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Investment Company Act of
1940, Section 17 and Rule
17f-4 thereunder

February 1, 1989

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

Re: Delta Government Options Corp.

Dear Mr. Harman:

As counsel to Delta Government Options Corp. ("Delta"), we ask that the staff of the Division of Investment Management (the "Staff") confirm that it will not recommend enforcement action to the Securities and Exchange Commission ("SEC") with respect to the participation of registered investment companies ("funds") in an over-the-counter options trading system (the "System") as described in this letter. The options traded through the System will be put and call option contracts issued by Delta on certain U.S. Treasury securities (the "Options"). RMJ Options Trading Corp. ("RMJ") provides certain brokerage services to the System. Participation in the System will be limited to persons designated as primary dealers by the Federal Reserve Bank of New York, and to well-capitalized and experienced broker-dealers, commercial banks, insurance companies and other institutional investors meeting the financial and other requirements established by Delta (the "Participants").

NO-ACTION POSITION REQUESTED

Specifically, we request the Staff's no-action position that:

1) an open-end fund having a position in Options issued by Delta not be required to treat such Options and, in the case of a writer of Options, the securities (or cash and money market instruments in the case of a put) used to cover such Options, as illiquid for purposes of the 10% limitation on investments by an open-end fund in illiquid securities;

2) Delta be treated as a securities depository with respect to a fund's position in Options within the meaning of Rule 17f-4 under the Investment Company Act of 1940 (the "Act") so that maintaining evidence of a fund's Option positions in Delta's book-entry system would not violate Section 17(f) of the Act;

3) a fund writing Options be permitted to deposit the necessary initial and any additional margin directly with Security Pacific National Trust Company (New York) (the "Clearing Bank") without violating Section 17(f) of the Act; and

4) a fund, its principal underwriter, promoter, an affiliated person of such fund, or an affiliated person of such principal underwriter, promoter or affiliated person be permitted to simultaneously enter Option opening, closing and exercise transactions through the System on a "blind broker" basis without treating such transactions as affiliated transactions in violation of Section 17(a) of the Act, provided that there is no prearrangement between such parties with respect to price or other variable Option terms.

The Staff has indicated that it will no longer respond to no-action requests on the subject referred to in paragraph (3) above unless novel or unique requests are presented. See e.g. Prudential-Bache Incomevertible Plus Fund, Inc. (pub. avail. November 20, 1985). We believe that the issues raised by the operation of the System with respect to the above matters are novel and unique. The System does not present novel or unique issues with respect to the question of whether the ongoing obligation to make margin payments with respect to written options may be a senior security under Section 18 of the Act, and we assume that the Staff's existing no-action position on this issue would apply.

BACKGROUND

Delta

Delta is a newly formed entity which has been registered with the SEC as a clearing agency under the provisions of Section 17A of the Securities Exchange Act of 1934 (the "1934 Act") (File No. 600-24). The initial registration is for a period of 36 months, which is standard for new clearing agency registrations. The no-action positions requested herein naturally would only apply while a registration under Section 17A is in effect. In addition, Delta has registered the public offering of the Options under the Securities Act of 1933 pursuant to its Registration Statement on Form S-1 (the "Registration Statement") (File No. 33-214091). A detailed description of Delta, the System and the Options is contained in the Registration Statement. Copies of the Registration Statement and Delta's application to register as a clearing agency, as amended, under Section 17A of the 1934 Act, and the Commission's order under Section 17A (the "17A Order") are attached hereto and incorporated herein by reference. Also enclosed for your information are copies of no-action letters issued by the Staff to Delta in connection with its clearing agency application, and to RMJ, in connection with the applicability of certain provisions of the 1934 Act to the System. We have summarized in this letter only the details which we believe are relevant to the analysis under the Act for purposes of this no-action letter.

The business of Delta will consist of the issuance of put and call Options, the acquisition of matching put and call Options from Participants and the performance of its obligations under the put and call Options. Delta succeeds Security Pacific National Bank ("SPNB") and, subsequently, GECC Options Corporation, as the proposed issuer of the Options to be traded in the System. Originally, SPNB proposed to act as the issuer of the Options but, due to certain considerations relating to federal banking law, SPNB withdrew from the role of issuer. SPNB had received certain no-action positions from the Staff relating to the applicability of certain provisions of the 1934 Act. See Security Pacific National Bank (pub. avail. May 19, 1986) and Security Pacific National Bank (pub. avail. July 12, 1985).

