

PUBLIC

30 DEC 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-747-CC
Global Exempt Certificates
of Ownership in NHA MBS
Securities Inc.
File No. 132-3

Your letter of November 11, 1994 requests our assurance that we would not recommend enforcement action to the Commission if Global Exempt Certificates of Ownership in NHA MBS Securities Inc. ("Global ECONS") issues securities without registering under the Investment Company Act of 1940 ("1940 Act") in reliance on rule 3a-7 thereunder. 1/

Global ECONS, a wholly owned Canadian subsidiary of Goldman Sachs Canada, proposes to acquire pools of NHA Mortgage-Backed Securities ("Underlying Securities") that evidence interests in pools of residential mortgages insured by an agency of the Canadian government. Global ECONS will issue and sell in the U.S. and in other countries certificates that provide holders with undivided co-ownership interests in the Underlying Securities ("Certificates").

Global ECONS will convey all of its right, title, and interest in a specific pool of Underlying Securities and the right to receive all payments thereon to a trustee ("Trustee") that meets the requirements of section 26(a)(1) of the 1940 Act. As required by paragraph (a)(4)(i) of rule 3a-7, the Trustee will not be affiliated with Global ECONS or Goldman Sachs Canada. 2/

The Trustee will act in various capacities as agent, nominee, and trustee for and on behalf of the Certificateholders. In its capacity as trustee, the Trustee will hold legal title to and act as the registered holder of the Underlying Securities. Beneficial ownership in the Underlying Securities, however, will be conveyed to the Trustee in its capacity as agent and nominee. Upon this conveyance and the issuance of any Certificates, the Certificateholders will hold beneficial ownership in the Underlying Securities as tenants in common, under a co-ownership arrangement between the Trustee as agent and the Certificateholders as principals. You state that the Trustee's ownership interest is valid against third parties and is, in your view, therefore consistent with the requirements and objectives of paragraph (a)(4)(ii) of rule 3a-7.

1/ Rule 3a-7 excludes from the definition of "investment company" certain issuers that pool specified eligible assets and issue securities backed by those assets.

2/ Telephone conversation with Alberto G. Santos on December 14, 1994.

The Trustee's responsibilities are limited under a pooling agreement to holding legal title to the Underlying Securities, receiving payments thereon, and protecting and enforcing its legal title and the rights of Certificateholders against adverse claims or actions. Consistent with paragraph (a)(4)(iii) of rule 3a-7, the Trustee will maintain a segregated account into which distributions on the Underlying Securities will be deposited. The Trustee will have no other managerial or administrative discretion with respect to the Underlying Securities. You state that, under the pooling agreement, the Trustee will agree to perform its rights, powers, and duties in accordance with a standard of care substantially consistent with that agreed to by trustees in typical United States structured financings. 3/

A Canadian bank or trust company will act as co-agent ("Agent") for the Certificateholders to carry out ministerial and administrative functions, including calculating payment amounts due on the Underlying Securities, making distributions to Certificateholders, preparing and sending monthly statements to Certificateholders, and acting as registrar and transfer agent with respect to the Certificates. The Agent will not be affiliated with Global ECONS or Goldman Sachs Canada. 4/

You state that both the conveyance of beneficial ownership to the Trustee as agent and the limitation on the Trustee's functions are necessary under Canadian law to avoid income taxation at the trust level. 5/ You further state that, notwithstanding the limitations on the Trustee's functions and the nature of its interest in the Underlying Securities, you have been advised by Canadian counsel that the Trustee will be subject to the fiduciary obligations of a trustee. 6/

3/ You state that this standard of care is substantially consistent with that imposed on indenture trustees under section 315 of the Trust Indenture Act of 1939.

4/ Id.

5/ In the United States, in contrast, mortgaged-backed financings may achieve pass-through tax treatment by qualifying as a real estate mortgage investment conduit or a grantor trust.

6/ The staff previously declined to interpret the term "trustee" to include a bank acting only as custodian. Brown & Wood (pub. avail. Feb. 24, 1994). The staff's position was premised on the absence of a fiduciary relationship between a custodian and its clients.

On the basis of the facts and representations in your letter and the telephone conversation, we would not recommend enforcement action to the Commission if Global ECONS does not register as an investment company under the 1940 Act in reliance on rule 3a-7.

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November 11, 1994

BY HAND

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

ACT ICA
SECTION -
RULE 3a-7
PUBLIC
AVAILABILITY 12-30-94

Re: Global Exempt Certificates Of Ownership
In NHA MBS Securities Inc.

