

## ICI Comment Letter Seeking Relief for Closed-End Funds' Auction Market Preferred Stock

April 18, 2008

Andrew J. Donohue, Esq.  
Director  
Division of Investment Management  
U. S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Request for Temporary Exemptive Relief from Certain Asset Coverage Requirements in Section 18(a) of the Investment Company Act for Closed-End Funds that Have Issued Auction Market Preferred Stock**

Dear Mr. Donohue:

The Investment Company Institute<sup>1</sup> is submitting a request under Section 6(c) of the Investment Company Act of 1940 for a temporary relaxation of the asset coverage requirements to permit closed-end funds to refinance auction market preferred stock (“AMPS”) outstanding on February 12, 2008.<sup>2</sup> For the last two months, the liquidity crisis that has affected the global markets generally has spilled over to the market for auction rate securities of all types, including those issued by closed-end funds. This is an unprecedented situation that requires swift and creative action by the Commission of the nature already provided by the Commission and other government entities to address, more generally, the liquidity crisis currently faced in the U.S. and other markets. Granting this request will help enable closed-end funds to obtain financing to provide much needed liquidity to closed-end fund preferred shareholders while maintaining the benefits of leverage for common shareholders.

The Institute has worked extensively with its members to develop this proposal and believes that if the requested relief is granted, many closed-end funds will be able to move forward to restore liquidity to their preferred shareholders while acting consistently with the interests of their common shareholders.

Given the time sensitive nature of this request, we request that the Commission make such relief immediately effective upon issuance.<sup>3</sup>

## Background

More than half of the 668 closed-end funds have AMPS outstanding with a total liquidation preference of approximately \$64 billion as of the end of the first quarter of 2008.<sup>4</sup> Closed-end funds typically issue AMPS that pay dividends at rates set through auctions (or in a few cases, remarketings, which are included in the term “auctions” for the purposes of this letter) held every seven or twenty-eight days. Bids are filled to the extent shares are available, and sell orders are filled to the extent there are bids. These auctions have operated successfully for the last twenty years.<sup>5</sup>

The press has widely reported that since mid-February all auctions for AMPS issued by closed-end funds have failed,<sup>6</sup> because there were more shares offered for sale than there were bids. The decreased demand may have resulted from changes in accounting standards, which generally caused AMPS to be treated as short-term instruments rather than cash equivalents, thereby making them a less attractive cash-management tool for businesses<sup>7</sup> and from broker-dealers that customarily bid in these auctions ceasing to do so. While broker-dealers previously submitted enough bids to make auctions successful, they never have been legally obligated to do so. The failed auctions were not caused by defaults under the terms of the AMPS or credit quality concerns with closed-end funds. The assets of closed-end funds, which are valued on a periodic basis, are the collateral underlying the issuance of the AMPS.

Holders of AMPS have continued receiving dividends from funds at a rate equal to a stated spread over a particular market benchmark rate provided in the funds’ organizational documents (“maximum rate”). This maximum rate only has varied slightly from the rates determined at past auctions. However, the maximum rates are much higher than the historic relative norms (e.g., relative to 7-day commercial paper rates). Our members are concerned about paying holders of AMPS a maximum rate for the intermediate or long-term, because as short-term interest rates rise, maximum rates will rise accordingly. As discussed below, AMPS permit funds to engage in leverage to the benefit of common shareholders.

Because auctions are not providing liquidity and there is no established secondary market, AMPS holders wanting to sell their shares are unable to do so. The loss of liquidity in the AMPS market has created significant hardship and uncertainty for many AMPS holders who may have viewed AMPS as akin to a liquid cash alternative. For example, failed auctions have made it difficult for some AMPS holders to make college tuition payments, pay medical bills, or pay their taxes.<sup>8</sup> Small companies that used these securities to manage cash are unable to make payroll or pay other bills and may be close to filing bankruptcy as a result.<sup>9</sup> A charitable foundation can no longer fund programs that help prevent AIDS in Africa, provide indigent people with laser vision correction, and correct the cleft palates of African children.<sup>10</sup>

