Our Ref No. 96-475-CC
Plymouth Commercial Mortgage Fund
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of September 10, 1996 requests assurance that we would not recommend enforcement action to the Commission if Plymouth Commercial Mortgage Fund ("Plymouth"), after electing to operate as a business development company ("BDC") under Section 54 of the Investment Company Act of 1940 (the "1940 Act"), (i) treats certain debt securities described below as eligible securities under Section 55(a)(3)(C) of the 1940 Act and (ii) treats its offer to provide certain assistance, also described below, as "significant managerial assistance" for purposes of Section 2(a)(47) of the 1940 Act.

Facts

Plymouth will be initially capitalized by an exchange offer made to security holders of SWF 1995 Limited Partnership ("SWF-1995"), a Texas limited partnership in the business of purchasing packages of distressed loans, and will succeed to SWF-1995's business. You state that Plymouth will then file a registration statement on Form 10 under the Securities Exchange Act of 1934 ("Exchange Act"), and a notification of election on Form N-54A to be regulated as a BDC.

Plymouth will purchase from governmental and non-governmental institutions packages of notes evidencing impaired loans to small business borrowers.[1] You state that the quality of loans within these packages vary significantly, and that Plymouth can purchase loan packages at a substantial discount. Thus, Plymouth can offer debtors significant forgiveness as an incentive to restructure the existing loan and to issue a new note. After purchasing a loan package, depending on the quality of the loan, Plymouth will either: (1) negotiate with the borrower to restructure the existing note, resulting in the issuance of a new note from the borrower to Plymouth that will reflect forgiveness of some principal and interest ("Workout Option 1")[2]; (2) offer the borrower forgiveness sufficient to allow the borrower to obtain a new loan from an unaffiliated third party, resulting in the borrower issuing a new note to the unaffiliated third party ("Workout Option 2"); or (3) immediately foreclose on the note or sell it to a third party ("Option 3").

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[1]You define the "impaired loans" to be purchased by Plymouth as those on which the borrower is "unable to meet its obligations as they [come] due without material assistance other than conventional lending or financing arrangements."

[2]You represent that Plymouth intends to hold these new notes for a period of six to twelve months. During this time period, you state that the portfolio company will have the opportunity to develop a timely payment history sufficient to allow it to refinance the loan with a conventional lender or to allow Plymouth to sell the note to a third-party lender.

You represent that after purchasing a package of impaired loans, Plymouth will contact the issuers of the notes it categorizes as either Workout Option 1 or Workout Option 2 assets (collectively, "qualifying assets"), and will make a written offer to provide, and if accepted will provide, the following guidance and assistance in the following manner:

(1) Applying standard financial analysis to review the borrower's current financial statements, suggesting modifications in financial practices and accounting treatment where appropriate, and otherwise making detailed recommendations to improve the borrower's cash flow and profitability and to enhance the likelihood of the borrower's receiving a favorable response to a request for refinancing from a third-party lender;

(2) providing comprehensive assistance to the borrower in its preparation of a third-party loan request including, but not limited to, examination of borrowing needs and capacity and assistance with the drafting of application forms and supporting schedules;

(3) introducing the borrower to prospective third-party lenders as well as to law firms, accountants, and other professionals for assistance with general business matters (such introductions to occur, depending upon the circumstances, either in person, by telephone or written correspondence); and

(4) informing the borrower about various loan and other programs sponsored by the U.S. Small Business Administration, and assisting the borrower in identifying prospective third-party lenders participating in the general business loan program authorized by Section 7(a) of the Small Business Act or the development company loan program authorized by Sections 503 through 505 of the Small Business Investment Act of 1958.

Analysis

To qualify as a BDC, an investment company must: (1) be a closed-end company organized under the laws of a state; (2) operate for the purpose of investing in securities described in paragraphs (1) through (3) of Section 55(a) of the 1940 Act[3]; (3) invest at least

[3]Qualifying assets described in Section 55(a)(1)(A) and (2) are generally securities issued by "eligible portfolio companies" purchased from any source; additionally, Section 55(a)(1) provides that the purchase transaction may not involve a public offering. Eligible portfolio companies are: (1) companies organized under the laws of a state; (2) neither investment

70% of its assets in securities described in paragraphs (1) through (6) of Section 55(a) ("70% test")[4];(4) make available "significant managerial assistance" to the portfolio companies whose securities are treated as satisfying the 70% test; and (5) file a notice of election to be regulated as a BDC with the Commission.

