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October 9, 1980

INVESTMENT COMPANY ACT OF 1940
SECTIONS 3(c)(5) and 6(c)

Act ICA-40
Section 3(c)(5) (c)
Rule
Public Availability 5/11/81

BY HAND

Sidney L. Cimmet, Esquire
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
500 North Capitol Street, Northwest
Washington, D. C. 20549

Re: American Home Finance Corporation

Dear Mr. Cimmet:

Our client, American Home Finance Corporation ("Finance"), is preparing to file with the Securities and Exchange Commission a Registration Statement on Form S-11 relating to a proposed issuance of bonds which will be secured by mortgage-backed certificates guaranteed by the Government National Mortgage Association.

Accompanying this letter is a letter requesting the Division to advise us that it will take a "no-action" position with respect to the issuance of the bonds described without registration of Finance under the Investment Company Act of 1940 (the "Act"). Alternatively, the letter requests that Finance be exempted from the provisions of such Act pursuant to Section 6(c) thereof.

Reference is made to two letters dated September 30, 1980 from Joseph G. Connolly to you requesting similiar advice or exemption based on a different set of facts. Since the submission of the September 30 letters, Finance has decided to restructure the proposed bond offering and, accordingly, the "no-action" request accompanying this letter is hereby submitted. We further respectfully request that the September 30 letters be withdrawn from your consideration.

Continental. The financing will be accomplished through the issuance by Finance of 30-year bonds in series, each series to be secured by mortgage-backed certificates (the "GNMA Certificates") issued by Mortgage and guaranteed by the Government National Mortgage Association ("GNMA"), together with a cash reserve fund. The GNMA Certificates securing each series will be selected and transferred to Finance prior to the issuance of that series. Finance will not acquire or dispose of any GNMA Certificates other than in connection with the original issuance of each series of bonds. The cash reserve funds, which will constitute less than 10% of Finance's assets, may be invested only in short-term obligations of the U.S. government or any agency thereof, obligations of the Federal National Mortgage Association, prime commercial paper, and bank deposits or certificates of deposit. Payments received with respect to the GNMA Certificates may be temporarily invested in the same manner.

Finance will not engage in any other business and is not expected to have any significant assets other than those securing the bonds.

Section 3(c)(5) of the Act provides an exemption from registration as an investment company for "any person who is not engaged in the business of issuing redeemable securities . . . and who is primarily engaged in . . . (C) purchasing or otherwise acquiring mortgages or other liens on or interests in real estate."

Finance Engaged In Purchasing Interests In Real Estate

The bonds to be issued by Finance will be secured by GNMA Certificates purchased by Finance from Mortgage, the issuer of the GNMA Certificates. The nature of the GNMA Certificates as "interests in real estate" is best understood by reviewing the procedure pursuant to which they are issued.

Mortgage, as originator of mortgage loans on single family residences constructed and sold by American Continental, assigns the mortgage loans to a custodian for the benefit of GNMA, and pays GNMA a fee, in exchange for GNMA's agreement to guarantee mortgage-backed certificates to be issued by Mortgage. The GNMA Certificates are based on and backed by all of the mortgage loans pooled by Mortgage and held by the custodian. They provide for the payment by Mortgage to the certificate-holder of fixed monthly payments of principal and interest, plus pass-through to such holders of prepayments made on the mortgage loans and proceeds of foreclosures. In the event that

Mortgage is unable to pay the amounts due on the GNMA Certificates, GNMA will make such payment directly to the certificate holder.

The GNMA Certificate by its terms represents an undivided interest in the pool of mortgage loans which secures it. Ihe GNMA Certificate states:

> "FURTHER, THE ISSUER CERTIFIES: That this Certificate, and each of the like securities composing the entire issue of which it is a part, is proportionately based on and backed by all the mortgages pooled by the Issuer and identified collectively in the records of the Government National Mortgage Association by the mortgage pool set forth herein, all such mortgages being insured under the National Housing Act or Title V of the Housing Act of 1949, or insured or guaranteed under the Servicemen's Readjustment Act of 1944 or Chapter 37 or Title 38, United States Code; and that with respect to this Certificate, the base and backing is in the proportion that the principal amount set forth bears to the total of such pool, such total being equal to the aggregate of the principal amounts of like securities composing the entire issue of which this Certificate is a part, and being equal to the aggregate of the principal amounts outstanding on the mortgages composing such pool, <u>and that the Holder is the owner of an undivided beneficial interest in the pool, in the foregoing proportion</u>." (emphasis added).

