

PUBLIC

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RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-121-CC
Municipality Finance
Ltd.
File No. 132-3

Your letter of March 8, 1993 requests our concurrence with, or no-action assurance regarding, your opinion that Municipality Finance Ltd. ("Municipality Finance") falls within the exception to the definition of investment company in Section 3(c)(5)(B) of the Investment Company Act of 1940 ("1940 Act").

According to your letter, Municipality Finance, a Finnish credit institution, is a wholly-owned subsidiary of the Finnish Local Government Pensions Institution ("LGPI"). You state that Municipality Finance's principal purpose is to meet the long-term financing needs of Finnish municipalities, federations of municipalities, and municipality-controlled companies. You state that Municipality Finance raises funds by selling debt instruments in the Euromarkets, Finland, and Asia, and that the LGPI guarantees these debt instruments. You state that the LGPI's more than 900 members (municipalities, federations of municipalities, and municipality-owned companies) are jointly responsible for the LGPI's expenditures and payment obligations. In addition, you state that the government of Finland does not guarantee the LGPI's obligations, nor is it legally obligated to assume the liability of any LGPI member that is unable to meet its obligations to the LGPI. You have explained to us that according to representatives from Municipality Finance, although not legally obligated to do so, the Finnish government has in the past assumed certain liability for pension payments to the LGPI on behalf of municipalities unable to make their payments. 1/ You state that Municipality Finance lends the funds it raises to municipalities for projects such as the construction and renovation of public works, housing, and transportation. You further state that, during its last full fiscal year, Municipality Finance made over 97% of its loans to municipalities and the remainder to municipality-controlled companies providing services such as power, water, and telecommunications. Finally, you state that Municipality Finance is contemplating a series of limited private placements of debt securities in the United States.

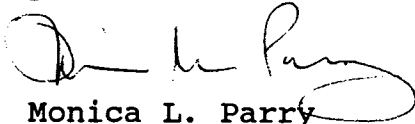
You state that Municipality Finance may fall within the definition of investment company in Section 3(a) of the 1940 Act. You believe, however, that Municipality Finance qualifies for the exclusion in Section 3(c)(5)(B). 2/ Section 3(c)(5)(B) excepts

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- 1/ Telephone conversations on March 24 and April 5, 1994 between Nora Jordan and Monica Parry.
- 2/ You believe that Municipality Finance would fall within Section 2(b) of the 1940 Act if that exclusion applied to non-U.S. governments and their agencies and

from the definition of investment company "any person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one of more of the following businesses . . . (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services"

You believe that Municipality Finance is primarily engaged in the business of making loans to municipalities to finance construction and renovation projects. You also believe that the municipal sponsors of these projects are prospective purchasers of specified merchandise and services, i.e., the materials, equipment, and labor needed for the construction and renovation projects.

Without agreeing with your legal analysis, we would not recommend enforcement action to the Commission under the 1940 Act if Municipality Finance proceeds as described in your letter in reliance on your opinion as counsel that it falls within the exception in Section 3(c)(5)(B). ^{3/} This position is 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

instrumentalities.

^{3/} See Banco Nacional de Obras y Servicios Publicos, S.A. (pub. avail. Nov. 24, 1977) (company primarily engaged in making loans to finance public works projects).

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March 8, 1994

Ms. Monica Parry
Office of the Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

ACT 1940 ICA
SECTION 3(c)(5)(B)
RULE _____
PUBLIC _____
AVAILABILITY 4/28/94

Re: 1940 Act: Section 3(c)(5)(B)

Dear Ms. Parry:

We represent Municipality Finance Ltd. (the "Company"), a centralized finance vehicle for the Finnish municipal sector. The Company has established a program to offer and sell, from time to time, debt instruments, guaranteed by the Local Government Pensions Institution (the "Guarantor"), of varying maturities in the Euromarkets, Finland and Asia. The Company currently is contemplating a series of limited private placements of debt securities in the United States pursuant to this program. On behalf of the Company, we request an interpretative or no action letter with respect to the status of the Company and the proposed offering under the Investment Company Act of 1940 (the "1940 Act").

The Company operates as a credit institution under Finnish law, subject to inspection and supervision by the Bank of Finland and by Financial Supervision, the Finnish governmental agency with responsibility for financial supervision. The principal purpose of the Company is to meet the long-term financing needs of Finnish municipalities, federations of municipalities and municipality-controlled companies whose loans are guaranteed by a municipality through lending and other funding. All of the Company's equity capital is owned by the Guarantor, which is a statutory pensions institution responsible for the pensions of municipal officials, employees and their families. In addition, the Company's fundraising operations are always supported by a guarantee of the Guarantor.

The Guarantor was founded in 1964 pursuant to a special law, the Local Government Officials' and Employees' Pensions Act (the "LGOEP Act"). The Guarantor is a public authority supervised by the Finnish Ministry of the Interior serving Finnish municipalities. The supervision of the Finnish Ministry of the Interior has the nature of legality control; it ensures that the Guarantor acts and makes its decisions within the framework of the law. The Guarantor has over 900 members, comprised of all 455 cities and municipalities, all federations of municipalities and companies owned by municipalities. All Finnish cities and municipalities and federations of municipalities are obliged by the LGOEP Act to be member bodies of the Guarantor and all members of the Guarantor are jointly responsible for the expenditures and payment obligations of the Guarantor.

