



COMMISSIONER OF FINANCIAL INSTITUTIONS
GOVERNMENT OF PUERTO RICO

JOSEPH P. O'NEILL
COMMISSIONER

CIRCULAR LETTER 96-5105-3

TO : ELIGIBLE INSTITUTIONS

RE : APPLICATION OF SECTION 6.5.7 (a) (i) OF REGULATION
5105 TO TRANSACTIONS WITH FIXED MATURITIES OF FIVE
(5) YEARS OR MORE THAT ARE TERMINATED PRIOR TO
MATURITY AS A RESULT OF THE REPEAL OF SECTION 936
OF THE U.S. INTERNAL REVENUE CODE.

DATE: September 16, 1996

AUTHORITY

This Circular Letter is issued by this, the Office of the Commissioner of Financial Institutions (the "Office"), pursuant to the provisions of Articles 10(a) (2) and 10(a) (8) of Act Number 4 of October 11, 1985 and Articles 3 and 11 of Regulation 5105.

PURPOSE

The purpose of this Circular Letter is to clarify the tenor of the exemption provided by Section 6.5.7(a) (i) of Regulation 5105 from the investment requirements established in Sections 6.1 and 6.3 thereof, in view of the repeal of Section 936 of the U.S. Internal Revenue Code.

BACKGROUND

Section 6.5.7(a) (i) of Regulation 5105 provides an exemption from the investment requirements of Sections 6.1 and 6.3 (the "Investment Requirements") for transactions with fixed maturities



of five years or more having a fixed rate of interest or a rate of interest fixed as a specific percentage of a specific published index on the date of the transaction.

Circular Letter 5105-1, issued by this Office on September 11, 1994, stated the following:

3. It is obvious that the exemption provided by Section 6.5.7 was adopted as an incentive for long term investment of Eligible Funds by the Exempt Businesses. Therefore, in order for a transaction to be exempt as provided by Section 6.5.7, the Eligible Funds must have been directly received from an Exempt Business in a transaction with a fixed maturity of 5 years or more, and in fact be retained for the full maturity of the transaction. Retirement of Eligible Funds prior to their maturity shall exclude the transaction from the benefits of Section 6.5.7, and shall render the Eligible Institution subject to the full requirements of the Regulation from the date of origination of the transaction.

APPROVED

CHANGE IN CIRCUMSTANCES

Section 936 of the U.S. Internal Revenue Code was repealed on August 20, 1996.¹

This Office has been advised that many outstanding transactions involving the investment of Eligible Funds in Eligible Institutions for five(5) years or more include provisions for the event of repeal of Section 936 of the U.S. Internal Revenue Code. Said provisions typically require an adjustment in the interest rate paid by the Eligible Institution in the event of repeal. They also provide that, in case of such rate adjustment rights, the Eligible Institution is allowed, under the terms of the transaction agreements, to opt for the prepayment of the investment of Eligible Funds. In other words, to prepay the Eligible Funds invested prior to the expiration of the five year or more period which originally triggered the exemption from the above mentioned investment requirements.

¹ PUBLIC LAW 104-188, 104th Congress - 2nd Session. August 20, 1996.



OFFICIAL INTERPRETATION IN LIGHT OF CHANGE IN CIRCUMSTANCES

This Office finds that the underlying policy for the exemption discussed above is not breached by continuing the effect of the original exemption in those transactions involving the investment of Eligible Funds for five (5) or more years, which are prepaid on the basis of the provisions contained in the investment agreement or in the instrument, in the event of the repeal of Section 936 or as a result of an adjustment in the interest rate payable by the Eligible Institution when such an adjustment is triggered by the repeal of Section 936.

We are persuaded by the arguments submitted by the Eligible Institutions regulated by this Office to the effect that the prepayments discussed above will, in fact, stimulate the re-investment of the prepaid Eligible Funds pursuant to the provisions of the presently proposed amendments to Regulation 5105. These amended provisions, when enacted, cater in a closer and more factual fashion to the present situation of the market of Eligible Funds and the needs of the Puerto Rican economy.

Such being the case, we find that the retroactive disqualification provided for by Section 6.5.7 in cases of prepaid investments of Eligible Funds with the ensuing consequences both for Eligible Institutions as well as for the industry which generates said Eligible Funds are inapposite to the purpose of Regulation 5105 and the Acts under which it is adopted in light of the change in circumstances.

Accordingly, prepayment of Eligible Funds by Eligible Institutions will not result in a retroactive disqualification of the transaction for purposes of exemption from the Investment Requirements.



APPROVED