Delta will act as the nominal issuer of all Options traded in the System in a manner similar to the role performed by the Options Clearing Corporation (the "OCC") relating to exchange-traded options. Specifically, after Participants in the System

agree, either directly with each other, or through the brokerage services provided by RMJ, on the variable terms of the Options, Delta will interpose itself between the buyer and seller. Delta will act as the issuer of each put or call Option purchased by a Participant and, accordingly, will be the party obligated to the holder to perform upon exercise of the Option. For each put or call Option issued by Delta, Delta contemporaneously will purchase from the other Participant in the transaction an identical offsetting put or call Option, as the case may be, so that Delta's short positions are at all times completely offset by corresponding long positions. In this manner, Delta will operate identically to the OCC in that it will run a "matched book" and be fully hedged throughout the life of each Option issued (assuming that no Participant defaults).

The Options

Each Option issued by Delta relates to particular underlying U.S. Treasury securities with an aggregate principal amount of $1 million. The maximum term, the expiration date within each month of each such Option and certain of the strike prices are standardized. By standardizing certain Option terms, Delta expects to attract a wider range of Participants and to facilitate the development of a more liquid trading market for the Options in the System. The variable terms of each Option such as the premium, the exercise price, the expiration month and the issue of the underlying Treasury securities (identified by maturity and coupon or yield) are negotiated between the selling and purchasing Participants.

Each Option is an uncertificated security, the issuance of which is evidenced in an automated book entry system and recorded by appropriate entries in an account maintained by Delta for each Participant. Each Participant receives a daily report evidencing the Option positions in its account and providing certain other information relative to its account.

The System

Participants may disseminate bid and ask quotations on Options to one another on an anonymous basis through an automated communications network linking video display terminals in their respective offices. Participants seeking to accept a bid or ask quotation anonymously may communicate a readiness to enter into an Options trade at a quoted price by telephone to RMJ. RMJ will act as a "blind broker" for Participants matching buying and selling interests in Options. As an alternative

to use of RMJ as a blind broker, Participants are free to communicate bid and ask quotations directly to each other. This type of communication and trading network is commonly used for trading among government securities dealers. See the 17A Order at p. 18.

Upon negotiation of an Option transaction, the Participants or RMJ (in the case of a blind-brokered trade) must report the trade directly to the Clearing Bank in order to clear the transaction through the System. The Clearing Bank will clear and settle the purchase, sale and exercise of Options traded through the System.

Each Participant writing Options will be required to deposit margin daily to secure its obligations arising under the Options written by such Participant. The amount of margin required will be calculated by taking into account market considerations and the amount of the Participant's short positions offset by the amount of the Participant's long positions. Additional margin may be requested if deemed advisable in view of the market price of the Participant's short positions, the size of a Participant's positions, its financial or operational condition or as otherwise necessary to protect the System, Delta or the public. The Clearing Bank will hold all such margin payments for the benefit of Delta. Margin account assets will be invested in overnight repurchase agreements fully collateralized with Treasury securities with a maturity of not more than 180 days, and the return on such investments, minus a service fee to the Clearing Bank, will be credited to the Participant's account.

A holder of an Option may exercise the Option by the submission of a timely exercise notice to the Clearing Bank. In addition, Participants as holders or writers of Options may liquidate their positions in offsetting closing transactions. Because holders and writers of Options are not contractually linked to each other, but instead have rights and obligations running only to Delta, the secondary market in Options does not operate in the same manner as the secondary market in stocks, in that Options are not actually transferred from one holder or writer to another in a closing transaction. Instead, closing transactions are placed and executed in the same manner as initial purchases and sales and, as a result, Delta provides a method for Participants to liquidate their positions which operates identically to the method utilized by the OCC.

