PART 71—DESIGNATION OF CLASS A, CLASS B, CLASS C, CLASS D, AND CLASS E AIRSPACE AREAS; ROUTES; AND REPORTING POINTS

1. The authority citation for 14 CFR part 71 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40103, 40113, 40120; E. O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of the Federal Aviation Administration Order 7400.9G, Airspace Designations and Reporting Points, dated September 1, 1999, and effective September 16, 1999, is amended as follows:

Paragraph 6005 Class E airspace areas extending upward from 700 feet or more above the surface of the earth.

* * * * *

AWP CA E5 Willows-Glen County Airport, CA [Revised]

Willows—Glen County Airport, CA
(Lat. 39°30′59″N, long. 122°13′03″W)
Maxwell VORTAC
(Lat. 39°19′03″N, long. 122°13′18″W)

That airspace extending upward from 700 feet above the surface within a 6.4-mile radius of the Willows-Glen County Airport and within 2 miles each side of the Maxwell VORTAC 360° radial, extending from the 6.4-mile radius to 3 miles north of the Maxwell VORTAC.

* * * * *

Issued in Los Angeles, California, on September 8, 1999.

John Clancy,

Manager, Air Traffic Division, Western-Pacific Region.

[FR Doc. 99–25225 Filed 9–28–99; 8:45 am]

BILLING CODE 4910–13–M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC–24050; File No. S7–21–99]

RIN 3235–AH56

Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for public comment a new rule and related rule amendments under the Investment Company Act of 1940 that would affect the ability of investment companies to invest in repurchase agreements and pre-refunded bonds under the Act. The proposed rule would generally codify and update staff positions that have permitted investment companies to ''look through'' counterparties to certain repurchase agreements and issuers of municipal bonds that have been ''refunded'' with U.S. government securities and treat the securities comprising the collateral as investments for certain purposes under the Act.

DATES: Comments must be received on or before November 23, 1999.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0609. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–21–99; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Marilyn Mann, Senior Counsel, Office of Regulatory Policy, at (202) 942–0690, or Alison M. Fuller, Assistant Chief Counsel, Office of Chief Counsel, (202) 942–0660, Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0506.

SUPPLEMENTARY INFORMATION: The Commission today is requesting public comment on proposed rule 5b–3 [17 CFR 270.5b–3] and conforming amendments to rules 2a–7 [17 CFR 270.2a–7] and 12d3–1 [17 CFR 270.12d3–1] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the ''Act'').[1]

Table of Contents

Executive Summary

Repurchase agreements provide investment companies (''funds'') with a convenient means to invest excess cash on a secured basis, generally for short periods of time. In a typical fund repurchase agreement, a fund enters into a contract with a broker, dealer or bank (the ''counterparty'' to the transaction) for the purchase of securities. The counterparty agrees to repurchase the securities at a specified future date or on demand for a price that is sufficient to return to the fund its original purchase price, plus an additional amount representing the return on the fund's investment.

The Commission is proposing a rule that would permit funds to ''look through'' certain repurchase agreements to the securities collateralizing the agreements for various purposes under the Act. Because a fund looks to the collateral as the ultimate source of repayment for its loan, the Commission staff has taken a ''no-action'' position in order to allow funds to treat certain repurchase agreements as investments in the securities making up the collateral rather than as a loan to the counterparty. Proposed rule 5b–3 would codify these positions and allow a fund to treat a repurchase agreement as an acquisition of the underlying collateral in determining whether it is in compliance with the investment criteria for diversified funds set forth in section 5(b)(1) of the Act.[2] The proposed rule also would codify staff no-action positions that allow a fund that enters into a repurchase agreement with a counterparty that is a broker-dealer to ''look through'' the repurchase agreement to the underlying collateral for purposes of section 12(d)(3) of the Act, which prohibits a fund from acquiring an interest in a broker-dealer.[3] The proposed rule would require the value of the collateral at all times to be sufficient to fully cover the amount payable under the repurchase agreement (that is, the amount that the counterparty would repay the fund to repurchase the securities). In addition, the fund must evaluate whether the counterparty is creditworthy and the repurchase agreement must qualify for an exclusion from any automatic stay of creditors' rights under the federal

[1] Unless otherwise noted, all references to rule 2a–7 or rule 12d3–1, or to any paragraph of those rules, will be to 17 CFR 270.2a–7 and 17 CFR 270.12d3–1, respectively.

[2] 15 U.S.C. 80a–5(b)(1).

[3] 15 U.S.C. 80a–12(d)(3).

Bankruptcy Code or other insolvency laws.

Proposed rule 5b–3 would provide similar ''look-through'' treatment for purposes of section 5(b)(1) of the Act in the case of investments in pre-refunded bonds, the repayment of which has been fully funded by escrowed U.S. government securities. As in the case of repurchase agreements, a fund may view its investment in pre-refunded bonds as an investment in the escrowed government securities rather than in the original bonds.

The conditions proposed for the treatment of repurchase agreements and pre-refunded bonds under the proposed rule would be substantially the same as those required by rule 2a–7, the rule governing money market funds, and would codify and update long-standing staff no-action positions.

I. Background

A. Repurchase Agreements

Repurchase agreements provide funds with a means to invest idle cash at competitive rates for periods as short as overnight. Economically, they may be viewed as loans from the fund to the counterparty in which the securities that the fund purchases serve as collateral for the loan and are placed in the possession or under the control of the fund's custodian during the term of the agreement.[4] By investing in repurchase agreements, funds can expand their available options for the productive investment of short-term cash. At the same time, fund participation in the market for repurchase agreements benefits other market participants by enhancing their ability to borrow to meet their short-term needs.

Two provisions of the Act may affect a fund's ability to invest in repurchase agreements. Section 12(d)(3) of the Act generally prohibits a fund from acquiring an interest in a broker, dealer, or underwriter.[5] Because a repurchase agreement may be considered to be the acquisition of an interest in the counterparty,[6] section 12(d)(3) may limit a fund's ability to enter into repurchase agreements with many of the firms that act as counterparties.[7] Section 5(b)(1) of the Act limits the amount that a fund that holds itself out as being a diversified investment company may invest in the securities of any one issuer (other than the U.S. government).[8] This provision may limit the amount of repurchase agreements that a diversified fund may enter into with any one counterparty.

