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July 15, 1985

Securities and Exchange Commission  
Judiciary Plaza  
450 Fifth Street  
Washington, D.C. 20549

Act.	ICA-40
Section	18(f)
Rule	
Public Availability	9/23/85

Attention: Sidney L. Cimmet, Chief Counsel,  
Division of Investment Management

Re: Putnam Option Income Trust II

Gentlemen:

Putnam Option Income Trust II (the "Fund") is a diversified open-end investment company which was established as a Massachusetts business trust under the laws of Massachusetts by an Agreement and Declaration of Trust dated February 21, 1985. Enclosed are three copies of the Fund's Prospectus and Statement of Additional Information. The Fund is managed by The Putnam Management Company, Inc. Putnam Financial Services, Inc. is the distributor of the Fund's shares. On March 4, 1985, the Fund had net assets of \$100,000, which were contributed by its investment manager. The Registration Statement under the Securities Act of 1933 and the Investment Company Act of 1940 (the "1940 Act") was declared effective on April 4, 1985.

The Fund will seek its primary investment objective -- high current return -- by investing in dividend-paying common stocks, securities convertible into common stocks and U.S. government securities, and by writing covered call and put options with respect to part or all of its portfolio. It may also write call options on stock indexes. In seeking its secondary objective -- relative stability of principal -- the Fund may hedge against changes in the market prices of securities which the Fund owns or plans to buy through purchasing and writing put and call options on such securities. The Fund may also write and purchase options on futures contracts with respect to U.S. government

securities and write covered call options and purchase options on futures contracts with respect to stock indexes.

Options on futures contracts, and the commodities exchanges on which they are traded, are subject to regulation by the Commodity Futures Trading Commission ("CFTC") under the Commodity Exchange Act ("CEA"). In addition to seeking a no-action letter from the Securities and Exchange Commission ("SEC") under the 1940 Act, the Fund intends to seek a no-action letter from the CFTC that the Fund is not a commodity "pool" under Section 4.10(d) of the CFTC's Regulations and that the Fund will not be a "commodity pool operator" as defined in Section 2(a)(1)(A) of the CEA.

The Fund will not engage in options on futures contracts until it obtains a no-action letter or other appropriate regulatory relief from the SEC under the 1940 Act, and from the CFTC under the CEA.

#### Writing Call and Put Options

The Fund may write covered call and put options on portfolio securities and may write covered call options on stock indexes.

The Fund will only write covered options. In the case of call options on portfolio securities this means that, so long as the Fund is obligated as the writer of a call option, it will own the underlying securities subject to the option (or comparable securities satisfying the cover requirements of securities exchanges and the requirements discussed in Investment Company Act Release No. 7221 (June 9, 1972)). When the Fund writes call options on stock indexes, it will hold in its portfolio underlying securities which, in the judgment of Putnam Management, correlate closely with the stock index and which have a value at least equal to the aggregate amount of the stock index options.

The Fund will cover put options that it writes by maintaining in a segregated account short-term U.S. government securities with a value equal to or greater than the price it will have to pay if the option is exercised.

Purchasing Put and Call Options

The Fund may purchase put options to protect its portfolio holdings in an underlying security against a substantial decline in market value. The Fund may purchase call options to hedge against an increase in prices of securities the Fund intends ultimately to buy. The Fund will invest no more than five percent of its assets in the purchase of put and call options (including the purchase of options on futures contracts, as described below).

Options on Futures Contracts

Subject to obtaining appropriate regulatory relief, as described above, the Fund may write and purchase options on stock index and U.S. government securities futures contracts and enter into closing transactions with respect to such options. The Fund will not purchase or sell options on futures contracts if as a result the sum of the initial margin deposits on the Fund's existing options on futures contracts would exceed 5% of the Fund's assets.

No consideration is paid or received by the Fund when it writes a call or put option on a futures contract. The Fund will be required to deposit cash or U.S. Treasury obligations equal to approximately 5% of the value of the underlying futures contract, plus the premium it received for writing the option, in a segregated account with State Street Bank and Trust Company, the Fund's Custodian. This account will be in the name of the broker. The nature of this deposit, which is known as initial margin, differs from that of margin in other contexts in that it does not involve borrowing funds to finance transactions. The initial margin is in the nature of a performance bond or good faith deposit on the contract which is returned to the Fund upon termination of the option, assuming the Fund satisfies all its contractual obligations.