Operation of the System may be suspended or terminated at any time by Delta or RMJ and may be suspended by the Clearing Bank. However, such suspension or termination will not alter the terms of any outstanding Option, unless such alteration is consented to by the Participants involved.

Risks

As the nominal issuer of the Options, Delta will be obligated to perform in the event of default by the writer of an Option. To lessen this credit risk, in addition to being fully hedged, Delta will impose trading limits and creditworthiness standards on all Participants, and may impose position limits as well. As stated above, Delta will also impose initial and additional margin requirements on Options written, and the Clearing Bank will hold margin funds for the benefit of Delta throughout the entire period between the issuance and the termination of the Options for which the funds are deposited. The additional margin requirements are designed to ensure that in the event of default by an Options writer, Delta may close out the position without incurring a loss. Each Participant grants a lien on any of its assets held by Delta and agrees to indemnify Delta in the event the Participant defaults, but no Participant is liable for the default of any other Participant. In this respect the System differs from all other SEC-approved clearing systems, which provide for some level of contributory obligation, or "risk mutualization," among system participants. See the 17A Order at p. 43-44.

In addition, Delta will maintain a credit enhancement facility at all times at least equal to three times its maximum potential System exposure, as described more fully in the Registration Statement. At present, the credit facility consists of a $100 million Letter of Credit provided by SPNB and, in the event that the Letter of Credit is exhausted, a $100 million Surety Bond (with maximum coverage of any Participant equal to $20 million) provided by Capital Markets Assurance Corporation, an indirect wholly-owned insurance subsidiary of Citicorp, each of which shall be payable to Delta in the event of a default by one or more Participants on certain obligations owed to Delta.

LEGAL ANALYSIS

Liquidity

Guide 13 of Guidelines to Form N-1A states that the usual limit on aggregate holdings by an open-end investment company

of illiquid assets, including debt securities for which there is no established market, is 10% of the value of the fund's net assets. In previous no-action requests, it has been recognized that the Staff views the absence of a trading market for over-the-counter ("OTC") options on U.S. Government securities as presenting a question whether the value of purchased OTC options and the assets used as "cover"[1] for written OTC options are illiquid securities and, as such, are to be included in the calculation of a fund's 10% limitation on illiquid securities. See, e.g., Prudential-Bache Government Plus Fund II (pub. avail. August 19, 1987); The Limited Term Government Series of Drexel Series Trust (pub. avail. March 3, 1988). We do not believe it is appropriate or consistent with the intent of Guide 13[2] to take the position that the Options to be traded in the System are illiquid or that the value of the cover for written Options should be included within the category of illiquid securities for the following reasons.

Specifically, we believe that the System provides both an organized and centralized OTC market for the trading of Options, and a registered clearing system which is based on operational principles that have proven quite satisfactory in analogous securities clearing situations. As a result, the problems which otherwise plague the trading of OTC options, i.e. the lack of an adequate method of valuation and the lack of any secondary market, are eliminated. This linked market will benefit funds that are Participants by creating a forum for the prompt pricing and trading of Options. Through the System, bid and ask quotations on the Options may be entered by Participants for opening and closing transactions simply by accessing RMJ's automated communications network on their video display terminals, and quotations entered by others can be watched on the terminal and acted upon. This aspect of the

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1 A call option is considered covered if the fund has in its portfolio the securities which are the subject of, or deliverable upon exercise of, the option. A put option is considered covered if the fund maintains in a segregated account cash or high quality liquid securities with a value equal to the value of securities that such fund is obligated to purchase under the option.

2 No similar policy is applicable to closed-end investment companies; however, certain closed-end investment companies may have adopted an analogous investment restriction. For the purpose of such restrictions, we also believe such Options should not be deemed to be illiquid.

System is also critically important to funds because it assists them in properly valuing their Option positions on a daily basis.

For example, if, before a call or put Option written by a fund is exercised, the writing fund decides that it would be desirable to terminate the Option because of occurring or anticipated changes in interest rates, the fund could seek to close out that Option by entering a blind bid on the screen through RMJ to buy an offsetting Option, or by privately seeking another Participant for such transaction. Once such fund's closing transaction is matched, either through RMJ or by direct negotiation with another Participant, the fund's Option position would be liquidated, the fund would not continue to be obligated on the Option, and its margin obligation with respect to the Option would cease.

