

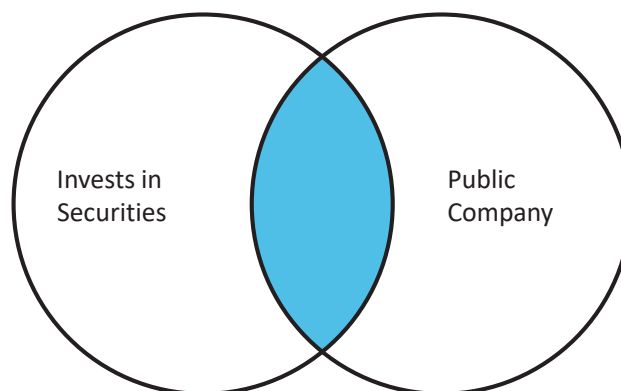
An Introduction to the Investment Company Act of 1940 and Recent SEC Rules

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Investment Company Act of 1940



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Definition of Investment Company

- **Orthodox Investment Company:** engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities
- **Inadvertent Investment Company:** owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of government securities and cash items) on an unconsolidated basis

Inadvertent Investment Companies

- An operating company raises capital to finance its operations and invests the capital in short-term, high quality debt securities
- An operating company sells a substantial subsidiary and, pending redeployment of the sale proceeds, invests the funds in securities
- Private equity company loses majority ownership in subsidiaries to meet redemptions

Inadvertent Investment Companies

- An operating company with strong cash flows, particularly irregular cash flows, seeks to increase the earnings on its cash reserves by investing in bonds or equity securities
- An operating company invests a substantial portion of its assets in securities of subsidiaries that are less than majority-owned
- An operating company that has relatively few “good assets” on its books

Consequences of Not Registering

- A company that operates as an unregistered investment company would violate various substantive provisions of the 1940 Act
- Any contract made in violation of the 1940 Act, or whose performance involves such a violation, is unenforceable

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