A few fund firms have announced that they have refinanced, or soon will be refinancing, some or all of the AMPS issued by some of their funds with debt in the near future.<sup>11</sup> Doing so will provide their AMPS holders with liquidity, but replacing all of their outstanding AMPS with debt is not an attractive option for most closed-end funds unless the Commission relaxes the asset coverage requirements for debt to 200 percent. Of the 358 funds with AMPS outstanding, eighty-two percent have asset coverage of at least 200 percent but lower than 300 percent. Only 18 percent of funds with AMPS outstanding have asset coverage of 300 percent or greater.<sup>12</sup>

## Relief Requested

We request that the Commission issue an exemptive order, effective upon issuance and subject to the conditions set forth below, that permits any closed-end fund to issue debt to sophisticated institutional investors for the purpose of redeeming or otherwise replacing the fund's AMPS that were outstanding on February 12, 2008 subject to the asset coverage limits described below.<sup>13</sup> We request that the order, for a three-year period beginning on the date of the order, permit any such fund to declare dividends or other distributions on common stock and to repurchase common stock so long as the fund has asset coverage with respect to its debt of 200 percent at the time of declaration after deducting such dividend, distribution, or repurchase price.<sup>14</sup>

Although we anticipate that this relief will be used primarily by taxable closed-end funds,<sup>15</sup> we request relief for both taxable funds and municipal and other closed-end funds that seek to make tax-exempt distributions to their common shareholders to provide maximum flexibility during this difficult period.<sup>16</sup> We also are aware that some closed-end funds have replaced some or all of their AMPS with debt or have announced plans to do so<sup>17</sup> and may have completed those transactions by the time that this relief is granted. We request that the relief also apply to those funds, as the goal is to place closed-end funds and their shareholders in a position similar to that they were in prior to auctions failing; funds that were able to refinance earlier should not be penalized simply because of this timing.

## Legal Discussion

Section 18 of the Investment Company Act permits closed-end funds to issue preferred stock, debt, or both. It requires debt to have, immediately after issuance, asset coverage<sup>18</sup> of at least 300 percent and preferred stock to have, immediately after issuance, asset coverage of at least 200 percent.<sup>19</sup>

Section 6(c) of the Investment Company Act provides the Commission with authority to exempt any class of person from any requirements of the Investment Company 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 provisions of the Act. The Commission explained the scope of its exemptive authority as being broad power that has been used "in situations where the Investment Company Act by its terms clearly applied, and has rejected the argument that simply because a provision prohibited certain conduct any exemption from that provision was contrary

to the intent of the Act.”<sup>20</sup>

### Analysis

The Commission has authority under Section 6(c) to grant the requested relief. It is consistent with investor protection because it is in the interests of both common and preferred closed-end fund shareholders. Relaxing the asset coverage requirements will remove a regulatory obstacle to closed-end funds seeking debt refinancing of AMPS. Once debt financing is obtained, holders of AMPS that are redeemed<sup>21</sup> will achieve liquidity by receiving the liquidation preference of their shares (plus any dividends payable).<sup>22</sup>

As a general matter, common shareholders benefit from funds maintaining leverage. Funds invest the additional capital raised through leverage in securities that are expected to earn a rate of return over the long-term that exceeds the short-term borrowing cost. The additional income or “spread” is then available for the benefit of the fund’s common shareholders and allows the fund to produce higher long-term returns for its common shareholders. Before relying on the requested relief, a fund’s board would have to determine that the refinancing is in the best interests of all fund shareholders taking into account the interests of both common and preferred shareholders.

The relief we request is consistent with the policy and provisions of the Investment Company Act in general and Section 18(a).

The Investment Company Act states that the national public interest and the interests of investors are adversely affected when investment companies, by excessive borrowing and issuance of excessive amounts of senior securities, increase unduly the speculative character of their junior securities, or when investment companies operate without adequate assets or reserves.<sup>23</sup>

Granting the requested relief would not impede these policies. In particular, closed-end funds would not be engaged in excessive leveraging. Rather, they would be maintaining the same level of leverage they are permitted to engage in today, simply through a different means. Similarly, they would not be operating without adequate assets. They would be required to have two dollars of assets for each one dollar of debt (and other senior securities) upon issuance and thereafter if they declare dividends (except with respect to privately arranged bank debt).

