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Our Ref. No. 94-49-CC
Long-Term Capital
Management, L.P.
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of January 24, 1994, requests our assurance that we would not recommend enforcement action to the Commission if Long-Term Capital Management, L.P. ("LTCM") does not treat certain holders of involuntary and non-contributory beneficial interests in trusts which are formed by LTCM's principals and invest in entities relying on Section 3(c)(1) as holders of "outstanding securities" of a trust for purposes of Section 3(c)(1)(A) of the Investment Company Act of 1940 ("1940 Act").

You state that LTCM serves as investment adviser to companies relying on the exception from the definition of investment company in Section 3(c)(1) of the 1940 Act ("3(c)(1) Company" or "3(c)(1) Companies"). Certain principals of LTCM wish to form trusts for estate planning purposes. Each trust will invest in a 3(c)(1) Company. You state that a trust may acquire more than 10% of the outstanding voting securities of a 3(c)(1) Company; in addition, the principal asset of each trust initially will be its interest in a 3(c)(1) Company.

The beneficiaries of a trust will be the principal forming the trust, his or her relatives, and/or charitable organizations. You state that the beneficial interests of the relatives and charitable organizations will be involuntary and noncontributory; that is, these beneficiaries will not elect whether to participate in the trust, and will not make any contribution to the trust ("Involuntary Beneficiaries"). You also state that the Involuntary Beneficiaries will not be able to direct the investment decisions of the trust or transfer their interests in the trust. 1/

Section 3(c)(1) excludes from the definition of investment company "any issuer whose outstanding securities (excluding short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities." Section 3(c)(1)(A) sets out a two part test to determine when an issuer's securities are beneficially owned by not more than 100 persons. First, an investing entity, and not the holders of its outstanding securities, will be counted as one beneficial owner of a 3(c)(1) Company if the investing entity owns less than 10% of the outstanding voting securities of the 3(c)(1) Company. Second, even if an investing entity owns more than 10% of the outstanding voting securities of a 3(c)(1) Company, the investing entity's security holders will not be counted as beneficial

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1/ Your request and our response are limited to the beneficial interests in a trust not held by the principal forming the trust or any trustee of the trust.

owners of the 3(c)(1) Company so long as not more than 10% of the investing entity's total assets are invested in the 3(c)(1) Company and any other 3(c)(1) Companies.

In International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), the Supreme Court held that an employee's interest in an involuntary, noncontributory pension plan was not a security within the meaning of the Securities Act of 1933 ("1933 Act") or the Securities Exchange Act of 1934. In Securities Act Release No. 6188 (Feb. 1, 1980) ("Release 6188"), the staff applied the Court's reasoning in Daniel to other types of employee benefit plans and took the position that the registration and antifraud provisions of the 1933 Act did not apply to interests in involuntary, noncontributory plans; involuntary, contributory plans; and voluntary, noncontributory plans. In Kodak Retirement Income Plan (pub. avail. Feb. 29, 1988), the staff stated that employee-participants in an involuntary, noncontributory defined benefit plan were not holders of outstanding securities of the plan, and were not required to be counted as beneficial owners of a 3(c)(1) Company under the attribution rules. 2/

You believe that the rationale of Daniel and Release 6188 applies outside the context of employee benefit plans. Therefore, you believe that, because the Involuntary Beneficiaries do not choose to become beneficiaries of a trust, and do not contribute assets to the trust, the Involuntary Beneficiaries' interests in a trust are not securities. Thus, the Involuntary Beneficiaries are not holders of outstanding securities of the trust for purposes of Section 3(c)(1)(A) and they should not be counted as beneficial owners of a 3(c)(1) Company.

We would not recommend enforcement action to the Commission if, as described in your letter, LTCM does not treat certain holders of involuntary and non-contributory beneficial interests in trusts which are formed by LTCM's principals and invest in 3(c)(1) Companies as holders of outstanding securities of the trusts for purposes of Section 3(c)(1)(A). This position is

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2/ See also Intel Corporation (pub. avail. Nov. 18, 1992); Sunkist Master Trust (pub. avail. June 5, 1992).

based on the facts and representations in your letter; any different facts or representations may require a different conclusion. This letter expresses the Division's position on enforcement action only and does not express any legal conclusions on the issues presented.

