February 24, 2000
Our Ref. No. 99-833-CC
Brown & Wood
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter dated February 23, 2000, requests our assurance that we would not recommend enforcement action to the Commission under Section 7 of the Investment Company Act of 1940 ("Investment Company Act") if a business trust with the characteristics described in your letter ("Trust") does not register with the Commission under the Investment Company Act in reliance on Rule 3a-5 thereunder.

FACTS

You state that the Trust will be a business trust established by a trust declaration, trust agreement or similar instrument ("Trust Agreement") under the laws of either Delaware or another state. The sponsor of the Trust ("Parent") will be a "parent company" as defined in section (b)(2) of Rule 3a-5 under the Investment Company Act.[1] The Trust, however, will have only one class of securities ("Securities") which will not be owned initially, or possibly ever, by the Parent or a company controlled by the Parent; the Securities will be the only class of securities authorized by the Trust Agreement. Nevertheless, you state that the Trust will be controlled by the Parent in all material respects. You further state that the Parent will agree to pay, directly or indirectly, the expenses of the Trust. In addition, you represent that, under generally accepted accounting principles, the Trust will be accounted for as a subsidiary of the Parent.

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[1] Section (b)(2) of Rule 3a-5 under the Investment Company Act defines, in relevant part, a "parent company" as "any corporation, partnership or joint venture:

> (i) That is not considered an investment company under section 3(a) or that is excepted or exempted by order from the definition of investment company by section 3(b) or by the rules or regulations under section 3(a);
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> (ii) That is organized or formed under the laws of the United States or of a state or that is a foreign private issuer, or that is a foreign bank or foreign insurance company as those terms are used in rule 3a-6 . . . ; and
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> (iii) In the case of a partnership or joint venture, each partner or participant in the joint venture meets the requirements of paragraphs (b)(2)(i) and (ii)."

You represent that the Trust will be formed solely to provide financing for the Parent or companies controlled by the Parent. At least 85% of the proceeds raised from the sale of Securities will be advanced by the Trust to the Parent or companies controlled by the Parent. Any other activities engaged in, or investments made, by the Trust will be consistent with section (a)(6) of Rule 3a-5.[2] In addition, the Parent will guarantee the payment by the Trust of dividends on and redemption and liquidation payments with respect to the Securities to the extent that the Trust has funds legally available therefor.

The parties to the Trust Agreement will be the Parent, two or more administrators ("Administrators"), a property trustee ("Property Trustee") and, if required by the laws of the state in which the Trust is established, a state trustee ("State Trustee"). The Administrators will be officers or other employees of the Parent. The Property Trustee will be a bank or trust company that is eligible to act as a trustee for purposes of the Trust Indenture Act of 1939. The State Trustee, if one is required, will be a bank or a trust company that will perform the functions required by applicable state law. The Administrators, Property Trustee and State Trustee will have the same functions, rights and obligations under the Trust Agreement as similar parties to trust agreements for business trusts that rely on Rule 3a-5.[3]

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[2] Section (a)(6) of Rule 3a-5 under the Investment Company Act provides, in relevant part, that a finance subsidiary will not be considered an investment company under Section 3(a) of the Investment Company provided that it "does not invest in, reinvest in, own, hold or trade in securities other than Government securities, securities of its parent company or a company controlled by its parent company . . . or debt securities (including repurchase agreements) which are exempted from the provisions of the Securities Act of 1933 by section 3(a)(3) of that Act."