Further, granting the requested relief would be consistent with the policies of Section 18. The legislative history of Section 18 explains that the greater amount of asset coverage for debt as compared to preferred stock was put in place to protect the debt holder.<sup>24</sup> In granting an early exemption from the asset coverage requirements, the Commission explained the general purpose of the asset coverage requirements as being a response to “managements representing the equity interests engaging in a variety of activities which, by design or accident, have tended to impair the asset and income protection of the principal and interest of the debt securities for the benefit and profit of the equity or management interests.”<sup>25</sup>

Such protection is not necessary here because the relief requested would require sophisticated institutional investors such as banks and insurance companies to hold the debt.<sup>26</sup> They would be able to make informed decisions regarding whether their interests would be adequately protected in making a loan on the basis of 200 percent asset coverage. The Commission already has recognized that such a high degree of asset coverage is not necessary in the circumstance where a debt holder is able to adequately protect its interests.<sup>27</sup>

Finally, granting the requested relief is consistent with the public interest because otherwise funds will have to: (1) deleverage; (2) not take steps toward providing AMPS holders with liquidity; or (3) replace AMPS with a new form of preferred stock. Deleveraging may have adverse consequences for holders of common shares, and in this volatile market, any deleveraging could produce further strain on the financial markets.<sup>28</sup> Not facilitating liquidity for preferred shareholders is yet another undesirable outcome.<sup>29</sup> Replacing AMPS with a new form of preferred stock may be an attractive resolution of the current situation but also will require regulatory relief<sup>30</sup> and likely will take a significant amount of time to implement, thus delaying liquidity for preferred shareholders in funds that will be able to take advantage of the requested relief.

Further, granting the requested relief will help to restore liquidity and confidence in the market at a time when both have been unusually stressed.

## Refunding Preferred Stock with Debt

We further request that the Commission provide relief from Section 18(e)(1) of the Investment Company Act to the extent necessary to permit a fund to refinance its AMPS with debt in a single transaction. The Articles Supplementary or other documents governing closed-end fund AMPS typically require a fund desiring to redeem AMPS to provide a redemption notice to holders in advance of the redemption date. The notice period typically runs between twenty and forty-eight days. In addition, many funds are prohibited from sending the notice unless the fund has available “deposit securities” in an amount equal to the redemption price. Deposit securities are variously defined but, in some cases, mean cash, U.S. Treasury securities, and certain other short-term money market instruments.<sup>31</sup> Liquidating portfolio securities in order to have deposit securities on hand is not a practical choice for closed-end funds because it would disrupt portfolio management and otherwise harm common shareholders as previously discussed.<sup>32</sup> Therefore, funds need to obtain debt financing before they can redeem outstanding AMPS. Consequently, a closed-end fund’s asset coverage would fall below 200 percent for the short period of time that both debt and AMPS are deemed outstanding if the fund were to redeem all of its AMPS in a single transaction.

Section 18(e)(1) addresses the temporary noncompliance that arises when one form of leverage replaces another by “exempt[ing] from the provisions of Section 18 senior securities issued by a closed-end fund for the purpose of redeeming any of the fund’s outstanding senior securities,” at least to the extent that the fund’s capital structure would comply with Section 18 at the completion of the

transaction. By its terms, however, Section 18(e)(1) is not available for transactions in which preferred stock is redeemed through the issuance of debt.

Absent this relief, a closed-end fund seeking to replace its AMPS with debt (or for those funds that already have replaced some or all of their AMPS with debt, to replace both its existing debt and AMPS with new debt) in accordance with the Section 18(a) relief discussed above might need to effect such replacement of AMPS and/or debt in a piecemeal fashion to assure that its asset coverage does not ever fall below 200 percent. Requiring funds to undertake multiple redemption transactions will increase expenses for shareholders, significantly delay the fund's redemption of AMPS, which may be subject to an unfavorable maximum rate compared to debt financing that may have more favorable terms, and inappropriately elevate form over substance. Therefore, we request that the Commission permit a closed-end fund to redeem its AMPS with the proceeds of debt financing in a single transaction, provided that following completion of the transaction, the fund has asset coverage of at least 200 percent. The requested relief would be consistent with no-action relief previously granted by the staff.<sup>33</sup>

## Conclusion and Proposed Conditions of Relief

For all of the reasons stated above, we request that the Commission grant the requested relief provided that any closed-end fund relying on the exemptive order meets the conditions provided below.