You represent that Plymouth will meet all of these statutory requirements. You request assurance only as to whether the staff would consider Plymouth's initial purchase of distressed loans at auction to be transactions "incident" to the later issuance of a new note by the issuer, and whether the staff would consider Plymouth's proposed offer of assistance to be "significant managerial assistance" for purposes of Section 2(a)(47)(A).

1. Qualifying Assets under Section 55(a)(3)(C)

Section 55(a)(3)(C) imposes restrictions on the source from which, and the manner in which, a BDC may acquire certain qualifying assets. Specifically, the securities must be issued by a company that, among other things, prior to the purchase of the securities by the BDC, was unable to meet its obligations without material assistance other than conventional financing ("issuer requirements"). In addition, the BDC must purchase these securities in a non-public offering from any of the issuer, a person who is, or was within the preceding

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companies (other than a small business investment company ("SBIC") licensed by the Small Business Administration that is a wholly-owned subsidiary of a BDC) nor companies excluded from the definition of an investment company by Section 3(c) of the 1940 Act; and (3) companies that either have no class of marginable securities, companies that are controlled by a business development company, or certain small portfolio companies. Section 2(a)(46)(A)-(C). If a company that otherwise would be deemed to be an eligible portfolio company has issued a class of marginable securities, Section 55(a)(1)(B) designates such securities as qualifying assets, provided that immediately prior to the purchase, the BDC owns at least 50% of certain securities of the issuer and is one of the 20 largest holders of record of the company's voting securities. Section 55(a)(3) qualifying assets are securities issued by financially distressed businesses that are organized under the laws of a state and are neither an investment company (other than a SBIC) nor a company excepted from the definition of an investment company by Section 3(c) of the 1940 Act, and that are purchased in transactions not involving a public offering.

[4]See n.3, supra (description of qualifying assets set forth in Section 55(a)(1)-(3)). Qualifying assets described in Section 55(a)(4)-(6) are: (1) securities issued by an eligible portfolio company purchased from any person, if there is no ready market for the securities and the BDC, immediately prior to the purchase, owns at least 60% of the outstanding equity securities of the issuer; (2) securities received in exchange for or relating to qualifying assets described in Section 55(a)(1)-(4), or pursuant to the exercise of options, warrants or rights relating to securities described in Section 55(a)(1)-(4); and (3) cash, cash items, government securities or high grade debt investments maturing in one year or less from the time of investment.

thirteen months, an affiliated person of the issuer or from any person in "transactions incident thereto."

In designating securities issued by a financially distressed business as a qualifying asset under Section 55(c)(3)(C), Congress intended to encourage BDCs to provide financial and managerial assistance to a company "before its circumstances are so dire that it must seek protection through formal bankruptcy proceedings."[5] The limitations on the sources from which BDCs may acquire these assets are intended to ensure that the financially distressed companies obtain the financial and managerial assistance that Congress envisioned.[6]

You represent that the issuers of notes that Plymouth intends to treat as qualifying assets for purposes of the 70% test will meet the issuer requirements set forth in Sections 2(a)(46) and 55(a)(3)(C) of the 1940 Act. With respect to Workout Options 1 and 2, you maintain that Plymouth's initial purchase of the existing note should be deemed a transaction incident to the subsequent issuance of the new note by the company to Plymouth or to an unaffiliated third party.[7]

2. Significant Managerial Assistance

Section 2(a)(47)(A) of the 1940 Act, in pertinent part, defines the phrase "making available significant managerial assistance" as "any arrangement whereby a business development company . . . offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company." In enacting Section 2(a)(47), Congress recognized that "the nature and amount of managerial assistance made available by a business development company will vary according to the particular needs of each portfolio company . . . ."[8]

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[5]Small Business Investment Incentive Act of 1980, H.R. Rep. No. 1341, 96th Cong., 2d Sess. (1980), reprinted in 5 U.S. Code Cong. & Ad. News 4800, 4824 (1980) ("House Report No. 1341").