Accordingly, the GNMA Certificates represent an interest in real estate, i.e., the underlying mortgages.

<u>Bonds Are Not Redeemable Securities</u>

We understand that debt securities are customarily structured to permit the holders thereof, at their option, to redeem the securities at their principal amount prior to stated maturity, subject to certain dollar limitations as to each holder. In the case of the bonds, it is proposed that rather than the issuer creating a fixed annual fund such redemptions may be made only to the extent of payments of principal of the underlying GNMA Certificate derived from scheduled amortization, prepayments, foreclosures and insurance proceeds of the residential mortgage loans securing the GNMA Certificate. Finance would not, in any calendar quarter, redeem more than $10,000 in principal amount of any series of bonds held by any one holder, unless the record holder of the bonds in question was deceased.

It is expected that the primary source of funds for redemptions will be pass-through payments of the underlying GNMA Certificates through prepayments of the residential mortgage loans securing the GNMA Certificates. The prepayment pattern of any particular group of residential mortgage loans cannot be predicted; however, the experience of the Federal Housing Administration and the mortgage banking industry suggests that a large portion of the underlying mortgage loans will be prepaid prior to maturity of the bonds.

Prior to 1970, Section 3(c)(5) of the Act did not condition the availability of the exemption on not being engaged in the business of issuing redeemable securities. The legislative history of the 1970 amendment which added that condition indicates that "The amendment applies only to those companies which purport to model themselves after open-end companies by issuing a security redeemable at the option of the holder."[1]

Section 2(a)(32) of the Act defines a "redeemable security" as:

> any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.

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1 Report of the Senate Committee on Banking and Currency, dated May 21, 1969, 1970-3 U.S. Code Congressional and Administrative News, p. 4933.

The proposed redemption features of the bonds do not appear to come within the terms of this definition. Holders of the bonds are neither absolutely entitled to redeem them nor only entitled to redeem them out of surplus; rather, redemptions are made from the liquidation of the underlying GNMA Certificates through scheduled amortization, prepayments, foreclosure and insurance proceeds of the residential mortgage loans securing the GNMA Certificates. In addition, the amount received upon redemption is limited to the principal amount of the redeemed bonds and is not based upon a proportionate share of the issuer's current net assets.

General

Finally, neither the proposed operations of Finance nor the proposed plan of distribution resembles those of a typical open-end company, which is engaged in a continuous offering of its own securities as well as continuous purchases and sales of the securities of others.

Based on the foregoing, we respectfully request that the Division take a "no-action" position with respect to Finance's status as an investment company and the proposed issuance of its bonds. If the Division concludes that it is unable to do so, we respectfully request that the Division recommend to the Commission that Finance be exempted from the provisions of the Act pursuant to Section 6(c) thereof.

Very truly yours,

Joseph G. Connolly

Joseph G. Connolly

09 APR 1981

PUBLIC

Our Ref. No. 80-314-CC
American Home Finance Corporation
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Based on the representations contained in your letters of October 9, November 3, and December 3, 1980, we would not recommend any action to the Commission against American Home Finance Corporation ("Finance") under the Investment Company Act of 1940 ("Act") if, without registering under the Act in reliance upon your opinion as counsel that it is excepted from the definition of "investment company" by Section 3(c)(5)(C) of the Act, it engages primarily in investing in modified pass-through certificates guaranteed by the Government National Mortgage Association ("GNMA certificates") and issues series of bonds secured by such GNMA certificates.