- The closed-end fund only will apply a 200 percent asset coverage requirement to debt issued to: (i) redeem any or all of its AMPS that were outstanding on February 12, 2008; and/or (ii) refinance or refund any financing previously used to redeem any or all of such AMPS.<sup>34</sup>
- Such debt will be issued only to sophisticated institutional investors, such as banks and insurance companies.
- The closed-end fund will have a minimum of 200 percent asset coverage upon the completion of the transaction that is the subject of this order, and (except with respect to privately arranged bank debt) will not declare a dividend or make any other distribution to common shareholders or repurchase common shares during the three-year period commencing from the date of the order unless the fund has asset coverage of 200 percent after deducting the amount of the dividend, distribution, or purchase price.
- The closed-end fund's board of directors, including a majority of directors that are not interested persons, will find that the proposed transaction is in the best interests of the fund's shareholders, taking into account the interests of the common and preferred shareholders.
- The closed-end fund, in applying the 200 percent asset coverage requirement to debt as permitted by the order, will comply with its organizational documents (including as amended to permit reliance on such order) and any other applicable law.
- The closed-end fund will inform its common shareholders of the replacement of preferred stock with debt and of the applicable asset coverage of such debt by means of press release and posting on its website within a short period of time of obtaining debt financing, and thereafter in its next regularly scheduled shareholder report.
- The order will expire three years from its date of issuance.

We look forward to discussing our request with you at your earliest convenience. Please feel free to contact me at (202) 326-5815, Bob Grohowski at (202) 371-5430, or Dorothy Donohue at (202) 218-3563 if you have any questions or would like additional information.

Sincerely,

Karrie McMillan  
General Counsel

cc: The Honorable Christopher Cox  
The Honorable Paul S. Atkins  
The Honorable Kathleen L. Casey  
Thomas R. Smith, Jr., Senior Adviser to the Director

Elizabeth G. Osterman, Associate Director  
Douglas J. Scheidt, Associate Director and Chief Counsel  
James M. Curtis, Branch Chief  
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Erik R. Sirri, Director  
Division of Market Regulation

## **ENDNOTES**

<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. The 684 closed-end fund members of ICI manage total assets of \$294.6 billion. All ICI members together manage \$12.34 trillion and serve almost 90 million shareholders.

<sup>2</sup> This was the first date on which auctions for most closed-end fund AMPS failed. They have continued to fail since then.

<sup>3</sup> See Investment Company Act Rel. No. 25156 (September 14, 2001) (where the Commission granted immediately effective exemptive relief to the investment company industry in response to disruption in the financial markets caused by the events of September 11, 2001).

<sup>4</sup> See Thomas J. Herzfeld Advisors, *The Investors Guide to Closed-End Funds*, p. 11 (March 2008). ICI data shows that these funds had a market value of \$127 billion in common shares outstanding as of year-end 2007.



- <sup>5</sup> See, e.g., Thomas J. Herzfeld Advisors, *The Investors Guide to Closed-End Funds*, p. 3 (April 2008) (“April Herzfeld”).
- <sup>61</sup> See, e.g., “New Trouble in Auction Rate Securities,” *The New York Times*, p. BU1 (February 15, 2008).
- <sup>7</sup> See, e.g., Structured Fin. Group, PriceWaterhouseCoopers, *Investors’ Classification of Auction Rate Sec.* (March 4, 2005).
- <sup>8</sup> See, e.g., Diya Gullapalli, Susanne Craig, and Liz Rappaport, “The Auction Rate Lockout: Values Tossed Around As Individual Investors Can’t Get at Their Cash,” *Wall Street Journal*, p. C1 (April 3, 2008); Jane J. Kim and Shefali Anand, “Trapped by Market Turmoil: Some Fund Investors Are Locked in as Tax Time Nears,” *Wall Street Journal*, p. B2 (March 1, 2008).
- <sup>9</sup> See, e.g., Rebecca Buckman, “Freeze in Auction-Rate Field Finds Its Way to Silicon Valley,” *Wall Street Journal* p. C1 (March 14, 2008).
- <sup>10</sup> See Gretchen Morgenson, “As Good as Cash, Until It’s Not,” *The New York Times*, p. BU1 (March 9, 2008).
- <sup>11</sup> See, e.g., John Flowers, “Nuveen Starts Auction-Rate Effort at Funds,” *Wall Street Journal*, p. C7 (April 2, 2008).
- <sup>12</sup> April Herzfeld. Funds with greater than 300% asset coverage tend to be equity funds that have experienced appreciation since AMPS were issued. As a practical matter, funds typically maintain a buffer of assets in excess of the minimum asset coverage required. For those funds that would benefit from the requested relief, i.e., those closed-end funds with asset coverage ratios between 200 and 300 percent, the median asset coverage is 271 percent. In addition, 86 percent of these funds have asset coverage of at least 250 percent. See April Herzfeld.
- <sup>13</sup> By the end of the three-year period, funds would be required to satisfy Section 18’s 300 percent asset coverage requirement for debt by replacing the debt with preferred stock, paying down the debt, or otherwise.
- <sup>14</sup> For simplicity, we will refer to dividends, distributions, and purchases hereinafter as “dividends.” Consistent with Section 18(g), we request that the order not restrict a fund from declaring dividends if its asset coverage falls below 200 percent for privately arranged bank debt. See note 19 *infra*.
- <sup>15</sup> One hundred and eighteen taxable funds have \$33 billion in AMPS outstanding. Of these, 71 funds with \$21 billion in AMPS outstanding have asset coverage of greater than 200 percent and less than 300 percent. See April Herzfeld.