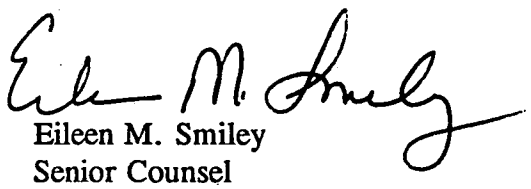
[6]See House Report No. 1341 at p. 4805. The fact that Congress recently expanded the permissible sources for acquiring the assets described in Section 55(a)(1) has no effect on the continued viability of the source limitations imposed, and not repealed, by Congress in Section 55(a)(3). H.R. 3005, The National Securities Markets Improvement Act of 1996, 104th Cong., 2d Sess., § 505 (1996).

[7]You acknowledge that loans falling into Option 3 may not be qualifying assets within the meaning of Section 55(a)(3), and do not request the staff's view on this issue.

[8]House Report No. 1341 at p. 4815.

You represent that Plymouth's offer of managerial assistance will involve guidance and counsel concerning the restructuring of the financially distressed companies' obligations, including assisting with loan applications, educating the borrower about small business loan programs, and introducing the borrower to other lenders. You maintain that this offer constitutes "significant managerial assistance" for purposes of Section 2(a)(47)(A).

We would not recommend enforcement action to the Commission if Plymouth treats as qualifying assets under Section 55(a)(3)(C) those notes that it purchases initially from governmental or non-governmental institutions, provided that it manages the notes in the manner described in Workout Option 1 or 2[9], or if Plymouth treats its proposed offer of assistance as "significant managerial assistance" within the meaning of Section 2(a)(47)(A) of the 1940 Act. The staff's position is based upon the facts and representations contained in your letter. Any different facts or representations might require a different conclusion.



Eileen M. Smiley
Senior Counsel

[9]You have not requested, and we do not express, our views regarding whether any of the notes, if purchased individually, also would be qualifying assets within the meaning of Section 55(a)(3).

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September 10, 1996

1940 Act/Sections 2(a)(48)(B), 55(a)(3)

By Messenger

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Assistant Chief Counsel
Division of Investment Management
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Securities and Exchange Commission
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Re: Plymouth Commercial Mortgage Fund

Dear Mr. O'Hanlon:

We are writing on behalf of Plymouth Commercial Mortgage Fund ("Plymouth"), to request the Staff of the Division of Investment Management ("Division" or "Staff") to advise us that it will not recommend that the Securities and Exchange Commission ("Commission") take any enforcement action if: Plymouth elects to be regulated as a business development company subject to the provisions of Sections 55 through 65 of the Investment Company Act of 1940, as amended (the "1940 Act")[1/]; for purposes of compliance with Section 55(a) thereof, treats certain debt securities (described below), held and to be held in its investment portfolio, as being assets of the type described in paragraph (3) of that section; and, with respect to the issuers of these debt securities, offers to provide and, if accepted, does so provide, certain guidance and counsel on restructuring their existing debt and related financial matters.

Specifically, Plymouth seeks your concurrence that: (1) its purchases from governmental or non-governmental institutions (through either competitive or negotiated bids) of groups of notes evidencing impaired loans to small business borrowers would be deemed to be transactions incident to the subsequent purchases directly from the issuer, by Plymouth or an unaffiliated third-party investor, of other securities also of the type described in Section 55(a)(3) of the 1940 Act; and (2) Plymouth's offer to provide, and, if accepted, actual provision of, certain guidance

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[1/] 15 U.S.C. §§ 80a-1 to -64.

and counsel concerning the current and alternative future financial structures of a portfolio company constitutes "making available significant managerial assistance" within the meaning of Section 2(a)(47) of the 1940 Act.

PLYMOUTH, SWF-95 AND SWFI

Plymouth was organized on August 23, 1996, as a Delaware business trust. Plymouth intends to succeed to the business of SWF 1995 Limited Partnership ("SWF-95") following certain transactions described below. Thereafter, Plymouth will elect to be regulated as a business development company ("BDC") under the 1940 Act.

SWF-95 was organized in 1995 as a Texas limited partnership. Since its inception, it has invested almost exclusively in impaired loans (as described below). As of July 31, 1996, it had total assets of approximately $3.2 million.