A fund investing in a properly structured repurchase agreement looks primarily to the value and liquidity of the collateral rather than the credit of the counterparty for satisfaction of the repurchase agreement.[9] In two separate no-action positions issued in 1979 and 1980, the staff stated that, for purposes of sections 12(d)(3) and 5(b)(1) of the Act, a fund may treat a repurchase agreement as an acquisition of the underlying collateral if the repurchase agreement is ''collateralized fully.'' [10] Because most repurchase agreements are collateralized fully by highly liquid U.S. government securities, this ''look-through'' treatment allowed funds to treat repurchase agreements as investments in government securities. As a result, a fund could invest in repurchase agreements with the same counterparty without the limitations of sections 12(d)(3) or 5(b)(1).[11]

The assumptions underlying the 1979 and 1980 no-action positions were challenged in the early 1980s as a result of the bankruptcy of Lombard-Wall, Inc., a large issuer of repurchase agreements, and the insolvency of several others.[12] The court in the *Lombard-Wall* case held that the purchaser of securities in a repurchase agreement was subject to the automatic stay of the Bankruptcy Code,[13] and could not close out its position without the approval of the bankruptcy court.[14] This decision created uncertainty regarding the status of repurchase agreements under the Bankruptcy Code and exposed a fund to the risk that it might be unable to liquidate the collateral securities immediately upon the insolvency of the counterparty.[15] Because of the possible adverse effect of counterparty insolvency on a fund's liquidity, the Commission issued a staff release that added a condition to the staff's earlier no-action position. In addition to requiring the repurchase agreement to be fully collateralized, the staff now required the fund to evaluate the creditworthiness of the counterparty.[16]

Congress later amended the Bankruptcy Code to resolve this uncertainty.[17] As amended, the

---

[4] *See* The Handbook of Fixed Income Securities 198 (Frank J. Fabozzi ed., 5th ed. 1997). Most repurchase transactions involve Treasury bills and other U.S. government securities, but bank certificates of deposit and bankers' acceptances, as well as commercial paper from major corporations, are used as well. *See* Jeanne L. Schroeder, *Repo Madness: The Characterization of Repurchase Agreements Under the Bankruptcy Code and the U.C.C.,* 46 Syracuse L. Rev. 999, 1005 (1996). When the counterparty lends to, rather than borrows from, the fund, the transaction is termed a ''reverse repurchase agreement.'' Reverse repurchase agreements raise issues under section 18 of the Act [15 U.S.C. 80a–18] because they can be viewed as the issuance by the fund of a senior security. These issues were addressed in Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 FR 25128 (Apr. 27, 1979)] (''Release 10666'').

[5] With minor exceptions, section 12(d)(3) prohibits an investment company from purchasing or otherwise acquiring ''any security issued by or any other interest in the business of any person who is a broker, a dealer, [or] is engaged in the business of underwriting.'' The staff has taken the position that fund repurchase agreements with banks that are engaged in a securities-related business, including dealing in government securities, may be subject to the prohibitions of section 12(d)(3). *See* Letter from Gerald Osheroff, Associate Director, Division of Investment Management, to Matthew Fink, General Counsel, Investment Company Institute (May 7, 1985) (''May 7, 1985 Letter'').

[6] *See* American Medical Ass'n Tax-Exempt Income Fund, Inc., SEC No-Action Letter (Apr. 23, 1978); May 7, 1985 Letter, *supra* note 5.

[7] Brokers and dealers (as well as banks that are engaged in securities related activities) often act as counterparties in repurchase transactions. *See* Schroeder, *supra* note 4, at 1004. If funds are unable to enter into repurchase agreements with these counterparties, they effectively may be unable to participate in this market.

[8] To be classified as a ''diversified'' fund under section 5(b)(1) of the Act, a fund is required, with respect to 75 percent of its assets, to invest no more than 5 percent of its assets in the securities of any one issuer (excluding cash and cash items, government securities, and securities of other investment companies). The remaining 25 percent of the fund's assets may be invested in any manner. Section 13(a)(1) of the Act [15 U.S.C. 80a–13(a)(1)] prohibits a fund that is classified as a diversified company from changing to a non-diversified company without shareholder authorization.

[9] *See infra* note 16 and accompanying text.

[10] In 1979, the staff announced that it would not recommend enforcement action under section 12(d)(3) if the repurchase agreement was ''structured in a manner reasonably designed to collateralize fully the investment company loan.'' Release 10666, *supra* note 4. The following year, the staff applied this no-action position to a fund's compliance with the diversification requirements of section 5(b)(1) of the Act. MoneyMart Assets, Inc., SEC No-Action Letter (Sept. 3, 1980).

[11] Repurchase agreements with broker-dealers affiliated with the fund would, of course, continue to raise serious questions under sections 17(a) and 17(d) of the Act [15 U.S.C. 80a–17(a), 15 U.S.C. 80a–17(d)]. *See* Release 10666, *supra* note 4, at n.24.

[12] *See In re* Lombard-Wall Inc., No. 82 B 11556, bench op. (Bankr. S.D.N.Y. Sept. 16, 1982).

[13] 11 U.S.C. 101 *et seq.*

[14] *See Omnibus Bankruptcy Improvements Act of 1983,* S. Rep. No. 98–65, at 47 (1983) (discussing *In re* Lombard-Wall Inc.).

[15] As a consequence, the repurchase agreement might be an illiquid investment subject to restrictions on the amount of these investments in a fund's portfolio.

[16] Investment Company Act Release No. 13005 (Feb. 2, 1983) [48 FR 5894 (Feb. 9, 1983)] (''Release 13005''). Release 13005 called for the evaluation of the counterparty's creditworthiness to be made by the fund's board of directors. In a recent letter to the Investment Company Institute, the staff revised this position to permit a fund's investment adviser, rather than the fund's board, to evaluate the creditworthiness of counterparties and otherwise assume primary responsibility for monitoring and evaluating the fund's use of repurchase agreements. Investment Company Institute, SEC No-Action Letter (June 15, 1999).

