89-18

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W.
Washington, D.C. 20581

November 21, 1988

[Addressee]

RE: Proposed Offerings of Commercial Paper

Dear :

By letters dated August 3, September 9, and November 8, 1988, you requested on behalf of . . . . that the staff of the Commodity Futures Trading Commission confirm that it will not recommend to the Commission that any enforcement action be taken in connection with the proposed issuance and offering of notes ("Notes") which constitute commercial paper under Section 3(a)(3) of the Securities Act of 1933 ("1933 Act"), the principal amount of which will at maturity be adjusted based on the fluctuation in the exchange rate between the United States dollar and a specified foreign currency. Based upon the characteristics of the Notes, which resemble in certain respects foreign currency denominated debt instruments, and other matters as discussed below, the staff has determined that it will not recommend to the Commission any enforcement action under Section 4(a) of the Commodity Exchange Act based upon the issuance of the proposed Notes.

As represented in your letters and at a meeting with Commission staff on August 18, 1988, the proposed Notes will constitute commercial paper under Section 3(a)(3) of the 1933 Act. Commercial paper represents short-term corporate borrowings used to finance the issuer's business operations. Under the 1933 Act, the Notes, to constitute commercial paper, are required to have a maturity at the time of issuance not exceeding nine months. The proposed Notes will be issued by corporations with prime commercial paper credit ratings in the two highest categories established by two recognized rating agencies. The commercial paper exemption is not available under applicable law if offered and sold to members of the general public. See, SEC Rel. No. 33-4412, September 20, 1961. Thus, . . . represents that the Notes will be issued in minimum denominations of $100,000 and "will be offered solely to financially sophisticated institutions." . . . also represents that, in the vast majority of cases, such commercial paper is held by the purchasers until maturity, and, in any event, commercial paper is not actively traded in a secondary market.

. . . further represents that the proposed Notes will have a principal face amount expressed in U.S. dollars, equal to the purchase price paid by the investors. The Notes will bear interest on the principal amount at a rate of interest not less than the market rate for pure debt instruments offered by the issuer and will be payable in full at the maturity of the Notes. The principal amount due at maturity will be increased or decreased based on the intervening fluctuations in the exchange rate between the U.S. dollar and a specified foreign currency using the following formulae, with the exchange rate quoted in foreign currency units per dollar;

1. where the dollar has risen in value against the foreign currency--

   (a) the principal; plus

   (b) the stated amount of interest due; plus

   (c) an amount equal to the product of the principal and the difference between the exchange rate at the time of maturity and the exchange rate at the time of issuance, that difference divided by the exchange rate at the time of maturity; or

2. where the dollar has fallen in value against the foreign currency--

   (a) the principal; plus

   (b) the stated amount of interest due; less

   (c) an amount equal to the product of the principal and the difference between the exchange rate at the time of issuance and the exchange rate at the time of maturity, that difference divided by the exchange rate at the time of maturity.

. . . further represents that the issuer will hedge fully the foreign currency risk attributed to the Notes through transactions entered into simultaneously with the offering.

The proposed Notes may be characterized as "hybrid instruments," in that they combine certain elements of traditional commodity interests with those of debt instruments. Based upon the representations in your letter it appears that the commodity interest component of the Notes distributes returns between the lender and borrower based upon the direction and magnitude of the price change in a foreign currency relative to the U.S. dollar. In this respect, the Notes resemble the instruments addressed by CFTC Interpretative Letters No. 88-10, 88-11 and 88-12 dated June 20, July 13 and July 20, 1988, respectively. A comparison of the proposed Notes with the criteria outlined in CFTC Interpretative Letter No. 88-12 follows:

1. the non-commodity component of the Notes is a debt instrument;

2. the principal amount of the Notes is indexed to a foreign currency on no more than a one-to-one basis;

3. the interest paid on the Notes is at no less than the market rate for the issuer;

4. the Notes are not offered pursuant to a registered offering, nor are they exempt under §3(a)(2) of the 1933 Act. Rather, the Notes are exempt from the 1933 Act's registration requirements by Section 3(a)(3) of the 1933 Act;

5. the net worth of the issuers is at least $100 million, and their outstanding debt has been rated as of investment grade by nationally recognized securities ratings organizations;

6. the Notes are in minimum denominations of $100,000 but have a term less than the stipulated three-year term;

7. the Notes will not be marketed to the public (regardless of how the commodity component is characterized);

8. the commodity-based risk of the instruments is to be covered simultaneously with the issuance thereof; and

9. . . . has represented that issuers will respond to special calls from the Commission.

From the above, it is clear that the Notes meet most of the criteria set forth in CFTC Interpretative Letter No. 88-12. However, they do not meet two of the enumerated criteria, i.e., that the instruments be offered pursuant to a registered offering or are exempt from registration under Section 3(a)(2) of the 1933 Act and that the term of the instrument be three years or more. The Notes do not meet these criteria because the nature of the security interest to which the commodity component is affixed differs from the security interests that were the subject of the referenced CFTC interpretative letters. In particular, the Notes are exempt from the registration provisions of the 1933 Act under Section 3(a)(3) of that Act.

In order to qualify for this exemption from the 1933 Act, the Notes must arise "out of a current transaction or the proceeds . . . have been or are to be used for current transactions, and [the paper] has maturity at the time of issuance of not exceeding nine months. . . ." Section 3(a)(3) of the 1933 Act. Additionally, as noted above, to qualify for this exemption the Notes may not be offered and sold to members of the general public. Thus, although the Notes are exempt from the 1933 Act registration requirements, they are subject to certain other regulatory proscriptions, such as their use, term to maturity, and the class of offerees. The Notes meet all of the remaining enumerated criteria of CFTC Interpretative Letter No. 88-12 except for their term to maturity. However, any term to maturity that would meet that criterion enumerated in the Interpretative Letter would preclude the instrument from qualifying for the commercial paper exemption under the 1933 Act.

Accordingly, 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 proposed Notes. The staff position is based upon the representations in your letter, including those relating to the terms and conditions of the instruments, the nature of the proposed offering as commercial paper qualifying for exemption from the Securities Act of 1933, and upon the agreement of the issuers to submit to special calls for information with respect to the Notes in the matters addressed herein. Moreover, the staff's position is predicated on the representation in your letter of November 8, 1988, that the Securities and Exchange Commission does not object to the offer and sale of these instruments in reliance upon an exemption from registration under Section 3(a)(3) of the Securities Act of 1933, and that although exempt from registration, this commercial paper product will still be subject to the antifraud provisions of the federal securities law and SEC oversight.

This position does not excuse the issuer from complying with any otherwise applicable provisions of the Commodity Exchange Act and is based upon the facts and representations contained in your letter. Any different, omitted or changed facts or conditions might require a different conclusion. Moreover, it should 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 outstanding Advance Notice of Proposed Rulemaking Relating to the Regulation of Certain Hybrid and Related Instruments, 52 Fed. Reg. 47022 (December 11, 1987), may require reconsideration of this position for subsequent offerings.

Sincerely,

Marshall E. Hanbury
Co-Chairman
Off-Exchange Task Force

Paula A. Tosini
Co-Chairman
Off-Exchange Task Force