

time and for any reason may (a) sell an outstanding loan to a Liquidity Provider, or (b) require a Liquidity Provider to provide financing to a Borrowing Fund instead of the Conduit. CNAI states that these arrangements provide additional assurances to holders of Promissory Notes that the Promissory Notes will be paid at maturity.

6. A Conduit purchases receivables and other assets from, and makes secured loans to, a broad range of sellers and borrowers in a variety of industries. Aggregate loans made by a Conduit to Borrowing Funds are not expected to be more than 10%, and usually would be considerably less than 10%, of the Conduit's outstanding loans and other assets.

7. CNAI represents that the revolving credit and security agreement of a Loan Facility, which will be negotiated by the parties, will contain representations, warranties, covenants and events of default that are customary for secured loan transactions involving open-end investment companies as well as such other terms that are specific to a particular Borrowing Fund and the conduct of its business. A Borrowing Fund will have the right to prepay its loans and terminate its participation in a Loan Facility upon prior notice at any time. The Pledged Assets of a Borrowing Fund will be available solely to secure repayment of the loans and other outstanding obligations incurred by that Borrowing Fund under a Loan Facility. CNAI further states that a Borrowing Fund would have the same rights and remedies under state and federal law with respect to a loan from a Conduit that it would have with respect to a comparable loan from a bank. CNAI also states that the arrangements with the Liquidity Providers protect Borrowing Funds by providing an alternative source of financing in the event a Conduit is unable to continue lending funds.

8. No Borrowing Fund will participate in a Loan Facility unless it has represented, in writing, to CNAI, that (a) its policies permit borrowing and, if applicable, the use of leverage; (b) all borrowing transactions pursuant to the Loan Facility will be subject to the requirements of the Act, the rules and regulations thereunder, and any other applicable interpretations or guidance from the Commission or its staff; and (c) each borrowing transaction will be conducted in accordance with all applicable representations and conditions of the application. Before a Borrowing Fund may participate in a Loan Facility, the Borrowing Fund's Board of Directors or Trustees ("Board") including a majority of the directors or

trustees that are not "interested persons" within the meaning of section 2(a)(19) of the Act ("Disinterested Directors") will determine that such participation is consistent with the Borrowing Fund's investment objectives and policies and in the best interests of the Borrowing Fund and its shareholders. Each Borrowing Fund's Board, including a majority of the Disinterested Directors, will also adopt procedures for evaluating and making certain determinations concerning the terms of each loan transaction between the Borrowing Fund and a Conduit.

9. CNAI states that the proposed Loan Facilities would enable Borrowing Funds to borrow money from the Conduits at lower cost than obtaining comparable loans from a bank. CNAI states that a Conduit's cost of funds is lower than that of banks, and this advantage will be passed on to the Borrowing Funds.¹

Applicant's Legal Analysis

1. Section 18(f)(1) of the Act prohibits open-end investment companies from issuing any senior security except that a company is permitted to borrow from any bank, if immediately after the borrowing, there is an asset coverage of at least 300 per cent for all borrowings of the company.² Section 2(a)(5) defines "bank" as a depository institution, a branch or agency of a foreign bank, a member bank of the Federal Reserve System, a banking institution or other trust company that, as a substantial portion of its business, receives deposits or exercises fiduciary powers similar to those permitted to national banks, or a receiver, conservator or liquidating agent of any of the foregoing. Applicant states that while a Conduit engages in many of the same business activities as banks, it is not a "bank" under this definition.

2. Section 6(c) of the Act permits the Commission to exempt any person or transaction or any class or classes of persons or transactions from any provision or provisions of the Act, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and

¹ The rate at which a Liquidity Provider would make a loan to a Borrowing Fund would not be as favorable as that of the Conduit, but would be comparable to the rates on secured lines of credit from banks. CNAI anticipates that a Conduit, rather than a Liquidity Provider, will be the lender to the Borrowing Funds under a Loan Facility, absent extenuating circumstances.

² Under section 18(g) of the Act, the term "senior security" includes any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness.

provisions of the Act. CNAI requests exemptive relief from section 18(f)(1) solely to the extent necessary to allow a Borrowing Fund to borrow from a Conduit that is not a bank. CNAI believes that permitting the Borrowing Funds to borrow from a Conduit is fully consistent with the purposes and policies of section 18(f)(1) and would not implicate the concerns underlying that provision.

3. CNAI states that section 18(f) of the Act reflects Congressional concern about excessive borrowing and the issuance of senior securities by open-end investment companies because these practices could unduly increase the speculative character and investment risk of junior securities. CNAI notes that Borrowing Funds would remain subject to the 300% asset coverage requirement in section 18(f)(1) of the Act for all borrowings, including those from a Conduit. CNAI further represents that Conduit loans will not impose any restrictions on a Borrowing Fund's shareholders that are different from those imposed by a collateralized bank loan. Finally, CNAI argues that permitting a Borrowing Fund to borrow from a Conduit rather than a bank is expected to reduce its costs of borrowing, which should decrease the risk that a Borrowing Fund's borrowing costs will exceed the return from securities purchased with borrowed money and lessen any related incentive to purchase more speculative portfolio securities to cover those costs.

4. CNAI states that section 18(f) of the Act also limited open-end investment companies to borrowing from traditional institutional lending sources out of a Congressional concern that public holders of senior securities might be unaware that they were much riskier instruments than senior securities issued by operating companies. Senior securities of investment companies typically were secured by assets that were subject to wide fluctuations in value. Further, common shareholders could redeem at any time, which also might affect an open-end investment company's ability to repay its outstanding debt.

5. CNAI argues that the Loan Facilities do not involve the type of senior security holder that section 18(f)(1) of the Act was designed to protect and that the structure of the Loan Facilities and related Conduits provide sufficient protection to the parties that face any risk of loss by lending to an open-end investment company. A Conduit is administered by CNAI, which has extensive expertise in administering loans collateralized by financial instruments that equals or