

MEMO# 4987

July 16, 1993

SEC PROPOSED RULE 3A-8 TO EXEMPT CERTAIN RESEARCH AND DEVELOPMENT COMPANIES FROM THE INVESTMENT COMPANY ACT

July 16, 1993 TO: SEC RULES COMMITTEE NO. 65-93 RE: SEC PROPOSED RULE 3a-8 TO EXEMPT CERTAIN RESEARCH AND DEVELOPMENT COMPANIES FROM THE INVESTMENT COMPANY ACT _____ The Securities and Exchange Commission recently proposed Rule 3a-8 under the Investment Company Act. Rule 3a-8 would codify the terms of a Commission order, by providing a safe harbor exclusion from investment company status for certain bona fide research and development companies ("R&D Companies"). (The Commission issued the proposal in response to a proposal that the Industrial Biotechnology Association filed with the Commission last year.) A copy of the Commission's proposing release is attached. Section 3(b)(2) of the Investment Company Act authorizes the Commission to declare that a company that invests in securities is not an investment company if it is not engaged primarily in the investment business. The Commission's traditional test for making this determination turns largely on the composition of the applicant's income and assets. During their product development phase, R&D Companies generally hold short-term, high quality debt instruments and their noninvestment business produces little or no income or assets. According to the release, when applied to R&D Companies the Commission's traditional Section 3(b)(2) test may understate the noninvestment business of R&D Companies. Rule 3a-8 would exclude from the definition of investment company any issuer engaged in research and development based upon how it uses its income and assets, instead of the sources of its income and the composition of its assets. An issuer would be eligible for the safe harbor if it, directly or through a company or companies that it "controls": 1. holds itself out as primarily engaged in a noninvestment business; 2. has: a. research and development expenses that are a substantial percentage of its total expenses for its four most recent fiscal quarters combined and that at least equal its investment revenues for that period; and b. investment-related expenses that do not exceed five percent of its total expenses for its four most recent fiscal quarters; and 3. makes its investments, taken as a whole, to conserve capital and liquidity until it uses its assets in its primary business. The proposal has a 90-day comment period. Please call me at 202/955-6251 with any comments you might have by August 6, 1993. Thomas M. Selman Assistant Counsel Attachment

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.