APR 23 1993

Our Ref. No. 92-573-CC
United Services Funds
File No. 811-8100

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of September 24, 1992, requests our assurance that we would not recommend that the Commission take any enforcement action under Section 17(d) of the Investment Company Act of 1940 ("1940 Act"), and Rule 17d-1 thereunder, if certain portfolios (the "Portfolios") 1/ of United Services Funds (the "Fund"), a registered open-end series investment company, engage in securities lending transactions with Bankers Trust Company ("BTC"), as described in your letter.

The Fund consists of thirteen series: eight equity portfolios, three bond portfolios, and two money market portfolios. BTC currently serves as the custodian for the eight equity portfolios, and the Fund proposes to appoint BTC as the custodian for the other portfolios. BTC also serves as sub-adviser to one of the equity portfolios, the All American Equity Fund ("AAEF"), and, thus, is an affiliated person of that portfolio. You state that AAEF is under common control with the Portfolios; thus, it is an affiliated person of the Portfolios, and BTC is an affiliated person of an affiliated person of the Portfolios. 2/ Accordingly, transactions involving BTC and the Portfolios are generally subject to Section 17 of the 1940 Act.

The Fund proposes to enter into a Master Securities Lending service agreement with BTC. Under the proposal, BTC will act as agent for the Portfolios and permit them to utilize its securities lending computer and communication systems in the lending of the Portfolios' securities to independent broker-dealers. Generally, for any given transaction, BTC will negotiate the lending fee on the Portfolio's behalf and will receive a portion of the fee from the Portfolio. 3/

1/ The Portfolios consist of the U.S. Treasury Securities Cash Fund, the U.S. Government Securities Savings Fund and the U.S. Intermediate Treasury Fund.

2/ Section 2(a)(3) of the 1940 Act defines "affiliated person" of another person to include any person under common control with such other person and, if such other person is an investment company, any investment adviser thereof.

3/ The broker-dealers may tender collateral to BTC in the form of cash or U.S. Government securities. In transactions where the collateral consists of U.S. Government securities, BTC and the Portfolio split the lending fee evenly. In transactions where the collateral is cash, BTC negotiates a fixed rate of return on the investment of the cash collateral, and the lending fee, which generally is paid out of the return from the investment of cash collateral, is split evenly between the Portfolio and BTC.

Except in limited situations, such as where an affiliated person acts as underwriter or broker, Section 17(e)(1) of the 1940 Act makes it unlawful for any affiliated person of a registered investment company, or any affiliated person of such a person, acting as agent, to accept any compensation from any source for the purchase or sale of any property to or for the investment company. 4/ In our view, a loan of a Portfolio's securities involves a "sale" of property of the Portfolio.

Section 2(a)(34) of the 1940 Act and Section 2(3) of the Securities Act of 1933 ("1933 Act") both define "sale" to include every contract of sale or disposition of a security or interest in a security, for value. In Rubin v. United States, the Supreme Court held that a pledge of stock to a bank as collateral for a loan was a "sale" within the meaning of Section 2(3) of the 1933 Act. 5/ The Court noted that although a pledge involves a transfer of less than absolute title, the interest transferred is nonetheless an "interest in a security" under the section. 6/

4/ Section 17(e)(2) of the 1940 Act provides a safe harbor from the general prohibition of Section 17(e)(1) for any affiliated person, acting as a broker, who receives remuneration for effecting securities transactions on behalf of an investment company. The remuneration proposed to be paid to BTC would not come within the safe harbor of Section 17(e)(2).

5/ 449 U.S. 424 (1981).

6/ Id. at 429. The Court held that the pledge of stock was a sale for purposes of Section 17(a), the general antifraud provision of the 1933 Act. We further note that some courts have concluded that a pledge is a sale under the Securities Exchange Act of 1934 ("1934 Act"), even though the definition of "sale" under the 1934 Act is more narrow because it does not include dispositions of an "interest in a security." See Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir.), cert. denied, 469 U.S. 884 (1984) (court held that borrower's pledge of stock of its subsidiary as security for loans to the subsidiary was a "sale" within the meaning of Section 10(b) of the 1934 Act); TCF Banking and Savings, F.A. v. Arthur Young & Co., 706 F. Supp. 1408 (D. Minn. 1988) (court stated in the context of a Section 10(b) action that it is "well established that a pledge constitutes a sale of securities under the federal securities laws"); Marine Bank v. Weaver, 455 U.S. 551 (1982) (the Court noted in the context of a Section 10(b) action that a pledge of stock is equivalent to a sale for purposes of the antifraud provisions of the federal securities laws); but see Shelter Mutual Ins. Co. v. Public

(continued...)

