

Levit



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

April 15, 1997

**The Honorable Christopher J. Dodd**  
United States Senate  
444 Russell Senate Office Building  
Washington, D.C. 20510-0702

Dear Senator Dodd:

Thank you for your letter of April 1, 1997 concerning the Commission's rules under new Section 3(c)(7) of the Investment Company Act, as amended by the National Securities Markets Improvement Act of 1996. Section 3(c)(7) creates a new exclusion from regulation under the Act for privately offered investment companies -- Section 3(c)(7) Funds -- that sell their securities solely to "qualified purchasers." As you may know, the Commission adopted rules implementing the new exclusion on April 3, 1997.

In your letter, you express concern that a sponsor of an existing privately offered fund might attempt to evade the provisions of Section 3(c)(7) that provide "dissenters rights" for existing investors if the sponsor decides to use the new exclusion from investment company regulation. Section 3(c)(7) includes a "grandfather" provision that permits an existing privately offered fund to convert into a Section 3(c)(7) Fund while continuing its existing relationships with investors that are not qualified purchasers. The grandfather provision requires the fund, prior to the conversion, to provide each beneficial owner of its securities (i) notice of the fund's intention to rely on section 3(c)(7) and (ii) an opportunity to redeem the owner's interest in the fund.

As a complement to this provision, the Act also requires an existing privately offered fund that wishes to become a qualified purchaser to obtain the consent of certain beneficial owners of its securities and certain other persons. The consent provision appears to be designed to prohibit an existing privately offered fund from avoiding the notice and redemption opportunity requirements of the grandfather provision by investing its assets in a Section 3(c)(7) Fund, either directly or indirectly through another privately offered fund.

**The Honorable Christopher J. Dodd  
United States Senate  
Page 2**

**I understand that the grandfather and consent provisions reflect Congress' concern for the rights of existing investors in privately offered funds, a concern I share. I believe that the SEC's new rule 2a51-2, which defines certain terms integral to the operation of the grandfather and consent provisions, effectuates the careful balance reflected in the legislative history. The Commission would therefore be very concerned if fund sponsors attempt to evade the operation of the grandfather provision to the detriment of their existing investors. I have directed the Commission staff to take appropriate actions if they become aware of any abusive practices under the grandfather provision. These actions could include recommending additional rules that address the issues raised in your letter.**

**Thank you for bringing your concerns to my attention. I believe that the enactment of the National Securities Markets Improvement Act of 1996 was a singular legislative achievement, due in no small part to your efforts. New section 3(c)(7) in particular may facilitate capital formation for U.S. companies. It will only do so, however, if fund sponsors adhere to the letter and the spirit of the framework established by Congress.**

**Sincerely,**

A handwritten signature in black ink, appearing to read 'A. Levitt', with a stylized flourish at the end.

**Arthur Levitt  
Chairman**