[3] *E.g.*, Lehman Brothers, Inc. (pub. avail. May 26, 1995) ("Lehman Brothers") (the staff agreed not to recommend enforcement action to the Commission if a finance subsidiary, organized as a business trust that issues non-voting preferred beneficial interests in the trust, relies on the exemption for finance subsidiaries under Rule 3a-5); Merrill Lynch & Co. (pub. avail. May 25, 1995) (the staff agreed not to recommend enforcement action to the Commission if a finance subsidiary, organized as a business trust that issues debt securities and non-voting preferred interests in the trust, relies on the exemption for finance subsidiaries under Rule 3a-5); and Goldman, Sachs & Co. (pub. avail. Apr. 27, 1995) (the staff agreed not to recommend enforcement action to the Commission if a finance subsidiary, organized as a business trust that issues non-voting preferred trust certificates instead of non-voting preferred

The Parent will have the power to appoint, remove and replace the Administrators. The Trust Agreement will provide that no change or amendment may be made to its terms that is inconsistent with the sole right of the Parent to select, appoint or remove the Administrators. Unless a specified event of default occurs and continues with respect to the advances made by the Trust to the Parent or companies controlled by the Parent ("Default Event"), only the Parent will have the power to appoint, remove and replace the Property Trustee and the State Trustee. In the event of a Default Event, the holders of at least a majority of the Securities may have the right to appoint, remove and replace the Property Trustee and the State Trustee.

You state that the Securities will not be voting securities, as defined in Section 2(a)(42) of the Investment Company Act.[4] You represent that holders of the Securities will not have the right to appoint, remove or replace the Administrators, although they may have such rights with respect to the Property Trustee and State Trustee under certain circumstances. You further represent that the rights and obligations of the holders of the Securities will be similar to the rights and obligations of the holders of trust preferred securities issued by business trusts that have relied on Rule 3a-5 to date.[5] Finally, you represent that, in reliance upon the Delaware Business Trust Act or another state's business trust statute, holders of the Securities will have limited liability like that of stockholders of a corporation.

ANALYSIS

Rule 3a-5 under the Investment Company Act generally exempts a subsidiary from the definition of investment company, and consequently from the obligation to register with the Commission under the Investment Company Act, provided that the primary purpose of the subsidiary is to finance the operations of its parent company or of companies controlled by the parent company. In the release accompanying the adoption of Rule 3a-5, the Commission stated that it was appropriate to exempt a finance subsidiary from all provisions of the Investment Company Act where neither its structure nor its mode of operation resembles

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corporate stock, relies on the exemption for finance subsidiaries under Rule 3a-5).

[4] Section 2(a)(42) of the Investment Company Act defines a "voting security" in relevant part as "any security presently entitling the owner or holder thereof to vote for the election of directors of a company."

[5] *See* no-action letters cited *supra* note 3.

that of an investment company.[6] The Commission stated that it found this to be the case where the primary purpose of the subsidiary is to finance the business operations of its parent or other subsidiaries of the parent; and where any purchaser of the finance subsidiary's debt instruments ultimately looks to the parent for repayment rather than to the subsidiary. Rule 3a-5 thus is intended to apply where the subsidiary is essentially a conduit for the parent to raise capital for its own business operations or for the business operations of its other subsidiaries.[7]

In your view, the Trust should be considered a finance subsidiary for purposes of Rule 3a-5 under the Investment Company Act and therefore not required to register with the Commission. You assert that, with one exception, the Trust either will meet the conditions in Rule 3a-5, or will have the same characteristics as other business trusts with respect to which the staff has agreed not to take enforcement action under Section 3(a) of the Investment Company Act or Rule 3a-5 thereunder.[8] The exception is that the Securities will constitute the only class of securities of the Trust and the Parent or companies controlled by the Parent will not, at least initially, own any of the Securities.

Rule 3a-5(b)(1) defines a "finance subsidiary," for purposes of the rule, in relevant part, as:

> any corporation . . . [a]ll of whose securities other than debt securities or non-voting preferred stock . . . or directors' qualifying shares are owned by its parent company or a company controlled by its parent company . . . .

You argue that although the Parent and companies controlled by the Parent will not "own" any of the Securities, the Parent will have, in all material respects, the same rights and responsibilities with respect to the Trust as parent companies

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[6] *See* Exemption from the Definition of Investment Company for Certain Finance Subsidiaries of United States and Foreign Private Issuers, Investment Company Act Release No. 14275 (Dec. 14, 1984).