As we understand it, Finance will own all of the GNMA certificates which are based on and backed by a pool of mortgages underlying any GNMA certificate it owns, and Finance will hold such GNMA certificates until they mature or are paid off or until Finance repurchases all of the bonds which it has issued that are secured by said GNMA certificates. In these circumstances, we would consider the GNMA certificates, although they are clearly securities within the meaning of Section 2(a)(36) of the Act, to be included within the phrase "mortgages and other liens on and interests in real estate" in Section 3(c)(5)(C) of the Act.

Furthermore, we understand that there are three ways that holders of Finance's bonds could receive payment of the principal amount of their bonds, plus accrued interest, prior to maturity: at the bondholder's option, at Finance's option, or mandatorily, as required by the bond indenture. Payments at the bondholder's option would be limited quarterly for each series to the the extent that Finance has sums available in that series of bonds' redemption fund (consisting of scheduled payments and prepayments of principal on the GNMA certificate securing that series of bonds) and, unless the redemption fund has amounts available to satisfy all prepayment requests, only up to $10,000 per bondholder ($100,000 if the estate of a deceased bondholder makes the request). Under these circumstances, we would not consider Finance's bonds to be redeemable securities for purposes of Section 3(c)(5)(C) of the Act.

Stanley B. Judd

Stanley B. Judd
Deputy Chief Counsel

LKoltun/jab/jlw

CC: NYRO WRO (under §2(a)(32))

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October 9, 1980

INVESTMENT COMPANY ACT OF 1940 -
SECTIONS 3(c)(5) and 6(c)

<u>BY HAND</u>

Sidney L. Cimmet, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Re: <u>American Home Finance Corporation</u>

Dear Mr. Cimmet:

We are counsel to American Home Finance Corporation ("Finance"), a wholly-owned subsidiary of American Continental Mortgage Company ("Mortgage"), which is in turn a wholly-owned subsidiary of American Continental Corporation ("American Continental").

On behalf of Finance, we respectfully request that the Division advise us that it will take a "no-action" position with respect to the issuance of the bonds described below, without registration of Finance under the Investment Company Act of 1940 (the "Act"). Alternatively, if the Division is unable to take a "no-action" position, we respectfully request that Finance be exempted from the provisions of the Act pursuant to Section 6(c) thereof.

Finance was organized recently by American Continental and Mortgage in order to facilitate the financing of residential mortgages on homes manufactured and sold by American

We would very much appreciate having the opportunity to discuss the accompanying letter with you prior to the taking of any action which might be adverse to the request contained therein. Please feel free to call Joseph G. Connolly (or, in his absence, the undersigned) collect (212-759-8400) if you wish to discuss any aspect of this request.

Very truly yours,

Joshua E. Fishman

Enclosure

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November 3, 1980

FEDERAL EXPRESS

Lawrence W. Koltun, Esq.
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington. D.C. 20549

Re: American Home Finance Corporation

Dear Larry:

In accordance with our discussion today, enclosed are four copies of a supplement to our request for "no-action" dated October 9, 1980. Also, enclosed is a copy of our September 30, 1980 letter.

Sincerely yours,

Joshua E. Fishman

JEF/mle
Enclosures

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November 3, 1980

INVESTMENT COMPANY ACT OF 1940 -
SECTIONS 3(c)(5) and 6(c)

FEDERAL EXPRESS

Lawrence W. Koltun, Esq.
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Re: American Home Finance Corporation

Dear Mr. Koltun:

This letter supplements our letter dated October 9, 1980 relating to the proposed issuance of bonds by our client, American Home Finance Corporation ("Finance"). Since the submission of that letter, Finance has negotiated certain changes in the proposed offering with a prospective underwriter, which changes relate primarily to the redemption features of the bonds to be offered.

It is currently contemplated that the bonds will be subject to redemption (a) at the option of the holders subject to certain limitations and (b) at the option of Finance under certain circumstances. In addition, Finance will be obligated to redeem bonds under other more limited circumstances.

Optional Redemptions

Bondholders will have the right to request that their bonds be redeemed on a quarterly basis. Such redemptions will be limited to amounts in a Redemption Fund consisting of payments of principal of the GNMA Certificates securing the bonds derived from scheduled amortization, prepayments, foreclosures and insurance proceeds of the residential mortgage loans securing the GNMA Certificates. Finance would not, in any calendar quarter, redeem more than $10,000 in principal amount of any series of bonds held by any one holder, unless the record holder of the bonds in question was deceased or unless there were amounts remaining in the Redemption Fund after redeeming bonds of other holders within the $10,000 limitation.

