

MEMO# 3935

July 16, 1992

DRAFT INSTITUTE LETTER ON PROPOSED EXEMPTIVE RULE FOR ASSET-BACKED ARRANGEMENTS

July 16, 1992 TO: SEC RULES COMMITTEE NO. 47-92 RE: DRAFT INSTITUTE LETTER ON PROPOSED EXEMPTIVE RULE FOR ASSET-BACKED ARRANGEMENTS

As we previously informed you, the SEC has proposed Rule 3a-7 under the Investment Company Act of 1940, which would establish an exception from the definition of "investment company" for certain asset-backed arrangements or structured financings. (See Memorandum to SEC Rules Committee No. 39-92, dated June 4, 1992.) Attached is a draft of the Institute's letter on the proposed rule. The first part of the Institute's letter argues that asset-backed arrangements are classic investment companies and, therefore, should be subject to regulation under the Act, with the Act modified to accommodate their unique characteristics. The remainder of the Institute's letter focuses on the specific provisions of the proposed rule, in recognition of the fact that it appears inevitable that some type of exemptive rule will be adopted by the SEC. Specifically, the letter emphasizes the need for tighter controls on portfolio management, noting that under the proposal, it appears that some asset-backed arrangements could be managed to virtually the same extent as mutual funds, yet be free from the provisions of the 1940 Act (e.g., restrictions on affiliated transactions.) The letter suggests that many of the investor protection concerns presented by asset-backed arrangements would be minimized if their portfolios were kept relatively fixed (allowing for substitutions only under very limited circumstances). The letter also expresses concerns about the condition in the proposed rule that the securities sold to the public be highly rated, since such reliance on the rating agencies will cause them to become de facto regulators. The letter states that if this provision is included in the final rule, it will be necessary for the SEC to assume a far greater degree of regulatory oversight of rating agencies. Alternatively, the letter suggests replacing the rating condition with a provision that would limit investments in asset-backed arrangements to "accredited investors", as defined under Regulation D. However, the letter notes that these steps may not be as necessary if the Institute's recommendations for tighter controls on portfolio management are adopted. Finally, the letter recommends that, in connection with the adoption of the exemptive rule, the SEC seek legislation to narrow the scope of Section 3(c)(5) of the 1940 Act, under which many asset-backed arrangements have claimed exemptions from the Act.

* * * The comment period for this proposal expires on August 4, 1992. Please call either me or Amy Lancellotta with your comments by July 27th. Craig S. Tyle Vice President -Securities Attachment

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