**DEPARTMENT OF LABOR**

**Office of Pension and Welfare Benefit Programs**

**[Prohibited Transaction Exemption 81-8]**

## Class Exemption Covering Certain Short-Term Investments

**AGENCY:** Department of Labor.

**ACTION:** Grant of class exemption.

**SUMMARY:** This exemption permits employee benefit plans to engage in transactions involving certain short-term investments notwithstanding the prohibited transaction restrictions of the Employee Retirement Income Secrity Act of 1974 (ERISA or the Act). The exemption will affect participants and beneficiaries of employee benefit plans, persons who manage the assets of such plans, and other persons who provide services to such plans.

**EFFECTIVE DATE:** January 1, 1975. (Certain conditions to the availability of the exemption are effective April 23, 1981).

**FOR FURTHER INFORMATION CONTACT:** William A. Schmidt, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, (202) 523-8610. (This is not a toll free number.)

**SUPPLEMENTARY INFORMATION:** On April 25, 1980, notice was published in the Federal Register (45 FR 28017) of the pendency before the Department of Labor (the Department) of a proposed class exemption from the restrictions of section 406(a)(1) (A), (B), and (D) of the Act and from the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c)(1) (A), (B) and (D) of the Code. The proposed class exemption was requested in two applications for class exemption—one filed by the American Bankers Association,[1] and the other filed jointly by six insurance companies.[2] In addition, the proposed exemption also related to certain matters that were raised in an application for individual exemption filed by E. I. du Pont de Nemours and Company.[3] Public comments were received pursuant to the provisions of section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).[4]

### Discussion

The Department received eleven comments regarding the proposed exemption. All of the commentators generally supported the exemption, but each comment also suggested changes to it. The Department has made substantial changes to the proposed exemption in response to these suggestions, and these changes, together with the specific issues raised by the commentators, are discussed below. The discusion deals first with the three kinds of short-term investment covered by the proposed exemption—banker's acceptances, commercial paper; and repurchase agreements—and then deals with several issues raised by the commentators that relate to the scope of the exemption.

I. *Banker's Acceptances.* Two commentators suggested that the exemption for banker's acceptances be expanded to include banker's acceptances issued by foreign banks. According to these commentators, the fact that a bank is subject to supervision by the United States or a State would seem to have little bearing on a determination whether a transaction involves the types of conflict of interest abuses that the prohibited transaction provisions were designed to preclude, and it is unlikely that a foreign bank would be a party in interest. In addition, one commentator asserted that a determination to invest in instruments issued by a foreign bank involves questions of purdence which should be left to the plan fiduciary making the investment deceision on behalf of the plan.

The Department has retained as a condition of the exemption as applied to banker's acceptances the requirement that the banker's acceptance be issued by a bank that is supervised by the United States or a State. The condition was included in the proposed exemption because the Department believed that the existance of state or Federal regulation of a bank would provide at least some independent protection of the interests of the plan acquiring the investment. Although a foreign bank may also be subject to regulatory supervision that is at least as strict as that to which a domestic bank is subject, the commentators provided no indication of the kinds of foreign banks from which a plan might acquire a banker's acceptance or the regulation to which such banks are subject. Therefore, the Department does not believe that it has a sufficent basis for concluding that the acquisition of such instruments from a party in interest would be in the interest of affected plans or protective of such plans and their participants and beneficiaries. However, because retroactive applicaiton of the condition would apparantly disrupt existing transactions, the condition will apply only to transactions occurring on and after a date 90 days from the date of this exemption.

One commentator also requested that the Department expand the scope of the exemption to include banker's acceptances issued by agencies of banks. In connection with this point, the commentator expressed particular concern that the exemption extend to banker's acceptances that are issued by "Edge corporations"—*i.e.* corporations organized under Federal Law (12 U.S.C. 611-631) "for the purpose of engaging in international or foreign banking or foreign financial operaitons, or in banking or other financial operaitons in a dependency or insular possession of the United States . . ."

In the Departemnt's view, a banker's acceptance issued by an Edge corporation is within the scope of the exemption because such corporations are organized pursuant to provisions of the National Banking Act, and, although they engage primarily in foreign banking transactions, they are required to file periodic reports with the Board of Governors of the Federal Reserve System and are subject to examination by examiners apponted by the body.[5]

Another commentator requested that the Department either clarify that the exemption extends to secondary market transactions involving banker's acceptances or that the exemption be extended to include such transactions. In this regard, the Department believes that the exemption for banker's acceptances extends to secondary market transactions if the conditions of the exemption are met.

Finally, the Department has added a condition to the final exemption which provides that the purchase, sale or disposition of the banker's acceptance must be as favorable to the plan as an arm's length transaction with an unrelated party would be. This condition

[1] Exemption Application No. D-653.

[2] Exemption Application No. D-1204. The exemption requested by the insurance companies covers short-term investment of plan assets as well as a wide range of other transactions with periods who provide services to plans. This class exemption is not intended to deal with those other transactions. They will be addressed separately.

