K&L GATES

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By E-mail

Paul G. Cellupica, Esq.
Deputy Director and Chief Counsel
Division of Investment Management
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for No-Action Relief from Section 17(f) of the Investment Company Act of 1940 and Rule 17f-2 Thereunder with respect to Custody of Loan Interests

Dear Mr. Cellupica:

We are writing on behalf of an investment advisory client ("Adviser") and certain of the registered management investment companies or series thereof for which it or one of its affiliates serves as investment adviser or sub-adviser (collectively, the "Funds") to request assurances that the Division of Investment Management of the U.S. Securities and Exchange Commission (the "Commission" or "SEC") will not recommend any enforcement action to the Commission under Section 17(f) of the Investment Company Act of 1940, as amended (the "1940 Act"), and paragraphs (b)-(f) of Rule 17f-2 thereunder against the Funds or their directors or officers if the Funds, each acting as self-custodian of its assets, maintain custody of loan interests pursuant to Rule 17f-2 in the manner, and subject to the conditions, described below, rather than in strict compliance with paragraphs (b)-(e) of Rule 17f-2 and do not comply with the requirement under paragraph (f) of Rule 17f-2. We believe that maintaining custody of such interests, as described herein, is consistent with the protections that Section 17(f) and Rule 17f-2 were intended to provide.

I. Factual Background Information

Adviser and certain of its affiliates are investment advisers that are registered with the SEC under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). The Funds invest in, among other things, term or delayed draw corporate loans ("Loans") that are originated, negotiated and structured by one or more primary lenders ("Primary Lenders") typically consisting of banks, insurance companies or other financial institutions. One or more of the Primary Lenders or another financial institution administers the Loans on behalf of the lending syndicate ("Administrative Agent"). The terms of the Loans typically are set forth in a Credit Agreement between the borrower, which typically is an operating company (the "Borrower"), the Administrative Agent and the Primary Lenders. The Credit Agreement sets forth the terms of the Borrower's obligation on the Loan. It also typically limits or conditions the ability of the Primary

Lenders to assign interests in the Loans. Loan documentation with the Borrower also typically includes a promissory note and, when the loan is secured, a security agreement or other collateral documentation.

Pursuant to the specific terms and subject to the conditions set forth in the Credit Agreement on permitted transfers, Primary Lenders may sell interests in a Loan ("Loan Interests")[1] to third parties such as the Funds. Such sales and the transfer of the Loan Interests are effected by contract, and typically are initiated by the execution of an Assignment and Assumption Agreement or a Purchase and Sale Agreement between the parties (the "Assignment Agreement"). The Assignment Agreement constitutes an agreement by the selling Lender to transfer the Loan Interest to the purchasing Fund subject to the satisfaction of various conditions including those mandated by the Credit Agreement.

The Loan Interests are not actually transferred to the purchasing Fund until a multi-step settlement process has been completed. That process typically includes: (1) settlement coordination under which the seller, the purchasing Fund and the Administrative Agent for the Loan Interest coordinate the proposed settlement date and other terms of the transfer, (2) counter-signature of the Assignment Agreement by the Administrative Agent, (3) communication of the details of the proposed transaction to the parties for review and confirmation, (4) transmission of information as to funding the purchase price needed to settle the transaction, (5) final verification by parties prior to funding, and (6) wire transfer of the purchase price and recordation of the purchasing Fund's interest on the ownership records maintained by the Administrative Agent on behalf of the Borrower. These steps normally are effected using ClearPar or a comparable, electronic trading and settlement platform for Loan Interests. As part of this process, the trading and settlement platform verifies transactions and documents prior to settlement. An Assignment Agreement, a countersigned Institutional Allocation Confirmation in some cases, and a Funding Memorandum or similar document (collectively, the "Loan Documents") usually are executed and exchanged electronically as part of this process. There typically are no manually executed original documents relating to transfers of Loan Interests using such platforms.

The Administrative Agent for a Loan generally administers the terms of the Loan, and it is responsible for the collection of principal and interest and fee payments from the Borrower and the transmittal of these payments to the record holders of the Loan Interests. In addition, the Administrative Agent is responsible for monitoring compliance with loan covenants and may hold collateral that secures the Loan. The Funds generally rely on the Administrative Agent to collect their portion of the payments on the Loan Interests that they purchase and to arrange for those payments to be remitted to the Funds' custodian. The Funds may invest in Loan Interests that are administered by entities that meet the definition of "bank" under the 1940 Act as well as by non-banks.

There typically is no note, certificate or other physical security that evidences a Fund's Loan Interest. Rather, the Funds' Loan Interests are uncertificated and, as noted above, are reflected on the records that are maintained on behalf of the Borrower, typically by the Administrative Agent, for the purpose of identifying the owners of all Loan Interests and the

[1] For purposes of this letter, Loan Interests do not include interests in collateralized loan obligations.

principal amount of the Loan attributable to each. Such records are analogous to those maintained by the transfer agent for an ordinary, publicly traded security.