SWF-95 was organized by SouthWest Federated, Inc. ("SWFI"), a Texas corporation that was founded in 1989. SWFI purchases groups of notes evidencing loans typically containing from 3 to 20 loans ("loan packages"), and in some instances individual loans, for its own account and for the account of certain related entities. The loan packages frequently have been, and are expected to be, purchased through auctions which attract buyers nationwide and in which SWFI has been and continues to be a regular participant. Sellers of the types of loans acquired by SWF-95 have included entities such as the Resolution Trust Corporation, the Federal Deposit Insurance Corporation, and various non-governmental institutions, including banks and thrift institutions. SWFI manages portfolios of impaired loans for certain private limited partnerships and other entities, including SWF-95 (collectively, "related entities"). For its management services, SWFI typically receives a percentage of collections as a management fee, and a portion of the cash flow distributions after a specified rate of return has been reached. SWFI holds a 14.4% equity interest in SWF-95 and is its general partner.

Since its inception, SWFI has raised approximately $14 million in equity and has utilized approximately $5 million in debt for purposes of investing in impaired loans for its own account and for its related entities. With this base of capital, SWFI has purchased approximately $175 million (outstanding principal amount) of various types of impaired loans. Generally, a loan is considered "impaired" when "based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual

terms of the loan agreement."[2/] Impaired loans purchased by SWF-95 generally are those on which the borrower is "unable to meet its obligations as they [come] due without material assistance other than conventional lending or financing arrangements" within the meaning of Section 55(a)(3)(C) of the 1940 Act. They include: commercial real estate mortgages; loans secured by business inventories, accounts receivable, and equipment; consumer credits; and unsecured loans. The difference between the amount invested and the face amount of each of the impaired loans in its portfolio reflects the deep discounts at which distressed debt, like these loans, tends to be priced. Since inception, SWF-95 has acquired loans for an average purchase price of $0.40 per dollar of outstanding principal amount.

In purchasing impaired loans, SWFI generally seeks outstanding debt obligations of small companies that can be converted into fully performing instruments through forgiveness of some principal and restructuring the terms of the note. SWFI will seek foreclosure only as a last resort. In selecting loans for purchase, SWFI emphasizes thorough due diligence investigation and analysis prior to making bids, and, to date, has been able to generate consistently high returns because of its experience and policy that emphasizes working with the borrower to assist in its restructuring or repaying the obligation. SWFI's participation in the market for impaired loans effectively benefits borrowers who are thereby able to retain ownership and use of their collateral without seeking protective measures such as bankruptcy and may also be able to enhance their ability to service their other obligations.

As noted above, SWFI currently purchases outstanding notes for its own account and for the accounts of the related entities. On August 2, 1996, SWFI organized a new interim private investment fund that invests in the same types of assets (*i.e.*, impaired loans) in which SWFI and the related entities currently invest. SWFI is expected to continue making purchases for this fund until the initial funding of Plymouth (described below) is completed. In no event, however, will the interim fund continue to purchase loans past December 31, 1996. Thereafter, it is expected that SWFI will not purchase loans of the type in which Plymouth intends to invest for any entity besides Plymouth for a period of two years.

[2/] Fin. Acct. Stds. Bd., Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* ¶ 8 (May 1993).

THE PROPOSED TRANSACTIONS

SWFI has determined to continue its activities through a newly formed Delaware business trust, Plymouth, which would operate as a BDC within the meaning of Section 2(a)(48) of the 1940 Act. Among other things, SWFI believes that use of the highly structured BDC format would improve the future capital-raising potential for an entity like Plymouth investing in impaired loans. Accordingly, pursuant to Section 54(a) of the 1940 Act, Plymouth intends to file both a registration statement on Form 10 under the Securities Exchange Act of 1934, as amended, and a notification of election on Form N-54A to be regulated as a BDC. Immediately prior to that election, Plymouth will be capitalized through an exchange offer made to holders of interests in SWF-95[3/] through a private offering exempt from registration under the Securities Act of 1933, as amended. The exchange offer will represent the first stage of a two-stage initial funding for Plymouth. Shortly after the exchange offer is completed, Plymouth would offer, also through a private placement, additional shares with the goal of attracting approximately $10 million in additional equity. It is anticipated that other infusions of capital would be made from time to time and could include, among a number of alternatives, a public offering of new shares by Plymouth after it develops a track record, acceptable to prospective underwriters, as a BDC. If a public offering is made, the BDC regulatory regime under the 1940 Act would permit Plymouth to offer a stock option plan and to utilize leverage to a greater extent than if it were to operate as a registered closed-end investment company.