The initial margin may be retained by the broker only if the Fund defaults in making payment on termination of the option or of the variation margin, and upon representation by the broker to the Custodian that all conditions precedent to its right to the initial margin have been satisfied. Variation margin is the payment on a daily basis to and from the broker, in a process known as "marking to market," as the value of the underlying futures contract fluctuates, thereby making the option more or less valuable to the holder. Variation margin does not represent a borrowing or

loan by the Fund but is instead the daily settlement between the Fund and the broker of the amount one would owe the other if on such day the written option were exercised. For example, when the Fund writes a call option on a futures contract and the price of the contract rises above the call's exercise price, the Fund's position declines in value. The Fund must then pay the broker a variation margin payment equal to the difference between the exercise price of the futures contract on which the option is written and the market price of the futures contract. Conversely, if the price of the contract falls below the exercise price of the option, the Fund's option position increases in value and the broker must make a variation margin payment equal to the difference between the exercise price of the futures contract on which the option is written and the market price of the futures contract.

The Fund undertakes that, on the occasions that it has the right to receive variation margin payments from the broker, it will promptly demand such payment upon notification by the broker that such amounts are payable. Any such funds received by the Fund will be held by the Fund's Custodian. At any time prior to the expiration of a written option on a futures contract, the Fund may elect to terminate that position by taking an opposite position. A final determination of variation margin will then be made, and if additional cash is required to be paid by or released to the Fund, the Fund will realize a loss or a gain.

The Fund represents that its writing of call options and purchase of put options on futures contracts will be for purposes of protecting its portfolio against a decline in value. The Fund's purchase of call options and writing of put options on futures contracts will be for the purpose of protecting the Fund against an increase in value in securities it wants eventually to buy.

The Fund will collateralize all long hedges involving the purchase of call options and the writing of put options on futures contracts. The Fund will deposit in a segregated account with its Custodian cash, short-term U.S. government securities or money market instruments equal in value to the exercise price of any futures contracts underlying such options, less in each case any margin deposits made on such options. These segregated funds will not be used to support any other transaction in which the Fund may enter for the duration of the option. The collateralization of such options on futures contracts makes the use of such options

consistent with the types of arrangements discussed in Investment Company Release No. 10666 (April 18, 1979) ("Release 10666").

Sections 17(f) and 18(f)(1) of the 1940 Act

Section 18(f)(1) of the 1940 Act limits the issuance of senior securities by an open-end registered investment company. The sale of options on futures contracts may constitute the issuance of a senior security because of the Fund's obligation to pay variation margin during the life of the instrument. To the extent that variation margin payments owed to the Fund in connection with the sale of an option on a future contract are held by a broker, the Fund may be unable to comply with the provisions of Section 17(f) of the 1940 Act.

The Fund requests your advice to the effect that the Division of Investment Management would not recommend enforcement action to the SEC under the provisions of Section 18(f)(1) and 17(f) of the 1940 Act if the Fund engages in the options transactions described above.

The Fund believes that its use of options on futures contracts for the purpose of hedging and the limitations placed on the Fund with respect to such options do not give rise to the speculative abuses that Section 18(f)(1) was designed to prevent. The limitation on the Fund's use of such options and its undertaking to deposit in a segregated account cash, U.S. government securities, or other cash equivalents equal to the exercise price of futures contracts underlying purchased call options and written put options on futures contracts are consistent with the procedures set forth in Release 10666 to minimize the speculative leverage aspects of the investments that were the subject of that Release.

The Fund also believes that if options on futures contracts are "securities" or "similar investments" within the meaning of Section 17(f) of the 1940 Act, a separate custodian agreement among the Fund, its Custodian and the futures commission merchant, pursuant to which the Fund's margin deposits are held by the Custodian subject to disposition by the futures commission merchant in accordance with rules and regulations of the SEC, CFTC and applicable commodities exchanges, will be consistent with the provisions of Section 17(f).

July 15, 1985

We refer you to the following no-action letters previously issued by the Staff of the Commission with respect to the foregoing issues. IDS Bond Fund, Inc. (available April 11, 1983), SteinRoe Bond Fund, Inc. (available January 17, 1984), Pension Hedge Fund, Inc. (available January 20, 1984), Z-Seven Fund Inc. (available May 21, 1984), Colonial Option Growth Trust (available June 15, 1984), Colonial Government Securities Plus Trust (available June 15, 1984), Colonial Option Income Trust -- Portfolio II (available September 10, 1984), Pilot Fund, Inc. (available October 22, 1984).

