

Westlaw Download Summary Report for LAHNE,SUSAN 1529427

Date/Time of Request:	Tuesday, March 06, 2007 14:09:00 Central
Client Identifier:	PTES
Database:	FR
Citation Text:	50 FR 13293-01
Lines:	367
Documents:	1
Images:	0

The material accompanying this summary is subject to copyright. Usage is governed by contract with Thomson, West and their affiliates.

NOTICES

DEPARTMENT OF LABOR

Office of Pension and Welfare Benefit Programs

[Prohibited Transaction Exemption 85-68; Application File No. D-5258]

Permanent Class Exemption To Permit Employee Benefit Plans to Invest in
Customer Notes of Employers

Wednesday, April 3, 1985

***13293** AGENCY: Office of Pension and Welfare Benefit Programs, Department of Labor.

ACTION: Grant of Class Exemption.

SUMMARY: This document contains a class exemption to permit employee benefit plans to purchase and hold customer notes of employers. [Replaces Prohibited Transaction Exemption 79-9]. The exemption affects participants, beneficiaries and fiduciaries of plans investing in customer notes, and employers of the plan participants.

EFFECTIVE DATE: July 1, 1984. A condition requiring independent fiduciary oversight will be effective with respect to transactions entered into after 30 days after the date of this Federal Register.

FOR FURTHER INFORMATION CONTACT: Paul Kelty of the Office of Regulations and Interpretations, Office of Pension and Welfare Benefit Programs, U.S. Department of Labor, (202) 523-7901. This is not a toll-free number.

SUPPLEMENTARY INFORMATION: On August 10, 1984, notice was published in the Federal Register ([49 FR 32127](#)) of the pendency before the Department of a proposed class exemption to allow an employee benefit plan to purchase and hold customer notes from an employer of employees covered by the plan. A temporary class exemption, Prohibited Transaction Exemption (PTE) 79-9 (44 FR 17819, March 23, 1979), permitting transactions of this kind expired on June 30, 1984. The exemption provided relief from the prohibited transaction restrictions of sections 406(a), 406(b) (1) and (2) and 407(a) of the Employee Retirement Income Security Act of 1974 (ERISA) and from the taxes imposed by [section 4975 \(a\) and \(b\) of the Internal Revenue Code](#) (the Code) by reason of [section 4975\(c\)\(1\) \(A\) through \(E\)](#) of the Code.

In order to establish a record on which to base a determination as to whether permanent relief should be granted for plan investments in customer notes, the Department contacted a number of plans that had relied on PTE 79-9 seeking information concerning their experience with the temporary class exemption. The Department also solicited the views of the Associated Equipment Distributors (AED), an association of several hundred small businesses engaged primarily in the sale of construction equipment. Responses to the Department's inquiries and to a survey conducted by the AED among its member companies indicated that PTE 79-9 had provided good investment opportunities to the participating plans which afforded them relatively favorable yields with a high degree of safety. At the urging of plans that have relied on PTE 79-9 and the AED, the Department proposed the new permanent

class exemption on its own motion under section 408(a) of ERISA and [section 4975\(c\)\(2\)](#) of the Code [FN1] and section 3.01 of ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

FN1 Section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 ([44 FR 1065](#), January 3, 1979), transferred the authority of the Secretary of the Treasury to issue exemptions of this type to the Secretary of Labor.

The notice gave interested persons an opportunity to comment and to request a hearing on the proposal. Public comments were received pursuant to the provisions of section 408(a) of ERISA and [section 4975\(c\)\(2\)](#) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1.

1. Description of the Exemption

The class exemption granted pursuant to this notice permits a plan to acquire customer notes accepted by an employer of employees covered by the plan in the ordinary course of the employer's primary business activity. The exemption covers sales as well as contributions of customer notes by an employer to its plan. The new exemption incorporates many of the same conditions or limitations imposed under PTE 79-9, which were intended as safeguards to ensure the protection of the plan assets involved in the transactions. These conditions include a written guarantee by the employer to immediately repurchase a note if it becomes more than 60 days delinquent. A plan may not invest more than 50 percent of its assets in customer notes and over 10 percent in the notes of a single customer. Each customer note sold to a plan must be secured by a perfected security interest in the property financed by the note and the collateral must be insured. Also, maximum terms ranging up to five years are imposed on the notes, depending on the type of property being financed.

