

PUBLIC

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Our Ref. No. 93-375-CC
PaineWebber Equity
Trusts
File No. 811-3722

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

By letter dated June 22, 1993, you request our assurance that we would not recommend enforcement action to the Commission under Section 4(2) of the Investment Company Act of 1940 (the "1940 Act") if, as more fully described in your letter, PaineWebber Inc. ("PaineWebber") sponsors unit investment trusts ("UITs") that include a provision in their trust indenture requiring the trustee automatically to dispose of a portfolio security under certain circumstances.

PaineWebber proposes to sponsor UITs comprised of equity securities, that, as of the date of deposit, are individually rated in the range of "1" to "3" on a five point scale. 1/ The securities will be rated by PaineWebber's research department, which currently performs this function on a regular basis as part of its service to institutional and individual clients, and has no connection with PaineWebber's unit investment trust group. The indenture will require the trustee to dispose of a security in the event its rating drops below "3" due to a downgrade by the research department. The proceeds from disposition will not be reinvested in substitute securities, and will be distributed to unitholders at the first distribution date following sale of the security. 2/ The proposal will be fully disclosed in the UIT prospectus and all sales literature will inform prospective investors that they may have a portion of their principal returned prior to the UIT's final termination date, which may cause the investor to incur additional sales charges upon reinvesting the funds. 3/

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- 1/ The ratings are based on several fundamental valuation factors, including, but not limited to, present and future earnings, projected cash flow, market share potential, expenses, capital expenditures, profitability, tax considerations and liquidation value.
 - 2/ Proceeds may be reinvested temporarily in U.S. Treasury obligations that mature on or prior to the next applicable distribution date.
 - 3/ You represent that the UIT will not include a reinvestment option that involves the imposition of a sales load or a special inducement to reinvest distributions. Telephone conversation between Amy R. Doberman and Kathleen H. Moriarty, dated July 8, 1993. This representation is intended to address concerns that the elimination provisions might lead to an exchange prohibited, absent Commission approval, by Section 11(c) of the 1940 Act.

On the basis of the facts and representations contained in your letter, particularly that the proceeds from the disposition of a security will be distributed to unitholders, and that the proposal will be fully disclosed in the UIT prospectus and sales literature, we would not recommend any enforcement action to the Commission under Section 4(2) if PaineWebber sponsors UITs for which the trust indenture directs the trustee to dispose of a security if it is downgraded below a certain rating level. ^{4/} You should note that this response expresses the Division's position on enforcement action only and does not express any legal conclusions on the question presented.


Amy R. Doberman
Senior Counsel

^{4/} Prudential Unit Trusts (pub. avail. Jan. 20, 1987).

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Investment Co. Act
Action
4(2)

Availability 7/19/93

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Investment Company Act of 1940
Section 4(2)

June 22, 1993

Thomas S. Harman
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1004

Re: PaineWebber Equity Trusts, Growth Stock Series

Dear Mr. Harman:

We represent PaineWebber Incorporated ("PaineWebber"), a broker-dealer registered with the Securities and Exchange Commission ("Commission" or "SEC"), which currently acts as sponsor (the "Sponsor") of a series of unit investment trusts, the PaineWebber Equity Trusts, Growth Stock Series (collectively, the "Trusts"), registered under the Investment Company Act of 1940 (the "Act"). We hereby request on behalf of PaineWebber your advice that the Division of Investment Management ("Division") will not recommend that the Commission take enforcement action under section 4(2) of the Act if PaineWebber, as Sponsor of the Trusts, conducts certain activities as described more fully below.

Description of the Trusts

Each Trust is one of a series of generally similar but separate unit investment trusts designated by a different series number. The Trusts are created under New York law by the Sponsor pursuant to a Trust Indenture and Agreement (the "Indenture"), dated as of the date the portfolio securities are deposited with the trustee (the "Date of Deposit"), between PaineWebber, as Sponsor and Investors Bank & Trust Company and The First National Bank of Chicago, N.A., as Co-Trustees (the "Trustee").

At the Date of Deposit, each Trust consists of a diversified portfolio of stocks selected by the Sponsor ("Equity Securities"). Each series of the Trust has a stated short term

maturity (approximately 13 months) and has the investment objective of providing for capital appreciation through an investment in equity growth stocks having, in PaineWebber's judgment, an above-average potential for appreciation. PaineWebber is the sole underwriter of the Trust Units (the "Units").