Accordingly, the Funds do not receive any securities certificate or other tangible token of ownership that could be custodied with its custodian or that, if endorsed and delivered to a subsequent purchaser or other third party, could be used by that third party to evidence its own right to a Fund's Loan Interest. A Fund does receive Loan Documents that together evidence the fact that the Fund has purchased a particular Loan Interest and the terms on which it did so. Possession of those documents, however, would be of no value to a purchaser or other purported transferee of a Fund's Loan Interests. Rather, a transfer by a Fund to such a subsequent transferee would be effected by following a multi-step settlement process such as that outlined above.

The Funds' practice has been to maintain the Loan Documents with the Fund's custodian for safekeeping. The Funds and the custodian have entered into a sealed envelope safekeeping letter agreement. Under the letter agreement, the custodian agrees to safekeep certain documents, including bank debt agreements in a secure and access-controlled environment. The custodian does not verify the contents of the sealed envelopes and is not responsible for the contents of the envelopes. In addition, the custodian does not reconcile the contents of the sealed envelopes (including the bank debt agreements) with the Funds' books and records. The custodian does not provide any other services with respect to the bank debt agreements. For the reasons indicated above, these practices do little to further the purposes underlying Section 17(f). Of greater importance is the fact that, as with all registered investment companies, each Fund is subject to an annual audit during which an independent public accountant confirms all of the Fund's investments, including its investments in Loan Interests.

The bank loan investment category is a growing asset class generally with approximately \$387.3 billion in new U.S. institutional bank loan issuance from January 1, 2020 through November 30, 2020, and approximately \$1.2 trillion in par amount outstanding as of November 30, 2020. Based on the volume of transactions and the frequency of refinancings and paydowns, which can occur daily, it has become extremely burdensome to maintain copies of the Loan Documents and amendments with the Funds' custodian. In addition, custodians have become reluctant to safekeep paper documents like these, particularly in light of the loss of securities certificates and other transaction-related documentation maintained at DTC's vault due to flooding caused by Hurricane Sandy.

The Funds propose to cease providing the Loan Documents to their custodian for safekeeping. Adviser recognizes that, as a result, the Funds may be deemed to have custody of the Loan Interests, in which case the Funds would be subject to Rule 17f-2 under the 1940 Act. However, as discussed below, the requirements of Rule 17f-2 present obstacles to, and impose unnecessary burdens on, self-custody of assets that are truly uncertificated or that are not represented by traditional securities, such as Loan Interests. Accordingly, Adviser requests assurance from the staff of the Commission's Division of Investment Management that it will not recommend that the Commission take enforcement action under Section 17(f) or Rule 17f-2 thereunder against the Funds or their directors, officers, advisers or sub-advisers if the Funds comply with Rule 17f-2(a)-(e) in the manner described below and do not comply with the requirement under paragraph (f) of Rule 17f-2 that each Fund's securities and similar investments deemed to be in the custody of the Fund be verified by an independent public accountant at least three times annually.

II. Relevant 1940 Act Provisions and Related Analysis

A. Applicable Requirements

Section 17(f) of the 1940 Act requires that "[e]very registered management company shall place and maintain its securities and similar investments in the custody of (A) a bank…; (B) a company which is a member of a national securities exchange…subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (C) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors." The legislative history of Section 17(f) indicates that Congress was concerned about, among other things, the ability of persons affiliated with a fund to misappropriate or otherwise misuse a fund's assets.

Rule 17f-2 under the 1940 Act sets forth the conditions under which a fund may act as a self-custodian, which generally include the following: (1) with certain exceptions not relevant here, all fund investments shall be deposited in the safekeeping of a bank (the "vaulting requirement"); (2) the fund's board must designate no more than five authorized persons for the fund and adopt a resolution permitting access to the fund's investments only by two persons jointly (the "access requirement"); (3) any person depositing or withdrawing investments from the depository or ordering their withdrawal and delivery from the safekeeping of the fund or other company shall sign a notation that contains certain specified information (the "notation requirement"); and (4) investments maintained by a fund must be verified by complete examination by an independent public accountant retained by the fund at least three times during the fiscal year, at least two of which shall be chosen by the accountant without prior notice to the fund (the "verification requirement"). Accounting Release No. 27 specifies the nature of the examination, requiring a physical examination of the securities themselves or in appropriate cases, a confirmation, a reconciliation of the physical count or confirmation with the book records, and an examination of the investment accounts and supporting records including a check or analysis of the security transactions since the last examination and the related entries.[2]

Rule 17f-2 was adopted in 1941 at a time when virtually all securities were issued in certificated form and when securities ownership normally entailed physical possession of securities certificates. Consequently, as noted above, the requirements of Rule 17f-2 present obstacles to, and impose unnecessary burdens on, self-custody of assets that are truly uncertificated or that are not represented by traditional securities, such as Loan Interests.