The risk that the fund would not be able to cancel its Option position by purchasing an offsetting Option does not materially differ from the risk that a fund would have with respect to an exchange-traded option. In both cases, a forum exists to seek a party to engage in an offsetting purchase transaction, but there is no assurance that such a party will be available at a favorable price, or at any price. The secondary market created by the existence of the System and the standardization of certain terms of the Options will make any Options written or purchased by a fund relatively liquid to the extent that other Participants are active in the System.

As with any options transaction, the creditworthiness of the Participants involved is critical to the integrity of the Options traded in the System. By imposing strict financial requirements on every Participant[3] and requiring each Participant to meet certain standards of financial responsibility, operational capability, experience and competence, as may from time to time be prescribed in the procedures governing the operations of the System, Delta, as an intermediary in every transaction, intends to reduce the likelihood that a Participant will default on its obligations to Delta. However, in the event that a Participant should default on its obligations to satisfy the System's premium or margin requirements, or to make delivery of or payment for the required securities upon exercise of an Option, as the case may be, Delta has

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[3] Generally speaking, $25 million of net capital for dealers and $500 million of total equity for banks and insurance companies. All Participants will also have to be approved by the issuers of the credit enhancement facility.

established what it believes to be sufficient capital through the credit enhancement facility to secure the performance of obligations of a defaulting Participant. Thus, the strict financial criteria required of all Participants and the availability of the credit enhancement facility gives Delta a strong credit base and enhances its ability to perform its obligations to Participants. The Commission has determined, for purposes of its criteria under Section 17A of the 1934 Act, that the System is adequately protected against default risk. See the 17A Order at pp. 31-40, 61-63.

The one remaining risk that threatens the liquidity of the Options to be traded in the System arises if the System is suspended or terminated. Such a result could leave funds holding Options that cannot be traded, although the terms of outstanding Options would not be altered and such Options could be exercised according to their terms. This risk is comparable to the risk that an exchange for listed options would suspend or terminate trading. But with proper controls and financial resources, this is not a significant risk from the perspective of the illiquidity analysis. Moreover, Delta is confident that, in the event of suspension or termination of the System, closing and exercising transactions would still be possible, since the Participants all will be major traders of U.S. Government securities with ongoing trading needs who would continue to be available as parties to offsetting Option transactions.

The no-action relief requested on liquidity with respect to any fund is based upon the condition that the directors or trustees of the fund have been advised of the risks and other factors relevant to participation in the System and have determined that such participation is in the best interest of the fund.

Custody of the Options

Section 17(f) of the Act requires that the securities of a management investment company be kept in the custody of (1) a custodian bank, (2) a member of a national securities exchange or (3) such investment company. However, Rule 17f-4 under the Act authorizes a fund or its custodian to deposit securities owned by the fund in a registered clearing agency which acts as a securities depository. "Securities depository" is defined in Rule 17f-4 as "a system for the central handling of securities where all securities of any particular class or series of any issuer deposited within the system are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery of the securities."

As described above, Delta issues Options in uncertificated form, maintains central book-entry records of all Options issued, effects all transfers by book-entry and treats Options of the same type or series as fungible. Consequently, we believe that Delta should be treated as a securities depository for the purpose of Rule 17f-4 and that such treatment is consistent with the intent and purposes of Section 17(f) and the Rule. The purpose of Section 17(f) and the Rule is to protect against risk of loss of the assets of a fund and to facilitate the "advantages inherent" in the use of depository or book-entry systems which eliminate the necessity of physically holding a certificate as evidence of ownership of a security. Treating Delta as a securities depository is consistent with the intent of Section 17(f) and the Rule in that the System adequately protects the deposited securities against the risk of loss. Specifically, the safeguards proposed under the System to protect fund assets are as follows:

(1) Delta establishes a separate account for each Participant's Options and provides each Participant with a daily position report evidencing the ownership of its Options;

(2) Each Participant must file a certified list of signatures of its representatives who are authorized to sign on its behalf. In addition, each Participant must file all supporting powers of attorney, resolutions or other documents granting such authority;

(3) Each Participant must have a representative available at a designated office on every business day to take any and all actions necessary for conducting business through the System; and

(4) Each Participant must provide certified copies of the power of attorney or investment management agreement granting authority to such fund's investment manager to act on its behalf.