[7] *Id.* at text accompanying nn.6-7.

[8] *See* no-action letters cited *supra* note 3. In Lehman Brothers, the staff stated that business trusts may rely on the exemption for finance subsidiaries under Rule 3a-5 if the trust is organized as a business trust under the Delaware Business Trust Act or similar state law and if the trust issues non-voting preferred trust interests. The staff further stated that it no longer would respond to letters on this subject unless they presented novel or unusual issues.

that own securities of finance subsidiaries that either meet all the conditions in Rule 3a-5 or that hold securities in business trusts that rely on the rule in accordance with the staff's no-action positions.[9] In addition, you assert that the holders of the Securities will have the same rights and obligations with respect to the Trust as holders of trust preferred securities issued by business trusts that have relied on Rule 3a-5 under the staff's no-action letters.[10]

You contend that the Trust will operate in a manner consistent with the policies underlying Rule 3a-5. In this regard, the Trust will be created as a financing vehicle for the Parent or companies controlled by the Parent; will operate essentially as a conduit for the Parent to raise capital for its business operations or the business operations of its other subsidiaries; and purchasers of the Trust's Securities ultimately will look to the Parent rather than the Trust for dividend, redemption and liquidation payments.

Without necessarily agreeing with your legal analysis, we would not recommend enforcement action to the Commission under Section 7 of the Investment Company Act if the Trust does not register with the Commission under the Investment Company Act in reliance on Rule 3a-5 thereunder, based on the facts and representations set forth in your letter. Any different facts or representations may require a different conclusion. Further, this response expresses the Division's position on enforcement action only and does not purport to express any legal or interpretive conclusion on the issues presented.

Wendy Finck Friedlander
Senior Counsel

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[9] *See* no-action letters cited *supra* note 3.

[10] *Id.*

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Investment Company Act of 1940--Section 7 and Rule 3a-5

Office of the Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington D.C. 20549

Re: Rule 3a-5 Business Trust Finance Subsidiary

February 23, 2000

Ladies and Gentlemen:

We are writing to request confirmation that, based on the facts described below, the staff of the Division of Investment Management (the "Staff") of the Securities and Exchange Commission (the "Commission") would not recommend enforcement action under Section 7 of the Investment Company Act of 1940 (the "1940 Act") to the Commission if a business trust with the characteristics described below (the "Trust") does not register under the 1940 Act in reliance upon Rule 3a-5 thereunder.

As discussed in greater detail below, with one exception, the Trust will in all material respects have the same characteristics as business trusts that the Staff has previously found to constitute "finance subsidiaries" as defined in Rule 3a-5. The exception is that the Trust will have only one class of securities (the "Securities"), which initially will not be, and may never be, owned by the "parent company" or a "company controlled by the parent company" (as those terms are defined in Rule 3a-5) of the Trust. Nevertheless, consistent with the fundamental purpose of Rule 3a-5, the Trust will be controlled by the parent company in all material respects to the same extent as business trusts that issue equity interests to their parent companies, will be

accounted for as a subsidiary of the parent company and will be formed solely to provide financing for the parent company or a company controlled by the parent company. The Trust will be in compliance with all other aspects of Rule 3a-5. Accordingly, we believe that the Trust should be considered a finance subsidiary as defined for purposes of Rule 3a-5 and, therefore, not an investment company under Section 3(a) of the 1940 Act.