[17] Before the passage of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98–353, 98 Stat. 333 (1984) (''BAFJA''), the treatment of a repurchase agreement under the

Continued

Bankruptcy Code now protects participants in repurchase agreements from the Code's automatic stay and preference avoidance provisions when the collateral consists of U.S. government and agency obligations, certificates of deposit, and eligible bankers' acceptances.[18] In 1996, when we amended the money market fund rule (rule 2a–7, which had codified the staff's position on repurchase agreements in connection with that rule's diversification requirements),[19] we tied the availability of the ''look-through'' more directly to the preferred treatment given to repurchase agreements under the Bankruptcy Code and related insolvency statutes.[20] We noted that if the collateral did not qualify for special treatment under these statutes, a fund could encounter significant liquidity problems if a large percentage of its assets were invested in a repurchase agreement with a bankrupt counterparty. In that case, the credit risks assumed by the fund would be directly tied to the counterparty rather than the issuers of the underlying collateral.[21]

The Commission is proposing a new rule 5b–3 that would codify the staff's positions that a fund may look through a fully collateralized repurchase agreement to the underlying securities for purposes of sections 5(b)(1) and 12(d)(3) of the Act,[22] supplemented by the requirement of rule 2a–7 that the repurchase agreement qualify for an exclusion from any automatic stay of creditors' rights under applicable insolvency law. Because the conditions for looking through a repurchase agreement for purposes of sections 5(b)(1) and 12(d)(3) are substantially the same as the conditions under rule 2a–7, the Commission is proposing to codify the same standard for all three purposes.

B. Pre-Refunded Bonds

Pre-refunded bonds are municipal bonds the repayment of which has been fully funded by a deposit into escrow of U.S. government securities. From time to time, a municipality may choose to refund previously issued bonds prior to their call date by issuing a second bond, the proceeds of which are used to purchase U.S. government securities. These securities are placed in escrow, and the principal and interest on the escrowed securities are used to pay off the original bonds.[23] The holders of the original bonds no longer look to the municipal issuer for repayment, but rather to the escrowed securities.

In 1993, the staff issued a no-action position permitting funds, under certain conditions, to look through pre-refunded bonds to the escrowed government securities for purposes of the section 5(b)(1) diversification requirements.[24] When the Commission amended rule 2a–7 in 1996, it codified this position for purposes of the money market fund diversification requirements, but omitted the condition that the pre-refunded bonds of any one issuer could account for no more than 25 percent of the fund's assets.[25] The Commission proposes to codify this revised treatment of pre-refunded bonds for purposes of section 5(b)(1).[26]

II. Discussion

A. Proposed Rule 5b–3(a): Treatment of Repurchase Agreements

Proposed rule 5b–3 would permit a fund to treat the acquisition of a repurchase agreement as an acquisition of the underlying securities for purposes of sections 5(b)(1) and 12(d)(3) of the Act, if the obligation of the seller to repurchase the securities from the fund is ''collateralized fully,'' as defined in the proposed rule.[27] Consistent with the staff's no-action positions, the proposed rule also would require the board of directors or its delegate to evaluate the counterparty's creditworthiness.[28] A similar requirement would be added to rule 2a–7.[29]

The proposed rule generally would incorporate the definition of ''collateralized fully'' currently employed in rule 2a–7.[30] A repurchase

---

Bankruptcy Code depended upon whether it was characterized as a secured loan or a purchase and sale transaction. If the transaction was characterized as a secured loan, the borrower-counterparty would retain at least an equitable interest in the securities, and the securities would be subject to the automatic stay provisions of the Bankruptcy Code, preventing the lender from taking any action against the borrower's property. If the transaction was characterized as a purchase and sale, the repurchase obligation would be viewed as an executory contract, which the bankruptcy trustee could accept or reject. Until acceptance or rejection, the fund would be exposed to the market risk of the securities. Regardless of the transaction's characterization, it was unclear whether ''mark-to-market'' payments (the payments required to keep the repurchase agreement fully collateralized) could be voided by the trustee as preferential transfers. The BAFJA amendments removed qualifying repurchase agreements from the operation of the Bankruptcy Code's automatic stay and preference avoidance provisions. *See* 11 U.S.C. 101(47) (defining repurchase agreement); 11 U.S.C. 559 (protecting repurchase agreement participants from the Bankruptcy Code's automatic stay provisions).

[18] *See* 11 U.S.C. 101(47); 11 U.S.C. 559. The Federal Deposit Insurance Act also provides preferred treatment to repurchase agreements in which a bank is the counterparty. *See* 12 U.S.C. 1821(e)(8)(A), (C) (affording preferred treatment to ''qualified financial contracts''); 12 U.S.C. 1821(e)(8)(D)(i) (defining qualified financial contracts to include repurchase agreements); 12 U.S.C. 1821(e)(8)(D)(v) (defining repurchase agreement).

In broker-dealer insolvencies, the buyer's ability to liquidate the repurchase agreement collateral is subject to the possible imposition of a judicial stay obtained by the Securities Investor Protection Corporation (''SIPC''). Representatives of SIPC, however, have indicated that SIPC would consent, and urge the trustee to consent, to the liquidation of repurchase agreement collateral upon SIPC's receipt of certain documentation, including an affidavit from the buyer that it has a perfected security interest in the collateral. *See* Letter from Michael E. Don, President, SIPC, to Seth Grosshandler, Cleary, Gottlieb, Steen & Hamilton (Feb. 14, 1996); Letter from Michael E. Don, Deputy General Counsel, Office of the General Counsel, SIPC, to Eugene Marans, Cleary, Gottlieb, Steen & Hamilton (Aug. 29, 1988).

[19] *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)], at nn. 30–33 and accompanying text.

[20] *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] (''1996 Amendments Proposing Release''), at nn. 168–74 and accompanying text; Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996) [61 FR 13956 (Mar. 28, 1996)] (''1996 Amendments Adopting Release''), at nn. 116–19.

[21] 1996 Amendments Proposing Release, *supra* note 20, at n.172.

[22] The Commission expects to withdraw the staff positions if we adopt the proposed rule.

[23] *See, e.g.,* Robert Zipf, How Municipal Bonds Work 44–47 (1995).

[24] T. Rowe Price Tax-Free Funds, SEC No-Action Letter (June 24, 1993). In the letter, the Division of Investment Management agreed not to recommend any enforcement action if a fund treated an investment in municipal bonds refunded with escrowed government securities as an investment in the government securities for purposes of section 5(b)(1). This no-action position was based on certain representations, including that (1) the deposit of the government securities was irrevocable and pledged only to the debt service on the original bonds, (2) payments from the escrow would not be subject to the preference provisions or automatic stay provisions of the Bankruptcy Code, and (3) no fund would invest more than 25 percent of its assets in the pre-refunded bonds of any single municipal issuer.

