



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

DIVISION OF
INVESTMENT MANAGEMENT

December 6, 1995

Ms. Maxine Harry
4978 Dalton Drive
Columbia, MD 21045

ACT ICA
SECTION 3(a)(1)
RULE _____
PUBLIC
AVAILABILITY 12/6/95

Dear Ms. Harry:

In our recent telephone conversation, you indicated that you are considering organizing an "investment club." You requested our guidance generally as to whether an investment club must be registered with the Securities and Exchange Commission ("SEC").

The initial question that must be considered is whether the investment club must be registered with the SEC as an "investment company" under the Investment Company Act of 1940 ("1940 Act").¹ As described in more detail below, most investment clubs are not required to register as investment companies, either because the club does not issue interests that are "securities," or because the club's membership interests are privately offered and are not held beneficially by more than 100 persons.

An investment club will only be required to register under the 1940 Act if (1) the club invests in securities, (2) the club issues membership interests that are themselves securities, and (3) no exclusion from the definition of investment company is available. While an investment club typically will invest in securities, its membership interests may not be securities.

A membership interest in an investment club would be a security if it is an "investment contract."² To determine whether an investment contract exists, we look to the "presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or

¹ Section 3(a)(1) of the 1940 Act defines "investment company" as "any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading securities [...]" A partnership (the organizational form of many investment clubs) is included in the definition of "company" for 1940 Act purposes. See Sections 2(a)(8), 2(a)(22), and 2(a)(28) of the 1940 Act.

² Section 2(a)(36) of the 1940 Act includes in the definition of "security" any investment contract.

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managerial efforts of others."³ Generally, where all of the members of an investment club participate actively in managing the club, the membership interests in the club would not be securities because a member would not rely on the entrepreneurial or management expertise of others.⁴ The investment club therefore would not be an investment company subject to regulation under the 1940 Act. In contrast, an investment club with passive members may be issuing securities.

Even if the club's membership interests are securities, many clubs rely on the "private investment company" exclusion from the definition of investment company. Section 3(c)(1) excludes from regulation under the 1940 Act any issuer that is not making and does not propose to make a public offering of its securities and whose securities are owned by 100 or fewer shareholders. An investment club that has passive members (and that therefore may be issuing securities) may rely on this exception to avoid regulation as an investment company. I am enclosing a copy of the SEC's Investment Company Registration Package, which contains a SEC release discussing when a public offering exists.⁵ I am also enclosing an article from the Business Lawyer that discusses Section 3(c)(1) of the 1940 Act in more detail.

In addition, you may wish to consult the appropriate state securities regulatory authority (authorities). The names and addresses of securities regulators in the state of Maryland and other states can be obtained by contacting the North American Securities Administrators Association, Inc., One Massachusetts Ave., N.W., Suite 410, Washington, D.C. 20001, Tel: (202) 737-0900. You may also want to speak with an attorney experienced in federal and state securities laws.

³ United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975) (emphasis supplied).


⁴ If the membership interests are not securities, they need not be registered as such under the Securities Act of 1933 ("1933 Act").

⁵ See Securities Act Rel. No. 4552 (Nov. 6, 1962). Securities sold in a private offering generally need not be registered under the 1933 Act.

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I hope that you will find this information useful. If you have any questions relating to specific provisions of the 1940 Act, you may call this office at (202) 942-0659.

Sincerely,


Natalie S. Bej
Attorney
Office of Chief Counsel

Enclosures