DISCUSSION

Relevant Provisions and Need for Relief

70 Percent "Qualifying Assets" Requirement. Section 55(a) of the 1940 Act makes it unlawful for a BDC to acquire any assets (other than those described in paragraphs (1) through (7) thereof) unless, at the time the acquisition is made, assets described in paragraphs (1) through (6) (collectively, "qualifying assets") represent at least 70 percent of the value of its total assets other than assets described in paragraph (7).

Paragraphs (1) through (4) of Section 55(a) describe qualifying assets which are either securities of an eligible

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3/ Currently, there are 23 holders of limited partnership interests, 15 holders of subordinated notes (two of whom also hold limited partnership interests), and the general partner, SWFI.

portfolio company within the meaning of Section 2(a)(46) of the 1940 Act or securities of an issuer described in subparagraphs (A) and (B) of Section 2(a)(46) that may not be an eligible portfolio company (*i.e.*, failing to satisfy one of the three alternative criteria of subparagraph (C) of Section 2(a)(46)). Paragraph (3) of Section 55(a) describes:

> securities purchased in transactions not involving any public offering from an issuer described in Sections 2(a)(46)(A) and (B) or from a person who is, or who in the preceding 13 months has been, an affiliated person of such issuer, or *from any person in transactions incident thereto*, if such securities were--
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> . . . (C) issued by an issuer that, immediately prior to the purchase of such issuer's securities by the [BDC], was not in bankruptcy proceedings but was unable to meet its obligations as they came due without material assistance other than conventional lending or financial arrangements

(emphasis added).

Neither the Commission nor its Staff appears to have issued any interpretive authority clarifying the meaning of "transactions incident thereto" in paragraph (3) above, and the legislative history also appears to be silent in that regard. Therefore, we seek the Staff's assurance that it would not recommend that the Commission take enforcement action if Plymouth treats loan packages it purchases "from any person" (*e.g.*, from governmental or non-governmental institutions) as qualifying assets for purposes of compliance with Section 55(a), so long as the borrower is an issuer described in Sections 2(a)(46)(A) and (B).

"Making Available Significant Managerial Assistance" Requirement. Section 54(a) of the 1940 Act provides that "[a]ny company defined in Section 2(a)(48)(A) and (B) may elect to be subject to the provisions of Sections 55 through 65" if certain conditions are met. Section 2(a)(48)(A) merely requires that the prospective BDC be "organized under the laws of, and [have] its principal place of business in, any State or States." In addition to requiring that the prospective BDC be "operated for the purpose of making investments in securities described in paragraphs (1) through (3) of Section 55(a)," Section 2(a)(48)(B) requires that the prospective BDC

> *make[] available significant managerial assistance with respect to the issuers of such securities*, provided that a [BDC] must make available significant managerial assistance only with respect to the companies which are treated by such [BDC] as satisfying the 70 per centum of the value of its total assets condition of Section 55

(emphasis added).

Section 2(a)(47) defines "[m]aking available significant managerial assistance" by a BDC as, *inter alia*:

> (A) any arrangement whereby a [BDC], through its directors, officers, employees, or general partners, offers to provide, and, if accepted, does so provide, *significant guidance and counsel concerning the management, operations, or business objectives and policies* of a portfolio company

(emphasis added).

Neither the Commission nor its Staff appears to have issued any interpretative authority clarifying the meaning of "significant guidance and counsel concerning the management, operations, or business objectives and policies" in subparagraph (A) above. Therefore, we seek the Staff's assurance that it would not recommend that the Commission take enforcement action if Plymouth, through its directors, officers, employees, or general partners, offers to provide, and, if accepted, does so provide, certain guidance and counsel to a portfolio company concerning the restructuring of that company's obligations and related financial matters.