Facts

The Trust

The parent company, as sponsor (the "Parent"), will establish the Trust as a business trust under the laws of the State of Delaware or another state. The Parent will be a "parent company" as defined in Rule 3a-5(b)(2). The terms of the Trust will be established in a trust declaration, trust agreement or similar instrument (the "Trust Agreement"). If the Trust registers the offering of the Securities under the Securities Act of 1933 (the "1933 Act"), the Trust Agreement will be qualified under the Trust Indenture Act of 1939 (the "1939 Act"). The parties to the Trust Agreement will be the Parent, two or more administrators ("Administrators"), a property trustee ("Property Trustee") and, if required by the laws of the state in which the Trust is established, a state trustee ("State Trustee"). The Administrators, the Property Trustee and the State Trustee will have the same functions, rights and obligations under the Trust Agreement as similar parties to trust documents for the many business trusts that have relied on Rule 3a-5 since the Staff first issued no-action letters to the effect that a business trust established under state law may qualify as a finance subsidiary for purposes of Rule 3a-5.[1]

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[1] See *Merrill Lynch & Co.*, SEC No-Action Letter (March 2, 1994), *Inco Limited*, SEC No-Action Letter (March 4, 1994), *Goldman, Sachs & Co.*, SEC No-Action Letter (April 27, 1995) and *Lehman Brothers, Inc.*,

(continued...)

The sole purpose of the Trust will be to act as a financing conduit for the Parent and companies controlled by the Parent. The Trust will advance at least 85% of the proceeds raised from the sale of Securities to the Parent or companies controlled by the Parent. Any proceeds not advanced by the Trust will be invested as permitted by Rule 3a-5(a)(6), as interpreted by the Staff. Any other activities engaged in by the Trust also will be consistent with Rule 3a-5(a)(6). This may include the Trust entering into interest and/or currency swaps with the Parent or companies controlled by the Parent. The Parent will agree to pay, directly or indirectly, the expenses of the Trust.

Administrators and Trustees

The Administrators will be officers or other employees of the Parent. The Administrators will serve a role analogous to that of directors of a corporation, although the functions, duties and responsibilities of the Administrators will be limited due to the limited purpose and the restricted business activities of the Trust. The Administrators will have similar responsibilities as those commonly granted to administrators, administrative trustees or regular trustees of the many business trusts that have relied on Rule 3a-5 to date. These responsibilities include administration of the Trust, execution of instruments, agreements and other documents on behalf of the Trust, sending notices and filing tax returns.

The Property Trustee will be a bank or trust company that is eligible to act as a trustee for purposes of the 1939 Act. The Property Trustee will hold and distribute the assets of the Trust, collect and distribute the income of the Trust and act as registrar and transfer agent for the

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(...continued)
SEC No-Action Letter (May 26, 1995).

Securities, in each case for the benefit of the holders of the Securities. The State Trustee, if one is required, will be a bank or a trust company that will perform the functions required by state law. The roles of the Property Trustee and the State Trustee will be predominantly ministerial in nature. The Property Trustee and the State Trustee will not perform any functions beyond those required by applicable law.

Control by the Parent

Even though the Parent is neither required nor expected to hold any securities issued by the Trust, the Parent will have the same right to control the Trust as the parents of similar business trusts that own such securities and have relied on Rule 3a-5 to date. In particular, only the Parent will have the power to appoint, remove and replace the Administrators. Accordingly, under the generally accepted accounting principles that apply to the Parent, the Trust will be accounted for as a subsidiary of the Parent. The Trust Agreement will provide that that no change or amendment may be made to its terms that is inconsistent with the foregoing or that would affect the sole right of the Parent to select, appoint or remove the Administrators. Also, generally, only the Parent will have the power to appoint, remove and replace the Property Trustee and the State Trustee. However, as is the case with the many business trusts that have relied on Rule 3a-5 to date, if specified events of default occur and are continuing with respect to the advances made by the Trust to the Parent or companies controlled by the Parent, the holders of at least a majority of the Securities may have the right to appoint, remove and replace the Property Trustee and the State Trustee.[2]

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[2] See, for example, *Goldman, Sachs & Co.*, SEC No-Action Letter, 1995 WL 271721 (April 27, 1995).

