

MEMO# 3979

August 5, 1992

INSTITUTE COMMENT LETTER ON PROPOSED 1940 ACT EXEMPTION FOR ASSET-BACKED ARRANGEMENTS

August 5, 1992 TO: BOARD OF GOVERNORS NO. 52-92 SEC RULES COMMITTEE NO. 55-92
UNIT INVESTMENT TRUST COMMITTEE NO. 41-92 RE: INSTITUTE COMMENT LETTER ON
PROPOSED 1940 ACT EXEMPTION FOR ASSET-BACKED ARRANGEMENTS

The Institute yesterday submitted to the SEC the attached comment letter on proposed Rule 3a-7 under the Investment Company Act of 1940. As we previously informed you, the proposed rule would exclude from the definition of "investment company" under the Act asset-backed arrangements meeting certain conditions. (See Memorandum to Board of Governors No. 41-92, SEC Rules Committee No. 39-92 and Unit Investment Trust Committee No. 31-92, dated June 4, 1992.) The proposed rule is based on the recommendation of the Division of Investment Management with respect to structured financings contained in the Division's report on investment company regulation released in May. In the attached letter, the Institute reiterates its view that asset-backed arrangements are classic investment companies that raise the same policy concerns as other investment companies. Accordingly, the letter states, these arrangements should be regulated under the Investment Company Act, and the Act should be modified to accommodate their unique characteristics. Recognizing that the Commission appears intent on following an exemptive approach, however, the Institute's letter proposes a number of modifications to the proposed rule. First, the letter indicates that the degree of portfolio management that the proposed rule would permit is inappropriate for an unregulated pool and should be narrowed. In particular, the letter notes that, as proposed, the rule would appear to allow for a degree of continuous portfolio management similar to that engaged in by mutual funds and closed-end funds. Second, the letter recommends that if rating agencies will be relied upon to perform a regulatory function, as the proposed rule contemplates, the Commission should exercise much greater oversight over those agencies. If Commission oversight is not obtained, the letter states, the proposed condition of the rule requiring a high rating should be deleted and the sale of securities issued by asset-backed arrangements should be limited to institutions and sophisticated individuals. In addition, the Institute's letter recommends deletion of the provision of proposed Rule 3a-7 that would allow asset-backed securities with a demand feature to qualify for the exemption. The letter also suggests certain restrictions in connection with marketing asset-backed securities to the public, including a prohibition on the use of the words "mutual fund" or "fund" in the asset-backed pool's name. Finally, the letter proposes that the Commission amend Section 3(c)(5) of the Investment Company Act to restrict its application to only those issuers which are engaged in active businesses, such as traditional factoring companies. We will keep you informed of developments. Craig S.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.