Similarly, in a loan of securities, a lender delivers securities to the borrower, who then disposes of them in accordance with its commitments. Thus, the borrower, who may freely dispose of the securities as long as he is able to deliver identical securities upon termination of the loan, arguably has a greater right to use the securities than a pledgee, who generally may not dispose of the pledged securities (prior to default). 7/ Moreover, if the lender defaults on its obligation to return the collateral, or the borrower defaults on its obligation to return the securities, the transaction may result in a permanent transfer of full title to the securities. We therefore believe that a loan of securities involves a disposition of a security or an interest in a security for value, and, thus, constitutes a "sale" under Section 2(a)(34) of the 1940 Act. Accordingly, because BTC, an affiliated person of an affiliated person of the Portfolios, would be acting as agent of the Portfolios and receiving compensation in effecting loans of the Portfolios' securities, we believe that those transactions would be subject to Section 17(e).

Further, we believe that where an affiliated person of an affiliated person of an investment company negotiates and accepts a fee for arranging a loan of the fund's securities, the transaction presents the potential for conflict of interest that Section 17(e) was designed to address. 8/ Therefore, we cannot

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6/(...continued)
Water Supply Dist., 569 F. Supp. 310 (E.D. Mo. 1983), aff'd, 747 F.2d. 1195 (1984) (the court, noting a split in the circuits, concluded that pledge of bonds to a bank was not a "sale" within the meaning of Section 10(b)).

7/ Similarly, like a loan, a repurchase agreement imposes a contractual obligation on one party to deliver identical securities back to another party on the settlement date. See SEC v. Drysdale Securities Corp., 785 F.2d 38 (2d Cir.), cert. denied, 476 U.S. 1171 (1986). The Second Circuit concluded that even if one focuses exclusively on the "loan" rather than the "purchase and sale" characteristics of a repurchase agreement, such an agreement involves a sale under the 1934 Act. See Manufacturers Hanover Trust Co. v. Drysdale Securities Corp., 801 F.2d 13 (2d Cir. 1986) cert. denied, 479 U.S. 1066 (1987).

8/ Section 1(b)(2) of the 1940 Act states that the national public interest and the interest of investors are adversely affected when investment companies are organized, operated or managed in the interest of their investment advisers or other affiliated persons, rather than in the interest of all classes of the companies' security holders. In light of the (continued...)

assure you that we would not recommend enforcement action under Section 17(e) if the Fund enters into the securities lending arrangement described in your letter. 9/

Jana M. Cayne
Attorney

8/(...continued)
fundamental importance of Section 17 of the 1940 Act and the policies underlying it, we reject the suggestion that the term "sale" should be interpreted more narrowly in the present context than for purposes of the antifraud provisions of the federal securities laws (as in Rubin).

9/ We express no view with respect to whether the securities lending arrangement constitutes a "joint arrangement" within the meaning of Rule 17d-1 or whether BTC might also be deemed to be "acting as principal" within the meaning of Section 17(d) or Rule 17d-1.

Investment Company Act of 1940
Section 17(d), Rule 17d-1

September 24, 1992

Mr. Thomas S. Harman
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W., Stop 5-2
Washington, D.C. 20549

RE: United Services Funds

Dear Mr. Harman:

This letter is written on behalf of United Services Funds ("USF"), requesting assurance that the staff of the Securities and Exchange Commission (the "Commission") will not recommend any enforcement action against USF pursuant to Sections 17(d) and Rule 17d-1 of the Investment Company Act of 1940 (the "1940 Act") if USF enters into a securities lending agreement with Bankers Trust Company ("BTC").

PARTIES

United Services Funds is a diversified, open-end management investment company organized as a Massachusetts business trust, consisting of thirteen separate series (funds) including eight equity funds, three bond funds and two money market funds. The Custodial Services Division of BTC currently serves as the custodian for the eight equity Funds of USF and the Investment Management Group of BTC serves as the investment sub-adviser to one of the Funds, the U.S. All American Equity Fund (an S&P 500 Index oriented Equity Fund). BTC is an affiliated person under Section 2 (a)(3)(E) of the 1940 Act of the one Fund it sub-advises (All American Equity Fund), which Fund would not participate in the securities lending program. Since all Funds are under common control, BTC is technically an affiliate of an affiliate in relationship to the Funds which would be lending securities. USF anticipates appointing BTC as the new custodian of its five bond and money market funds and entering into a securities lending agreement which would be utilized by three of those five funds, the U.S. Treasury Securities Cash Fund, U.S. Government Securities Savings Fund, and U.S. Intermediate Treasury Fund.