The SEC staff has granted no-action relief under Rule 17f-2 in certain circumstances involving uncertificated investments. In *Gardner Fund* (Mar. 7, 1988), the SEC staff agreed not to recommend enforcement action under Rule 17f-2 if a fund-of-funds maintained its investments in other investment company securities in the book-entry systems of the underlying investment companies' transfer agents, subject to certain internal controls and verification procedures. In seeking no-action relief, the applicant noted that (i) the physical count, inspection and confirmation of its investments in investment company securities required under Rule 17f-2(f) was

[2] 1940 Act Release No. 279, Accounting Series Release No. 27 (Dec. 11, 1941).

impossible due to the fact that such investments are uncertificated and only evidenced by confirmations and account statements and (ii) the requirements of Rule 17f-2(b) and (e) contemplated the physical safekeeping of certificated securities.

Instead of requiring the applicant to comply with the self-custody requirements under Rule 17f-2, the SEC staff permitted the fund to rely on then-current Rule 17f-4 ("Former Rule 17f-4") (which authorized an investment company or its custodian, subject to certain conditions, to deposit securities in a registered clearing agency that functioned as a securities depository). In so doing, the staff regarded the investment company transfer agents that held the fund's investment company shares as analogous to "securities depositories" because they performed similar functions. This relief was conditioned on various internal controls designed to adapt Former Rule 17f-4's requirements to uncertificated securities. In addition, with respect to compliance with the verification requirements of paragraph (f) of Rule 17f-2, the staff permitted the fund to retain an auditor to conduct reconciliations of the fund's records of securities held with the confirmation and account statements of the issuer and, in appropriate cases, to independently confirm the fund's records of its holdings of such securities with the records maintained by the issuers.

B. Proposed Custody Arrangements for Loan Interests

Adviser believes the full protections afforded by Rule 17f-2 are not necessary in connection with the self-custody of Loan Interests and proposes that the Funds maintain custody of Loan Interests pursuant to Rule 17f-2 in the following manner.

Vaulting Requirement. As in *Gardner Fund*, the Funds do not have a certificated security to deposit in a vault and therefore it is impossible to satisfy the vaulting requirement. The Loan Documents themselves are not equivalent to certificated securities. Possession does not give the holder any rights. They cannot be used or exchanged for payments of principal and interest and their physical delivery to another party is not sufficient either to effect a transfer of the Loan Interests or to entitle the transferee to be reflected as the owner of the Loan Interests on the records maintained by the Administrative Agent. The Loan Documents simply evidence the fact that the Fund itself had acquired the Loan Interests.

Hence, as in *Gardner Fund*, the Funds propose to implement the conditions described in the bullet points below, which are similar to those that were required under Former Rule 17f-4. This is consistent with SEC guidance in the 2003 Adopting Release for revised Rule 17f-4, in which the SEC acceded to comments suggesting that, rather than codify the staff's analogy of fund transfer agents to securities depositories, the matter of funds' direct holdings of uncertificated securities should be considered as part of a contemplated revision of the self-custody requirements under Rule 17f-2, but also said that "until then" funds should continue to rely on the staff's previous guidance on such matters.[3]

Access and Notation Requirement. Similarly, the Funds propose to implement internal control procedures similar to those permitted in *Gardner Fund* as a means of complying with the access and notation requirements of Rule 17f-2. The alternative procedures implemented

[3] *Custody of Investment Company Assets with a Securities Depository*, 1940 Act Release No. 25934 (Feb. 13, 2003), at n. 15.

pursuant to *Gardner Fund* included: (1) limitations on the number of persons authorized to transmit instructions to the transfer agent, (2) use of passwords to ensure that only properly authorized persons can transmit instructions, (3) transmission by the transfer agents of confirmation of each transaction to persons employed by the fund's administrative agent other than those who transmit the investment instructions, and (4) internal accounting controls that subject all confirmations from the transfer agents to daily proof against the transaction authorizations of the fund. Adviser proposes that the requested relief be subject to the Funds implementing the following conditions, which are similar to those implemented pursuant to *Gardner Fund* and are consistent with those required under Former Rule 17f-4:

- Only a limited number of authorized personnel of the Funds would provide instructions to the Funds' custodian and the Administrative Agents.