[25] The Commission also eliminated the 25 percent limitation for funds other than money market funds that rely on the staff no-action position set forth in T. Rowe Price Tax-Free Funds. 1996 Amendments Adopting Release, *supra* note 20, at n.122.

[26] The Commission expects to withdraw the staff position if we adopt the proposed rule.

[27] Proposed rule 5b–3(a). A fund would be permitted to look through only that portion of the repurchase agreement that is collateralized fully. Any agreement or portion of an agreement that is not collateralized fully would be treated as a loan by the fund to the counterparty. Even if a repurchase agreement is collateralized fully, a fund may elect to look to the counterparty rather than the underlying securities in meeting the diversification requirements of section 5(b)(1).

[28] *Id. See* Release 13005, *supra* note 16; Investment Company Institute, *supra* note 16.

[29] Proposed rule 2a–7(c)(4)(ii)(A). This requirement is not new. In Investment Company Act Release No. 22383 (Dec. 10, 1996) [61 FR 66621 (Dec. 18, 1996)] (proposing technical amendments to rule 2a–7), at note 32, the Commission stated that a money market fund must continue to evaluate the counterparty's creditworthiness in order to minimize the risk of becoming involved in bankruptcy proceedings, consistent with the no-action position stated in Release 13005.

[30] Rule 2a–7(a)(5).

agreement would be collateralized fully if: (i) the value of the underlying securities (reduced by the costs that the fund reasonably could expect to incur if the counterparty defaults) is, and at all times remains, at least equal to the agreed resale price; [31] (ii) the collateral for the repurchase agreement consists entirely of cash items, U.S. government securities, or other securities of a high quality; [32] and (iii) the repurchase agreement qualifies for an exclusion from any automatic stay of creditors' rights against the counterparty under applicable insolvency law in the event of the counterparty's insolvency.[33]

The rule 2a–7 definition of ''collateralized fully'' also requires either the fund or its custodian to have physical possession of the collateral or a book entry to be maintained in the name of the fund or its custodian.[34] This provision derived from a Commission staff position requiring funds to acquire actual or constructive possession of repurchase agreement collateral.[35] In lieu of this requirement, the proposed rule would require the fund to perfect its security interest in the repurchase agreement collateral and maintain the collateral in an account with the fund's custodian or a third party that qualifies as a custodian under the Act.[36] This proposal, which we believe generally would not require a change from current practice, is intended to update the definition of ''collateralized fully'' in light of the 1994 revisions to the Uniform Commercial Code, which address the evolution of the indirect system for holding securities.[37] The updated requirement would, we believe, more accurately reflect the steps that a fund should take to protect its interests in repurchase agreement collateral. The Commission requests comment on this proposal. Should the definition of collateralized fully specifically require funds to perfect their security interests in repurchase agreement collateral by obtaining ''control'' of the collateral? [38]

We understand that some funds engage in ''hold-in-custody'' repurchase agreements (''HIC repos'')[39] with their custodians as a means of investing cash that they receive late in the business day. Some commentators have suggested that these transactions entail the risk that the fund would not be able to liquidate the collateral promptly if the custodian were to become insolvent.[40] The Commission requests comment on risks posed by these transactions and whether HIC repos should be considered ''collateralized fully'' under rule 5b–3.

Most repurchase agreements are collateralized with U.S. government securities, and the staff positions with respect to section 5(b)(1) have limited the collateral to those securities.[41] Under the proposed rule, cash collateral also could be used, as well as other high quality securities. The Commission is proposing to limit the high quality securities that may be used as collateral based on the same standards currently contained in rule 2a–7 for money market funds.[42] The high quality requirement is designed to limit a fund's exposure to the ability of the counterparty to maintain sufficient collateral.[43] In addition, use of this rule 2a–7 standard would permit a fund complex to establish uniform criteria for repurchase agreements among funds. Comment is requested whether the rule should include these minimum quality standards for collateral. Are there any other criteria that would be preferable?

As discussed above, the proposed rule also requires the fund to evaluate the counterparty's creditworthiness.[44] This evaluation, which currently is required

[31] Proposed rule 5b–3(c)(1)(i) requires the value of the securities collateralizing the repurchase agreement to be, and during the entire term of the agreement to remain, at least equal to the resale price. The term ''resale price'' is defined in paragraph (c)(7) of the proposed rule as the acquisition price paid to the seller plus the accrued resale premium, *i.e.*, the return on investment specified in the agreement. Consistent with prior staff positions, the market value of the securities held as collateral must be marked to market daily during the entire term of the agreement to ensure that the collateral is at all times at least equal to the resale price, and the repurchase agreement should provide for the delivery of additional collateral if the market value of the securities falls below the resale price. *See* Letter from Gerald Osheroff, *supra* note 5. Under the proposed rule, the fund's expected return on its investment may be either the full amount specified in the agreement or the daily amortization of the difference between the purchase price and the resale price specified in the agreement. This allows the counterparty to add to the collateral as interest on the loan accrues. *See* 1996 Amendments Proposing Release, *supra* note 20, at n.176 and accompanying text.

[32] Proposed rule 5b–3(c)(1)(iv). Any securities other than government securities must be rated in the highest rating category by the ''requisite NRSROs.'' *Id. See also infra* text accompanying notes 41–43 (describing this proposed quality requirement and requesting comment). ''Requisite NRSROs'' are defined in paragraph (c)(6) of the proposed rule as any two NRSROs, or, if only one NRSRO has issued a rating at the time the fund acquires the security, that NRSRO. ''NRSRO'' is defined in paragraph (c)(5) as any nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi)(E), (F) and (H) of rule 15c3–1 [17 CFR 240.15c3–1] under the Securities Exchange Act of 1934 [15 U.S.C. 78a–mm], that is not an ''affiliated person,'' as defined in section 2(a)(3)(C) of the Act [15 U.S.C. 80a–2(a)(3)(C)], of the issuer of, or any insurer or provider of credit support for, the security.

[33] Proposed rule 5b–3(c)(1)(v).

[34] Rule 2a–7(a)(5)(ii).

