

**MEMO# 8036**

July 5, 1996

## **NO-ACTION LETTER EXPANDING THE TYPES OF SECURITIES PERMITTED TO BE PLACED IN SEGREGATED ACCOUNTS**

July 5, 1996 TO: CLOSED-END FUND MEMBERS No. 17-96 COMPLIANCE COMMITTEE No. 17-96 SEC RULES MEMBERS No. 32-96 UNIT INVESTMENT TRUST MEMBERS No. 28-96 RE: NO-ACTION LETTER EXPANDING THE TYPES OF SECURITIES PERMITTED TO BE PLACED IN SEGREGATED ACCOUNTS

The Division of Investment Management has issued a no-action letter addressing the types of securities that a fund may place in a segregated account for purposes of avoiding the creation of a senior security under Section 18(f) of the Investment Company Act of 1940. A copy of the no-action letter is attached. The investment adviser to a large number of investment companies requested relief to be able to "cover" its obligations under certain trading practices by placing liquid assets, including equity securities and debt securities of any grade, in a segregated account established on the books of a funds custodian. The adviser noted that in 1979 the Commission issued Investment Company Act Release 10666, which stated that a fund could avoid creation of a senior security under Section 18(f) by maintaining a segregated account containing assets that are unencumbered, liquid and marked to market daily. By way of example, the Commission listed cash, U.S. government securities, and other appropriate high-grade debt obligations. Since that time, the staff has restricted the assets that may be included in a segregated account to the examples listed in the release. The adviser asserted that this position "distorts the economics of fund portfolio management and serves to discourage many funds from entering into Senior Security Transactions to hedge their portfolios." In responding favorably to the advisers request, the staff took the position that it would be consistent with the language and policy of Section 18(f) and Release 10666 to permit a fund to place any asset, including equity securities and non-investment grade debt, in a segregated account, so long as the asset is liquid, unencumbered and marked to market daily. The funds board of directors would have ultimate oversight responsibility for determining the liquidity of such securities. The functions of determining and monitoring liquidity may be delegated by the board to the funds adviser, so long as the board establishes guidelines and procedures and oversees the advisers performance of the functions on an ongoing basis. The letter further states that the board, or its delegate, has a continuing duty to monitor the liquidity of segregated account assets and must take appropriate steps if circumstances change. Moreover, the letter notes that a funds compliance responsibilities with respect to marking the assets to market "may require greater vigilance" if the securities are subject to a higher degree of price volatility than cash, U.S. government securities and high-grade debt obligations. Amy B.R. Lancellotta Associate Counsel Attachment (in .pdf format)

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