We believe these safeguards are consistent with the requirements of the Act and with prior SEC positions relating to the custody of securities that are issued in uncertificated form. Most notably, in Institutional Equity Fund (pub. avail. January 27, 1984) the SEC indicated it would not recommend enforcement action where stock index put options issued by the OCC in uncertificated form to a fund were maintained in the book-entry system at the OCC. Accordingly, because the service provided by Delta is very similar, if not identical in this

respect, to the service provided by the OCC, Delta should be treated as a securities depository with respect to the Options within the meaning of Rule 17f-4 and funds should be able to maintain assets in Delta's book-entry system without violating Section 17(f) of the Act.

Custody of Margin Deposits

Section 17(f) of the Act, as stated above, requires that the securities and other assets of a fund be maintained in the custody of a qualified bank custodian, a member of a national securities exchange or the fund. The Clearing Bank, which holds margin payments for the benefit of Delta to secure the obligations of writing Participants, is an entity authorized under Section 17(f) to act as a custodian of a a fund's assets. However, it is presently contemplated that the Clearing Bank would expressly hold a fund's margin payments solely for the benefit of Delta and not in a dual capacity as the fund's sub-custodian.

When entering Option transactions through the System, a fund writing an Option must deposit initial and additional margin with the Clearing Bank for the benefit of Delta. The initial margin is usually equal to a small percentage of the value of the securities underlying the Option. Initial margin is not a borrowing, but represents a good faith deposit by a fund on the Option it has written securing its performance as required upon exercise of the Option. Subsequent payments, called additional margin, are calculated daily over the life of the Option. The daily calculation of additional margin is based upon the estimated cost to liquidate a Participant's written (short) Option positions, less the proceeds from a Participant's long (purchased) Option positions, taking into account reasonably anticipated adverse price changes in the underlying Treasury securities, plus additional economic factors relevant to the financial condition of the System or the Participant.

Margin requirements that exist in connection with the writing of Options through the System do not exist for the benefit of the writing Participant. Instead, such margin deposits are essential for the protection of the System, Delta and other Participants in the event that a writer of an Option defaults on its obligations. So long as the Option has not expired, been exercised or terminated by means of a closing transaction, the fund has no right to any assets deposited as margin except for those assets which may be refunded as a

result of a favorable variation in the value of the Option.[4] Because the fund has no right to the assets held as margin until the Option is exercised, terminates or expires, such assets should not be considered fund assets and, therefore, should not have to be maintained in the custody of an entity specified in Section 17(f) of the Act.

Furthermore, the fact that a fund has a right to have deposited margin refunded under certain circumstances does not render such margin an asset of the fund. Rather, a fund's interest in the cash or securities used to satisfy its margin requirement is cut off and replaced by the fund's interest in the Option it has written. The right to have deposited margin refunded is embodied in the Option itself. These rights are governed by the System rules and procedures, which are subject to SEC review and approval under Section 17A of the 1934 Act. Because the Option is maintained in Delta's book-entry system, the Option, and the rights arising under it, are properly protected as permitted by Rule 17f-4, assuming that the Staff takes the no-action position requested above with respect to custody of the Options.

This analysis is analogous to the position taken by the Department of Labor ("DOL") with respect to the assets of employee benefit plans invested in futures contracts. DOL Opinion No. 82-49A. In its opinion, the DOL found that margin deposits with respect to futures contracts were essential for the protection of all investors and participants in the commodity futures market. Therefore, such margin could not be considered to be a benefit accruing exclusively to an employee benefit plan nor could it be considered a plan asset. The DOL analysis is economically accurate, and we recommend its adoption by the Staff for this particular request.