Analysis

Section 55(a)(3). To the extent that Plymouth purchases impaired loans in packages and not individually (which will usually be the case), the quality of the loans so acquired can vary significantly. In most cases, a purchaser of impaired loans like Plymouth performs the valuable service of permitting the small business obligor to stave off foreclosure or other precipitous action by its creditors. Having purchased the loans at a discount (usually substantial) from the outstanding principal balance plus accrued interest balance, Plymouth often will be able to offer the borrower substantial forgiveness as an incentive to restructure its loan. Depending upon the quality of

the particular loan, such forgiveness of debt by Plymouth would likely lead to one of the following two alternative scenarios:

1. Plymouth offers to take a new note. This new note would reflect some forgiveness of principal and interest and is issued by the borrower in exchange for cancellation of the impaired note purchased by Plymouth. Once the borrower has shown 6-12 months of consistent and timely payments to Plymouth according to the terms of the new note, this note is either refinanced by the borrower with a bank or other institution as a third-party lender or sold outright by Plymouth to such a third-party lender.

2. Plymouth offers forgiveness sufficient to allow the borrower, which may or may not accept Plymouth's offer of guidance and counsel for this purpose, to identify, contact, negotiate with, and obtain a new loan from a third-party lender.

In some cases, however, a substantial forgiveness is not sufficient because the borrower's cash flow is otherwise so encumbered that any lender would be forced to foreclose and sell the collateral in order to recover at least some of its investment in the impaired note. Indeed, only by retaining the flexibility to commence foreclosure proceedings can Plymouth ensure that a borrower negotiates in good faith to refinance its impaired loan.

Plymouth acknowledges that, with respect to a loan on which SWFI proceeds to foreclose or a loan of "bankable" quality which SWFI proceeds to sell immediately to a new third-party investor, SWFI's purchase of an impaired loan for Plymouth's account from a governmental or non-governmental institution is not likely to be deemed to be a transaction incident to a prior or subsequent purchase of a newly issued security directly from the borrower. However, with respect to scenario (1) above, Plymouth believes that the new note issued to it by the borrower upon the restructuring of the borrower's impaired loan acquired in a loan package would cause Plymouth's original purchase of the impaired loan from the governmental or non-governmental institution to be classified as a transaction incident to the subsequent purchase of a newly issued security directly from the borrower by Plymouth. With respect to scenario (2) above, Plymouth similarly believes that its original purchase of the impaired loan from the governmental or non-governmental institution as part of a loan package is a transaction incident to the subsequent purchase of a newly issued security directly

from the borrower by a new third-party investor. In sum, Plymouth believes that loans in either scenario (1) or scenario (2) above, when acquired as part of a loan package, are assets described in Section 55(a)(3) of the 1940 Act and therefore are qualifying assets for purposes of the 70 percent requirement.[4/] Indeed, without Plymouth or another intermediary taking the risk of purchasing a package of impaired loans of varying credit quality and likelihood of rehabilitation, it would likely not be possible for this type of small business obligor to be matched with a third-party investor which has the capacity to hold a newly restructured note with these credit characteristics to maturity.

Section 2(a)(48)(B). Plymouth, through its trustees, officers, or employees, will promptly contact the borrower on each loan that Plymouth intends to treat as a qualifying asset for purposes of the 70 percent requirement and will make a written offer to provide, and if accepted will so provide, significant guidance and counsel to the borrower concerning its management and its business objectives and policies in the following manner:

1. applying standard financial analysis to review the borrower's current financial statements, suggesting modifications in financial practices and accounting treatment where appropriate, and otherwise making detailed recommendations to improve the borrower's cash flow and profitability and to enhance the likelihood of the borrower's receiving a favorable response to a request for refinancing from a third-party lender;

2. providing comprehensive assistance to the borrower in its preparation of a third-party loan request including, but not limited to, examination of borrowing needs and capacity and assistance with the drafting of application forms and supporting schedules;

3. introducing the borrower to prospective third-party lenders as well as to law firms, accountants, and other professionals for assistance with general business matters (such introductions to occur, depending upon the

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[4/] This letter is not seeking the Staff's views with respect to the status under Section 55(a)(3) of loans purchased individually by Plymouth.

circumstances, either in person, by telephone or written correspondence); and

4. informing the borrower about various loan and other programs sponsored by the U.S. Small Business Administration, and assisting the borrower in identifying prospective third-party lenders participating in the general business loan program authorized by Section 7(a) of the Small Business Act (so-called "7(a) loans") or the development company loan program authorized by Sections 503 through 505 of the Small Business Investment Act of 1958 (so-called "504 loans").