[35] *See* Release 13005, *supra* note 16, at n.2 and accompanying text. In Release 13005, the Division stated that the requirement of actual or constructive possession was intended to ensure that the fund would be able to liquidate the collateral immediately upon any default or insolvency of the seller. Constructive possession included the transfer of book-entry securities. *See id.* The staff also provided guidance with respect to the custody requirements in a letter from Kathryn McGrath, Director, Division of Investment Management, to Matthew Fink, General Counsel, Investment Company Institute (June 19, 1985). Among other things, the letter noted the staff's position that ''a repurchase agreement is fully collateralized only if the collateral is in the actual or constructive possession of the investment company.'' The letter also noted that the staff would consider a fund to have constructive possession of collateral when the collateral has been transferred to the fund's custodian or to the care of a third party to the repurchase agreement that would qualify as a custodian for fund assets under section 17(f) of the Act [15 U.S.C. 80a–17(f)].

[36] Proposed rule 5b–3(c)(1)(ii), (iii).

[37] *See generally* UCC, Revised Article 8—Investment Securities (With Conforming and Miscellaneous Amendments to Articles 1, 4, 5, 9, and 10) (1994 Official Text with Comments), 2C Uniform Laws Annotated (West Supp. 1997), Prefatory Note at I.D., II.B., II.C., II.D. As of April 1, 1999, the 1994 amendments to UCC Article 8 had been adopted by 48 states, the District of Columbia, and Puerto Rico. The most recent information regarding the status of proposed UCC revisions in the state legislatures can be obtained by contacting the National Conference of Commissioners on Uniform State Laws at (312) 915–0195.

[38] Under the 1994 revisions to the UCC, the primary means to perfect a security interest in investment securities is by obtaining ''control'' of the securities. *See* UCC, Revised Article 8, §§ 8–106, 9–115(4). In general, obtaining ''control'' means taking the steps necessary to place a secured lender in a position where it can have the collateral sold off without the further cooperation of the debtor. *See* UCC, Revised Article 8, Prefatory Note at II.D.

[39] In a HIC repo, the seller merely segregates the collateral during the term of the agreement, rather than transferring it to the buyer or to a third party. **Ellen Taylor, Trader's Guide to the Repo market** 25–26 (1995).

[40] *See* Seth Grosshandler, Lech Kalembka & Daniel Feit, Securities, Forward and Commodity Contracts and Repurchase and Swap Agreements Under U.S. Insolvency Laws (1995), *available in* LEXIS, 721 PLI/Comm 401, 434 (qualified financial contract provisions do not protect the right of a purchaser of securities under a HIC repo to compel delivery of the securities from the FDIC as conservator or receiver); *see also id.* at 416 (Bankruptcy Code does not appear to protect the right of a purchaser of securities under a HIC repo to compel delivery of the securities from the bankrupt).

[41] *See* MoneyMart Assets, *supra* note 10. The staff's no-action positions with respect to the treatment of repurchase agreements for purposes of section 12(d)(3) did not expressly limit the type of eligible collateral. *See* Release 10666, *supra* note 4; Release 13005, *supra* note 16.

[42] Rule 2a–7(a)(5)(iii); *see also supra* note 32.

[43] Securities of lower quality may be subject to greater price fluctuation. In the event of a steep drop in the market value of the collateral, it may be difficult for the counterparty to deliver additional securities sufficient to ensure that the repurchase agreement remains fully collateralized. If the counterparty does not deliver sufficient additional securities and thus defaults, the fund may be unable to realize the full value of the repurchase agreement upon liquidation of the collateral. In addition, high quality securities are generally more liquid than lower quality securities. A fund could more readily liquidate high quality securities in the event of a counterparty default.

[44] *See supra* note 28 and accompanying text.

under staff no-action positions, is designed to require the fund to determine whether the counterparty presents a serious risk of becoming involved in bankruptcy proceedings.[45] The Commission requests comment on the need for this evaluation of the counterparty's creditworthiness in light of the proposed requirement that repurchase agreements qualify for the preferred treatment now given to certain repurchase agreements under the Bankruptcy Code.[46]

B. Proposed Rule 5b–3(b): Treatment of Pre-Refunded Bonds

Proposed rule 5b–3 would codify for purposes of section 5(b)(1) the conditions specified in the staff's no-action position permitting a fund to treat an investment in a ''refunded security'' as an investment in the escrowed U.S. government securities for purposes of section 5(b)(1).[47] The rule, however, would not limit the amount of pre-refunded bonds of any one issuer that a fund could acquire.[48]

Under the proposed rule, a ''refunded security'' would be defined as a debt security the principal and interest payments of which are to be paid by U.S. government securities that have been irrevocably placed in an escrow account and are pledged only to the payment of the debt security.[49] The escrowed securities must not be redeemable prior to their final maturity, and the escrow agreement must prohibit the substitution of the escrowed securities unless the substituted securities are also U.S. government securities.[50] Finally, an independent certified public accountant must have certified to the escrow agent that the escrowed securities will satisfy all scheduled payments of principal, interest and applicable premiums on the refunded securities.[51] This treatment corresponds to the treatment given to pre-refunded bonds in rule 2a–7.[52]

C. Availability of Rule 12d3–1 for Repurchase Agreements

The Commission also proposes to amend rule 12d3–1, which provides an exemption from the prohibition in section 12(d)(3) on acquiring an interest in a broker-dealer or a bank engaged in a securities-related business.[53] The amendment would affect only repurchase agreements that do not meet the conditions for looking through the agreements to the underlying collateral. As discussed above, if a fund enters into a repurchase agreement with a broker-dealer or other counterparty that is engaged in securities related activities, and the fund is unable to look through the agreement to the underlying collateral, the fund may be in violation of section 12(d)(3) of the Act.[54] Rule 12d3–1 provides an exemption from section 12(d)(3) under certain conditions, but a note appended to rule 12d3–1 currently makes the rule unavailable for repurchase agreements that fail to meet the requirements for look-through treatment set forth in Investment Company Act Release No. 13005 (''Release 13005'').[55] We are proposing to eliminate that note, and thus allow funds to rely on rule 12d3–1 even if the repurchase agreement does not meet the requirements of Release 13005. The Commission requests comment whether it is appropriate to permit funds to enter into repurchase agreements with broker-dealers when the transaction does not meet all of the requirements of proposed rule 5b–3, but does meet the requirements of rule 12d3–1.[56]

D. Conforming Amendments to Rule 2a–7

We are also proposing conforming amendments to rule 2a–7. These amendments would add to rule 2a–7 the requirement that a money market fund must evaluate the counterparty's creditworthiness in order to treat the acquisition of a repurchase agreement as an acquisition of the underlying securities.[57] In addition, the proposed amendments would replace the definitions of ''collateralized fully,'' ''event of insolvency,'' and ''refunded security,'' currently set forth in rule 2a–7 with cross references to the corresponding definitions set forth in proposed rule 5b–3.[58]

E. Request for Comments

Any interested persons wishing to submit written comments on the proposed rule and rule amendments that are the subject of this Release, to suggest additional provisions or changes to the rules, or to submit comments on other matters that might have an effect on the proposals contained in this Release, are requested to do so. The Commission specifically requests comment whether a fund should be allowed to look through any other types of investments to underlying securities for purposes of diversification, the prohibition of section 12(d)(3), or any other provision of the Investment Company Act. Commenters suggesting alternative approaches are encouraged to submit suggested rule text.