Security Holders

Even though the Securities will be the only class of securities authorized by the Trust Agreement, the rights and obligations of the holders of the Securities will be similar to the rights and obligations of the holders of trust preferred securities issued by the many business trusts that have relied on Rule 3a-5 to date. The Trust Agreement will specify the payments which holders of the Securities will be entitled to receive out of principal and interest payments or other income from the business trust's assets, as well as at liquidation or upon redemption of the Securities. The dividend rate on the Securities will be calculated by reference to a fixed rate or a formula. Holders of the Securities will have limited liability like that of stockholders of a corporation in reliance upon Section 3803(a) of the Delaware Business Trust Act (the "DBTA") or a similar provision in another state's business trust statute.

The Securities will not be voting securities, as defined in Section 2(a)(42) of the 1940 Act.[3] As discussed above, holders of the Securities will not have the right to appoint, remove or replace the Administrators, although they may have such rights with respect to the Property Trustee and State Trustee under certain circumstances. Specified percentages of the holders of Securities will also have the right to approve certain amendments to the Trust Agreement.

Guarantee

The Parent will guarantee payments under the Securities to the extent required by Rule 3a-5, as interpreted by the Staff, particularly in the context of trust preferred securities issued by

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[3] Section 2(a)(42) of the 1940 Act defines "voting security" as "any security presently entitling the owner or holder thereof to vote for the election of directors of a company...."

business trusts.[4] In other words, the Parent will guarantee, on a subordinated basis, the payment of dividends on and redemption and liquidation payments with respect to the Securities by the Trust to the extent that the Trust has funds legally available therefor.[5] In addition, like the holders of trust preferred securities issued by many of the business trusts that have relied on Rule 3a-5 to date, the holders of the Securities will also have the right to proceed directly against the Parent upon the occurrence of specified events of default.

Residual Distributions

As with other business trusts that have issued trust preferred securities to date in reliance upon Rule 3a-5, any income or assets not distributed to the holders of the Securities at the termination of the Trust will be paid to the Parent as a fee or otherwise, except that the residual income and assets of the Trust, if any, will be distributed pursuant to the Trust Agreement or other instrument, and not as a right of a common security holder. It is unlikely that there will be much, if any, residual income or assets to distribute to the Parent.

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[4] See, for example, *KDSM, Inc. and Sinclair Capital*, SEC No-Action Letter (March 17, 1997); see also *Chieftain Int'l Funding Corp.*, SEC No-Action Letter (November 3, 1992) and *Cleary Gottlieb, Steen & Hamilton*, SEC No-Action Letter (December 23, 1985) (a guarantee that covered dividends on preferred stock when, as and if properly declared out of legally available funds and redemption and liquidation payments on the preferred stock to the extent of funds held by the finance subsidiary permitted to give effect to Rule 3a-5 without requiring recharacterization of the preferred stock as debt for income tax purposes; *Sony Capital Corporation*, SEC No-Action Letter (April 27, 1992) (private placement of non-guaranteed debt securities permitted by the Staff in light of the fact that Rule 3a-5 only requires the guarantee of securities "issued to or held by the public") and *MEC Finance USA, Inc.*, No-Action Letter (October 25, 1991) (the phrase "issued to or held by the public" interpreted by the Staff not to include non-guaranteed debt securities issued in an offering conducted in compliance with Regulation S).

[5] Generally, trusts in a capital securities structure such as this do not "declare" dividends. As discussed above, the Trust will automatically pay dividends according to a fixed rate or formula to the extent there are funds legally available. From an economic standpoint, the holders of the Securities should be in the same or better position than the holders of the securities described in the no-action letters cited in note 4, in which the guarantees were contingent upon two events, i.e., the proper declaration of dividends and the availability of funds. The guarantee described herein is contingent only upon the legal availability of funds. Accordingly, we believe the guarantee described herein is consistent with Rule 3a-5, as interpreted by the Staff.