The above services will be made generally available on an ongoing basis as long as Plymouth holds the borrower's loan in its portfolio. To the extent that the borrower abuses the offered managerial assistance by failing to negotiate in good faith to restructure its impaired loan, by not making the contracted payments on Plymouth's loan without good reason, or by not otherwise using the offered assistance in good faith, Plymouth may determine to withhold certain aspects of the managerial assistance.

Plymouth believes that the managerial assistance program outlined above should be deemed to constitute "significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company," as that phrase appears in the definition of "[m]aking available significant managerial assistance" in Section 2(a)(47)(A) of the 1940 Act. Therefore, Plymouth believes that offering to provide, and if accepted so providing, such guidance and counsel to its small business obligors on restructuring their existing debt and related financial matters should be deemed to fulfill its obligation under Section 2(a)(48)(B) of the 1940 Act to "make available significant managerial assistance with respect to the companies which are treated by such [BDC] as satisfying the 70 per centum of the value of its total assets condition of Section 55" thereof.

Policy Considerations

The assurances sought in this letter are consistent with the policy underlying the Small Business Investment Incentive Act of 1980 (the "1980 Amendments" to the 1940 Act)[5/], which introduced the BDC regulatory regime as an alternative to

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[5/] Pub. L. No. 96-477, 94 Stat. 2275 (1980).

registration under the 1940 Act for closed-end investment companies. That legislation had as its purpose the promotion of investments in small businesses. By participating in the market for distressed debt of smaller companies, entities like Plymouth frequently act as a last resource for entrepreneurs to avoid bankruptcy or foreclosure when faced with an untenable burden of interest and principal payments on an outstanding loan. Indeed, the existence of buyers of impaired loans makes the primary sources of debt financing to small business borrowers (*e.g.*, banks) more willing, at least to some extent, to make the loans in the first instance and with lower levels of debt service payments than would otherwise be the case.

SWFI has observed three recent trends in the banking industry that underscore the importance of the role of entities like Plymouth. First, following the combination of two banks through merger or other means, the acquiring bank often decides to liquidate the impaired loans it inherits from the acquired bank, which typically has a relatively high proportion of impaired loans on its books (contributing, in part, to a troubled bank's demise). Without a demand for impaired loans by entities like Plymouth, foreclosure by the acquiring bank would be the likely result. Second, many banks have downsized their staffs over the past few years, a pattern which among other things has led disproportionately to the scaling back or, in the case of many smaller- to mid-sized banks, complete elimination of their "workout" capacity. Absent that capability, foreclosure has become a more common result. Notably, many of the downsized banks have shown a preference for selling impaired loans rather than working with debtors. Third, possible revisions to risk-based capital requirements may make bank lenders somewhat more anxious to dispose of impaired loans.[6/] Plymouth provides a non-foreclosure option for many of these loans.

To the extent a purchaser like Plymouth stands prepared to purchase the types of notes described above at a discount and to work with borrowers whose cash flow or asset quality has deteriorated, small businesses can be given increased chances of survival which they might not otherwise have. While impaired loans of large denominations can be rehabilitated through pooling, securitization, or other strategies that appeal to investment banking firms or other large institutional buyers looking for economies of scale, very few alternatives are available for lenders desiring to resolve smaller credits. These

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6/ *See* Jaret Seiberg, *Greenspan Hints at Revision in Capital Rules on Credit Risk*, American Banker, May 3, 1996, at 1.

types of resolutions also help avoid costly litigation, which itself could prove fatal for a small business.

Rep. Broyhill of North Carolina, the Ranking Minority Member of the House Committee on Interstate and Foreign Commerce reiterated the intent of Congress moments before the House voted to concur with the Senate's amendments to H.R. 7554, which shortly thereafter was signed into law by the President as the 1980 Amendments to the 1940 Act:

> As the principal sponsor to this legislation I want the record to reflect that its purpose is to remove unnecessary regulatory impediments on the ability of small businesses, growing businesses, and *financially troubled businesses* to raise much-needed capital[7/]

(emphasis added).