A condition of PTE 79-9 that required a plan to notify the Department annually in writing if it relied on the exemption is not retained in the new exemption for reasons discussed in the preamble to the proposal. [FN2] On the other hand, a new requirement for independent fiduciary oversight in regard to plan investments in customer notes has been included in the exemption. Under this new condition, a plan fiduciary who is independent of the employer must approve in advance any acquisition of customer notes by a plan and must monitor the plan's ongoing rights with respect to the customer notes held in its portfolio.

FN2 See 49 FR at 32129.

2. Discussion of Comments Received

The Department received nine letters commenting on various aspects of the proposed class exemption. The comment letters in general urged that the class exemption be adopted and stated that an exemption of this kind is in the best interests of the participants and beneficiaries of plans.

Four comment letters objected to the requirement proposed in the exemption that a fiduciary, who is independent of the employer, approve in advance any sales of customer notes to a plan and ***13294** monitor the ongoing plan investments in these notes. The letters asserted that the available evidence indicates that the

temporary exemption worked well without an independent fiduciary requirement and that sufficient safeguards already are present in the proposed new exemption. The commenters maintain that the requirement for an independent fiduciary would add an unnecessary expense to a plan's operation which would reduce the plan's net investment return. Some of the letters further indicated that certain financial institutions either would be reluctant to serve in the capacity defined in the exemption or would demand a broader fiduciary role. The commenters noted that many employers relying on the exemption are smaller companies that traditionally have not utilized independent fiduciaries.

As stated in the preamble to the proposed exemption, the Department believes, based on its experience with both class exemptions and individual exemptions, that independent fiduciary oversight is an important method of protecting the plan assets involved in an exempt transaction and avoiding a potential conflict of interest situation where, for example, the employer, who is typically a fiduciary, engages in transactions with the plan. The Department recognizes that PTE 79-9 appears to have operated well with the safeguards incorporated in the temporary exemption and that this new requirement may impose some added expense on the part of plans utilizing the exemption. The Department is not convinced, however, that the marginal savings to a plan in cost or effort from eliminating this condition outweigh the added protection of having any covered transaction subject to the prior approval and monitoring of a fiduciary independent of the employer. For this reason and the reasons previously outlined in the preamble to the proposed exemption, condition III(b) is being retained in the final exemption.

Two comment letters recommended, without further explanation, that the scope of the exemption be expanded to permit sales of customer notes to a plan by affiliates of the sponsoring employer as well as by the employer itself. Section II of the proposal states, in part, that the exemption provides relief for the "acquisition from an employer with respect to a plan * * * of customer notes." Under the definition of customer notes in Section I, such a note must be accepted in connection with the employer's primary business activity as a seller of the tangible personal property being financed by the note. The commenters point out that an individual exemption (PTE 82-48, [47 FR 10924](#)) was granted on March 12, 1982 on a temporary basis to the retirement plans of the Bale Chevrolet affiliated group. The exemption covers transactions similar to those described in PTE 79-9 except that the customer notes are purchased from Bale Finance Company (Bale Finance) which finances automobile sales for customers of the Bale Chevrolet Company (Bale Chevrolet). Bale Chevrolet and Bale Finance are the sole members of a controlled group as defined in section 1563(a) of the Code. The Department stated in the preamble to the notice of pendency that the exemption was proposed to be in effect only through June 30, 1984 to coincide with the expiration date of PTE 79-9, so that the Department could make a determination at that time in regard to future relief for the applicant.

The Department does not believe that a sufficient showing has been made that the problems associated with the scope of the exemption are commonplace and, consequently, has determined not to modify the definition of customer notes in the exemption. However, the Department continues to be prepared to consider individual exemptive relief for transactions of the type described in PTE 82-48 if the requisite findings under section 408(a) of ERISA can be made.

The Associated Equipment Distributors submitted a letter of comment concerning

condition III(d) of the proposed exemption. Under that condition, an employer is required to repurchase a customer note from a plan in the event the note becomes over 60 days in arrears. As noted in the preamble to the proposal, the AED had stated in a letter to the Department dated April 5, 1984 that business customers sometimes experience seasonal or temporary cash-flow problems not reflective of their basic financial condition. As a result, the 60-day default period has occasionally caused good notes with favorable yields to be removed from a plan. At that time the AED recommended that the default period be extended from 60 to 90 days. The Department tentatively rejected that earlier recommendation for reasons discussed in the preamble to the proposed exemption.