The Commission also requests comment whether the proposals, if adopted, would promote efficiency, competition, and capital formation. We will consider these comments pursuant to our responsibilities under section 2(c) of the Investment Company Act.[59] The Commission encourages commenters to provide empirical data or other facts to support their views. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[60] the Commission also requests information regarding the potential impact of the proposed rule and rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data to support their views.

III. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. For the most part, the proposed rule would codify current staff positions. By codifying a number of staff no-action positions issued over a nearly twenty year period, the proposed rule should make it easier for funds to determine whether, and under what conditions,

[45] *See* Release 13005, *supra* note 16, at n.6.

[46] When we proposed amendments to rule 2a–7 in 1993, we requested comment on the need for a credit risk determination in light of the amendments to the Bankruptcy Code. 1996 Amendments Proposing Release, *supra* note 20, at n.173 and accompanying text. Most commenters urged that the determination be retained.

[47] Proposed rule 5b–3(b).

[48] *See* T. Rowe Price Tax-Free Funds, *supra* note 24.

[49] Proposed rule 5b–3(c)(4).

[50] Proposed rule 5b–3(c)(4)(i), (ii).

[51] Proposed rule 5b–3(c)(4)(iii). The proposed rule makes an exception to the certification requirement if the refunded security has received the highest rating from an NRSRO. *Id.*

[52] *See* rule 2a–7(a)(20), (c)(4)(ii)(B); *see also* 1996 Amendments Proposing Release, *supra* note 20, at section II.A.3.

[53] *See supra* note 5.

[54] *See supra* notes 5–7 and accompanying text.

[55] *See* Release 13005, *supra* note 16. Rule 12d3–1 provides an exemption for purchases of securities of any entity that derived fifteen percent or less of its gross revenues from securities related activities in its most recent fiscal year, unless the acquiring company would control the entity after the purchase. If the entity derived more than fifteen percent of its gross revenues from securities related activities, the rule provides a limited exemption based on the amount and value of the securities purchased. The note to the rule states: ''**Note**: It is not intended that this rule should supersede the requirements prescribed in Investment Company Act Release No. 13005 (Feb. 2, 1983) with respect to repurchase agreements with brokers or dealers.''

[56] A fund investing in a repurchase agreement that does not meet the requirements of the proposed rule would not be able to ''look through'' the agreement and must instead treat the counterparty to the agreement as the issuer.

[57] Proposed rule 2a–7(c)(4)(ii)(A). As noted above, this merely codifies a current staff requirement. *See supra* note 29.

[58] Proposed rule 2a–7(a)(5), (11) and (20) (cross-referencing proposed rule 5b–3(c)(1), (2), and (4)).

[59] 15 U.S.C. 80a–2(c).

[60] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

they are permitted to look through repurchase agreements or pre-refunded bonds to the underlying securities for purposes of sections 5(b)(1) and 12(d)(3) of the Act. In addition, the proposed rule would use substantially the same standards currently specified in rule 2a–7 for the treatment of repurchase agreements and pre-refunded bonds by money market funds. With this uniform treatment, fund complexes that include money market funds may be more efficient in monitoring compliance with the requirements of the rules for all types of funds.

As discussed above, the proposed rule would be limited to repurchase agreements in which the underlying collateral consists of cash items, U.S. government securities, or other securities that meet certain quality standards. As proposed, the rule tracks the language of rule 2a–7, generally requiring any ''other securities'' to carry the highest rating of two national rating agencies (''NRSROs,'' as defined in the rule). This proposed requirement is intended to ensure that the market value of the collateral will remain fairly stable and that the fund will be able to liquidate the collateral quickly in the event of a default. This limitation on collateral is more restrictive than the staff's position with respect to the treatment of repurchase agreements for purposes of section 12(d)(3),[61] but it is less restrictive than the staff's position with respect to section 5(b)(1).[62] Since most repurchase agreements are collateralized by U.S. government securities, which clearly fall within the proposed rule's limitations, it appears that the limitation will not have any significant impact on funds.

The proposed rule is limited to repurchase agreements that qualify for an exclusion from any automatic stay under applicable insolvency law. Although this requirement is included in rule 2a–7, it was not a feature of the staff positions, which generally pre-dated the relevant changes in the Bankruptcy Code. Again, because most repurchase agreements qualify for an exclusion, this limitation should not have any significant impact on funds. The limitation will, however, provide important protections for investors by ensuring that a fund can liquidate the collateral quickly in the event of the counterparty's bankruptcy.

The proposed amendment to rule 12d3–1 would eliminate the ''Note'' to the rule that renders the rule unavailable to repurchase agreements. The Commission believes that funds should be allowed to rely on rule 12d3–1 in cases in which a repurchase agreement does not meet all of the conditions of proposed rule 5b–3. This amendment will provide additional flexibility for funds without impairing investor interests.

The Commission requests comment on the costs and benefits of the proposed rule and rule amendments. To the extent possible, please quantify any significant costs or benefits.

IV. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA'') in accordance with 5 U.S.C. 603 regarding proposed rule 5b–3, and the conforming amendments to rules 2a–7 and 12d3–1. The IRFA indicates that the new rule would codify the staff's position that a fund may look through a fully collateralized repurchase agreement to the underlying securities for purposes of sections 5(b)(1) and 12(d)(3) of the Act, and add the requirement of rule 2a–7 that the repurchase agreement qualify for an exclusion from any automatic stay of creditors' rights under applicable insolvency law. The IRFA indicates that proposed rule 5b–3 also would permit a fund to treat the acquisition of certain pre-refunded bonds as an acquisition of the escrowed securities for purposes of section 5(b)(1) of the Act. In addition, the IRFA explains that the proposed amendment to rule 12d3–1 would eliminate the ''Note'' appended to the rule in order to allow funds to rely on rule 12d3–1 even if the repurchase agreement is not collateralized fully. Finally, the IRFA states that the conforming amendments to rule 2a–7 are intended to simplify and update the provisions of that rule that address repurchase agreements and refunded securities.