<sup>16</sup> Municipal and other closed-end funds that seek to make tax-exempt distributions to their common shareholders also are able to pass through tax-exempt dividends to preferred shareholders. This means that those funds are generally able to pay preferred shareholders dividends at lower rates (because of the federal and/or state tax exemption of those dividends) as compared to dividend rates paid by taxable funds (whose dividends are taxable). If a municipal fund were to use debt financing, the interest paid to the debt holder would be taxable and, therefore, would be set at a taxable rate.

<sup>17</sup> Supra note 11.

<sup>18</sup> Section 18(h) defines asset coverage of a senior debt security as the ratio which the value of the fund's total assets less all liabilities and indebtedness not represented by senior securities bears to the aggregate amount of senior debt securities.

<sup>19</sup> See Section 18(a)(1)(A) and Section 18(a)(2)(A), respectively. Section 18 also prohibits funds from declaring dividends, unless such senior securities have at the time of declaring such dividend their requisite asset coverage (after deducting the amount of any such dividend). See Section 18(a)(1)(B) (regarding debt) and Section (a)(2)(B) (regarding preferred stock). Section 18(g) makes the restrictions on dividend payments inapplicable in the case of privately arranged bank debt.

<sup>20</sup> See Investment Company Act Rel. No. 17534 (June 15, 1990) (soliciting comments on reform of the regulation of investment companies).

<sup>21</sup> The organizational documents of closed-end fund that have issued AMPS typically provide that the AMPS are redeemable at the fund's option provided that certain procedures are followed.

<sup>22</sup> Some brokers have written down the value of these shares in their own and their customers' accounts. Other brokers continue to account for them at liquidation preference. We understand that the write down resulted from liquidity concerns and not from any other diminution in the value of the AMPS. We note that funds that have redeemed, or announced that they soon will redeem, AMPS are doing so at liquidation preference (plus any dividends payable).

<sup>23</sup> Section 1(b) of the Investment Company Act.

<sup>24</sup> See Hearings on S.3580 before a Subcommittee of the Committee on Banking and Currency, U. S. Senate, at 1116-17 (1940) (where David Schenker testified that "[s]ince the debenture holder gets a smaller return than the preferred stockholder, and since he is a creditor of the company, rather than having an equity interest in the company, as the preferred stockholder holds, he ought to have more security than the person who is a preferred stockholder. That is the reason for distinguishing between those two situations.").

<sup>25</sup> In the Matter of G.E. Employees Securities Corporation, Investment Company Act Rel. No. 271 (December 2, 1941) (CCH) ¶75,226 at p. 75,524. See also Report of the Securities and Exchange

Commission Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies (1940) at p. 1803 (noting that one of the abuses that existed prior to enactment of the Investment Company Act in the investment company industry was that provisions intended to protect debt holders were rarely enforced or enforceable and that in other instances no safeguards were made available to bond and debenture holders).

