Investors Group of Companies

1000 Roanoke Building
Minneapolis, Minnesota 55402

Leslie L. Ogg
Vice President and
General Counsel

Telephone 612/372-3717

November 19, 1982

Stanley B. Judd, Deputy Chief Counsel
Division of Investment Management
Securities and Exchange Commission
Judiciary Plaza
450 Fifth Street, N.W.
Washington, D.C. 20549

Act	ICA-40
Section	18(f)
Rule	
Public Availability	4/11/83

Re: IDS Bond Fund, Inc.
File No. 811-2503
Interest Rate Futures Contracts
Request for a No-Action Letter

Dear Mr. Judd:

Background

IDS Bond Fund, Inc. is a diversified open-end management type investment company which was incorporated in the State of Nevada in June 1974. It presently has net assets of approximately $750 million. In July 1981, it asked for and obtained permission from its shareholders to use interest rate futures contracts traded on contract markets with the understanding that such contracts would not be used until certain regulatory issues were resolved. Since that date, it has worked to resolve all the regulatory issues.

The first issue was resolved on December 23, 1981, when it received from the Commodity Futures Trading Commission (CFTC) an interpretation of Section 4.10(d) of the CFTC's Regulations that Bond Fund is not a pool operator. The CFTC's letter stated,

> "Based upon our evaluation of that information, it is our opinion that IDS Bond Fund, Inc. is not a 'pool' within the meaning and intent of §4.10(d). This opinion is based upon, among other things, the facts that: (1) Bond Fund intends to use interest rate futures contracts solely to hedge against anticipated interest rate changes and not for speculation; 7/ (2) no more than 5% of

"Bond Fund's assets will be committed to commodity futures trading; (3) the aggregate market value of the commodity futures contracts that Bond Fund may hold will not exceed 30% of the market value of Bond Fund's total assets; (4) Bond Fund has not been, and will not be, marketed to the public as a commodity pool; and (5) Bond Fund will disclose to each prospective investor therein the purpose and scope of Bond Fund's commodity futures trading, including the limitations on positions which may be taken and on the assets which may be committed to margin futures contracts in connection with such trading."

"7/ Our opinion that Bond Fund is not a pool does not also constitute a finding that Bond Fund's contemplated hedging activities are examples of 'bona fide hedging transactions and positions' as defined in §1.3(z), 17 C.F.R. §1.3(z) (1981). Under that definition, for a transaction to be a bona fide hedging transaction, there must be an historical daily correlation between the cash and the futures prices thereof which evidences the risk-shifting essential to hedging transactions. Moreover, by this statement we do not mean to imply that an entity which otherwise would be a pool is not a pool because the nature of its activity in the commodity futures markets places it in the category of a hedger. As noted above, whether an entity is a pool 'depends on an evaluation of all the facts relevant to the entity's operation'."

While Bond Fund was in the process of obtaining an opinion from the CFTC, representatives of Bond Fund's investment manager worked to resolve issues arising under the laws of various states. These issues have been resolved by the offices of the securities commissioners in the States of Wisconsin, California, Texas, Michigan and Illinois giving permission for, or not objecting to, Bond Fund implementing a pilot program.

The only regulatory issues remaining unresolved are found in the Investment Company Act of 1940 (Act), as amended, and there are two. The first issue arises under Section 18(f) of the Act which makes it unlawful for any registered open-end investment company to issue any class of senior security. The second issue is whether Bond Fund, in complying with the margin requirements of a futures contract, would violate Section 17(f) which requires Bond Fund to place and maintain its securities with its custodian. In my opinion, Bond Fund, using the standards and procedures it has established, will not violate either section of the Act. I would appreciate your concurrence in that opinion.

The Senior Security Issue

Section 18(f) provides that it is unlawful for an open-end fund to issue a senior security. Because a futures contract requires a fund to pay monies or deliver a specific security to another person at some time down the road, I understand it has been considered by the Securities and Exchange Commission (SEC) to be the issuance of evidence of indebtedness which the Act defines to include security. Since such indebtedness would have priority over any class of shareholders in the distribution of assets, it, therefore, has been considered to be a senior security and subject to the provisions of Section 18(f). However, in 1972, the Guidelines to the Preparation of Form N-8B-1, Item 4(f), Investment Company Act Release No. 7221 (June 9, 1972), stated the SEC staff has not objected if a fund engages in commodities futures contract trading within prescribed limits. Those limits included the requirements that a fund's net assets be equal to at least three times the value of the futures contracts, initial margin be maintained in a segregated account, the fund not invest more than 10% of its assets in such contracts, and no more than twice the amount of the original margin deposit be invested in any futures contract.

With the exception of the last limitation, which is that no more than twice the amount of the original margin can be invested in any one futures contract, the limits the SEC staff established use the same criteria as Bond Fund but Bond Fund's standards are more restrictive than those set by the SEC staff. With respect to the limitation on the amount of additional margin a fund can invest, Bond Fund's commitment to limit the use of futures contracts to a hedge also is a more restrictive standard than the limit imposed by the SEC staff. Briefly stated, what Bond Fund means by the term "hedge" is that it will use futures contracts by entering into a short position against bonds being held in the portfolio or by entering into a long position against its short-term investments. Both strategies could be accomplished by actual cash transactions but accomplishing the same results through the use of futures contracts appears at times to be a desirable alternative. Since the futures contracts positions are countered by actual "cash" positions, a limitation of how much Bond Fund could pay out as variation margin would be inappropriate. The offsetting position concept falls squarely in line with the position expressed in Investment Company Act Release No. 10666 (April 18, 1979) which stated the SEC agrees that "...if the investment company 'covers' the senior security by establishing and maintaining 'segregated accounts'," it would limit the risk of loss. And, in such cases, the Division of Investment Management has determined the issue of compliance with Section 18 will not be raised. It also follows the reasoning set forth in the Emerald Management Company no-action letter (publicly available January 21, 1978).