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7900 Callaghan Road ▼ Mail Address: P.O. Box 29467 ▼ San Antonio, Texas 78229
(512) 308-1234 ▼ 1-800-US-FUNDS ▼ Fax (512) 308-1217

THE TRANSACTION

BTC has offered a comprehensive, securities lending program since 1976. BTC has committed significant capital outlays for sophisticated queuing methodology to provide superior loan processing capabilities. BTC's program also allows for efficient access to the large number of dealers who borrow debt securities on a regular basis. BTC will monitor collateral requirements daily, negotiate the terms of loans, and select borrowing dealers and review their creditworthiness. USF currently cannot lend securities efficiently or effectively without BTC's services and computer and communication systems.

USF anticipates entering into a Master Securities Lending service agreement with BTC. Pursuant to the proposal, BTC will act as agent of two of USF's money market funds and the U.S. Intermediate Treasury Fund and will allow these Funds to utilize its securities lending computer and communication systems in the lending of portfolio securities to independent broker-dealers. The broker-dealer will be required to tender collateral to be held by BTC in the form of either cash or U.S. Government securities in an amount equal to 102% of the value of the loaned securities.

In transactions where the collateral consists of U.S. Government securities, beneficial ownership of the collateral remains with the dealer, as does the right to the income from such securities. USF is paid a fee by the dealer (currently 15 to 25 basis points), 1/2 of which fee is retained by BTC for its services and access to its systems. BTC indemnifies USF against the risk of loss from broker default or loss of the loaned securities.

Where the collateral is cash, the transaction is structured in the same way except that BTC as USF's agent negotiates on the Fund's behalf with the borrowing dealer a fixed rate on investment of the cash collateral. USF directs the investment of cash collateral in securities or pooled vehicles which satisfy the Fund's investment restrictions. The Fund's lending fee comes out of those earnings, and the Fund pays BTC 1/2 of the fee for the use of its services. The Fund directs the investment of the cash collateral. In the cash collateral case, the Fund bears the risk of loss of the collateral, and the risk that BTC will be unable to obtain sufficient earnings on the collateral to satisfy the Fund's obligation to pay the dealer its guaranteed earnings rate, and generate BTC's and the Fund's anticipated fees. BTC has represented to USF that it is rare that fees from a lending transaction do not cover the rate guaranteed to the borrowing dealer plus some fee. When this does occur BTC's traders are alerted by the system and the transaction is closed out, limiting such situations to one day.

The Funds' Trustees will make an annual determination that (1) the agreement is in the best interests of the investment company and its shareholders; (2) the investment company needs the services; (3) the nature and quality of the services are at least equal to those offered by others; and (4) the fees are fair and reasonable in comparison with those of other providers of such services.

The Issue

Would the proposed securities lending arrangements involving UST and BTC be subject to the restriction of Rule 17-d-1?

Discussion

I.

Section 17(d) of the 1940 Act makes it unlawful for any "affiliated person" of a registered investment company acting as principal to effect any transaction in which such registered investment company is a joint or joint and several participant with such persons in contravention of such rules and regulations as the Commission may provide for the purpose of limiting or preventing participation

by such registered or controlled company on a basis different from or less advantageous than that of such other participant.

Rule 17d-1 under the 1940 Act prohibits an affiliate of a registered investment company, acting as principal, from participating or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit sharing plan. Subsection (c) of the Rule defines "joint enterprise" as an arrangement whereby the investment company and the affiliate have a joint or joint and several participation or share in the profits of such enterprise.

The legislative history of Section 17 illustrates that the section was designed to prohibit "self-dealing" between insiders of a registered investment company and the investment company itself to ensure consistency with the policies of the investment company and the purpose of the 1940 Act. S. Res. 3580, Cong. 3d Sess., 86 CONG. REC. 7846 (1940) (enacted).

II.

Section 17(c) states that

> "...a person may, in the ordinary course of business, sell to or purchase from any company merchandise or may enter into a lessor-lessee relationship with any person and furnish the services incident thereto..."

Congress did not intend to prohibit in Section 17(d) what is specifically allowed under Section 17(c). Federated Securities Corp, SEC No-Action Letter [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,548, 78,767 (October 21, 1983). In Federated, the staff concluded that in the case of a sale of an insurance policy by an affiliate to a registered investment company, that Congress did not intend such a service arrangement to be subject to Section 17(d).

The Master Securities Lending Agreement is a service arrangement between three of the Funds, and their agent, BTC. Furthermore, unlike the Fidelity bond in Federated, the securities lending agreement does not involve a sale of property or a borrowing of money or property from a registered investment company to an affiliate. The borrowing of securities will be between the participating Funds and unaffiliated broker-dealers.