Ladies and Gentlemen:

Global Exempt Certificates Of Ownership In NHA MBS Securities Inc., an Ontario corporation ("Global ECONS") and a wholly-owned subsidiary of Goldman Sachs Canada ("GS Canada"), proposes to issue and sell series of securities (the "Certificates") representing undivided co-ownership interests in specified pools of NHA Mortgage-Backed Securities (the "Underlying Securities") and the payments thereon. The Underlying Securities are fully guaranteed as to timely payment of principal and interest by Canada Mortgage and Housing Corporation ("CMHC") and carry the full faith and credit of Canada. The Certificates may be distributed in offshore transactions pursuant to Regulation S under the Securities Act of 1933, as amended, and in private placements in the United States, in each case by or through GS Canada or a syndicate of securities dealers managed by GS Canada. Goldman, Sachs & Co., an affiliate

of GS Canada and a broker-dealer registered under Section 15(b) of the Securities Exchange Act of 1934, as amended, would act as the agent of GS Canada in the private placement of Certificates sold in the United States.

On behalf of Global ECONS and GS Canada, we respectfully request that the Staff of the Division of Investment Management advise us that it will not recommend that the Commission take any enforcement action if Global ECONS issues Certificates as described herein without registering under the Investment Company Act of 1940, as amended (the "Act"), in reliance on rule 3a-7 thereunder.

Global ECONS

Global ECONS was incorporated under the laws of the Province of Ontario, Canada, by GS Canada on February 11, 1994 for the purpose of purchasing NHA Mortgage-Backed Securities and selling securities representing interests in or derived from NHA Mortgage-Backed Securities. GS Canada is the sole owner of the share capital of Global ECONS.

The Underlying Securities

Each Certificate will constitute evidence of the right of the holder thereof in and to an undivided co-ownership interest in the Underlying Securities and the right to receive a specified portion of the payments made thereon. The Underlying Securities, in turn, will evidence undivided co-ownership interests in pools of residential mortgages originated by financial institutions in Canada (the "MBS Issuers") and insured by CMHC, the agent of the Government of Canada with respect to the Canadian housing sector. CMHC guarantees the timely payment of principal, interest and penalty interest payments and prepayment bonuses or indemnities payable on each NHA Mortgage-Backed Security. The obligations of CMHC carry the full faith and credit of Canada and constitute obligations of and by Canada.

Proposed Financing Structure

Global ECONS proposes to purchase pools of Underlying Securities from time to time. Pursuant to a pooling agreement relating to a series of Certificates (the "Pooling Agreement"), Global ECONS will convey all of its right, title and interest in a specific pool of Underlying Securities and the right to receive all payments thereon to a corporate trustee (the "Trustee") acting in varying capacities as agent, nominee and trustee for

and on behalf of the holders of the Certificates (the "Certificateholders"). The Trustee, acting in its capacity as trustee, will hold legal title to the Underlying Securities and, as the registered holder thereof, will receive all payments thereon, which it will hold in trust for the benefit of the Certificateholders. Beneficial ownership in the Underlying Securities (as distinct from legal ownership) will be conveyed to the Trustee acting in its capacity as agent and nominee of, for and on behalf of the Certificateholders. Canadian counsel to Global ECONS and GS Canada has advised us that upon conveyance of such beneficial ownership to the Trustee, acting as agent and nominee of the Certificateholders, and the issuance of the Certificates, the beneficial ownership in the Underlying Securities will be owned directly by the Certificateholders, as tenants in common, under a co-ownership arrangement (the "Co-ownership Arrangement") between the Trustee as agent and the Certificateholders as principals.¹

The Trustee's responsibilities under the Pooling Agreement, insofar as it is acting in its capacity as trustee, will be limited to certain matters relating to the legal title to the Underlying Securities, the right to receive payments thereon and the responsibility to protect the rights of the Trustee and the Certificateholders therein. Specifically:

(a) the Trustee will be the sole registered holder of the Underlying Securities on the transfer books maintained on behalf of the applicable MBS Issuers and CMHC;

(b) the Trustee will establish for the exclusive benefit of Certificateholders a segregated account (the "Certificate Account") over which it will have sole dominion and control and into which all monies payable on the

¹ Canadian counsel to Global ECONS and GS Canada has further advised us that there must be a conveyance of beneficial ownership in the Underlying Securities to the Trustee as agent in order to create the Co-ownership Arrangement under Canadian law and that such a co-ownership arrangement is necessary to achieve favorable Canadian income tax treatment of the financing, as described below, and favorable Canadian legal investment treatment of an investment in the Certificates. In effect, as a result of the Co-ownership Arrangement, the Certificateholders will be treated for Canadian income tax and legal investment purposes as if they had invested directly in the Underlying Securities.