Requested Relief

Based on the information discussed above, the Fund requests your advice that the Division of Investment Management would not recommend enforcement action under Sections 18(f)(1), or 17(f) of the 1940 Act if the Fund engages in the transactions described above.

If further information is required with respect to this request, would you kindly telephone the undersigned or Susan O'Connell Johnson of this office.

Very truly yours,

*John W. Gerstmayr*  
SCT

John W. Gerstmayr

**PUBLIC**

AUG 23 1985

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 85-373-CC  
Putnam Option Income Trust II  
File No. 811-4242

On several occasions, we have stated that we would not recommend any enforcement action to the Commission under Section 18 of the Investment Company Act of 1940 ("Act") if a registered investment company ("fund") enters into futures and options transactions as described below:

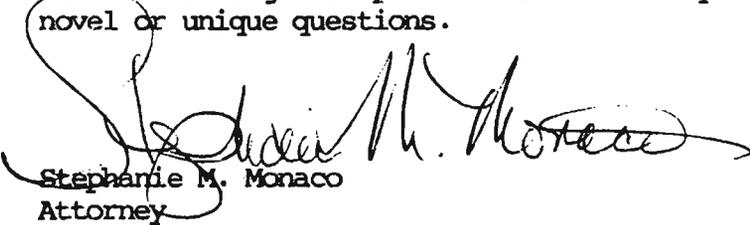
1. sells futures contracts to offset expected declines in the value of its portfolio securities, provided the value of such futures contracts does not exceed the total market value of those securities; 1/
2. writes covered call options on futures contracts, indexes of securities, or other securities; 2/
3. purchases futures contracts, provided it creates a segregated account consisting of cash or cash equivalents in an amount equal to the total market value of any such futures contract, less the amount of initial margin for the contract; 3/ and
4. writes covered put options on futures contracts, indexes of securities, or other securities. 4/

E.g., GMO Core Trust (pub. avail. Aug. 19, 1985), Koenig Tax-Advantaged Liquidity Fund, Inc. (pub. avail. March 27, 1985), Z-Seven Fund, Inc. (pub. avail. May 21, 1984), Pension Hedge Fund, Inc. (pub. avail. Jan. 20, 1984), and SteinRoe Bond Fund, Inc. (pub. avail. Jan. 17, 1984)[hereinafter cited as Supporting Letters].

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- 1/ We have not objected if the total market value of futures contracts a fund sells is more than the total market value of the fund's portfolio securities solely because of differences in the volatility factor of the portfolio securities vis-a-vis the futures contracts. Z-Seven Fund, Inc. (pub. avail. May 21, 1984).
  - 2/ A fund can cover a call option on a futures contract it writes by owning a long futures position. A fund can cover a call option on a stock index it writes by, for example, having a portfolio of securities which correlates with the stock index. Id. See Investment Company Act Rel. No. 7221 (June 9, 1972) ("Release 7221") for alternative methods by which a fund can cover call options.
  - 3/ In this regard, we no longer take the position that a fund may purchase a futures contract only for "hedging" purposes. Compare SteinRoe Bond Fund, Inc. (pub. avail. Jan. 17, 1984) (which permitted a fund to purchase futures contracts only for hedging purposes) with GMO Core Trust (pub. avail. Aug. 19, 1985) (which permitted a fund to purchase futures contracts without the hedging requirement). See Investment Company Act Rel. No. 10666 (April 18, 1979) for a discussion of segregated accounts.
  - 4/ A fund can cover a put option on a futures contract it writes by owning a short futures position. A fund may cover a put option on a stock index it writes only by complying with one of the alternatives stated in Release 7221. See Koenig Tax-Advantaged Liquidity Fund, Inc. (pub. avail. March 27, 1985).

In addition, we have stated that we would not recommend any enforcement action to the Commission under Section 17(f) of the Act if the initial margin for a futures contract is maintained by the fund's custodian in an account in the name of the fund's futures commission merchant ("FCM"), provided that the FCM is permitted access to the account only upon the fund's default on the contract. We also have stated that we would not recommend any enforcement action to the Commission if the fund's FCM temporarily retains excess variation margin gains overnight or over a weekend. E.g., Supporting Letters.

Having stated our interpretation of these provisions in this context, we will no longer respond to no-action requests in this area unless they raise novel or unique questions.



Stephanie M. Monaco  
Attorney