In its most recent comment letter, the AED urged the Department to reconsider this matter and reiterated its view that such an extension would be in the best interests of plan participants. According to the AED, an employer, such as an equipment dealer, knows its customers well and therefore usually knows whether a customer is in a sound financial position despite occasional seasonal difficulties.

The AED recommended that the proposed exemption be modified to state that, while a note would still be considered to be in default if it was 60 days in arrears, the employer would have another 30 days to repurchase the note or to see that payments on the note are made timely. Alternatively, the AED recommended that, in cases of a 60-day delinquency, the employer could petition the independent fiduciary referred to in section III(b) of the proposed exemption to grant a 30-day extension.

After consultation with the employer, the independent fiduciary would have the discretion to grant or deny the requested extension based on his or her judgment as to the soundness of the note and the likelihood of its becoming current.

Upon consideration of the arguments put forth by the AED, the Department has decided to accept the second alternative suggested in the comment letter and has modified section III(d) of the exemption accordingly. In all other respects, the proposed exemption is being adopted without change.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of ERISA and [section 4975\(c\)\(2\)](#) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of ERISA which require, among other things, that a fiduciary discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan; nor does it affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) In accordance with section 408(a) of ERISA and [section 4975\(c\)\(2\)](#) of the Code, the Department makes the following determinations:

(i) The class exemption set forth herein is administratively feasible,

(ii) It is in the interests of plans and of their participants and beneficiaries, and

(iii) It is protective of the rights of the participants and beneficiaries of plans;

***13295** (3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and

(4) The class exemption is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

Accordingly, the following class exemption is hereby granted under the authority of section 408(a) of ERISA and [section 4975\(c\)\(2\)](#) of the Code and in accordance with ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

Section I. Definition of Customer Notes. For purposes of this exemption, a customer note is a two-party instrument, executed along with a security agreement for tangible personal property, which is accepted in connection with, and in the normal course of, an employer's primary business activity as a seller of such property. A two-party instrument is a promissory instrument used in connection with the extension of credit in which one party (the maker) promises to pay a second party (the payee) a sum of money.

Section II. Transactions Covered. Effective July 1, 1984, if the conditions of section III of this exemption are satisfied, the prohibitions of sections 406(a), 406(b) (1) and (2) and 407(a) of ERISA and the taxes imposed by [section 4975 \(a\) and \(b\)](#) of the Code, by reason of [section 4975\(c\)\(1\) \(A\) through \(E\)](#) of the Code, shall not apply to the acquisition from an employer with respect to a plan and holding by the plan of customer notes (which, pursuant to section III(d), are guaranteed by the employer), or the repurchase of those notes by the employer.

Section III. Conditions. The following conditions must be met in the case of each plan which engages in covered transactions in reliance on the exemption:

(a) The transaction is on terms at least as favorable to the plan as an arm's-length transaction with an unrelated party would be.

(b) Effective with respect to customer notes sold after May 3, 1985--

(1) Prior to the consummation of a transaction described in section II of this exemption, the transaction is approved on behalf of the plan by a fiduciary who is independent of the employer, upon a determination made by such fiduciary that the (other) conditions of this exemption will be satisfied. The independent fiduciary shall acknowledge his or her plan fiduciary status in writing with respect to the transaction. For purposes of this paragraph, a person is independent of an employer even though he or she was selected by the employer (or by a person with an interest in the employer) if he or she has no other interest in the transaction for

which an exemption is sought that might affect his or her best judgment as a fiduciary;

(2) The plan's continuing rights under the terms and conditions of the acquired customer note(s) and under this exemption shall be monitored and enforced on behalf of the plan by the same or another plan fiduciary who is independent of the employer and who has acknowledged his or her fiduciary status and liability as described in paragraph (b)(1) of this section. The independent fiduciary shall be responsible for taking all appropriate actions necessary to protect the plan's rights with regard to the safety and collection of the notes purchased by the plan. These actions shall include, but not be limited to, ascertaining that payments are received timely, diligently pursuing the receipt of delinquent payments and enforcing the employer's guarantee to repurchase delinquent notes, with accrued interest, as described in paragraph (d) of this section.