While the staff has not to date addressed such a no-action request under these specific circumstances, the staff has granted no-action requests for agreements for services entered into in the ordinary course of business between a fund and an affiliated person. The staff has approved agreements to provide typesetting, printing and report distribution if the compensation provided for in such an agreement is fair and reasonable and there are adequate safeguards to prevent over-reaching. See Washington Square Cash Fund (pub. avail July 9, 1990) (agreement to provide shareholder services); Unified Management Corporation (pub. avail. June 28, 1990) (agreement to provide printing, typesetting, report distribution services); Flex-Fund (pub. avail. November 22, 1985) (service arrangements such as agreement to provide stock transfer and accounting services, generally not joint transactions under Section 17(d) or Rule 17d-1).

Furthermore, the Board of Trustees of USF intends to review the securities lending arrangement annually to assure that the Funds are being treated fairly and that the arrangement continues to be in the best interests of the Funds, in the same fashion that it reviews the Advisory Agreement under Section 15(c) of the 1940 Act.

USF believes the relationship between the lending Funds and BTC regarding custody, global custody, cash management and securities lending are all parts of a unified custodial relationship.

III.

USF further contends that the agreement is not in contravention of Section 17(d) or Rule 17d-1, which were prescribed to limit or prevent participation by USF on a basis different from, or less advantageous than, that of BTC. The agreement does not promote self-dealing between the affiliates. BTC's status of an affiliate of an affiliate of the Funds in question is not a substantive affiliation. BTC is an affiliate only because it is sub-adviser to U.S. All American Equity Fund, an equity index oriented fund. The securities lending agreement will apply only to USF's two money market funds and its U.S. Intermediate Treasury Fund.

It is common industry practice for money market and bond funds to use their custodian banks as agents to lend securities. Indeed, to effect these transactions through entities other than the custodian is costly, impractical, and unprofitable. The compensation to BTC and from the broker-dealers to USF is competitive and the arrangement complies with industry standards as will be determined annually by the Board of Trustees. BTC's duties are ministerial only. It merely acts as the Funds' instrument/agent.

Furthermore, USF has initiated adequate safeguards such as to ensure that the arrangement is fair and reasonable and to prevent overreaching by the affiliate. Some of these measures are as follows:

1. Requiring collateral to equal 102% of loan value and only U.S. Government debt.
2. Investing cash collateral at the Fund's direction in securities or pooled vehicles which satisfy the Fund's investment restrictions.
3. BTC's representation that it will not continue a loan for more than one day unless the return on cash collateral investments will cover the dealers' guaranteed rate and a lending fee.
4. BTC has in place a system that will not lend more than 1/3 of any fund's securities.
5. Collateral must be maintained at the end of each day at least equal to the value of the securities loans and the loan is terminable by the Funds upon 5 business days notice.

The agreement is in the best interests of the security holders of the Funds lending securities. BTC can provide the service called for in the agreement more efficiently and profitably than if USF pursued other alternatives. The agreement provides the participating Fund's shareholders with an avenue for increased revenues previously unavailable to the Funds.

Given these facts and circumstances, there is no potential for abuse by self-dealing as contemplated by the legislative history of § 17(d), nor is there any participation by the three Funds on a basis different from or less advantageous than that of BTC by engaging in the securities lending agreement.

The transaction is with a remote affiliate of an affiliate and poses no risk of a conflict of interest. The transaction involves services BTC provides to others in the ordinary course of business. Therefore, the lending agreement is a type of transaction the Division of Investment Management has specifically recommended that the Commission allow subject to directors' approval. *See* "Protecting Investors: A Half-Century of Investment Company Regulation." Division of Investment Management, U.S. Securities and Exchange Commission, May 1992, ch. 12,p. 488. The trustees of USF have authorized the transaction with BTC.

IV.

Finally, USF is of the opinion that BTC will be acting as an agent and not as principal in these transactions, which would in itself remove the transaction from the ambit of Rule 17d-1. The loaned securities remain the property of the Funds alone. The Funds are paying a percentage of the loan fee to BTC much as funds normally pay their custodian a percentage of net assets for custodial services. BTC is not acting for its own account. BTC merely offers or "shows" the lendable securities to the dealer community on the Fund's behalf though its systems, and any BTC approved dealer can accept the offer by notifying BTC.

Accordingly, USF respectfully requests that the staff advise us that it would not recommend any enforcement action to the Commission if USF enters into a Master Securities Lending Agreement with BTC for the U.S. Intermediate Treasury Fund, U.S. Government Securities Savings Fund and U.S. Treasury Securities Cash Fund.