The IRFA sets forth the statutory authority for the proposed rule and rule amendments. The IRFA also discusses the effect of the proposed rule and rule amendments on small entities. For purposes of the Investment Company Act and the Regulatory Flexibility Act, a fund is a small entity if the fund, together with other funds in the same group of related funds, has net assets of $50 million or less as of the end of its most recent fiscal year.[63]

The IRFA states that proposed rule 5b–3 will affect (i) any fund that invests in a repurchase agreement with a broker, dealer, underwriter, or bank that is engaged in a securities-related business, when the investment may otherwise be prohibited by section 12(d)(3) of the Act, and (ii) any fund that holds itself out as a diversified investment company under section 5(b)(1) of the Act and that invests in repurchase agreements or pre-refunded bonds.

As of December 31, 1998, there were approximately 4,300 registered funds. Of this number, the Commission staff estimates that there are approximately 269 funds that are small entities. These funds could be affected by the proposed rule's treatment of investments in repurchase agreements for purposes of section 12(d)(3) of the Act. As of December 31, 1998, there were approximately 2,500 registered funds with one or more portfolios that hold themselves out to be diversified companies. Of this number, the Commission staff estimates that there are approximately 73 funds that are small entities. These funds could be affected by proposed rule's treatment of investments in repurchase agreements and pre-refunded bonds for purposes of section 5(b)(1) of the Act.

The IRFA explains that the proposed rule should not have a significant economic impact on these funds, including those that are small entities. It would not effect significant changes to the current treatment of repurchase agreements and pre-refunded bonds, but instead would codify and update a number of no-action positions that have been taken by the Commission staff.

The IRFA states that the proposed amendment to rule 2a–7 would affect money market funds. As of December 31, 1998, there were approximately 300 registered funds with one or more portfolios that are money market funds. Of this number, it is estimated that approximately 3 were small entities. The proposed amendment, however, would only update one aspect of rule 2a–7, and it appears that the updated provision would not require a change from current practice. The proposal thus should not have a significant economic impact on a substantial number of small entities.

The IRFA states that the proposed amendment to rule 12d3–1 will affect any fund that invests in a repurchase agreement with a broker, dealer, underwriter, or bank that is engaged in

[61] Release 13005, *supra* note 16, did not specify the type of collateral, merely noting that the ''securities most frequently used in connection with repurchase agreements are Treasury bills and other United States Government securities.''

[62] The staff's no-action position in MoneyMart Assets, *supra* note 10, was conditioned on the collateral consisting entirely of U.S. government securities.

[63] 17 CFR 270.0–10.

a securities-related business, when the investment may otherwise be prohibited by section 12(d)(3) of the Act. As stated above, there were approximately 4,300 registered funds as of December 31, 1998, of which approximately 269 funds were small entities. These funds would benefit from the proposed amendment to rule 12d3–1, which would allow funds to rely on that rule even if the repurchase agreement does not meet the requirements of the Commission staff positions.

The IRFA explains that the proposed rule and rule amendments would not impose any new reporting or recordkeeping requirements. The proposals do not involve major changes in compliance requirements because they mainly codify existing Commission staff positions. The IRFA states that the definition of ''collateralized fully'' in proposed rule 5b–3 supplements prior staff positions by requiring that the repurchase agreement qualify for an exclusion from any automatic stay of creditors' rights under applicable insolvency law. The definition also has been updated to reflect the 1994 revisions to the UCC. It appears, however, that this change generally would not require a change from current practice. There are no rules that duplicate, overlap or conflict with the proposed rule and rule amendments.

The IRFA discusses the various alternatives considered by the Commission that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed rule and rule amendments, the Commission considered the following alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the rule, or any part thereof, for small entities. The IRFA notes that the proposed rule and rule amendments are not intended to effect major substantive changes to the current treatment of repurchase agreements and pre-refunded bonds, but would essentially codify a number of no-action positions taken by the Commission staff. Because the proposed rule and rule amendments are designed to clarify the appropriate treatment of investments by funds in repurchase agreements and pre-refunded bonds for various purposes of the Act, and to provide investment flexibility for funds of all sizes, it would be inconsistent with the purposes of the Regulatory Flexibility Act to propose to exempt small entities from their coverage. Further clarification, consolidation, or simplification of the proposals, or specification of different compliance standards for small entities, would not be appropriate, because the proposals set forth the minimum standards consistent with investor protection. For the same reasons, the use of performance standards would be inappropriate. Overall, it appears that the proposed rule and rule amendments would not have an adverse effect on small entities.

The IRFA states that the Commission encourages the solicitation of comments with respect to any aspect of the IRFA. Comment is specifically requested on the number of small entities that would be affected by the proposed rule and rule amendments, and the likely impact of the proposals on small entities. A copy of the IRFA may be obtained by contacting Marilyn Mann, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549–0506.

V. Statutory Authority

The Commission is proposing new rule 5b–3, and is proposing amendments to rule 2a–7 and to rule 12d3–1, pursuant to the authority set forth in sections 6(c) and 38(a) of the Act [15 U.S.C. 80a–6(c) and 80a–37(a)].

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule and Rule Amendments

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–34(d), 80a–37, 80a–39 unless otherwise noted:

* * * * *

2. Section 270.2a–7 is amended by revising paragraphs (a)(5), (a)(11), (a)(20) and (c)(4)(ii)(A) to read as follows:

§ 270.2a–7 Money market funds.

(a) *Definitions.* * * *

(5) *Collateralized Fully* means ''Collateralized Fully'' as defined in § 270.5b–3(c)(1).

* * * * *

(11) *Event of Insolvency* means ''Event of Insolvency'' as defined in § 270.5b–3(c)(2).

* * * * *

(20) *Refunded Security* means ''Refunded Security'' as defined in § 270.5b-3(c)(4).

