



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

DIVISION OF
INVESTMENT MANAGEMENT

April 1, 1993

Mr. Richard L. Mertz
Executive Discount Realty
Company
1122 Silverado Street
La Jolla, CA 92037

Act	ICA of 1940
Section	3(c)(1)
Rule	
Public Availability	4-1-93

Dear Mr. Mertz:

Chairman Breeden forwarded your letter dated February 23, 1993 to this Office for response. You have requested information regarding the registration requirements for mutual funds. I have enclosed a copy of the Commission's Investment Company Registration Package, which includes Form N-1A, the form used to register a mutual fund with the Commission under the Investment Company Act of 1940 ("1940 Act") and to register the securities issued by the mutual fund under the Securities Act of 1933 ("1933 Act"); a copy of the 1940 Act; and other explanatory materials.

You also ask the following specific questions:

1. Is an investment company exempt from the registration requirements because the total amount of securities offered is less than \$500,000 and will be less than \$500,000 in a 12 month period?

Section 3(c)(1) of the 1940 Act generally excludes from the definition of "investment company," and thus from registration and regulation under the 1940 Act, any issuer whose outstanding securities are beneficially owned by not more than 100 persons, and which is not making and does not propose to make a public offering of its securities. This private offering exclusion is not contingent upon any particular dollar amount. Whether an offering is public depends on the facts and circumstances of the offering. In determining whether an investment company's offering of its securities is nonpublic for purposes of Section 3(c)(1), the Division of Investment Management generally looks to whether an offering is nonpublic for purposes of Section 4(2) of the 1933 Act and Rule 506 thereunder. 1/ The enclosed registration package contains a release entitled "Nonpublic Offering Exemption," on page 58, which may assist you in determining whether your proposed offering will be public. If you decide to register the investment company under the

1/ See, e.g., Frontier Capital Management Company, Inc. (pub. avail. July 13, 1988); Santa Barbara Securities (pub. avail. Apr. 8, 1983).

1940 Act, you should note that Section 14(a) generally prohibits an investment company from registering with the Commission and making a public offering of that company's securities unless the company has a net worth of at least \$100,000.

2. Does being exempt from the registration requirement have any effect on being a regulated investment company under Subchapter M of the Internal Revenue Code ("IRC")?

To qualify under Subchapter M of the IRC, an investment company must be registered under the 1940 Act. In addition, an investment company must comply with the other requirements set forth in Subchapter M, including certain gross income and diversification requirements. You may wish to contact the Internal Revenue Service for further information on the taxation of registered investment companies.

3. Are both a prospectus and a statement of additional information ("SAI") required?

Form N-1A is a three part registration form, consisting of a prospectus, SAI, and other information. Thus, both a prospectus and SAI are required to be filed with the Commission. An investment company need not automatically distribute its SAI to investors, but only must make it available free of charge to investors upon request.

4. Are audited financial statements required?

Item 23 of the SAI requires a registered management investment company to include in its registration statement: (1) an audited balance sheet or statement of assets and liabilities as of the end of the most recent fiscal year; (2) an audited statement of operations for the most recent fiscal year; and (3) audited statements of changes in net assets for the two most recent fiscal years. These statements must conform to the requirements in Regulation S-X. Item 3 of Form N-1A also requires the registrant to furnish in its prospectus condensed financial information, including per share income and capital changes for each of the last ten fiscal years of the registrant (or for the life of the registrant, if less).

5. Is incorporation of the fund required?

The 1940 Act does not require that an investment company be organized in a certain form. Most investment companies are organized as corporations or business trusts, and some are organized as limited partnerships.

6. What does the Investment Company Institute's ("ICI") requirement that a member be "fully registered under the 1940 Act" mean?

The ICI is a trade group, not associated or affiliated with the Commission. You should contact the ICI directly regarding its membership qualifications. The ICI is located at 1600 M Street, N.W., Washington, D.C. 20036, (202) 293-7700.

I hope this information is helpful. I have also enclosed a copy of an unpublished article entitled "The Regulation of Investment Companies in the United States," which briefly explains the structure under which the Commission regulates mutual funds and other investment companies. You may want to consider contacting an attorney who has experience in this area for guidance with respect to the issues involved in organizing a mutual fund. If you have any further questions, you may write or call this Office at (202) 272-2030.

Sincerely,



Thomas S. Harman
Associate Director
(Chief Counsel)

Enclosures



Richard L. Mertz
Owner • Broker

**ED
RC**

Executive Discount
REALTY COMPANY

05363

1122 Silverado Street
La Jolla, CA 92037

Tel: (619) 459-4440

February 23, 1993

The Honorable Mr. Richard Breeden
Chairman
United States Securities and Exchange Commission
Washington, D.C. 20549

Dear Mr. Breeden:

I am a small businessman (on a tight budget) that is interested in starting a diversified open-end no-load registered investment company/mutual fund and realize that they are complex, vigorously regulated--having to comply with a large number of federal and state laws and regulations. Having gained an appreciation for this high degree of regulation, I am writing to you hoping it will be possible to obtain references or answers to some questions.

In trying to obtain information on this mutual fund dream of mine, I have contacted the Investment Company Institute which mailed me a disappointing and discouraging guide: "The Organization and Operation of a Mutual Fund" (eight pages and \$25.00!!!) that summaries "the numerous factors that should be considered carefully when deciding whether or not to organize and operate a mutual fund." To me, this guide seems like a scare tactic to discourage the small businessman from their interests in this area.

My five year plan for this proposed registered investment company/mutual fund to start with \$100,000 and one investor; and, to grow this to at least 1,000,000 and 35 investors over a five year period. Eventually, in the five to ten year time-frame, I would plan to develop this registered investment company into a "full scale" multi-million dollar mutual fund.

In the first five years, my goal is to avoid a complicated and costly process; at the same time having strict adherence to the "myriad of regulatory requirements." My advertising would be limited, if at all. (Advertising via family, friends, word of month, and possibly listed by a no load mutual fund guide). I'm a newly registered investment adviser and am considering incorporating this proposed fund in either Maryland or California, and registering it in California initially. (I am a California resident).

The following questions are in regard to the registration requirements of this fund: 1) My understanding is that this proposed investment company would be exempt for the registration requirement because the total amount of securities offered is less than \$500,000 and will be less than \$500,000 in a 12 month period. Is this correct? 2) Does being exempt from the registration requirement have any effect on being a regulated investment company under Subchapter M of the Internal Revenue Code? 3) Are both a Prospectus and a Statement of Additional Information required? 4) Is incorporation of the fund required? 5) Are audited financial statements required? 6) The Investment Company Institute has a requirement that members be fully registered under the 1940 Investment Company Act--under the above scenario does this qualify as being fully registered?

Any additional information would be greatly appreciated!

Truly Yours,

Richard Mertz
Richard Mertz