(c) The acquisition of a customer note from the employer shall not cause a plan to hold immediately following the acquisition (i) more than 50 percent of the current value (as defined in section 3(26) of ERISA) of plan assets in customer notes of the employer or (ii) more than 10 percent of the current value of plan assets in the notes of any one customer.

(d) The employer guarantees in writing the immediate repayment of the outstanding balance of the notes and accrued interest in the event the note is more than 60 days in arrears or if other events occur that, in the opinion of the independent fiduciary referred to in paragraph (b) of this section, impair the safety of the note as a plan investment. The independent fiduciary may at his or her discretion grant an additional 30-day extension before repurchase of the note by the employer is necessary upon a petition by the employer, if the fiduciary determines, after consultation with the employer, that such an extension is in the best interests of the participants and beneficiaries of the plan. The other events (of impairment) referred to above include, but are not limited to, the following:

(1) The obligor on the note fails to comply with any terms or conditions of the note.

(2) The obligor becomes insolvent, commits an act of bankruptcy, makes an assignment for the benefit of creditors or a liquidating agent, offers a composition or extension to creditors or make a bulk sale.

(3) Any proceeding, suit or action at law, in equity or under any of the provisions of the Bankruptcy Act or amendments thereto for reorganization, composition, extension, arrangements, receivership, liquidation or dissolution is begun by or against the obligor.

(4) A receiver of any property of the obligor is appointed under any jurisdiction at law or in equity.

(5) The obligor fails to take proper care of or abandons the property being financed by the note.

(e) The plan receives adequate security for the note. For purposes of this exemption, the term adequate security means that the note is secured by a perfected security interest in the property purchased by the obligor on the note so that if

the security is foreclosed upon, or otherwise disposed of, in default of repayment of the loan, the value and liquidity of the security is such that it may reasonably be anticipated that loss of principal or interest will not result. In no event shall adequate security mean an interest in intangible personal property, such as, but not limited to, accounts, contract rights, documents, instruments, chattel paper, and general intangibles.

(f) Insurance against loss or damage to the collateral from fire or other hazards will be procured and maintained by the obligor until the note is repaid or repurchased by the employer, and the proceeds from such insurance will be assigned to the plan.

(g) Repayment must be provided for in the following manner:

(1) Where the note is secured by heavy equipment, the term shall in no event exceed 60 months. For purposes of this exemption, heavy equipment shall include machinery sold by equipment distributors such as, but not limited to, earth moving, material handling, pipe laying, power generation, and construction machinery manufactured according to standard specifications, but shall not include such equipment which has been specifically designed and manufactured to a user's specifications and which cannot reasonably be expected to be resold in the ordinary course of the equipment distributor's business.

***13296** (2) Where the note is secured by passenger automobiles and light-duty highway motor vehicles, the term shall in no event exceed 48 months. For purposes of this exemption, passenger automobiles and light-duty highway motor vehicles are defined as vehicles which have a gross weight of 10,000 pounds or less, are propelled by means of their own motor and are a type used for highway transportation.

(3) Where the note is secured by tangible personal property other than heavy equipment or motor vehicles described in paragraph (g) (1) and (2) of this section, the term shall in no event exceed 36 months.

(h) All records, information and data required to be maintained which relates to plan investments in customer notes covered by this exemption shall be unconditionally available at their customary location for examination during normal business hours by:

- (1) The Department of Labor,
- (2) The Internal Revenue Service,
- (3) Plan participants and beneficiaries, or
- (4) Any duly authorized employee or representative of a person described in subparagraph (1) through (3) above.

Signed at Washington, D.C., this 28th day of March 1985.

Alan D. Lebowitz,

Acting Administrator, Office of Pension and Welfare Benefit Programs.

50 FR 13293-01

50 FR 13293-01, 1985 WL 86429 (F.R.)

(Cite as: 50 FR 13293)

[FR Doc. 85-7901 Filed 4-2-85; 8:45 am]

BILLING CODE 4510-29-M

50 FR 13293-01, 1985 WL 86429 (F.R.)

END OF DOCUMENT