Monica L. Parry
Senior Counsel

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January 24, 1994

ACT 1940 ICA
SECTION 3(c)(1)
RULE
PUBLIC AVAILABILITY 4/28/94

Re: Long-Term Capital Management, L.P.
Investment Company Act of 1940
Section 3(c)(1)

Thomas S. Harman, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
Mail Stop 5-2
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Harman:

We are writing on behalf of our client, Long-Term Capital Management, L.P. ("LTCM"). We request advice from the staff of the Commission that no enforcement action will be recommended if, as more fully described below, certain holders of involuntary and non-contributory beneficial interests in certain trusts formed by principals of LTCM (the "Principals") are not treated by LTCM as holders of "securities" of such trusts for purposes of Section 3(c)(1) of the Investment Company Act of 1940, as amended (the "1940 Act"). For your convenience, enclosed are seven additional copies of this letter.

I. Factual Background

LTCM is a recently formed firm which engages in an investment management business. LTCM relies upon the exemption from registration as an investment adviser under the Investment Advisers Act of 1940, as amended, set forth in Section 203(b)(3) thereof. LTCM proposes to act as investment adviser for various investment vehicles which will rely upon the exclusion from the definition of "investment company" under the 1940 Act set forth in Section 3(c)(1) thereof (individually, a "3(c)(1) Fund" and collectively, the "3(c)(1) Funds").[1/] For their personal estate and charitable planning purposes, the Principals wish to form trusts (individually, a "Trust" and collectively, the "Trusts") to invest in the 3(c)(1) Funds alongside other investors in the 3(c)(1) Funds. The beneficial owners of the interests in each Trust will consist of the Principals, relatives of the Principals and/or various charitable organizations selected by the Principals. The subject of this letter is limited to those beneficial interests in a Trust ("Beneficial Interests") that are not held by the Principal forming the Trust or by any trustee of the Trust.

Each Beneficial Interest in a Trust will be involuntary, meaning that the beneficiary holding the Beneficial Interests will not elect whether or not to participate in the Trust. In addition, each Beneficial Interest in a Trust will be non-contributory, meaning that all

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1/ Section 3(c)(1) of the 1940 Act excludes from the definition of "investment company" any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities. LTCM represents, and the staff may assume for purposes of this letter, that, assuming receipt of the relief requested herein, each 3(c)(1) Fund will meet the requirements of the Section 3(c)(1) exclusion.

contributions to the Trust will be or have been made as a gift or charitable donation by the Principal forming the Trust. Beneficial Interests in each Trust will also be non-transferable except upon the death, bankruptcy, dissolution or similar event with respect to a beneficiary. Finally, no holder of a Beneficial Interest will have any right to direct the investment decisions of the Trust, remove the Trust's trustee (except in limited circumstances such as the trustee's insanity or incompetency, a breach of the trustee's fiduciary duty or similar events) or otherwise participate in the management of the Trust.

II. Legal Discussion

Based upon the foregoing and for the reasons set forth below, we are of the opinion that Beneficial Interests in the Trusts are not "securities" for purposes of the 1940 Act and, therefore, that the beneficiaries holding Beneficial Interests in the Trusts are not holders of "outstanding securities" of the Trusts who may be required to be counted as beneficial owners of the Section 3(c)(1) Funds in which the Trusts invest for purposes of Section 3(c)(1) of the 1940 Act.

Section 3(c)(1)(A) of the 1940 Act provides that for the purposes of determining under Section 3(c)(1) whether an issuer's securities are beneficially owned by not more than 100 persons:

> "beneficial ownership by a company[2/] shall be deemed to be beneficial ownership by one person, except that, if the company owns 10% or more of the outstanding voting securities of the issuer, the beneficial ownership shall be deemed that of the holders of such company's outstanding securities (other that short-term paper) unless, as of the date of the most recent acquisition by such company of securities of that issuer, the value of all securities owned by such company of all issuers which are or would, but for the exception set forth in the subparagraph, be excluded from the definition of investment company solely by this paragraph, does not exceed 10% of the value of the company's total assets."