Rep. Broyhill was emphasizing the expansive interpretation that he, as the principal sponsor of H.R. 7554, hoped would be given to the 1980 Amendments. We seek herein the Staff's concurrence that the proposed transactions by Plymouth are consistent with the purpose of the 1980 Amendments.

Recent initiatives also support a flexible interpretation of the BDC provisions of the 1940 Act. The Senate version of H.R. 3005 (S. 1815), which is currently awaiting reconciliation with the House version by the soon-to-be-convened Conference Committee, reflects the belief of the Senate Committee on Banking, Housing, and Urban Affairs

> that changing BDC regulation to make it easier and less costly for BDCs to offer securities and to invest in small businesses will make this type of investment vehicle more attractive. S. 1815 creates a new class of portfolio companies in which BDCs may invest without making available "significant managerial assistance," permits BDCs to acquire more freely the securities of portfolio companies, and allows BDCs greater flexibility in their capital structure.[8/]

[7/] 126 Cong. Rec. 28,632 (1980).

[8/] S. Rep. No. 293, 104th Cong., 2d Sess. 13 (1996).

Specifically, the proposed "new class of portfolio companies in which BDCs could invest without making available significant managerial assistance . . . would include any company that has total assets of $4 million or less and capital and surplus of more than $2 million."[9/] In addition, S. 1815 would expressly permit BDCs to treat securities of "eligible portfolio companies" (*i.e.*, issuers that meet the criteria set forth in all three subparagraphs of Section 2(a)(46) of the 1940 Act rather than merely in subparagraphs (A) and (B) thereof) as qualifying assets for purposes of the 70 percent requirement of Section 55(a) even if acquired from a person other than the issuer or a current/former affiliated person thereof.[10/] If this becomes law, the meaning of "transactions incident thereto" as used in Section 55(a)(3) would no longer be determinative of the qualifying asset status of a note evidencing an impaired loan purchased by a BDC from a governmental or non-governmental institution as long as the borrower meets not only the criteria of subparagraphs (A) and (B) of Section 2(a)(46), already a necessary condition of qualifying asset status under Section 55(a)(3), but also the criteria of subparagraph (C) of Section 2(a)(46) so that it is an "eligible portfolio company."

The transactions described above are consistent with both the public interest as well as the policy and purposes of the 1980 Amendments and the currently pending legislation. They also are consistent with the protection of investors in Plymouth, who stand to benefit from the returns earned on the investments in impaired loans without being exposed to risks of a type not anticipated by the 1980 Amendments.

CONCLUSION

In view of the foregoing, Plymouth respectfully requests that you advise that the Staff will not recommend the Commission to take any enforcement action if: Plymouth elects to be regulated as a BDC subject to the provisions of Sections 55 through 65 of the 1940 Act; for purposes of compliance with Section 55(a) thereof, treats certain debt securities (described above), held and to be held in its investment portfolio, as being assets of the type described in paragraph (3) of that section; and, with respect to the issuers of these debt securities, offers

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9/ *Id.* (discussing S. 1815 §§ 303-304, which propose to amend Sections 2(a)(46)(C) and 2(a)(48)(B) of the 1940 Act).

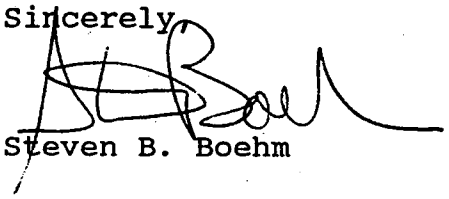
10/ *See* S. 1815, 104th Cong., 2d Sess. § 305 (1996) (proposing to amend Section 55(a)(1)(A) of the 1940 Act).

to provide and, if accepted, does so provide, certain guidance and counsel on restructuring their existing debt and related financial matters.

* * *

If you have any questions or require any additional information, please call the undersigned at (202) 383-0176, or David L. Abrams at (202) 383-0181.

Sincerely,



Steven B. Boehm

cc: Jack W. Murphy/SEC
John C. Mosher/SWFI
David L. Abrams/SA&B