Underlying Securities to the Trustee as registered holder will be deposited; and

(c) the Trustee will have the exclusive right to protect and enforce its legal title to and the rights of Certificateholders in the Underlying Securities in the event of a payment default on an Underlying Security or the assertion of a claim or the commencement of an action which might adversely affect the rights of the Trustee or the Certificateholders in the Underlying Securities, in each case by an action or proceeding (a "Protective Action") as determined by the Trustee to be most effectual to protect such title or rights.

The Trustee will not take any Protective Action without receiving instructions or directions from the Certificateholders and the provision of a reasonable indemnity, satisfactory to the Trustee, against any costs or liabilities which may be incurred in the exercise of such power. If, however, the Trustee deems a Protective Action necessary to protect its rights or the rights of Certificateholders in the Underlying Securities, it may take such action or proceeding prior to receipt of instructions or indemnity from the Certificateholders. Except as described in the preceding sentence, the Trustee will have no managerial, administrative or other discretion with respect to the Underlying Securities or the payments thereon, or any power to deal with such assets.

Under the Pooling Agreement, Global ECONS will direct the Trustee to appoint a Canadian bank or trust company to act as a co-agent (the "Agent") for and on behalf of Certificateholders. The Agent will carry out certain customary ministerial and administrative functions in connection with the proposed financing. For example, the Agent will calculate the amount of payments on the Underlying Securities distributable to the various classes of Certificateholders; make distributions to Certificateholders from amounts on deposit in the Certificate Account maintained by the Trustee; prepare and send to Certificateholders monthly remittance statements; maintain an office where Certificates may be surrendered for registration of transfer or exchange and where notices may be delivered; and act as registrar and transfer agent with respect to the Certificates. The Agent will have no property interest in the Underlying Securities or the proceeds thereof.

The proposed financing and the responsibilities of the Trustee and the Agent have been structured to avoid undesirable

Canadian tax consequences while permitting Global ECONS to rely on the exemption from registration under the Act available under rule 3a-7. Canadian counsel to Global ECONS and GS Canada has advised us that income of a trust would be subject to entity-level income taxation in Canada if (a) the beneficial ownership of securities is conveyed to a trustee in trust for designated beneficiaries and such trustee issues certificates of beneficial interest in trust property and (b) significant discretion is granted to the trustee with respect to securities so deposited, beyond the functions of the Trustee described above.² The imposition of an entity-level tax would require the payment of Canadian income tax by the trust on all income earned by the trust on its assets, in effect resulting in a double layer of taxation on the assets backing the financing, with one layer of tax imposed at the trust level and the other at the investor level. Such additional cost could have the effect of making Canadian structured mortgage financings economically infeasible. By contrast, structured mortgage financings in the United States are customarily structured in a manner which does not result in any material double layer of income taxation.³

Consequently, unless Canadian issuers that seek to offer their securities both in Canada and the United States have the flexibility under rule 3a-7 to structure their financings as described above, such issuers could face significant incremental costs compared to United States issuers availing themselves of the REMIC Rules or the Grantor Trust Rules of the Internal Revenue Code. In our opinion, the proposed financing by Global ECONS conforms to the requirements of rule 3a-7. Because the issue is not free from doubt, however, we respectfully request your concurrence in our view.

² As previously noted, such entity-level taxation would not arise if a Canadian co-ownership arrangement is created by the conveyance of beneficial ownership of securities to an entity acting as agent, rather than as a trustee, of security holders.

³ In the United States, structured mortgage financings are generally taxed under the rules governing either "real estate mortgage investment conduits" pursuant to Sections 860A-860G (the "REMIC Rules") of the Internal Revenue Code of 1986 or "grantor trusts" pursuant to Sections 671-679 thereof (the "Grantor Trust Rules"). Such entities are generally not subject to entity-level taxation.

Basis for the No-Action Request

Rule 3a-7 excludes from the definition of "investment company" any issuer that pools certain eligible financial assets and issues securities backed by these assets in accordance with the requirements of such rule.⁴ An issuer relying on rule 3a-7 is required by paragraph (a)(4) thereof to (1) appoint a trustee meeting the requirements of clause (i) of such paragraph; (2) take "reasonable steps" to cause the trustee to have a perfected security interest or ownership interest, valid against third parties, in the assets principally generating the cash flow for payment to security holders; and (3) take such actions as are necessary to have the cash flows from the eligible assets deposited periodically in a segregated account maintained or controlled by the trustee.