The municipal sector in Finland and other Nordic countries comprises a more important part of the public sector than elsewhere in Europe. The Finnish Constitution establishes a system of local government based on municipalities which are independent of the central government. Finnish municipalities employ approximately 445,000 persons representing one-fifth of the Finnish work force. In 1991 total budgeted expenditure by municipalities and federations of municipalities amounted to FIM 138.3 billion, approximately 27% of the Finnish gross domestic product. Measured in terms of both budgets and personnel, the local government is a substantially larger entity than the central government.

The Local Government Act obliges the municipalities to ensure sufficient revenues to cover their expenditures and to this end municipalities have unlimited power to levy taxes on individuals and power limited by law to levy tax on property owners and corporations, resident within the municipality. In 1993 the municipalities budgeted to raise FIM 48 billion from taxation, representing approximately 40 per cent of total revenues.

As noted above, the primary purpose of the Company is to meet the long-term financing needs of the Finnish municipalities. Its main objective is to secure and satisfy the funding requirements of the Finnish municipal sector at the lowest possible costs. The funding requirements of the Finnish municipal sector are based on financing municipal investment projects, including municipal development projects, educational institutions, health care facilities, housing, transportation and utilities. Its function for the municipal sector can be compared to that of the Treasury Management Unit of the Ministry of Finance for the Republic

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of Finland. Funds borrowed by the Company are lent to the municipalities at a margin above the Company's cost of funds to cover both the expenses associated with raising funds and other administrative expenses. In effect, the Company is a financing arm of the municipal sector and its sole mission is to satisfy the long-term financing needs of the local government, and it is not expected to maximize profits or otherwise to carry on activities which are not related to its role as a local government and public sector credit institution. As a result of the foregoing the Company's net profit before tax has been practically zero in each of its operating years.

Although the Company has a separate corporate existence, it is under the full control of the Guarantor and wholly owned by the Guarantor, which is a statutory entity supervised by the central government, and is employed in practice to perform financing services usually carried out in the United States by the government itself.

Because the Company appears to be an instrumentality of the local government and public sector and is wholly owned by the Guarantor, we believe it to be beyond the scope of the 1940 Act. And, if Section 2(b) of the 1940 Act applied to non-U.S. political subdivisions and their authorities and instrumentalities and corporations which are wholly owned directly or indirectly by them, the Company, and its owner, the Guarantor, would not be subject to the 1940 Act.

However, because it could be argued that the Company is an "investment company" within the strict terms of the 1940 Act, we are of the opinion that the Company falls within the exemption afforded by Section 3(c)(5)(B). That Section exempts from the definition of "investment company":

any person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in [the business of]... (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services....

A review of the loan portfolio of the Company indicates that the Company is primarily engaged in the making of loans to purchasers of "specified merchandise... and services" as that term is used in Section 3(c)(5)(B) of

the 1940 Act. During its last full fiscal year, over 97% of the outstanding loans of the Company were made to the municipalities and federations of municipalities. The rest of the loans of the Company were made to the municipality-controlled companies, whose loans are guaranteed by a municipality. These municipality-controlled companies provide public services such as transport, telecommunications, power, water and sewage. As more fully described above, these loans were used, among other things, to finance the construction and renovation of administrative buildings, educational institutions, industrial and commercial premises, housing and hospitals, homes for the aged and day-care centers. The municipal sponsors of these projects are "prospective purchasers" of "specified merchandise and services" -- the materials, equipment and labor associated with the construction and renovation of public works, housing projects and transportation.

Additionally, we refer to Banco Nacional de Obras y Servicios Publicos, S.A. (Available November 24, 1977, Ref. No. 77-932CC), which describes similar circumstances. In your response letter, you stated that while you would not agree that the exclusion from the definition of investment company in Section 3(c)(5)(B) of the 1940 Act was available to Banco Nacional de Obras y Servicios Publicos, S.A. ("Banobras"), you would not recommend any action because of the unique facts, which are substantively similar to the situation described here. Banobras was controlled by, and its bonds were to be guaranteed by, the Federal Government of Mexico and Banobras functioned as the principal instrumentality for contracting domestic and foreign credit sources for public works construction in Mexico. Likewise, the Company is fully controlled by, and its debt instruments are and will be guaranteed by, a federally created and regulated public institution, and it functions as the local government's and public sector's instrumentality for providing credit for public investment projects in Finland.

Accordingly, we are of the opinion that the Company is excluded from the definition of an investment company under the 1940 Act, and exempt from the registration requirements of Sections 7 and 8 of the Act, by reason of the exemption afforded in Section 3(c)(5)(B). We would appreciate it if the Staff would advise us as to whether it concurs in our opinion.

Securities and Exchange
Commission

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March 8, 1994

Please call the undersigned at (212) 450-4525 or
Nora Jordan at (212) 450-4684 if you have any questions.

Very truly yours,

Pierre de Saint Phalle