The Custodial Issue

The second issue has to do with the custody of Bond Fund's assets and its compliance with Section 17(f) of the Act. This issue arises from the margin requirements established by the contract markets, which are boards of trade or other exchanges designated as a contract market by the CFTC. The CFTC does not control margin policy. (See Johnson, Commodities Regulation Vol. 1 ¶2.43, 1982) While each contract market's rules prohibit members from accepting trades without adequate margin, a futures commission merchant (FCM) establishes its own terms with a customer. There are two types of margins. The first, initial margin, is a good faith deposit. The second margin is the variation or maintenance margin. With respect to the initial margin, Bond Fund has discussed with certain FCMs the possibility of establishing a custodial account with Bond Fund's custodian. Under such arrangements, the account would be that of Bond Fund and the FCM could gain access to the assets held in the account only if Bond Fund failed to live up to the terms of its agreement. Since Bond Fund's assets are being held by its custodian in a segregated account, it is in full compliance with the terms of the Act.

With respect to the maintenance margin, any agreement which might be entered into between Bond Fund and a FCM will require the FCM to receive or to pay out an amount equal to all changes in the value of a futures contract on a daily basis. And, it is Bond Fund's intention to receive or pay out the monies on such basis. Since this margin is, in fact, adjusting the value of Bond Fund's position on a daily basis in negotiable funds, monies paid out are not assets of Bond Fund and monies received are to be held by the custodian. Accordingly, the requirements of Section 17(f) have been met.

It further appears that the custodian procedures, which Bond Fund proposes to follow, are within the concepts the SEC staff expressed in the Claremont Capital Corporation no-action letter (publicly available September 16, 1979).

Conclusion

For your information, I have enclosed Bond Fund's current prospectus dated October 25, 1982. Interest rate futures contracts are referred to in the Summary of Contents, on pages 5 and 19 and extensively in Appendix B.

It is my opinion that Bond Fund, following the procedures outlined above, will be in compliance with the requirements of Sections 18(f) and 17(f) of the Act. I would appreciate your advising me what action the Division of Investment Management would pursue if such procedures were followed.

Very truly yours,

Leslie L. Ogg

Leslie L. Ogg
Vice President and General Counsel

LLO:vb
Enclosure

MAR 1 0 1983

PUBLIC

Our Ref. No. 82-225-CC
IDS Bond Fund, Inc.
File No. 811-2503

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

With respect to the applicability of section 18(f) of the Investment Company Act of 1940 ("Act") to the proposed use by IDS Bond Fund, Inc. ("Bond Fund"), a registered open-end investment company, of interest rate futures contracts, we note that section 1(b) declares that the policy and purposes of the Act, in accordance with which its provisions shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in section 1(b) which adversely affect the national public interest and the interest of investors, and that section 1(b)(7) states that the national public interest and the interest of investors are adversely affected when investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities.

Bond Fund proposes to use interest rate futures contracts only for hedging and not for speculation. Hedging is intended to reduce risk rather than increase it. Bond Fund will hedge against anticipated interest rate changes by entering into a short position against bonds being held in the portfolio or by entering into a long position against its short-term investments. The purposes, procedures, and risks of such use of futures contracts are described more fully in Appendix B of Bond Fund's prospectus dated October 25, 1982. On February 3, 1983, you represented to me in a telephone conversation that the condition that no more than 5 % of Bond Fund's assets will be committed to commodity futures trading means that no more than 5% of Bond Fund's assets would be in initial plus variation margin and that there would be daily settlement of variation margin payments. Under these circumstances, we do not believe that Bond Fund's use of such contracts would increase unduly the speculative character of its junior securities. Accordingly, based on the facts and representations contained in your letter and in your telephone conversation with me, we would not recommend enforcement action to the Commission if Bond Fund uses interest rate futures contracts in the manner you have described without complying with section 18(f) of the Act.

With respect to the applicability of section 17(f), you state that Bond Fund would establish a custodial account with its custodian to hold the initial margin payment. Under such an arrangement, the account would be that of Bond Fund and the futures commission merchant ("FCM") could gain access to the assets held in the account only if Bond Fund failed to live up to the terms of its agreement with the FCM. Regarding the variation margin, you state that any agreement which might be entered into between Bond Fund and a FCM will require the FCM to receive or to pay out an amount equal to all changes in the value of a futures contract on a daily basis. It is Bond Fund's intention to receive or pay out the monies on such basis. We understand that if a customer has an unrealized gain above the amount of any net variation margin it has already received, the FMC, as of the close of that trading day, may receive, on behalf of such customer, a variation margin payment from the clearing corporation in the amount of such gain. By 10:30 a.m. the next business day, the FMC would notify the customer of its entitlement to receive a variation margin payment whereupon the customer is able to demand this amount from the FCM. Although the FCM may hold any excess margin overnight for Bond Fund's account, we would consider such custody by the FMC to be incidental to the transaction and not of sufficient duration to trigger the requirements of section 17(f) and the rules thereunder if Bond Fund demands payment promptly upon notification by the FCM that funds are due. Based on these facts and on the representations contained in your letter and in your telephone conversation with me, we would not recommend enforcement action to the Commission under section 17(f) of the Act if Bond Fund pays and receives initial and variation margin in the manner you have described.

Stanley B. Judd

Stanley B. Judd
Deputy Chief Counsel