Trustee qualifications. In the proposed financing, we understand that Global ECONS will appoint a trustee that meets the requirements of Section 26(a)(1) of the Act and otherwise complies with the eligibility criteria for a trustee set forth in paragraph (a)(4)(i) of rule 3a-7.⁵

Ownership of Eligible Assets. Under the proposed financing structure, the Trustee will have an ownership interest in the Underlying Securities consistent with the requirements and objective of paragraph (a)(4)(ii) of rule 3a-7. Global ECONS will convey and deliver legal right and title to the Underlying Securities to the Trustee. Upon such conveyance and delivery, the Trustee will have the sole ownership interest in the legal right and title to the Underlying Securities, which ownership interest will be valid against third parties. We have been

⁴ In our opinion, the Underlying Securities will constitute "eligible assets" within the meaning of paragraph (b)(1) of rule 3a-7. In addition, we understand from Global ECONS that the requirements of paragraphs (a)(1), (a)(2) and (a)(3) of rule 3a-7 will be met in the proposed financing.

⁵ In Brown & Wood (pub. avail. February 24, 1994), by contrast, the Staff noted that rule 3a-7(a)(4) "specifically requires an issuer to appoint a trustee" and concluded that a custodian bank, although performing the same functions as a trustee, would not meet the requirements of the rule. Under the proposed financing structure, Certificateholders will have the protection of a trustee appointed by Global ECONS.

advised by Canadian counsel that such conveyance and delivery to the Trustee is a transfer in trust for the benefit of the Certificateholders, and that the Trustee will be subject to the fiduciary obligations of a trustee with respect to the property so transferred.⁶ The Pooling Agreement will provide that Certificateholders may not deal with the Underlying Securities or otherwise control the operation, ownership, disposition or management of the Underlying Securities.

Deposit of cash flows. All monies distributed on the Underlying Securities will be deposited promptly after receipt in the Certificate Account, which is a segregated account that will be maintained and controlled by the Trustee, consistent with paragraph (a)(4)(iii) of rule 3a-7.

Based on the foregoing, it is our view that the proposed financing structure adequately protects investors with respect to the safekeeping of the Underlying Securities, thereby serving the purposes intended by rule 3a-7 with respect to the appointment of an independent trustee. See Exclusion from the Definition of Investment Company for Structured Financings, Investment Company Act, Release No. IC-19105, 57 Fed. Reg. 56,248, at 56,255 (November 27, 1992) (the "Issuing Release"). The Trustee's functions are consistent with the requirements of paragraph (a)(4) of rule 3a-7 and not contrary in any material respect to market practice in structured financings in the United States.⁷ The Certificateholders in the proposed financing, as in the case of typical U.S. structured financings, will be afforded the protection that the Trustee may act if its legal right and title to the Underlying Securities is challenged or if there is a default in payment with respect to the Underlying Securities. Under the Pooling Agreement, the Trustee will agree to perform its rights, powers and duties in accordance with a standard of care substantially consistent with that agreed to by

⁶ Property which is the subject matter of a trust may consist of either a legal or equitable interest or both. See Austin W. Scott & William F. Fratcher, *The Law of Trusts* § 2.6 (1987).

⁷ In a typical structured financing in the United States for "pass-through" securities, all legal title and beneficial rights in assets backing the securities are transferred to a trustee, in its capacity as trustee, and the trustee in turn issues securities evidencing the security holders' beneficial ownership of the assets so transferred.

trustees in typical U.S. structured financings.⁸ Certificateholders will have the added protection that the Certificates will not be issued unless they are rated investment-grade by at least one nationally recognized statistical rating organization. To obtain such rating, the rating organization will closely evaluate the functions and responsibilities of the Trustee and the safekeeping arrangements for the underlying assets.

We note that the Staff observed in the Issuing Release that, in proposing rule 3a-7, one of the Commission's objectives was "to accommodate future innovations in the structured finance market, consistent with investor protection." Issuing Release at 56,249. In accordance with such goal, the proposed financing would enable United States investors to invest in securitizations backed by Canadian government-guaranteed mortgage assets without subjecting investors to additional structural risk.

Conclusion

For the reasons set forth above, we respectfully request the concurrence of the Staff in our opinion that the appointment of the Trustee in the manner contemplated in the proposed financing complies with the requirements of paragraph (a)(4) of rule 3a-7.

⁸ Such standard of care is also substantially consistent with that imposed on indenture trustees under Section 315 of the Trust Indenture Act of 1939, as amended.

Office of Chief Counsel,
Division of Investment Management, p. 9

Global ECONS would like the flexibility to proceed with the offering of Certificates as contemplated hereby at the earliest possible time, and would therefore appreciate your earliest consideration of this matter. If for any reason you do not concur in our conclusion, we respectfully request a conference with the Staff prior to any adverse written response to this letter. If you would like to discuss any issues raised in the foregoing, or would like further clarification, please do not hesitate to call David L. Sugerman of this firm at (212) 225-2890 or the undersigned at (212) 225-2422.

Very truly yours,



Alberto G. Santos

cc: Monica L. Parry, Esq.
Jennifer G. Cooperman (Goldman, Sachs & Co.)