 1940 prohibits a mutual fund from lending its portfolio securities.

Guideline (3) of my interpretation: All stock loans should be made in accordance with the rules of the New York Stock Exchange which require the borrower, after notice, to redeliver the borrowed securities within the

normal settlement time of five days. Guideline (4): "reasonable interest on such loan" could include the fund's investing the cash collateral in high yielding short-term investments which give maximum liquidity to pay back the borrower when the securities are returned. The type of investment for the cash collateral is a decision for directors of the fund and should not be delegated to anyone unless such person serves as an investment adviser meeting the requirements of Section 15 of the Investment Company Act. In addition, we would not insist on separate segregation of investments relating to the lending of portfolio securities. Guideline (5): A fund can pay reasonable custodial fees to its custodian in connection with the lending of portfolio securities. However, the fees to be charged should be negotiated between the fund and the custodian, reduced to a contract, and approved by the fund directors. We will not pass on the fee proposals of State Street Bank and Trust Company as they are subject to negotiation with each separate fund. Guideline (6): We would not object if voting rights pass with the lending of securities. However, this does not relieve the directors of a fund of their fiduciary obligation to vote proxies. If the fund management has knowledge that a material event will occur affecting an investment on loan, the directors would be obligated to call such loan in time to vote the proxies. (7) If the fundamental policies of the fund, or those which may not be changed without shareholder approval, do not permit lending of portfolio securities, shareholder approval of the change in investment policy must be obtained prior to engaging in the practice. (8) Although a fund receives all dividends and interest income on loaned securities from the borrower, we understand that such monies received may, for tax purposes be treated as other income (not dividend or interest income) thus possibly affecting the Sub-chapter M status of the fund. (9) The fund that engages in the practice of lending its portfolio securities must make the following disclosures in its prospectus; that one of its policies is the lending of portfolio securities, that the voting rights may pass with the lending of securities; however, the directors will be obligated to call loans to vote proxies if a material event affecting the investment is to occur, that the lending of portfolio securities may adversely affect pass through tax treatment afforded "regulated" investment companies by Sub-chapter M of the Internal Revenue Code.



Alan Rosenblat, Chief Counsel  
Division of Corporate Regulation  
Securities and Exchange Commission

May 22, 1972  
GHB:hb