[illegible] (1877-1943)
[illegible] (1879-1959)

[illegible]
[illegible]
[illegible] O DICUS
[illegible] B. BURROWS
[illegible] L. MITCHELL
[illegible] V FAZIO
[illegible] N. VANDER VRIES
[illegible] A CUTLER
BRUCE L MOORE
NORMAN R. GLENUNG
[illegible] W. WATTS
[illegible] A MORRIS
[illegible] J. MOONEY
[illegible] LANDIS
[illegible] W. MUMFORD
[illegible] A MOLDERMAKER
[illegible] C WELCH
[illegible] W. SHARP
GEORGE D. RAMSPECK
PETER P. COLADARCI
JAMES N. ZARTMAN
[illegible] G. FORWARD
JOHN B. HUCK

DAVID TALLANT, JR.
DAVID H. NELSON
ABBEY BLATTBERG
DONALD H. MURPHY
PHILLIP H HOLM
HERBERT H. HANSEN
THOMAS W. [illegible]
LEE A ROYE
KENNETH J. [illegible]
[illegible]
[illegible] M TAYLOR
HOWARD [illegible], JR.
LARRY [illegible]
ROBERT V LEWIS
DAVID G. WILLIAMS
DANIEL J. [illegible]
RICHARD H. GOSS
C. ROBERT FOLTZ
JOHN M. DIXON
KENNETH R. M. THOMPSON
JOHN A. WARD
MICHAEL W. FORD
[illegible] WILSON

WILBERT R. SCHULTZ
RICHARD A MAKARSKI
EDWIN S. BROWN
STEVEN L. CLARK
HARRY P. LAMBERSON
JAMES E. JENZ
JOHN S. RICE
TERRENCE M. WALSH
PAUL C. KOSIN
RONALD E ROKOSZ
ROBERT C. NASH
JAMES R. RICHARDSON
EARL T. BYRON
RANDALL L. MITCHELL
THOMAS A. WINGADER
STEVEN N. WOHL
TERRY A. McILROY
WALTER C. KNUTSON
GEORGE P. SULLIVAN, JR.
J. RICHARD FISHER, JR.

NANCY S. WHITTEN
RAYMOND A FYLSTRA
WENDY C. BINDER
MARK J. KNEEDY
STEPHEN F. STROH
JAMES E. SPIOTTO
EMIL [illegible] BAFFO
TIMOTHY V. McGREE
JAMES [illegible]
TERENCE [illegible] O'MEARA
RICHARD J. SCOTT
ROBERT P. DAVIS
JEFFREY [illegible]
CHRISTOPHER D. NEWMAN
RICHARD S. SMOLEV
ROBERT [illegible], JR.
TIMOTHY [illegible]
RONALD [illegible]
THOMAS [illegible]
TIMOTHY P. SCHWERTFEGER
PAUL C. MARENGO

LAW OFFICES OF

CHAPMAN AND CUTLER

111 WEST MONROE STREET

CHICAGO 60603

726-6130
AREA CODE 312
TWX 910-221-2103

RECEIVED
DIVISION OF INVESTMENT
[illegible] REGULATION

November 13, 1975

RECEIVED
NOV 14 1975
OFFICE OF
[illegible]

Sydney H. Mendelsohn, Assistant Director
Division of Investment Management Regulation
Securities and Exchange Commission
Washington, D. C. 20549

Re: <u>The First Trust of Insured Municipal Bonds</u>

Dear Mr. Mendelsohn:

Reference is made to the meeting on October 31, 1975 among you and other members of the Staff and representatives of various insured municipal bond funds, including our client, The First Trust of Insured Municipal Bonds, and us relating to the issue of valuing portfolio insurance in computing net asset value. At such meeting you suggested that we present any comments we had to you in writing for purposes of ultimate submission of the issue to the Commission. We wish to take this opportunity to expand on our views as expressed in our letter, dated October 6, 1975, addressed to Wauterlek & Brown, Inc., the sponsor of the subject Trust, copies of which were furnished the Staff (an additional copy is attached hereto as Exhibit A for your convenience).

I. The Legal Issue

At the above-mentioned meeting, most of the discussion centered on the problems of valuing the portfolio insurance. There are many problems, some of which we will briefly mention below. However, we believe that the threshold issue is a legal one, i.e., whether portfolio insurance must be considered in the computation of net asset value by the Trust. We submit that the insurance feature does not constitute "value" as defined in Section 2(a)(41)(B)(ii) of the Investment Company Act of 1940 (the "Act") when read in the context of determining the net asset value of a

redeemable security*. While portfolio insurance may well be an attractive feature to an investor, it is our view that it is "value" for purposes of computing net asset value only if it can be converted into cash equivalent to that value. Put another way, if X buys one unit in the Trust on June 1, 1976 and pays a price which includes a specific amount attributable to the portfolio insurance then Y, who tenders one unit for redemption on June 1, 1976 ought to receive as part of his redemption proceeds, cash equivalent to what X paid for the portfolio insurance. This is the essence of a redeemable security. But since the only way in which the Trust can obtain cash for the purpose of effecting redemptions is the sale of portfolio bonds, and since such bonds are sold out of the portfolio on an uninsured basis, the cash which the Trust receives upon the sale of the bond and the cash which a unit holder ultimately obtains upon redemption cannot and does not include any "value" attributable to the insurance.