Discussion

The Trust should be entitled to the exception afforded by Rule 3a-5 to the same extent as business trusts with respect to which the Staff has already issued no-action letters under Rule 3a-5. Except for having only a single class of securities, the Trust will have the same characteristics as those business trusts. Specifically, the Parent, in all material respects, will have the same rights and obligations with respect to the Trust as parent companies that hold common securities in those business trusts. We also note that the Staff has previously recognized that "voting securities", as defined in Section 2(a)(42) of the 1940 Act, should generally be interpreted to include not only the formal legal right to vote for the election of directors of a corporation but also the *de facto* power, based on all the surrounding facts and circumstances, to determine or influence the determination of, the identity of a corporation's directors.[6]

Equally important, the Securities will afford the holders the same rights and obligations with respect to the Trust as trust preferred securities issued by the business trusts that have relied on Rule 3a-5 to date. As required in effect by Rule 3a-5 and those business trusts, the Trust has been created such that the holders of the Securities have no more voting rights than holders of preferred stock typically issued by a corporation.[7] We believe that this is ensured by establishing the Trust with the following characteristics: (a) the Parent will possess the ability to select the Administrators to the same extent as if it held all voting securities of the Trust, (b) the Trust is treated for accounting purposes as a subsidiary of the Parent, (c) only one class of securities is

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[6] See *Mr. Phillip L. Mann, Tax Legislative Counsel*, SEC No-Action Letter (November 4, 1998).

[7] See, for example, *Merrill Lynch & Co.*, SEC No-Action Letter, (May 25, 1995); *KDSM, Inc. and Sinclair Capital*, SEC No-Action Letter (March 17, 1997).

authorized by the terms of the Trust Agreement and (d) the owners of those securities will possess limited rights to approve amendments to the Trust Agreement, to take certain actions in the event of default and, possibly, to appoint or remove the Property Trustee or the State Trustee.

From a policy perspective, the Trust should be exempted from Rule 3a-5. The overriding intent of the Commission in adopting Rule 3a-5 was to exempt subsidiaries from unnecessary regulation under the 1940 Act when "neither the structure nor mode of operation of a qualifying finance subsidiary resembles that of an investment company." The Commission "found this to be the case where the primary purpose of the subsidiary is to finance the business operations of its parent..." or "(when) any purchaser of the finance subsidiary's debt instruments ultimately looks to the parent for repayment and not to the finance subsidiary. The rule therefore describes a situation where the finance subsidiary is essentially a conduit for the parent to raise capital for its own business operations or for the business operations of its other subsidiaries."[8]

The Trust will be a financing vehicle for the Parent, created solely as an alternative means of financing for the Parent and its other subsidiaries. Except for the fact that the Parent will not be required to hold any securities issued by the Trust and the Securities will be the only securities issued by the Trust, the terms and conditions of the Trust, the Trust Agreement and the Securities will in all material respects be consistent with those of the business trusts, trust agreements and trust preferred securities with respect to which the Staff has previously granted no-action relief.[9]

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[8] Exemption from the Definition of Investment Company for Certain Finance Subsidiaries of United States and Foreign Private Issuers, SEC Release No. IC-14275, 1984 WL 52669, at 3 (December 14, 1984) (Adopting Release).

[9] See *Merrill Lynch & Co.*, SEC No-Action Letter, 1995 WL 329625 (May 25, 1995); *Goldman, Sachs & Co.,*

(continued...)

On the basis of the foregoing, we respectfully request confirmation that the Staff will not recommend enforcement action to the Commission if the Trust does not register as an investment company in reliance on Rule 3a-5 under the 1940 Act.

Should you require further information or would like to discuss the matter raised by the letter further, please contact Brian M. Kaplowitz at (212) 839-5370 or Craig E. Chapman at (212) 839-5564.

Very truly yours,

Brown & Wood LLP

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SEC No-Action Letter, 1995 WL 271721 (April 27, 1995).