

WILLIAM E. TAYLOR

ATTORNEY AT LAW

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Act	ICA-40
Section	18(f)
Rule	March 25, 1977
Public	
Availability	1/21/78

MAILED  
DEC 22 1977  
MAIL PROCESSING SECTION SEC.

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MAILING ADDRESS:

POST OFFICE BOX 1000  
EUGENE, OR 97405

William E. Taylor  
Attorney at Law  
2735 Almaden Street  
Eugene, OR 97405

Securities and Exchange Commission  
Washington, D.C. 20549

RECEIVED  
MAR 28 1977  
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MAIL PROCESSING SECTION SEC.

Re: Emerald Management Company

Gentlemen:

I am registered under the Investment Advisors Act under the above name, but at this point have no clients, and have taken no steps to obtain any. The more I think about it, the more inclined I am to proceed (if I proceed at all) by using an investment company of the type envisioned in Section 10 (d) of the Investment Company Act of 1940 as amended.

I do have a question concerning the Commission's interpretation of that act, and would appreciate your consideration.

How has the Commission interpreted section 12 (a)? It appears to me that the three acts specified in (1) to (3) are permissible per se unless the Commission has made rules prohibiting or limiting them. Are there such rules? I am particularly concerned here with the use of options.

Incidentally, I realize that before I do anything under the Investment Company Act my ADV would have to be amended.

Thank you.

Very truly yours,

William E. Taylor

WT:lt

**PUBLIC**

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 77-199CC  
Emerald Management Company  
File No. 132-3

A recent review of our records indicated that we had failed to provide you with a substantive response to your letter which we previously acknowledged receiving. Please excuse our delay.

Section 12(a) of the Investment Company Act of 1940 ("Act") provides that:

"It shall be unlawful for any registered investment company, in contravention of such rules and regulations or orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors --

- (1) to purchase any security on margin, except such short-term credits as are necessary for the clearance of transactions;
- (2) to participate on a joint or a joint and several basis in any trading account in securities, except in connection with an underwriting in which such registered company is a participant; or
- (3) to effect a short sale of any security, except in connection with an underwriting in which such registered company is a participant."

No rules or regulations have been adopted pursuant to Section 12(a). Nevertheless, the staff of the Commission, through publicly available letters and Commission approved guidelines, has indicated that the activities referred to therein may be limited by other provisions of the Act. For example, a purchase on margin by a registered investment company is limited by Section 18(f) of the Act which prohibits borrowing by an open-end company unless such borrowing is from a bank.

Short sales are limited by Section 18 of the Act which prohibits the issuance of senior securities by registered investment companies. For a short sale by an investment company not to involve the creation of a senior security, the selling company must put, in a segregated account with a bank, an amount of cash or government securities equal to the difference between (a) the market value of the securities sold short at the time they were sold short and (b) any cash or government securities required to be deposited as collateral with the broker in connection with the short sale (not including the proceeds from the short sale). In addition, until the company replaces the borrowed

security, it must maintain the segregated account at such a level that (1) the amount deposited in it plus the amount deposited with the broker as collateral will equal the current market value of the securities sold short, and (2) the amount deposited in it plus the amount deposited with the broker as collateral will not be less than the market value of the securities at the time they were sold short.

The writing of put and call options is also subject to certain restrictions in order that it not result in the issuance of a senior securities in violation of Section 18 of the Act. An investment company desiring to write call options must provide that it will own the securities against which call options are written or purchase a call on the same securities at the same price or maintain a reserve, in the form of cash, government securities or high grade senior securities, equal to the market value of the optioned securities. Put options are required to be offset by either a purchase of a put on the same securities at the same price, a segregated account, consisting of cash, U.S. government securities or high grade debt securities, equal to the price at which the securities underlying the option may be sold to the company, or by a corresponding short sale.

  
Stanley B. Judd, Assistant Chief Counsel  
Division of Investment Management

PS/ch/cf/hbg

DEC 22 1977

cc: SRO