Optional Redemptions by Finance

As currently contemplated, Finance will be entitled to redeem bonds of any series (1) prior to the 6th anniversary of the issuance of such series, if the outstanding principal balance of the GNMA Certificates securing such series of bonds declined to 20% of the original principal balance of such GNMA Certificates (which reduction would indicate that the Certificates, and the underlying mortgage loans, would have been substantially prepaid), and (2) at any time on or after the 6th anniversary of the issuance of such series.

Mandatory Redemptions by Finance

It is anticipated that Finance will be obligated to redeem bonds of a series quarterly, to the extent any amounts remain in the Redemption Fund after making all redemptions at the option of the holders, if (a) the Redemption Fund cannot be invested (in short-term obligations of the United States Government or any agency thereof, obligations of the Federal National Mortgage Association, prime commercial paper, and bank deposits or certificates of deposits) at a rate of interest at least equal to the rate on a series of bonds and (b) the cash reserve fund (which is pledged as additional security for such series of bonds) has been reduced below 75% of its required level.

In the case of all redemptions, whether at the option of the holders or Finance, the redemption price will be equal to 100% of the unpaid principal amount of the bond plus accrued but unpaid interest.

Although the redemption features described herein are slightly different from the features described in our October 9 letter, we continue to be of the opinion that these redemption features do not cause the bonds to come within the terms of the definition of "redeemable security" in Section 2(a)(32) of the Investment Company Act of 1940. Holders of the bonds continue to be neither absolutely entitled to redeem them nor only entitled to redeem them out of surplus; rather, redemptions are made from a Redemption Fund consisting of payments resulting from the liquidation of the underlying GNMA Certificates. In addition, the amount to be received upon redemption will be limited to the principal amount of the redeemed bonds plus accrued interest and will not be based upon a proportionate share of Finance's current net assets.

Please feel free to call the undersigned (or, in his absence, Joshua E. Fishman) if you have any further questions regarding this matter.

Very truly yours,

Joseph G. Connolly

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December 3, 1980

INVESTMENT COMPANY ACT OF 1940 -
SECTIONS 3(c)(5) and 6(c)

<u>FEDERAL EXPRESS</u>

Lawrence W. Koltun, Esq.
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Re: <u>American Home Finance Corporation</u>

Dear Mr. Koltun:

This letter supplements our letters dated October 9, 1980 and November 3, 1980 relating to the proposed issuance of bonds by our client, American Home Finance Corporation ("Finance"), a wholly-owned subsidiary of American Continental Mortgage Company ("Mortgage"). This letter is intended to respond to certain questions raised in connection with the proposed offering and to confirm certain information previously furnished you orally.

<u>Creation of GNMA Pool and Issuance of Certificate</u>

As previously described in our letter dated October 9, 1980, each series of bonds to be issued by Finance will primarily be secured by one or more mortgage-backed certificates ("GNMA Certificates"). Mortgage, as originator of mortgage loans on single-family residences constructed and sold by American Continental Corporation (Mortgage's parent corporation) and its affiliates, assigns the mortgage loans to a custodian for the benefit of the Government National Mortgage Association ("GNMA"), and pays GNMA a fee, in exchange for GNMA's agreement to guaranty mortgage-backed certificates to be issued by Mortgage.

As presently contemplated, each GNMA Certificate issued by Mortgage to Finance will represent the entire beneficial interest in the pool of mortgages backing such GNMA Certificate. (For example, if a $2,000,000 pool of mortgages is created, one GNMA Certificate, representing the beneficial interest in all of those mortgages, will be issued to Finance and no other party will have a beneficial interest in that pool of mortgages.)