- Passwords or other appropriate security procedures would be used to ensure that only properly authorized persons can transmit such instructions.[4]

- The Funds would reconcile settled Loan Interests to the records of Administrative Agents on a regular basis (*i.e.*, at least monthly). This reconciliation would be performed by portfolio accounting, investment operations personnel, or the Funds' accounting agent and not by Adviser's portfolio management personnel. The Funds also will review interest payments for accuracy. This verification process will supplement the monthly reconciliation because the Loan's principal amount is a component of the interest calculation and some interest payments are paid on dates other than month-end.

- Loan Interests would be titled or recorded at the Administrative Agents in the name of a Fund and not in the name of Adviser.

- Neither the Funds nor Adviser would be affiliated with the Administrative Agents for the Loan Interests.

- The Funds would adopt policies and procedures reasonably designed to prevent violation of the conditions in the preceding bullet points, and such policies and procedures would be part of the Fund's compliance program under 1940 Act Rule 38a-1.

Verification Requirement. As in *Gardner Fund*, the investments at issue here are not certificated securities, and therefore literal compliance with paragraph (f) of Rule 17f-2, as interpreted under Accounting Release No. 27, is impossible. In *Gardner Fund*, the SEC staff permitted the funds to retain an auditor to conduct reconciliations of the fund's records of securities held with the confirmation and account statements of the issuer and independently

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[4] For example, Adviser personnel who are authorized persons of the Funds currently utilize a two-step authorization process for any bank debt transaction; *i.e.*, the trade is authorized through one trade operations team and the instruction on cash movement is authorized through a second trade operations team. Thus, even when trade-related instructions cannot be transmitted through a password protected system, this two-step process provides security to ensure that only properly authorized persons can transmit such instructions to the Funds' custodian and the Administrative Agents.

confirming the fund's records of such securities held with the issuers, rather than comply with the express verification requirements of Rule 17f-2. However, Adviser believes that reconciliations of the type contemplated in *Gardner Fund* for uncertificated securities are not necessary for the protection of investors under the facts presented here and that, given the proposed procedures outlined above, the Funds should not be required to incur the expense of hiring an independent public accountant to perform two surprise verifications annually.

Each Fund currently is subject to an annual audit during which the independent public accountant confirms all of the Fund's investments, including its investments in Loan Interests, and reconciles the Loan Interests to the Fund's account records. The independent auditor relies on controls testing as reported in the Service Organization Controls Report (SOC 1) on Adviser's fund accounting system and controls around trade authorization, trade confirmation, position reconciliation, cost roll-forward, and the systematic calculation of realized gains and losses. In addition, the multi-step settlement process needed in order to sell Loan Interests in the secondary market requires the involvement of multiple unaffiliated parties and is subject to numerous conditions and controls that make it unlikely that a Loan Interest could be misappropriated by persons associated with the Funds.

Moreover, retaining an independent public accountant to perform three verifications annually, including two surprise verifications, would be unnecessarily duplicative and time consuming and would not provide a corresponding benefit. The annual cost of two surprise verifications (in addition to the regular annual audit) could be significant and would be borne by the Funds.

Lastly, Adviser believes that granting the requested relief from the verification requirement would be consistent with the position taken by the SEC in Rule 206(4)-2 under the Advisers Act where the SEC recognized that a single annual audit, such as that normally performed for mutual funds, provides sufficient custody protections to investors in pooled investment vehicles. In 2009, the SEC adopted Rule 206(4)-2 under the Advisers Act, which sets forth the requirements where an adviser may have custody of client funds and securities.[5] Paragraph (a)(4) of this rule requires one surprise annual verification of assets by an independent public accountant. However, this paragraph also provides that an adviser is deemed to comply with the annual verification requirement with respect to any pooled investment vehicle that, like all mutual funds, is subject to annual audit by an independent public accountant. Adviser believes that there is no compelling policy reason to require two surprise verifications in the context of mutual fund self-custody under Rule 17f-2 and none where an investment adviser is deemed to have custody of client assets under Rule 206(4)-2.

III. Conclusion

Based on the foregoing and on behalf of Adviser, we seek your assurance that the Division of Investment Management will not recommend that the Commission take any enforcement action under Section 17(f) or Rule 17f-2 thereunder if, in connection with their investments in Loan Interests and subject to the conditions outlined herein, the Funds comply with Rule 17f-2(a)-(e) in the manner described herein and do not comply with the requirement under paragraph (f) of Rule

[5] *Custody of Funds or Securities of Clients by Investment Advisers*, Advisers Act Release No. 2968 (Dec. 30, 2009).

17f-2 that each Fund's securities and similar investments deemed to be in the custody of the Fund be verified by an independent public accountant at least three times annually.

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If you have any questions, please feel free to contact Mark C. Amorosi ((202) 778-9351)) or Robert A. Wittie ((202) 778-9066)).

Sincerely,

Mark C. Amorosi

cc: Robert A. Wittie, K&L Gates LLP