Finally, the margin is held, accounted for, invested, and returned to Participants, when appropriate, by the Clearing Bank, which is a national bank subject to regulation by the Office of the Conptroller of the Currency and subject to

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[4] Such assets are returned, plus any other amounts owed to the Participant, such as premiums for Options written or exercise sale proceeds, net of other liabilities of the fund to Delta, such as premiums or service fees owed, on the next business day, which is consistent with the Staff's no-action position taken in Putnam Option Income Trust II (pub. avail. September 23, 1985). A daily net settlement system of this type is efficient and typical for contemporary clearing systems.

indirect SEC control through its contractual relationship with Delta as a facilities manager for a registered clearing agency. See the 17A Order at pp. 25-28.

We are familiar with the staff's no-action position expressed in the Putnam letter cited above, and in a series of other similar no-action letters. These letters conclude in essence that initial margin for listed options and futures transactions is a fund asset which must be held by the fund's custodian, but in the name of and subject to the right of the broker or futures commission merchant to reach the initial margin upon default by the fund. These letters also contemplate that variation margin may be paid to and held by the broker or futures commission merchant since such payments represent money actually owed by the Fund to such broker or futures commission merchant. We believe, however, that the situation presented in this letter has important factual distinctions which are described below. Even if the Staff does not agree with our conclusion that a fund's margin payments are not fund assets, we believe that the purposes of Section 17(f) of the Act will be entirely served if the Clearing Bank is permitted to hold the margin payments.

In the traditional margin situation described in the Putnam letter, the alternative to retention by the fund custodian would have been to have the broker or futures commission merchant hold the margin. Considering that many of these entities may have relatively low capitalization and are exposed to significant market and trading risks, as well as to extensive obligations for the financial protection of the relevant clearing corporation (i.e. "risk mutualization," as noted above), the risk of loss of a fund's margin payments made use of the fund's custodian bank the clearly preferable alternative. In the case of the System, however, the fund will be the direct participant, without interposition of a broker, and the holder of the margin assets will be an experienced national bank and trust company which is qualified to serve as a fund custodian. Furthermore, the funds which will be Participants in the System will be responsible only for their own obligations, unlike brokers or futures commission merchants participating directly in other clearing systems, which are liable for obligations of the clearing system. This direct participation adds another component of risk that such participants could become insolvent and the funds would be unable to recover their margin deposits. Delta's ability to perform its obligations in the event of default, as noted above, is supported by the credit enhancement facility rather than by the credit of its Participants. The fund's margin

account in the System would be as safe and well protected as the interests of the funds in the Putnam and other no-action letters referred to above.

We therefore would request the Staff's no-action position permitting the Clearing Bank to have custody of margin payments as described herein even if the Staff views the initial or additional margin as an asset of the fund.

Affiliated Transactions Under Section 17(a)

Section 17(a) of the Act generally prohibits any affiliated person or promoter of or principal underwriter for an investment company, or any affiliated person of such a person, promoter or principal underwriter, acting as principal, from knowingly purchasing from or selling to such investment company securities or other property. This section was included in the Act largely to protect shareholders from the potential abuses inherent in an investment company's purchase or sale transaction with a party who has both the ability and the pecuniary incentive to influence the actions of the investment company. Hearings on S.3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., 17 (1940). To the extent that a fund and its principal underwriter, an affiliated person of the fund and/or an affiliated person of such principal underwriter or affiliated person are each Participants in the System, it might well be argued that the fund could not directly negotiate a transaction in Options traded in the System with any such affiliate without violating Section 17(a) of the Act, notwithstanding the interpositioning of Delta as the contra-party to each Participant, since the price and other terms would have been established by the Participants. However, in situations where RMJ serves as a blind broker for Options traded in the System, and the fund and the affiliated person independently enter bona fide quotations through RMJ, with no pre-arrangement as to price or other Option terms, it would not be possible for any of the above-mentioned persons to knowingly buy from or sell Options on a basis that offends the policy underlying Section 17(a) of the Act.

