

MEMO# 3830

June 4, 1992

SEC PROPOSES CONDITIONAL EXEMPTION FROM 1940 ACT FOR STRUCTURED FINANCINGS

June 4, 1992 TO: BOARD OF GOVERNORS NO. 41-92 SEC RULES COMMITTEE NO. 39-92
UNIT INVESTMENT TRUST COMMITTEE NO. 31-92 RE: SEC PROPOSES CONDITIONAL
EXEMPTION FROM 1940 ACT FOR STRUCTURED FINANCINGS

In its first formal action on the recommendations contained in the Division of Investment Management's recently issued report on investment company regulation, the SEC last Friday unanimously voted to issue for public comment proposed Rule 3a-7 under the Investment Company Act of 1940 ("Act"). The rule would exempt issuers of asset-backed securities (also referred to as structured financings) from the definition of investment company in Section 3(a) of the Act, provided certain conditions were met. A copy of the release proposing Rule 3a-7 is attached. Proposed Rule 3a-7 is intended to remove barriers that exist to the public offering of certain types of structured financings because they are unable to operate in compliance with all of the requirements of the Act. Specifically, proposed Rule 3a-7 would exempt an issuer that (a) is engaged in purchasing or otherwise acquiring or holding "eligible assets" (essentially, assets requiring scheduled cash payments and other assets, such as letters of credit and guarantees, that serve solely to support the credit of the issuer), and (b) does not issue redeemable securities or debt securities with demand features allowing payment within 14 days, from the definition of an investment company if the following four conditions are met: (1) the issuer primarily issues fixed-income securities or other securities with similar characteristics; (2) securities offered or sold to any person other than a Rule 144A "qualified institutional buyer" or an affiliate of the issuer must be fixed-income securities that are rated in one of the top two rating categories by at least one nationally recognized statistical rating organization ("NRSRO") that is not affiliated with the issuer; (3) the issuer holds all pooled assets to maturity, with certain exceptions, including the ability to substitute assets of the same type and similar or higher credit quality, to substitute government securities for eligible assets under certain circumstances, to acquire additional eligible assets if this will not cause a downgrading of the issuer's outstanding fixed-income securities and to dispose of assets in connection with the issuer's termination; and (4) eligible assets and related cash flow, as well as any other assets of the issuer not needed for the operation of the issuer's business must be held in a segregated account by an unaffiliated trustee meeting the requirements of Section 26(a)(1) of the Act. As you may recall, in comments responding to the staff's concept release on reform of investment company regulation, the Institute recommended that structured financings (and all other pooled securities vehicles offered to the public) be covered under the Act, subject to appropriate exemptions to accommodate features that cannot comply with particular

provisions of the Act. In contrast, proposed Rule 3a-7 would exempt structured financings from the Act, but impose certain conditions in the case of public offerings. Comments on the proposal must be filed within 60 days. If there are issues you would like the Institute to consider including in a comment letter, please contact me at (202) 955- 3514 by Friday, June 26. Frances M. Stadler Assistant Counsel Attachment

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