UNITED STATES OF AMERICA

## COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W. Washington, D.C. 20581

July 22, 1988



[Addressee]

Dear

By letter dated July 7, 1988, you advised the staff of the Commodity Futures Trading Commission ("Commission") of . . . intention to underwrite proposed offerings of instruments denominated as . . . on behalf of . . . These proposed offerings would be identical, except as specifically delineated in your letter, to the instruments which were addressed in earlier no-action letters from Commission staff, dated June 20, 1988, and July 13, 1988, ("staff no-action letters"). In your letter, you also propose a procedure to be followed for future proposed issues which rely upon those letters.

The three proposed issuers are companies having in excess of \$100 million net worth and which are in the business of financial services. The previously issued and outstanding debt of each of the issuers has been rated by a nationally recognized securities rating organization as investment grade. In particular, . . . an indirect wholly-owned subsidiary of . . . finances the sale of equipment and is involved in factoring, commercial and other lending, and other financial services. Similarly, . . . and . . . offer a broad array of financial services, including lending and financing services.

The proposed notes are substantially identical to those which were the subjects of the earlier staff no-action letters. They resemble debt instruments denominated in a foreign currency but differ from the earlier instruments with regard to the identity of the issuers and may involve different interest rates and foreign currencies to which the notes are tied. Also, we understand that the proposed notes will be registered with the Securities and Exchange Commission, will be marketed as debt securities and will not be marketed to the public as having the beneficial characteristics of commodity option or futures contracts. The proposed notes will be issued in denominations of not less than U.S. \$20,000. The proposed notes also will have similar return characteristics to those which were the subject of the staff no-action letters, i.e., they will provide a principal return linked to a foreign currency exchange rate on no more than a one-to-one basis as well as

a fixed rate of interest which is no less than the applicable market rate for that issuer. The term of the notes will be not less than three and not more than seven years to maturity. The issuers will cover the foreign currency risk of the notes in the forward market for foreign currencies, will disclose that the notes are not subject to regulation by the Commission, and will undertake to submit to special calls requested by the Commission for information relating to the instruments and their offering.

As the staff has indicated to you in its previous no-action letters, it appears that the commodity interest component of the proposed notes distributes returns between the lender and the borrower based upon the direction and magnitude of the price change in a foreign currency relative to the United States dollar. Thus, the notes have been viewed by the staff as coupon-bearing instruments where repayment of the principal has been indexed to the U.S. dollar value of a foreign currency on a one-to-one basis. The characteristics of these instruments, which resemble those of foreign currency-denominated debt instruments, "preclude ready characterization of the Notes as futures equivalents." (C.F.T.C. Interpretative Letter No. 88-10, dated June 20, 1988, at p. 5.)

Moreover, as the staff further noted, although the proposed notes are not specifically encompassed by the pending advance notice of proposed rulemaking relating to hybrid instruments, 52 Fed. Reg. 47022 (December 11, 1987), the no-action position set forth in our previous letters is not inconsistent with the analysis and requirements of that release. Accordingly, based upon the representations in your letter that the three proposed issues are identical to the instruments addressed in our previous no-action letters, except as specifically detailed in your letter, and for the reasons explained more fully in those no-action letters, the staff will not recommend to the Commission any enforcement action under Section 4(a) of the Commodity Exchange Act based upon the issuance of the three proposed instruments. Proposed offerings with criteria that vary from those in this and the previous staff no-action letters will continue to be considered on a case-by-case basis.

In addition, you indicate that . . . contemplates underwriting issues in the future which are substantially identical to those which have been the subjects of the staff no-action letters. Of course, the staff would extend similar no-action treatment to all such identical instruments which meet the relevant criteria, including the qualifications of the issuers. In this connection, the staff has determined that a procedure should be established to facilitate the application of the staff's prior no-action position to instruments which may be proposed in the future.

The staff's no-action position will apply to proposed instruments which are identical in all material respects, as reiterated below, to the notes which were the subjects of the no-action letters:

- 1) the instruments are debt instruments;
- 2) the principal amount of the note is indexed to a foreign currency on no more than a one-to-one basis;
- 3) the interest paid on the note is at no less than the market rate for that issuer;
- the public offering of the notes is registered with the Securities and Exchange Commission under the Securities Act of 1933 and a prospectus has been prepared in compliance with the Securities Act and regulations thereunder and delivered to purchasers of the notes, unless the issuer is exempt from such registration requirements;
- 5) the net-worth of the issuer is at least \$100 million and its previously issued and outstanding debt has been rated as of investment grade by a nationally recognized securities rating organization;
- 6) the notes have a term of at least three-years and are in minimum denominations of \$20,000;
- 7) the notes are marketed to the public as debt securities not having the beneficial characteristics of commodity options or futures contracts and disclosure is made that the notes are not regulated by the CFTC;
- 8) the commodity-based risk of the instruments is to be covered simultaneously with the issuance thereof; and
- 9) the issuer agrees to respond to special calls from the Commission for information confirming that the instrument meets the criteria set forth herein.

Where the above criteria are clearly satisfied on the face of the offering, specific confirmation that each such issue is covered by the staff's prior no-action position is unnecessary. However, notification to the Commission prior to the public offering of such a proposed issue is required. Specifically, a filing which represents that each such proposed issue qualifies for this exemptive treatment must be received by the Commission two business days prior to the issuance of the proposed notes. The failure of the staff to

notify the proposed issuer that its instrument does not fall within the bounds of the staff no-action letters within this time period, however, does not reflect acquiescence in, nor approval of, the issuance of the notes. Nor does such a failure to notify in any way limit the action that may be taken by the Commission or its staff with respect to the offering.

The position of the staff is based upon the representations contained in your letter. This position does not excuse . . . or any of the proposed issuers from complying with any otherwise applicable provision of the Commodity Exchange Act, nor does it address any instrument or proposed instrument other than those which clearly fall within the scope of this letter. Any different, omitted or changed facts or conditions might require a different conclusion. It should also be noted that this position is that of the staff and is not binding upon the Commission and that any subsequent determination by the Commission with regard to the rulemaking proceeding initiated by the advance notice of proposed rulemaking may require a reconsideration of this staff position.

Sincerely,

Marshall E. Hanbury Co-Chairman Commodity Futures Trading Commission

Paula A. Tosini
Co-chairman
Commodity Futures Trading
Commission
Off-Exchange Task Force