As stated above, Delta is the contra-party to each Participant. For each Option issued by Delta, Delta contemporaneously will purchase from a writing Participant a matching Option. Although Participants could be matched by Delta with an affiliated fund or other affiliated person that happened to be seeking quotations simultaneously through RMJ, such transactions are matched, not for the purpose of establishing permanent parties to the transaction, but rather as a

means of relieving Delta of risk by allowing it to purchase an offsetting Option for every Option it issues. Similarly, in instances where a Participant exercises an Option, Delta would exercise the corresponding open Option position, whether or not the writer of that Option has any affiliation with the exercising Participant. If there is more than one corresponding open Option position, Delta may, in turn, exercise a matching Option on a random basis from a third party that may also be affiliated with the exercising Participant. Moreover, if the purchaser or writer of an Option decides to enter into a closing transaction, such transaction may be matched by Delta with a third party that also could be an affiliated person. Because Delta will interpose itself in each transaction, Participants executing trades will be in privity of contract solely with Delta and may look only to Delta to perform the obligations arising under the terms of an Option. Thus, there is technically no transaction in violation of Section 17(a). Provided that all such transactions in Options traded through the System are entered without prearrangement and consummated on a blind broker basis, the policy behind Section 17(a) will not be violated. In all of the foregoing examples, an affiliated party will not be in a position to influence the actions of a fund Participant because such affiliated party will not know the identity of the other party to the transaction. Therefore, such transactions should not be deemed to be affiliated transactions in violation of Section 17(a) of the Act.

We also believe that investment companies dealing with other affiliated investment companies participating in the System would not violate Section 17(a) if they deal directly with each other pursuant to the guidelines of Rule 17a-7 under the Act or through RMJ as described above.

* * *

We therefore respectfully request that the Staff confirm that it will not recommend enforcement action to the SEC with respect to the matters discussed above under "No-Action Position Requested."

If further clarification or amplification of any of the facts or issues discussed in this letter is required, please contact the undersigned or Michael J. Richman of this office. You may also wish to confer with Jonathan Kallman, Esq. of the Division of Market Regulation, who is quite familiar with the

System, Delta's registration under Section 17A of the 1934 Act, and the no-action letters on issues under the 1934 Act referred to above.

Very truly yours,

Peter L. Curry

PLC/lrb
Enclosures
cc. Jonathan Kallman, Esq.
Division of Market Regulation

PUBLIC

JUL 21 1989

Our Ref. No. 89-66-CC
Delta Government
Options Corp.
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of February 1, 1989 requests our assurance that we would not recommend that the Commission take any enforcement action under the Investment Company Act of 1940 ("1940 Act") if registered investment companies participate in an over-the-counter options trading system ("System") in the manner described in your letter. 1/ You specifically request that:

(1) a fund having a position in options issued by Delta, a registered clearing agency, not be required to include such options and, in the case of a writer of options, the securities (or cash and money market instruments in the case of a put) used to cover such options, in the ten percent limitation on investments by an open-end fund in illiquid securities; 2/

(2) Delta be treated as a securities depository within the meaning of Rule 17f-4 under the 1940 Act with respect to a fund's position in options, so that maintaining evidence of a fund's option positions in Delta's book-entry system would not violate Section 17(f) of the 1940 Act;

(3) a fund writing options be permitted to deposit the necessary initial and any additional margin directly with Security Pacific National Trust Company (the "Clearing Bank") without violating Section 17(f) of the 1940 Act; and

(4) a fund, its principal underwriter, promoter, an affiliated person of such fund, or an affiliated person of such principal underwriter, promoter, or affiliated person be permitted to simultaneously enter option opening, closing and exercise transactions through the System on a "blind broker" basis without treating such transactions as affiliated transactions in violation of Section 17(a) of the 1940 Act.

First, you believe that it is appropriate and consistent with the intent of Guide 13 of the Guidelines to Form N-1A 3/ to

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1/ The options traded through the System will be put and call option contracts issued by Delta Government Options Corp. ("Delta") on certain U.S. Treasury securities.

2/ As your letter states, certain closed-end investment companies may have adopted analogous investment restrictions.

3/ Guide 13 to Form N-1A, the registration form for open-end

(continued...)

take the position that the options in the System are liquid and that the value of purchased options as well as the assets used as cover for written options should not be included within the category of illiquid securities. We cannot agree. While the System provides a forum for the trading of options on U.S. Treasury securities, on the basis of the facts in your letter we are unable to conclude that such a forum is either "established" or provides a liquid market. Indeed, you state that the secondary market created by the System and the standardization of certain option terms will make options written or purchased by a fund "relatively liquid to the extent that other Participants are active in the System."