The insurance cannot be converted into cash. It is very much like a term life insurance policy which has no cash surrender value. This is true even where the existence of the insurance is most important, i.e., when there is a default on a portfolio bond. Since that bond is sold on an uninsured basis, there is no cash equivalent for the insurance obtainable by sale of the defaulted bond. The logical result of the Staff's position in the case where all units were tendered for redemption would be that some unit holders would receive cash in excess of the underlying market value of the bonds and the unlucky ones who came at the end of the line would receive nothing.

As is mentioned in the attached letter there is precedent for linking the cash obtainable upon sale of an asset and the computation of "net asset value". If a mutual fund acquires a $1,000,000 debenture in a private placement, it cannot freely resell that debenture and thus any purchaser (who would also be restricted in method of sale) will only be willing to pay a discounted price -- for illustration purposes let us say $700,000. It is the Commission's position that such a mutual fund must value that debenture at $700,000 for the purpose of computing the net asset value of its outstanding shares. This is the case even if the obligor on the debenture is paying interest

*"Redeemable security" is defined in Section 2(a)(32) of the Act as a security under the terms of which the holder upon its presentation to the issuer is entitled to receive approximately his proportionate share of the issuer's "...current net assets, or the cash equivalent thereof."

when due and the fund expects timely repayment of the principal thereon. The reason is because if the fund had to sell to obtain cash to effect redemptions, it could only obtain $700,000. We believe the issue presently under discussion is directly analogous to the "restricted security" problem.

We believe that the method of computing net asset value for the purposes of determining redemption price should also be controlling when determining the price of the units in the primary and secondary markets, whether or not a portfolio bond is in default. It may well be that an investor would be better off to hold his unit and not sell or redeem; however, the methods and operations of the Trust are disclosed to him at the time of his initial purchase and he can usually obtain current information from the Sponsor or the Trustee. If he decides in favor of liquidity, he should expect to receive only his share of the then liquidation value of the Trust's assets and not a share of the ultimate benefits a long-term investor may eventually receive.

We will certainly cooperate with the Staff in providing adequate disclosure in the prospectus so that an investor will understand that the benefits of the insurance will be realized only so long as bonds which are in default are not sold to meet redemptions, but our legal conclusion is that the sponsor of the Trust is not required to attribute any "value" to the insurance feature of the Trust in any calculation of current net asset value. If, however, the Staff takes an adverse position, from a legal standpoint, we believe the situation is one where an order could be properly issued under Section 6(c) of the Act to permit the Trust to operate in its present manner. We would like to briefly mention the problems which we feel would be caused by adherence to the Staff's position.

II. Problems Arising from Valuation

For the reasons set forth above, we do not believe that there can be any doubt that redemption prices cannot include any amount attributable to the insurance; there simply is no way to obtain the cash equivalent thereof since bonds must be sold out of the portfolio on an uninsured basis. Therefore, there would have to be a two-tiered pricing system: one price for redemption, computed in the same manner as is presently done; and the other for secondary market purposes (we understand the Staff is of the view that the Sponsor may not charge a higher price in the primary market since the value of the insurance at that point in time would be "negligible").

It should be understood at the outset of the discussion that at the present time the Sponsor does not charge any investor an amount attributable to the insurance in the portfolio nor does it base its sales charge on any such amount. Thus if the secondary market price is increased because of the "value" of the insurance, the investor will not only pay a higher price, he will pay a higher sales charge and in addition as a Unit holder will pay his portion of the cost of insurance to the Trust. Further increasing the disparity between secondary market prices and redemption prices (the former is already based on the "offering" price of the underlying bonds while the latter is based upon the "bid" price) may serve to limit an already limited market (we have attached hereto as Exhibit B data furnished to us by the Sponsor of the Trust relating to the amount of secondary trading in outstanding Series of the Trust). Investors will be less willing to buy in the secondary market and thus the Sponsor will be less willing to take the risk of purchases in the secondary market (unless it has an identified buyer and effects the transaction on this basis). It should be remembered that if the Sponsor tenders a unit for redemption, it can only receive what it paid for the unit if that is lower than the redemption price at the time of tender. Therefore, there is no incentive for the Sponsor to buy for purposes of redeeming.

If, as a result of illiquidity in the secondary market, the number of redemptions increases, the size and composition of the portfolio will change since bonds will be sold to raise cash to effect redemptions.

A second problem is the mechanical one of valuing the insurance. How will it be done? Who will assume the responsibility (and potential liability)? Since reasonable men can differ, the identical bonds in two different portfolios could have different net asset values, causing competitive and disclosure problems.

III. Conclusion

When all is considered, we feel the problem is really one of disclosure -- of being sure that the investor understands how the insurance feature of the Trust operates and the possible disadvantages of sale or redemption.

We would appreciate the opportunity of presenting our views in person before the Commission at such time as it is

deemed appropriate prior to a final decision on this issue.

We wish to express our appreciation and that of our client for the opportunity to meet with members of the Staff and to express our views regarding this issue. If we can assist the Staff in resolving this problem, please do not hesitate to contact us.

Very truly yours,

CHAPMAN AND CUTLER

By [signature]
John M. Dixon

JMD:ko