

PUBLIC

APR 24 1997

ACT ICA

SECTION 3(c)(7)

RULE 2a51-1, 2a51-2, 2a51-3, 3c-1, 3c-5, 3c-6

PUBLIC

AVAILABILITY 4-24-97

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 97-177-CC
Davis Polk & Wardwell
File No. 132-3

Your letter dated April 23, 1997 requests our assurance that we would not recommend enforcement action to the Commission if certain clients of your firm intending to rely on the exclusion from regulation under the Investment Company Act of 1940 (the "Act") provided by Section 3(c)(7) of the Act issue securities to qualified purchasers prior to the effective date of rules implementing Section 3(c)(7), in the manner described in your letter.

The National Securities Markets Improvement Act of 1996 provides that Section 3(c)(7) will become effective on the earlier of April 9, 1997, or the date on which the Commission completes rulemaking defining the term "investments" under Section 2(a)(51) of the Act. On April 9, 1997, the Federal Register published a release in which the Commission adopted such rules (the "Rules").¹ The Rules will be effective on June 9, 1997, 60 days after publication in the Federal Register ("Effective Date"). The 60-day waiting period was established pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),² which is designed in part to give Congress the opportunity to review rules adopted by federal agencies.³ Issuers intending to rely on Section 3(c)(7) may not have anticipated the application of SBREFA's 60-day waiting period to the Rules.

You represent that although Section 3(c)(7) became effective on April 9, 1997, the unanticipated delay of the effectiveness of the Rules will impose hardship on a number of types of issuers that intend to rely on Section 3(c)(7). You state that the 60-day delay could materially affect the ability of these issuers to meet their expected funding requirements and investment deadlines. Specifically, you represent that one of your clients currently relying on the exclusion from regulation under the Act provided by Section 3(c)(1) of the Act intends to convert to a Section 3(c)(7) fund. You state that the Rules would provide guidance as to which of this issuer's holders are beneficial owners that must receive notice and redemption rights before conversion. You also represent that other clients of your firm would seek to rely on the Rules to determine whether assets held by prospective investors qualify as "investments," including the provisions specifying the treatment of controlling interests and

¹ Private Investment Companies, Investment Company Act Release No. IC-22597 (Apr. 3, 1997) (adopting Rules 2a51-1, 2a51-2, 2a51-3, 3c-1, 3c-5 and 3c-6).

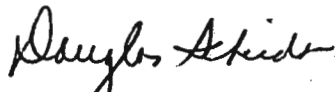
² Pub. L. No. 104-121, §251, 110 Stat. 857 (1996) (codified at 5 U.S.C. §§ 801-808).

³ In addition to requiring a 60-calendar day waiting period prior to the effective date of major rules, SBREFA also provides for a 60-legislative day period during which a joint resolution of disapproval under the procedures set forth in SBREFA may occur.

investor indebtedness.

You maintain that it is appropriate for an issuer to rely on the Rules prior to the Effective Date, provided that the issuer: (i) will issue its securities only to persons who meet the definition of qualified purchaser under the Act and the requirements of the Rules at the time of their acquisition of such securities; (ii) in the event that the Rules do not take effect (or continue) pursuant to a joint resolution of disapproval under the procedures set forth in SBREFA (a "Disapproval"), will fully comply with any new rules that the Commission may adopt in response to the Disapproval and take all action necessary to comply with such new rules as if they had been in effect since April 9, 1997; and (iii) will fully comply with all other applicable laws and rules, including the Rules in their entirety. To the extent that issuers take action to comply with any such new rules as if they had been in effect since April 9, 1997, you maintain that the fact that issuers relied upon the Rules prior to the Effective Date will not result in harm to investors.

We would not recommend enforcement action to the Commission if any issuer intending to rely on Section 3(c)(7) of the Act issues securities to qualified purchasers in accordance with the Rules prior to the Effective Date,⁴ provided that in the event of a Disapproval, the issuer will take all action necessary to comply with any new rules that the Commission may adopt in response to the Disapproval as if they had been in effect since April 9, 1997. This response is limited to actions taken by issuers prior to the earlier of the Effective Date, or of any pre-Effective Date Disapproval. This response expresses the Division's position on enforcement action only, and does not purport to express any legal conclusions on the questions presented.


Douglas Scheidt
Associate Director and
Chief Counsel

⁴ Your letter only discusses issues arising under Rule 2a51-1 (defining investments and addressing certain other matters) and Rule 2a51-2 (defining certain terms for purposes of the grandfather and consent provisions). Our response is not so limited, but rather applies to all of the Rules.

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April 23, 1997

Re: **Effective Date of Section 3(c)(7)**

Mr. Douglas J. Scheidt, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Investment Company Act
Section 3(c)(7)

Dear Mr. Scheidt:

We represent a number of clients which are in the process of forming private investment companies that intend to rely upon new section 3(c)(7) of the Investment Company Act of 1940. We request your confirmation that the Staff will not recommend enforcement action under the 1940 Act if, as of the April 9, 1997 effective date of section 3(c)(7), these funds issue securities to persons who meet the Qualified Purchaser requirements set forth in rules adopted by the Commission on April 3 and subsequently published in the Federal Register.

