

MEMO# 10545

December 8, 1998

SEC STAFF NO-ACTION LETTER ON ""GRANDFATHERING"" CERTAIN ASSET- BACKED SECURITIES COMMERCIAL PAPER PROGRAMS UNDER RULE 2A-7

1 New Center Asset Trust, SEC No-Action Letter (Nov. 5, 1998). 2 Under Rule 2a-7(a)(3), an ABS means a fixed income security (other than a Government security) issued by a "special purpose entity" substantially all of the assets of which consist of "qualifying assets". Under that provision, a "special purpose entity" means a trust, corporation, partnership, or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from qualifying assets. In addition, under that provision, "qualifying assets" means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period. [10545]
December 8, 1998 TO: MONEY MARKET FUNDS ADVISORY COMMITTEE No. 6-98 SEC RULES MEMBERS No. 107-98 RE: SEC STAFF NO-ACTION LETTER ON "GRANDFATHERING" CERTAIN ASSET-BACKED SECURITIES COMMERCIAL PAPER PROGRAMS UNDER RULE 2a-7

The staff of the Securities and Exchange Commission ("SEC") recently issued a no-action letter¹ concerning the applicability of certain provisions of Rule 2a-7 under the Investment Company Act to asset-backed securities ("ABSs") commercial paper programs.² The staff's letter is summarized below and a copy is attached. Rule 2a-7 generally provides that a money market fund may not invest more than five percent of its assets in a single issuer. For purposes of the portfolio diversification requirements, Rule 2a-7 generally considers a "special purpose entity" ("SPE") as the issuer of an ABS. An exception, however, is made with respect to an issuer of qualifying assets whose obligations constitute 10 percent or more of the principal amount of all qualifying assets held by the SPE ("10 percent obligor"). Funds must treat the 10 percent obligor as an issuer of a proportionate amount of the ABS for purposes of the portfolio diversification requirements of the rule. The no-action letter addresses the applicability of Rule 2a-7's "grandfathering" provisions to ABS commercial paper programs that continuously issue or rollover commercial paper. When the SEC adopted the most recent amendments to Rule 2a-7, it grandfathered certain securities "first issued" on or before February 10, 1998 that do not meet certain specified requirements of the amended rule relating to ABSs. At that time, the SEC stated that a security that is continuously issued or rolled over pursuant to a continuous offering program is "first issued" for purposes of determining whether it is a grandfathered security on the date it was issued or rolled over, not on the date that the program was organized. Securities that were first issued or rolled over after February 10, 1998 therefore are not grandfathered securities. This position caused difficulties for ABS commercial paper programs that were

continuously offered over an extended period of time and for which investors periodically rolled over their holdings. 3 The SEC staff stated that this position applies only to ABS commercial paper that is continuously issued or rolled over to money market funds in connection with a commercial paper program, shelf registration or similar continuous offering arrangement. 4 The no-action letter also responds to a request in the incoming letter for clarification of the definition of "restricted special purpose entities." In particular, the letter discusses the requirement that an SPE only qualifies as a restricted SPE if, among other things, its securities are held by companies that "control, are controlled by, or are under common control" with the SPE. - 2 - No-action relief therefore was requested by a financing trust that was formed for the purpose of issuing commercial paper notes. The financing trust stated that it and other similar programs would face difficulties if required to revise their structures to conform to the new ABS diversification standards. The SEC staff agreed and stated that it would not recommend enforcement action against a money market fund that: (1) acquires ABS commercial paper issued by an SPE organized on or before February 10, 1998;³ (2) treats the ABS commercial paper as a grandfathered security first issued on the date the program was organized; and (3) satisfies all applicable provisions of Rule 2a-7 with respect to the ABS commercial paper, except the "look-through" provision to the 10 percent obligors. The no-action letter, however, states that the look-through requirement may be disregarded in reliance on this position only with respect to obligors whose obligations were acquired by the SPE of an ABS commercial paper program on or before July 1, 1998, the compliance date for the amendments to Rule 2a-7. An obligor whose obligations are acquired by an SPE after July 1, 1998, and who is or becomes a 10 percent obligor, will be considered to be a proportionate issuer of the ABS commercial paper issued by the SPE for purposes of the rule's portfolio diversification standards.⁴ Ari Burstein Assistant Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326- 8304, and ask for this memo's attachment number: 10545.