Very Truly Yours,

Paul K. Robertson
General Counsel
United Services Advisors, Inc.

Enclosure

cc: Philip Newman
Goodwin, Procter and Hoar

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17(d)

February 24, 1993

VIA FEDERAL EXPRESS

Mr. Thomas S. Harman,
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W. **Stop 5-2**
Washington, D.C. 20549

RE: United Services Funds
No-Action Request
Dated September 24, 1992

Dear Mr. Harman:

The Staff has advised us that, in connection with our no-action request of September 24, 1992, it is considering whether securities lending services where an affiliated person acts as agent presents a situation in which that person is acting as agent in connection with the sale of securities contrary to Section 17(e)(1) of the Investment Company Act of 1940 (the "Act").

Whether the securities lending transactions constitute sales is a pivotal issue. Section 2(a)(34) of the Act defines the term sale as a "disposition of . . . a security or interest in a security for value."

The Staff has referred us to Rubin v. United States, 449 U.S. 424 (1981) which holds that a pledge of a security as collateral for a loan is a sale within Section 2(3) of the Securities Act of 1933 (the "1933 Act") for purposes of Section 17(a) of the 1933 Act. In Rubin the Court appears to base its conclusion on two facts: 1) the transfer to the lender of a security interest in exchange for substantial consideration, the loaned money; and 2) the lender's risk of and reliance upon the value of the securities themselves. The Court reasons that the secured debtor is placed in much the same economic position as any investor in securities. Because Rubin was in the context of a prosecution for a criminal violation of the security laws, the Court stressed the need for an investor or a lender to be able to depend upon representations of value made by the transferor of the security.

We submit that a loan of a security as conducted by custodian banks as a service to mutual funds is very different from the pledge in Rubin. In Rubin the borrower approached the bank to borrow money. To obtain the money the borrower pledged securities and received an amount based upon the full value represented (actually misrepresented) of the securities transferred -- in the Court's words: "substantial consideration." In the securities lending situation you have broker-dealers or similar persons looking to borrow the securities and mutual funds or similar persons looking to lend those securities on a secure basis. The borrower of the securities pays a fee for the use of the securities, typically 15 - 30 100ths of 1% of the value of the loaned securities -- which is not "substantial consideration" of the type present in the Rubin case. Securities lending transactions typically call for the pledge of cash or cash equivalents such as government securities to protect the

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lender in the event the borrower does not return the securities. In the bank loan situation, if the loan is not repaid, the lender looks to the collateral to cover its loan, and thereby assumes the risk that the value of the collateral will change. In the securities lending situation, if the securities are not returned, the fund keeps the cash or government securities which involves little or no market risk. The economic consequences are different. While the borrower of the security in a securities lending transaction receives title to the securities, he is not put at risk with respect to or placed in reliance on the value of the security. The custodian bank on behalf of its fund client has a contractual right to receive (or obligation to take back) the same security from the borrower. The mutual fund lender remains at risk and exposed to the value of the security during the term of the loan and receives the dividends or interest paid by the security's issuers; and, the fund may demand return of the securities at any time in the event it wishes to dispose of them. It is true that the lender passes legal title to the borrower of the security in a form that allows the borrower to alienate the security, which alienation might, in some circumstances, put the borrower at risk that the security's value might change. However, it is not the loan that brings this risk about, but the borrower's use of the security.

The Rubin case is further distinguishable from the security lending transaction. Rubin involved fraud in connection with the pledge of a security; as a consequence, the purposes and policy of the 1933 Act with respect to protecting an investor from fraud were furthered by including a pledge within the definition of the term "sale". The policy underlying Section 17(e) of the Act is different -- as indicated in Section 1(b)(2) of the Act, it is aimed at overreaching by affiliates. This policy would not be furthered by characterizing securities lending services as sales of securities -- particularly in light of the nature of the securities lending transaction, the common and customary way such transactions are effected as a service rendered by the custodian banks in the industry, and, in our case, the remoteness of the affiliation between the custodian and the lending investment company.

In our view the proposed arrangement is one for provision of services covered by Section 17(c) of the Act, and the fairness and desirability of continuing the service can be readily monitored by independent trustees as proposed in our original letter.

I understand from the Staff that there is a good possibility that the Staff will decline to give us any positive assurances in this matter. This being the case, I would appreciate it if you would grant us the opportunity to discuss the matter in person at your offices. I will be in Washington for the SEC Speaks Conference March 5th through 7th and would like to meet with you then.

Sincerely,

Paul K. Robertson
Executive Vice President
General Counsel

PKR/mjw

cc: Mr. Rob Carroll
Senior Special Counsel
Mail Stop 10-6

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