Pursuant to the terms of the Indenture, the Trustee will make distributions on the Distribution Dates to all Unitholders of record. Until distributed, dividends and principal received upon the sale of Equity Securities may be reinvested, until the next applicable distribution date, in interest-bearing U.S. Treasury obligations. Upon termination of the Trust, the Trustee will distribute to each Unitholder of record his or her pro rata share of the Trust's assets, less expenses.

After the Date of Deposit, the Sponsor may, from time to time, deposit additional Equity Securities in a Trust if additional Units are to be offered to the public). Such deposits maintain the original proportional relationship between the individual Equity Securities in the Trust and replicate any cash or cash equivalents held by the Trust, subject to certain adjustments. The original proportionate relationship in a Trust is subject to adjustment to reflect the occurrence of a stock split or a similar event which affects the capital structure of the issuer of an Equity Security but which does not affect the Trust's percentage ownership of the Equity Security, to reflect a sale or maturity of a Security, to reflect the acquisition of Treasury Obligations or to reflect a merger or reorganization. If any stock dividends are received by the Trust, they will be sold by the Trustee and the proceeds therefrom will be distributed on the next quarterly Distribution Date.

A Trust portfolio is not "managed" by the Sponsor or the Trustee; rather, their activities are governed solely by the provisions of the applicable Indenture. Currently, each Indenture pursuant to which a Trust is organized provides that the Sponsor may direct the Trustee to sell or liquidate Equity Securities in a Trust if:

1. there has been a default in the payment of dividends, after declared and when due and payable;
2. any action or proceeding has been instituted at law or equity seeking to restrain or enjoin the payment of dividends, or if there exists any legal question or impediment affecting such Equity Securities or the payment of dividends from the same;

3. there has occurred any breach of covenant or warranty in any document relating to the issuers of the Equity Securities which would adversely affect either immediately or contingently the payment of dividends, or the general credit standing of the issuer or otherwise impair the sound investment character of such Equity Securities;
4. there has been a default in the payment of dividends, principal of or income or premium, if any, on any other outstanding obligations of the issuer of such Equity Securities;
5. the price of any such Equity Securities has declined to such an extent or other such credit factors exist so that in the opinion of the Sponsor as evidenced in writing to the Trustee, the retention of such Equity Securities would be detrimental to the interest of the Unit holders;
6. a public tender offer or exchange offer is made for an Equity Security, or a merger or acquisition is announced affecting an equity Security that in the opinion of the Sponsor makes the sale or tender of the Equity Security in the best interests of the Unitholders;
7. all of the securities in the Trust must be sold pursuant to mandatory termination of the Trust as provided for in the Indenture; or
8. such is necessary to pay Trust expenses or a sale is required because Units are tendered for redemption.

Pursuant to the terms of each Indenture, the Trustee also is required to reject any offer to issue new securities by the issuer of any of the Equity Securities or any other party. If an exchange is effected notwithstanding such rejection or without an initial offer, any Equity Securities, cash or other property received in exchange will be deposited in the Trust and promptly sold, if securities or property, by the Trustee pursuant to the Sponsor's direction. The proceeds of such sale and any cash received in the exchange will be distributed to the Unitholders.

Cash proceeds received upon the sale of an Equity Security (except for sales to meet redemption requests) and dividends received may be reinvested in U.S. Treasury obligations which mature on or prior to the next applicable Distribution Date. The Sponsor anticipates that, where permitted, such proceeds will be reinvested in Treasury obligations unless

factors exist that reinvestment is not in the interest of the Unitholder or is otherwise impractical. Any sale proceeds not reinvested will be held in a non-interest bearing account until distribution on the next Distribution Date.

The Trustee will terminate and liquidate a Trust if the value of a Trust is less than fifty percent (50 %) of the total market value of the Trust after the completion of the deposit period during which the Sponsor deposits additional Equity Securities in the Trust in connection with offering additional Units to the public. A Trust also may be terminated at any time by the written consent of fifty one percent (51 %) of the Unitholders or by the Trustee upon the resignation or removal of the Sponsor if the Trustee determines termination to be in the best interest of the Unitholders. In no event will the Trust continue beyond the Mandatory Termination Date.