* * * * *

(c) *Share Price Calculations.* * * *

(4) *Portfolio Diversification.* * * *

(ii) *Issuer Diversification Calculations.* * * *

(A) *Repurchase Agreements.* The Acquisition of a repurchase agreement may be deemed to be an Acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully and the fund's board of directors (or the person delegated by the board under paragraph (e) of this section) has evaluated the seller's creditworthiness.

* * * * *

3. Section 270.5b–3 is added to read as follows:

§ 270.5b-3 Acquisition of repurchase agreement or refunded security treated as acquisition of underlying securities.

(a) *Repurchase Agreements.* For purposes of sections 5 and 12(d)(3) of the Act (15 U.S.C. 80a–5, 80a–12(d)(3)), the acquisition of a repurchase agreement may be deemed to be an acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the investment company is Collateralized Fully and the board of directors or its delegate has evaluated the seller's creditworthiness.

(b) *Refunded Securities.* For purposes of section 5 of the Act (15 U.S.C. 80a–5), the acquisition of a Refunded Security shall be deemed to be an acquisition of the escrowed Government Securities.

(c) *Definitions.* As used in this section:

(1) *Collateralized Fully* in the case of a repurchase agreement means that:

(i) The value of the securities collateralizing the repurchase agreement (reduced by the transaction costs (including loss of interest) that the investment company reasonably could expect to incur if the seller defaults) is, and during the entire term of the repurchase agreement remains, at least equal to the Resale Price provided in the agreement;

(ii) The investment company has perfected its security interest in the collateral;

(iii) The collateral is maintained with the investment company's custodian or a third party that qualifies as a custodian under the Act;

(iv) The collateral consists entirely of cash items, Government Securities or other securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the Requisite NRSROs; and

(v) Upon an Event of Insolvency with respect to the seller, the repurchase agreement would qualify under a provision of applicable insolvency law providing an exclusion from any automatic stay of creditors' rights against the seller.

(2) *Event of Insolvency* means, with respect to a person:

(i) An admission of insolvency, the application by the person for the appointment of a trustee, receiver, rehabilitator, or similar officer for all or substantially all of its assets, a general assignment for the benefit of creditors, the filing by the person of a voluntary petition in bankruptcy or application for reorganization or an arrangement with creditors; or

(ii) The institution of similar proceedings by another person which proceedings are not contested by the person; or

(iii) The institution of similar proceedings by a government agency responsible for regulating the activities of the person, whether or not contested by the person.

(3) *Government Security* means any ''Government Security'' as defined in section 2(a)(16) of the Act (15 U.S.C. 80a–2(a)(16)).

(4) *Refunded Security* means a debt security the principal and interest payments of which are to be paid by Government Securities (''deposited securities'') that have been irrevocably placed in an escrow account pursuant to an agreement between the issuer of the debt security and an escrow agent that is not an ''affiliated person,'' as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a–2(a)(3)(C)), of the issuer of the debt security, and, in accordance with such escrow agreement, are pledged only to the payment of the debt security and, to the extent that excess proceeds are available after all payments of principal, interest, and applicable premiums on the Refunded Securities, the expenses of the escrow agent and, thereafter, to the issuer or another party; *provided* that:

(i) The deposited securities shall not be redeemable prior to their final maturity;

(ii) The escrow agreement shall prohibit the substitution of the deposited securities unless the substituted securities are Government Securities; and

(iii) At the time the deposited securities are placed in the escrow account, or at the time a substitution of the deposited securities is made, an independent certified public accountant shall have certified to the escrow agent that the deposited securities will satisfy all scheduled payments of principal, interest and applicable premiums on the Refunded Securities; *provided, however,* an independent public accountant need not have provided the certification described in this paragraph (c)(4)(iii) if the security, as a Refunded Security, has received a rating from an NRSRO in the highest category for debt obligations (within which there may be sub-categories or gradations indicating relative standing).

(5) *NRSRO* means any nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi)(E), (F) and (H) of § 240.15c3–1 of this chapter, that is not an ''affiliated person,'' as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a–2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security.

(6) *Requisite NRSROs* means:

(i) Any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or

(ii) If only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the investment company acquires the security, that NRSRO.

(7) *Resale Price* means the acquisition price paid to the seller of the securities plus the accrued resale premium on such acquisition price. The accrued resale premium shall be the amount specified in the repurchase agreement or the daily amortization of the difference between the acquisition price and the resale price specified in the repurchase agreement.

4. Section 270.12d3–1 is amended by removing the appended Note.

By the Commission.

Dated: September 23, 1999.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–25253 Filed 9–28–99; 8:45 am]

BILLING CODE 8010–01–U

DEPARTMENT OF THE TREASURY

Bureau of Alcohol, Tobacco and Firearms

27 CFR Part 9

RIN 1512–AA07

[Notice No. 882]

Diamond Mountain Viticultural Area (99R–223P)

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Bureau of Alcohol, Tobacco and Firearms (ATF) has received a petition proposing the Diamond Mountain viticultural area. This petition was submitted by Rudy von Strasser of Von Strasser Winery on behalf of the Diamond Mountain Appellation Committee, whose 15 growers and vintners represent 87 percent of the total vineyard holdings in the proposed area. The Diamond Mountain proposed viticultural area is located entirely within the Napa Valley viticultural area. The proposed viticultural area encompasses approximately 5,000 acres, of which approximately 450 acres are planted to vineyards.

DATES: Written comments must be received by November 29, 1999.

ADDRESSES: Send written comments to: Chief, Regulations Division, Bureau of Alcohol, Tobacco and Firearms, P.O. Box 50221, Washington, DC 20091–0221 (Attn: Notice No. 882). Copies of the petition, the proposed regulations, the appropriate maps, and any written comments received will be available for public inspection during normal business hours at the ATF Reading Room, Office of Public Affairs and Disclosure, room 6480, 650 Massachusetts Avenue, NW, Washington, DC 20226

FOR FURTHER INFORMATION CONTACT: Thomas B. Busey, Regulations Division, Bureau of Alcohol, Tobacco and Firearms, 650 Massachusetts Avenue, NW, Washington DC 20226 (202) 927–8199.

SUPPLEMENTARY INFORMATION:

Background

On August 23, 1978, ATF published Treasury Decision ATF–53 (43 FR 37672, 54624) revising regulations in 27 CFR Part 4. These regulations allow the establishment of definitive viticultural areas. The regulations allow the name of an approved viticultural area to be used as an appellation of origin on wine labels and in wine advertisements. On