The National Securities Markets Improvement Act of 1996 created section 3(c)(7), which excludes from regulation under the 1940 Act privately offered investment companies whose securities are held exclusively by Qualified Purchasers. The new act requires the Commission to adopt rules that implement section 3(c)(7), and provides that section 3(c)(7) is effective the earlier of April 9 or the date on which the Commission completes its rulemaking. Although the Commission adopted these rules on April 3, it announced that they would not be effective until 60 days after their publication due to a separate statutory requirement requiring delayed effectiveness of regulations. Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), Pub. L. No. 104-121, §251. As a result of this apparently unforeseen complication, there will be an almost two-month period during which the law is effective but the rules implementing its provisions are promulgated but not yet effective. We also understand that there is a 60 legislative day period after effectiveness during which

Congress could disapprove the rules. During both of these periods, Congress could disapprove the rules under the procedures set forth in SBREFA.¹

The delayed effectiveness of these rules imposes undue and unnecessary hardship on 3(c)(7) funds which have timed their formation in anticipation of an April 9 effective date. A delay could materially hinder the ability of these funds to meet their expected funding requirements and investment deadlines. As described below, although section 3(c)(7) is effective on April 9, the Commission's rules provide practical guidelines for compliance with section 3(c)(7). Thus, it would be extremely useful for these funds to be able to rely upon the Commission's rules before the date of their effectiveness.

We represent one of the largest privately offered funds in the country which has been working over the past two months to convert from section 3(c)(1) to section 3(c)(7) upon adoption of the Commission's rules. The rules relating to the Grandfather provision would guide the fund in determining which of its holders are beneficial owners that must receive notice and redemption rights before conversion.

We also represent a client which is forming a new 3(c)(7) fund and has been marketing the fund for several months. Potential investors have signed subscription agreements committing to invest in the fund, which commitments expire at the end of May (this gave the sponsor six weeks after effectiveness of section 3(c)(7) to close the fund). If the fund were now to wait until effectiveness of the rules in June, all of its commitments from investors would expire. It would be difficult for the fund to close without reliance on the rules because it intends to require that investors in the fund certify as to their Qualified Purchaser status, and would like to rely upon the Commission's rules to ascertain which assets held by prospective investors will count as investments for these purposes. For example, the rules reveal whether securities of certain controlled issuers would be deemed investments, or whether to deduct leverage from the amount of assets held. The rules also guide the fund in its reliance on the reasonable belief standard in admitting prospective investors. It may also be the case that a potential investor may be a privately offered fund formed before April 30, 1996, in which case the consent provisions relating to the investor's treatment as a Qualified Purchaser would apply. We in fact have a number of other clients that are in various stages of capital raising for 3(c)(7) funds, and the rules would prove helpful to these funds for the same aforementioned reasons. In many cases, these funds anticipated

¹We understand that issuers do not need no-action relief during the 60 legislative day period after effectiveness because they may then rely upon the provisions of SBREFA.

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the rules becoming effective in April in planning and executing the marketing of the funds.

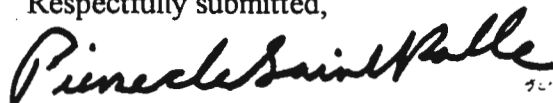
We believe that it is appropriate to allow an issuer to rely on the Commission's rules after April 9 but before the rules are effective, as long as (i) its securities will be sold only to persons who meet the definition of Qualified Purchaser under the 1940 Act and the requirements of the rules at the time of their acquisition of such securities; (ii) in the event that the rules do not take effect or do not continue pursuant to a joint resolution of disapproval under the procedures set forth in SBREFA, the issuer will fully comply with the rules the Commission may adopt in response to the disapproval and take all corrective actions necessary to comply with such new rules as if they had been in effect as of April 9, 1997; and (iii) the issuer will fully comply with all other applicable laws and rules, including the rules adopted by the Commission in Release No. IC-22597 in their entirety.

The ability of issuers to rely upon the Commission's rules before their effectiveness would not affect Congress' ability to disapprove the rules during the waiting period, and would not harm investors. If Congress did disapprove the rules, as stated above, the issuers would ensure that their investors received the protection afforded by the new rules the Commission may adopt.

In summary, these clients intend to fully comply with section 3(c)(7) and its related rules as of the date of the effectiveness of section 3(c)(7). We respectfully request confirmation that the Staff would not recommend enforcement action under the 1940 Act if these issuers sell securities to Qualified Purchasers in the manner described above as of April 9, 1997. The Staff provided similar relief to companies relying on new section 3(c)(2) before its statutory effective date. See Cleary, Gottlieb, Steen & Hamilton (Nov. 25, 1996).

Please feel free to contact me at (212) 450-4525 or Nora Jordan at (212) 450-4684 if you have any questions regarding this request.

Respectfully submitted,


Pierre de Saint Phalle