The Proposal

The Sponsor proposes to include a provision in the governing Indenture applicable only to future Trusts whereby the Trustee would be required to automatically dispose of a particular Equity Security from the portfolio of a Trust upon the attainment by a particular Equity Security of certain fixed criteria. More specifically, the Sponsor proposes to offer future series of the Trust with the following characteristics:

1. The portfolio of each Trust will be comprised of individually-rated Equity Securities, on a scale of 1 to 5, according to fundamental valuation factors, including (but not limited to) present and future earnings, projected cash flow, market share potential, expenses, capital expenditures, profitability, tax considerations and liquidation value;
2. The Sponsor's research department will be solely responsible for rating and reevaluating the rating of each Equity Security and currently performs this function on a regular basis as part of its service to institutional and individual clients;
3. The Sponsor's research department is a totally separate entity and has no connection with the unit investment trust group of the Sponsor;
4. Equity Securities deposited on the initial Date of Deposit will be rated in the range of 1 to 3 according to the rating scale above;
5. The disposition of any Equity Security from a Trust's Portfolio will be due to a downgrade in

rating from 3 to 4 based on an overall fundamental evaluation of the issuer's economic viability as described above; and

6. The proceeds of any such disposition will not be reinvested, but will be distributed directly to Unitholders.

These provisions would not give either the Sponsor or the Trustee the discretion to sell an individual Equity Security, to reinvest the proceeds or to terminate a Trust. The Trustee will merely distribute to Unitholders proceeds from the sale of an Equity Security. Each prospectus will fully disclose the details of the proposal, and all sales literature will prominently disclose that investors may receive a portion of their principal back before the final Termination Date of a Trust and be required to invest in another investment vehicle, which may impose additional sales charges.

Analysis

Section 4(2) of the Act in relevant part defines a unit investment trust as an investment company which "...issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities." The Staff has stated its view that unit investment trusts "may not contemplate trading of securities" and that "the portfolio of the trust must be relatively fixed." Nike Securities, L.P., 1992 SEC No-Act LEXIS 1194 (avail. November 20, 1992). The Staff takes the position that a unit investment trust may not "sell securities and reinvest proceeds in substitute securities solely because of the decline in value of a portfolio security due to general market or industry conditions." Investment Company Act Release No. 15162 (March 9, 1987), 37 SEC Dock. 1078, 1113.

We believe the Sponsor's proposal is consistent with the purposes of the Act and the principles governing unit investment trusts. By definition, unit investment trusts are fixed trusts in which the trustee has limited managerial discretion and a relatively unchangeable portfolio. See Municipal Investment Trust Fund, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,322 (avail. April 28, 1986). In complying with the staff interpretation of "limited managerial discretion," a provision containing the Sponsor's proposal would be properly incorporated into the governing Indenture for each Trust and would be fully described in the registration statement and prospectus. In our view, under the Sponsor's proposal, management discretion will be "completely or almost completely eliminated." See S. Rep. No. 1775, 76th Cong., 3d Sess., at 2-3 (1940).

In Prudential Unit Trusts, 1988 SEC No-Act LEXIS 86 (avail. January 20, 1987), the Staff took a no-action position

with respect to a proposed series of future unit investment trusts consisting of equity securities selected by the sponsoring broker-dealer and meeting, as of the date of deposit, specified minimum quality standards fixed in the governing indenture and described in the registration statement. The trusts were to be structured to require the sale of a security from the portfolio of a trust where a quality rating of the security based on a numerical rating system from "1" to "5" fell below a minimum level. There would be no reinvestment of the proceeds. All proceeds from the sale of a security were to be distributed to Unit holders of the trust. The broker-dealer's research department assigned ratings according to its view of the capital appreciation or depreciation potential of security and based upon an assessment of technical factors relating to a particular company. Such ratings were not based on historical, quantitative models, general market conditions or the price action of shares; rather, they reflected a research analyst's view regarding the likely future course of each company's share price based upon a variety of fundamental factors. The research department evaluated its ratings of a company on a regular basis and operated independently of the unit investment trust group.