The staff of the Commission has also taken the position that where a company is formed primarily for the purpose of investing in an issuer relying upon the Section 3(c)(1) exclusion, each holder of such company's outstanding securities should be treated as a beneficial owner of securities of the issuer. See, e.g., Merrill Lynch & Co., Inc. (pub. avail. April 23, 1992). Indeed, where the company itself relies upon the Section 3(c)(1) exclusion, the staff has required that the company limit its investment in the issuer to no more than 40% of its total assets. See, e.g., Handy Place Investment Partnership (available July 19,1989); CMS Communications Fund, L.P. (available April 17, 1987).

We are advised by LTCM that, although the possibility is considered unlikely, a Trust may acquire more than 10% of the voting securities of a 3(c)(1) Fund. In addition, at least initially, the principal asset of each Trust will be its investment in a 3(c)(1) Fund. Accordingly, a question arises as to whether holders of Beneficial Interests in a Trust

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2/ The term "company" is defined in Section 2(a)(8) of the 1940 Act to include a corporation, partnership, trust or any organized group or persons whether incorporated or not. Therefore, a Trust formed by a Principal would be considered a "company" for the purposes of Section 3(c)(1) of the 1940 Act.

should be considered beneficial owners of securities of a 3(c)(1) Fund in which the Trust invests.

In International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), the Supreme Court held that an interest in a noncontributory and involuntary pension plan does not constitute a "security" under either the Securities Act of 1933, as amended (the "1933 Act") or the Securities Exchange Act of 1934, as amended (the "1934 Act"). The Supreme Court in Daniel applied the test set forth in Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293 (1946), to determine whether the participants' interests in the pension plan in question constituted an "investment contract" and thus came within the definition of a security under the 1933 Act and 1934 Act. Under the Howey test, an investment contract must involve the investment of money in a common enterprise with profits to come solely from the efforts of others. Looking separately at each element of the test, the Court concluded that an employee's participation in a noncontributory and involuntary pension plan does not comport with the commonly held understanding of an investment contract. Daniel, 439 U.S. at 559.

In SEC Release No. 33-6188 (February 1, 1980) (the "Release"), the staff, applying the Court's reasoning in Daniel to other types of plans, took the position that the interests of employees in (i) involuntary, noncontributory plans, (ii) involuntary, contributory plans, and (iii) voluntary, noncontributory plans are not securities and that the registration and antifraud provisions of the 1933 Act will not be interpreted to apply to interests in such plans. Based on the reasoning set forth in the Daniel case, the staff acknowledged that where a plan is noncontributory, the "investment of money" aspect of an investment

contract is generally not present and that where a plan is involuntary, the plan participants may not make an investment decision in which they "choose to give up a specific consideration in return for a separable financial interest with the characteristics of a security," a factor which the Supreme Court relied on in the Daniel decision. See Daniel, 439 U.S. at 559.

In Kodak Retirement Income Plan (pub. avail. Feb. 29, 1988) the staff adopted the reasoning of Daniel and the Release in the context of the 1940 Act's definition of a security. In Kodak, counsel requested the staff's concurrence with counsel's view that participants in a noncontributory and involuntary pension plan are not holders of "securities" and are therefore not required to be counted as beneficial owners of a Section 3(c)(1) entity in which the plan invests. In its reply, after summarizing Daniel and the Release, the staff concluded:

> We believe it is appropriate to apply the reasoning of Daniel and the Release to the issue presented. Accordingly, we concur in your view that the employee-participants in [the plan] are not holders of outstanding securities of [the plan] and, therefore, are not required to be counted as beneficial owners of a Section 3(c)(1) entity under the attribution rule set forth in Section 3(c)(1)(A) of the [1940] Act.