Second, you believe that Delta should be treated as a securities depository for the purpose of Rule 17f-4 under the 1940 Act and that such treatment is consistent with the intent of Section 17(f) and the Rule. 4/ As support for this, you cite Institutional Equity Fund (pub. avail. Feb. 27, 1984) 5/ and assert that Delta's book-entry system is very similar, if not identical, to the OCC's system. We cannot agree. While your letter states that Delta issues options in uncertificated form, maintains central book-entry records of all options issued, effects all transfers by book-entry, and treats options of the

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3/(...continued)
investment companies, in relevant part, states the staff's position that "[t]he usual limit on aggregate holdings by open-end companies of illiquid assets, including debt securities for which there is no established market, is 10 percent of the value of its net assets." (emphasis added). In Investment Company Act Rel. No. 7221 (June 9, 1972) the staff included restricted securities, interests in real estate, and commodities futures contracts as other investments to be considered when determining the ten percent limitation on illiquid investments. See generally Investment Company Act Rel. No. 5847 (Oct. 21, 1969) (Commission sets forth the ten percent limitation on restricted securities and other assets not having readily available market quotations).

4/ Rule 17f-4 defines a securities depository as a "system for the central handling of securities where all securities of any particular class or series of any issuer deposited within the system are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery of securities." (emphasis added).

5/ In Institutional Equity the staff granted no-action relief to a fund to permit its bank custodian to maintain stock index put options owned by the fund at the Options Clearing Corp. ("OCC") through a clearing member of the OCC.

same type or series as fungible, your letter does not state that options within the System can be pledged as required by paragraph (a) of the Rule. 6/

Third, we are unable to agree that a fund's margin payments are not assets of a fund and thus need not be maintained in a manner that complies with Section 17(f). 7/ Nor can we agree with your alternative assertion, that "the purposes of Section 17(f) of the 1940 Act will be entirely served if the Clearing Bank is permitted to hold the margin payments." Particularly, we note that your letter does not state in whose name the margin payments would be held (i.e., Delta's or a fund's) or, if held in a fund's name, under what circumstances Delta would have access to such payments.

Finally, we would not recommend that the Commission take any enforcement action under Section 17(a) of the 1940 Act in situations where RMJ Options Trading Corp. ("RMJ"), a registered broker-dealer, serves as a blind broker, as described in your letter, for options traded in the System, provided the fund and any affiliated person independently enter bona fide quotations through RMJ with no pre-arrangement as to price or other option terms. 8/ Because this response is based on the facts and representations made in your letter, you should note that any

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6/ See Institutional Equity Fund letter where counsel represented that the OCC can effect the transfer or pledge of stock index options by book-entry.

7/ See, e.g., Putnam Option Income Trust II (pub. avail. Sept. 23, 1985).

8/ However, on the basis of the facts provided in your letter, we are unable to agree with your belief that investment companies may rely on Rule 17a-7 under the 1940 Act. For example, paragraph (a) of the Rule prevents an investment company from relying on the Rule with respect to transactions in securities for which market quotations are not readily available. See Investment Company Act Rel. No. 11676 (March 10, 1981) (adopting amendments to Rule 17a-7). Moreover, subparagraphs (b)(1)-(3) do not appear to apply to the System and it is not clear to us that investment companies would be able to satisfy subparagraph (b)(4) of Rule 17a-7. Subparagraph (b)(4) contemplates that a fund would solicit, from disinterested third parties, a sufficient number of bid and offer prices for the options to be purchased or sold to allow the current market price to approximate the actual value of the option in the secondary market. See Principal Preservation Tax-Exempt Fund, Inc., Principal Preservation Tax-Exempt Portfolios, Inc. (pub. avail. Dec. 8, 1986).

different facts or conditions may require a different conclusion. Further, this response only expresses the Division's position on enforcement action and does not purport to express any legal conclusions on the questions presented.

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