In Nike Securities, supra, the Staff granted no-action relief in connection with unit investment trusts that included a provision in their indenture requiring the trustee automatically to dispose of a portfolio of equity security, or terminate a trust, under certain circumstances. If a portfolio security reached a predetermined growth level, the trustee would be required to sell the security and distribute the proceeds to the unit holders. In addition, if a trust's entire portfolio achieved a predetermined total growth goal, the trustee would be required to terminate the trust and distribute the proceeds to unit holders. The growth goals were determined at the initial date of deposit and fully described in the prospectus. In granting relief, the Staff concluded that "[w]here the UIT indenture permits elimination of securities upon the occurrence of certain specified events, and does not permit the sponsor to purchase new securities, ... the indenture does not involve management." Id.

In Municipal Investment Trust Fund, supra, the Staff stated that Congress desired investors know "with a high degree of specificity" the securities constituting a trust's portfolio. In this connection, the Staff noted that in Guide 10 to proposed Form N-7, a proposed registration form for unit investment trusts, it had formally interpreted the term "specified securities" to require that "any additional securities deposited in a trust ... substantially replicate the initial composition of the trust portfolio...." Investment Company Act Release No. 15162 (March 9, 1987), 37 SEC Dock. 1078, 1113. The Staff's interpretation of the term "specified securities" appears to focus more on the issue of the reinvestment of the proceeds in

qualifying substitute securities than on the sale of securities out of the trust portfolio.

In PaineWebber Equity Trust Growth Stock Series, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,367 (avail. September 24, 1986), the Staff declined to take a no-action position regarding the addition or deletion of a stock from the portfolio of a trust based on whether the stock was added to or deleted from Standard & Poor's 500 Stock Price Index. Although an automatic formula was used in determining whether the stock would be sold, the proposal allowed for reinvestment of the proceeds in substitute securities as well as the possibility of continuous additions and deletions of securities. In its response letter, the Staff took the position that a "... sponsor may sell portfolio securities and reinvest the proceeds ... only in extraordinary circumstances." The Staff's underlying concern appears to be with the reinvestment of proceeds and not with the actual sale of a security pursuant to an automatic formula.

Similar to the proposal in Prudential Unit Trusts, the present proposal of the Sponsor assigns a mandatory minimum value to each Equity Security. In contrast to the Staff's earlier unfavorable position in PaineWebber Growth Stock, the later and favorable Staff response in Prudential Unit Trusts appears to have resulted from satisfactorily addressing the Staff's concerns regarding reinvestment of proceeds upon disposition. Moreover, Sponsor's proposal is similar to the disposal mechanism permitted in Nike Securities in that an Equity Security will be eliminated upon the occurrence of certain specified events, without the reinvestment of proceeds. Under the Sponsor's proposal, once an Equity Security is sold out of a Trust, a substitute security will not be added back into the Trust portfolio. Accordingly, under the Sponsor's proposal, Unit holders will be assured that the "specified securities" originally deposited in the Trust would remain relatively unchanged but for the automatic disposition of a particular Equity Security.

The Sponsor's proposal is wholly consistent with the Staff's view of Congressional intent surrounding the enactment of Section 4(2). The Sponsor's proposal will function automatically with no discretion on the part of either the Sponsor or the Trustee and no reinvestment of the proceeds. The governing Indenture will mandate sale of an Equity Security automatically upon attainment of the above-mentioned fixed level. Where a particular Equity Security is sold, the Sponsor's proposal will result in a distribution to Unit holders while maintaining a relatively unchanged portfolio with no reinvestment in any substitute security, thereby precluding the ownership of a security which was not included in the Trust portfolio on the initial Date of Deposit. Accordingly, Sponsor's proposal addresses the Staff's concern regarding the prevention of excessive trading of securities based on general market conditions and continuous substitution of securities.

Conclusion

For the reasons and based upon the facts stated herein, it is respectfully requested that the Staff advise us that it will not recommend that the Commission take any enforcement action under section 4(2) of the Act if the Sponsor's proposal is implemented.

Should you have any comments or questions, or if there is any way that we can be of further assistance, please feel free to contact Kathleen H. Moriarty at (212) 326-8837 or the undersigned at (212) 326-8890.

Very truly yours,



Donald J. Robinson