<sup>26</sup> Other sophisticated institutional investors could include dealers and special purpose entities that issue commercial paper and are backed by banks. We have not precisely identified all possible lenders because we do not want to limit the universe in a way that will require individual firms to seek individual exemptive orders to borrow from sophisticated institutional investors that we were unable to identify at the time of submitting our request.

<sup>27</sup> See Frankel, Tamar, *The Regulation of Money Managers* at p. 21-91 (stating that the Commission has provided exemptions from the asset coverage requirements where senior security holders were legally able to protect their interests, citing *United States & Intl. Sec. Corp., Investment Company Act Rel. No. 1313 (1949)* (wholly-owned subsidiary issued debt and stock to parent company, which together represented price of portfolio securities sold by parent to subsidiary at market price; subsidiary's stock and note would be held solely by parent and would not be transferred) and *St. Louis Midwest Co., Investment Company Act Rel. No. 1766 (1952)* (investment company established to enable employees to purchase stock in their employer company from estate; estate would sell stock to investment company for investment company's notes; purchased stock would be put in voting trust; voting control of stock would be vested in persons controlling voting trust). See also Frankel at p. 21-92 (stating that Section 18(k) of the Investment Company Act exempts loans from the Small Business Administration to small business investment companies from the asset coverage requirements, presumably because the SBA can bargain to provide appropriate protections for its investments).

<sup>28</sup> Some have suggested that funds simply deleverage -- sell portfolio securities and use the sale proceeds to redeem preferred shareholders instead of refinancing AMPS with debt. Many fund boards may find it difficult to approve of a fund deleveraging in the current market environment because of the negative effects it would have on common shareholders in that it would deprive common shareholders of the accretive long-term benefits of leverage, cause funds to incur transaction costs, and possibly cause tax recognition events. Given the current volatile market conditions, such sales may depress net asset values for closed-end funds, which would further disadvantage common shareholders by reducing the value of their investments. This is particularly likely for bank loan funds, real estate investment trust funds, and municipal securities funds because the market for these securities is unusually weak at the present time.

Moreover, in this volatile market, extensive deleveraging could produce further strain on the financial markets, particularly in the municipal securities market. As of year-end 2007, all registered investment companies held approximately \$925 billion in municipal securities accounting for 35 percent of total

municipal securities outstanding. For this same time period, closed-end funds held approximately \$92 billion in municipal securities, accounting for approximately three percent of total municipal securities outstanding. Not granting the requested relief will make it more likely that some portion of closed-end funds will determine that deleveraging is the option that best serves the interests of their common and preferred shareholders (e.g., if rising maximum rates were to make it uneconomical to leave the AMPS outstanding). Such sales likely will create downward pressure on the net asset values of mutual funds, money market funds, unit investment trusts, other closed-end funds, and exchange-traded funds that hold municipal securities. Implicitly encouraging widespread sales of municipal securities by closed-end funds would be at odds with the Commission's view that it should be careful not to trigger unnecessary sales of securities in the interest of the integrity of the municipal marketplace. See Statement of Erik R. Sirri, Director, Division of Trading and Markets, U.S. Securities and Exchange Commission Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (February 14, 2008).

<sup>29</sup> See text accompanying notes 8, 9, and 10 *supra*.

<sup>30</sup> See, e.g., Merrill Lynch Investment Managers (May 10, 2002) (where the staff agreed not to recommend enforcement action if a money market fund bought AMPS subject to a demand feature) ("MLIM Letter"). By means of a separate request, we are asking that the staff modify the MLIM Letter.

<sup>31</sup> In other cases, deposit securities have been deemed to include a commitment from a lender. These closed-end funds need the requested relief (though for a shorter period of time) because such funds in the nature of deposit securities typically must be deposited with the auction agent the day before the redemption occurs in order to defease the preferred shares.

<sup>32</sup> See note 28 *supra*.

<sup>33</sup> See The New America High Income Fund, Inc. (July 29, 1993) (where the staff agreed not to recommend enforcement action if a closed-end fund's asset coverage declined below permissible levels when it refinanced outstanding debt and auction rate stock with a new issue of auction rate stock so long as at the completion of the redemption, the fund's asset coverage complied with Section 18).

<sup>34</sup> It may be necessary for a fund to refinance existing debt as part of a transaction to redeem AMPS with other debt because, for example, a lender may not permit a fund to take on additional credit arrangements.