The mortgage loans backing each GNMA Certificate securing a series of bonds will be either mortgage loans insured by the Federal Housing Administration (and may be either level payment mortgage loans or graduated payment mortgage loans) or mortgage loans guaranteed by the Veterans Administration and will consist of first mortgage loans on single-family residences constructed by American Continental Corporation or its affiliates, as well as first mortgage loans on other single-family residences, all of which will be originated by Mortgage.

<u>Finance's Ownership of GNMA Certificates as an Investment in an Interest in Real Estate</u>

It is our view that Finance's ownership of GNMA Certificates for the purpose of issuing bonds secured by such Certificates constitutes an investment in real estate within the meaning of Section 3(c)(5)(C) of the Investment Company Act of 1940. We view Finance's activities as being no different in substance from the activities of U.S. Home Finance Corporation ("U.S. Home") which was granted a no-action letter by the staff in reliance on Section 3(c)(5)(C). (Letter available May 30, 1980.) In both the U.S. Home case and Finance's case, the purpose for the issuance of the bonds is to finance mortgage loans in order to facilitate the home-selling activities of the parent corporations.

In the U.S. Home case, U.S. Home purchased mortgage loans originated by its parent corporation and pledged those mortgage loans as security for the issuance of series of bonds by U.S. Home. Those mortgage loans were conventional mortgage loans and were partially insured by private mortgage insurance.

The primary difference between the U.S. Home case and the case presented here is, in our view, the form by which Mortgage, in substance, insures its mortgage loans. In lieu of private mortgage insurance on the FHA and VA mortgage loans after their purchase by Finance (if the transaction were patterned after the U.S. Home transaction), Mortgage is in effect obtaining the guaranty of GNMA on its mortgage loans prior to their transfer to Finance. Accordingly, the GNMA certificate issued by Mortgage represents merely a different form of insurance for its mortgage loans. In addition, the GNMA guaranty is a less expensive method of obtaining insurance for the mortgage loans than comparable private insurance would be. Finally, Finance believes that the presence of the GNMA guaranty, as opposed to the private insurance used by U.S. Home will enable it to issue its bonds at relatively lower rates of interest.

We also believe that Finance's activities differ markedly from the typical unit investment trusts which purchase securities of other persons and then issue participations in such securities. In our case, the GNMA Certificates are issued by Finance's parent in connection with its normal practice of financing its mortgage loans and as part of an overall business plan by American Continental Corporation in implementation of its home building activities.

Marketing of Bonds

The bonds to be issued by Finance will be marketed by means of a prospectus which, while recognizing that the bonds are primarily secured by GNMA Certificates the full and timely payment of principal of and interest on which is guaranteed by GNMA, makes clear that the bonds themselves are an obligation solely of Finance and are not guaranteed by GNMA. The payment and redemption terms of the bonds, as previously described in our November 3, 1980 letter, are substantially different from those applicable to direct purchases of GNMA Certificates. In addition, while there is no risk to a holder of a GNMA Certificate, there are risks to the holder of the bonds arising primarily from the fact that principal prepayments on the GNMA

Certificates received by Finance are not automatically paid to bondholders (as they are to holders of the GNMA Certificates themselves) and must be reinvested at a rate comparable to the rate on the bonds in order to provide sufficient income for the payment of interest on the bonds.

Redemption Features of the Bonds

In our letter dated November 3, 1980, we elaborated on the various redemption features applicable to the bonds: optional redemption by bondholders, mandatory redemptions by Finance and optional redemptions by Finance.

All redemptions of bonds either at the option of the bondholders or mandatory redemptions by Finance will be made only to the extent of funds available in a redemption fund consisting of undistributed principal payments on the GNMA Certificates (including, e.g., prepayment of GNMA Certificates resulting from principal prepayment and proceeds of liquidation on the mortgage loans backing the GNMA Certificates). Optional redemptions by Finance (which may only be redemptions of the entire outstanding principal amount of a series of bonds and not a partial redemption) may be made from both the redemption fund and from funds otherwise acquired by Finance. All mandatory redemptions by Finance will be made by random selection.

Please feel free to call the undersigned (or, in his absence Joshua E. Fishman) if you have any further questions regarding this matter.

Very truly yours,

Joseph G. Connolly