The position of the staff in Kodak has been confirmed in subsequent no-action letters. See Sunkist Master Trust (pub. avail. June 5, 1992) and Intel Corporation (pub. avail. Nov. 18, 1992).[3/]

[3/] It is instructive in this regard that in Intel the staff concluded that while beneficial interests in an involuntary and non-contributory pension plan were not securities for purposes of the 1940 Act, interests in a voluntary and contributory 401(k) plan were securities for purposes of the 1940 Act.

We are of the opinion that the rationale of Daniel, the Release and Kodak in the context of trusts for pension plans should be applied in the context of a Beneficial Interest in a Trust. Because Beneficial Interests in a Trust are involuntary and non-contributory, they do not involve the investment of the beneficiary's funds in the Trust or an investment decision by a beneficiary as to whether an investment should be made in the Trust. Furthermore, holders of Beneficial Interests have no right to participate in the investment decisions of the Trust. As such, the Beneficial Interests in the Trusts are not "investment contracts" under the Howey test. Therefore, they are not "securities" for purposes of the 1940 Act and the holders of Beneficial Interests in a Trust are not holders of outstanding securities of the Trusts.

We also believe that this result is consistent with the purposes of Section 3(c)(1) and that no policy would be served by looking through to the holders of Beneficial Interests in a Trust for purposes of Section 3(c)(1). The attribution rules under Section 3(c)(1) of the Act are designed to prevent circumvention of the 100-person limitation through use of an entity formed to act as a conduit for a broader investor participation in an unregistered investment company. However, the Trusts will not be formed for the purpose of circumventing this limitation. The Trusts are essentially estate and charitable planning devices for the Principals, not capital-raising devices or vehicles for increasing investor participation in the 3(c)(1) Funds. Furthermore, in light of the identities of the beneficiaries, their relationships to the Principals and the prohibition on transfers, there is no interest on the part of the public in the Trusts that requires protection through registration under the Act. Therefore, we believe no purpose would be served in

applying the attribution rules of Section 3(c)(1) to the holders of Beneficial Interests in the Trusts.

We are aware that the staff has indicated in previous no-action letters that under some circumstances holders of beneficial interests of a trust may be counted as beneficial owners of a Section 3(c)(1) entity in which the trust invests. See, e.g., Nemo Capital Partners, L.P. (pub. avail. July 28, 1992); Handy Place Investment Partnership (pub. avail. July 19, 1989); Rosenberg Capital Management (pub. avail. Feb. 18, 1979). These letters contain statements in a generalized context to the effect that the beneficial ownership of securities of a 3(c)(1) entity by a trust shall be deemed to be the beneficial ownership by one person unless the trust owns 10% or more of the outstanding voting securities. However, none of these letters specifically addresses the issues raised in this letter and we believe that these no-action letters are distinguishable on their facts since none of these letters were limited to beneficial interests which are involuntary and non-contributory and where the beneficiaries have no participation in the investment decisions of the trust. In addition, Nemo Capital Partners and Handy Place involved trusts with identical or overlapping beneficiaries, and in order to avoid double counting, the attribution rules were invoked to reduce the number of beneficial owners of a Section 3(c)(1) entity rather than to increase the number. As a result, we believe that these letters should be understood to be limited by the principles set forth in Kodak and related authorities in the context of trusts which are involuntary and non-contributory pension plans and that these authorities remain the appropriate precedents with regard to the issues raised by this letter.

III. Conclusion

For the foregoing reasons, we respectfully request that the staff advise us that no enforcement action will be recommended if, as described above, holders of Beneficial Interests in the Trusts are not treated by LTCM as holders of "securities" of the Trusts who may be required to be counted as beneficial owners of the Section 3(c)(1) Funds in which the Trusts invest for purposes of Section 3(c)(1) of the 1940 Act. If for any reason you do not concur in the views expressed herein, we respectfully request the opportunity to confer with you by telephone or in person prior to any written response to this letter. If you have any questions regarding this request, please call, collect, Thomas H. Bell, (212) 455-2533, or Andrew R. Keller, (212) 455-3577, of this office.

Very truly yours,

Simpson Thacher & Bartlett

SIMPSON THACHER & BARTLETT