[3] Exemption Application No. D-1294.

[4] The applications for exemption were filed with the Internal Revenue Service, pursuant to Rev. Proc. 75-26, 1975-1 C.B. 722, as well as with the Department. However, the notice of proposed exemption was issued, and the exemption is being granted, solely by the Department because, effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) transferred the authority of the Secretary of the Treasury to issue this type of exemption to the Secretary of Labor.

[5] 12 CFR 211.7(b), (c).

is included as an additional protection to plans and their participants and beneficiaries.

II. *Commercial Paper.*

A. *Guarantees of Commercial Paper.* One commentator requested that the Department modify the proposed exemption to make it clear that commercial paper that is guaranteed by a party in interest, but issued by another person, is covered by the exemption. With respect to this request, the commentator stated that a company may guarantee commercial paper that is issued by another company and this commercial paper might be purchased by an employee benefit plan with respect to which the guarantor is a party in interest. According to the commentator, there is little or no potential for abuse with respect to a plan's acquisition of such commercial paper in the circumstances contemplated by the exemption, and, if the exemption is not modified to clearly cover commercial paper guaranteed by a party in interest, many subsidiaries of large, reputable corporations, as well as other issuers, would be unable to borrow funds in the commercial paper market because many of the same problems exist in determining the existence of a prohibited transaction with respect to a guarantee of commercial paper as exist in connection with the mere issuance of commercial paper. The Department has modified the exemption in response to the commentator's request to make it clear that the exemption contemplates a plan's acquisition, holding or disposition of commercial paper that is guaranteed by a party in interest, provided the other conditions to the exemption are satisfied.

B. *The rating requirement.* A condition to the proposed exemption provided that an acquisition, holding or disposition of commercial paper would be subject to the exemption only if the commercial paper involved in the transaction were ranked in the highest category by at least two nationally recognized statistical rating services. Several commentators noted that commercial paper that does not meet the requirements of this condition may nonetheless be an acceptable investment for employee benefit plans and that, because the rating of an issue of commercial paper reflects the relative "riskiness" of the investment, higher rated paper generally carries relatively lower interest rates, and a lower rating will result in higher interest rates. According to the commentators, the rating requirement of the proposed exemption would have the practical effect of limiting employee benefit plans to investments *only* in commercial paper given the highest ranking by two nationally recognized rating services because the nature of the commercial paper market, in many cases, makes it impossible for a fiduciary or issuer to determine whether a transaction is prohibited under section 406(a) of ERISA.[6] Therefore, the commentators state, the imposition of a rating requirement would have the practical effect of preventing a plan fiduciary from making an independent judgment regarding appropriate commercial paper investments for the plan, and would limit the potential return that might be available to the plan with respect to such investments. Finally, one commentator also noted that commercial paper may be offered in a private transaction, and, even though such commercial paper may be an attractive investment for an employee benefit plan, it would not be rated by a nationally recognized rating service.

The Department has modified, but has not deleted, the rating condition in response to the comments summarized above. As modified, the condition requires that, with respect to transactions occurring on or after a date 90 days from the date the exemption is granted, commercial paper must be ranked in one of the three highest rating categories by at least one nationally recognized statistical rating service. This modification is intended to allow fiduciaries who make investment decisions regarding the short-term investments of a plan to choose from a broad range of issues of commercial paper while assuring that the quality of the issue has been assessed by an independent party. However, the Department does not intend to suggest that, merely because commercial paper may be acquired by a plan pursuant to the exemption, such an acquisition would necessarily be an appropriate investment for an employee benefit plan; that determination must be made by the responsible plan fiduciaries, taking into account all the relevant facts and circumstances.

With respect to unrated issues of commercial paper that are sold in a private offering, the extent to which commercial paper is issued in the ordinary course of business without being rated by an independent rating agency is unclear, and the comments received did not provide the Department with a basis for concluding that unrated private offerings of commercial paper have such protective characteristics that affected plans would not need the independent safeguards that the rating condition is intended to provide.

C. *The section 13 filing requirement.* Several commentators objected to the requirement contained in a condition of the proposed exemption that commercial paper be issued by a company required to file reports under section 13 of the Securities Exchange Act of 1934 (the 1934 Act). These commentators note that many insurance companies do not file periodic reports under section 13(a) of the 1934 Act because they are specifically exempt under section 12(g)(2)(G) of the 1934 Act from the registration requirements of section 12 of that act, and are not otherwise required to file such reports.[7]

In addition these commentators noted that the filing requirements of other paragraphs of section 13 of the 1934 Act—*i.e.* sections 13(d) and 13(g) (Generally applicable to purchasers and holders of more than five percent of a class of equity securities registered under section 12 of the 1934 Act), 13(e) (relating to registered issuers that purchase their own shares), and 13(f) (relating to institutional investment

[6] As described in the notice of proposed exemption, the applicants for the exemption stated in their application that in view of the nature of the short-term investment market and the way the investment decision making process in large plans is structured, it is not feasible for trustees and investment managers of these plans to know, or determine prior to consummation of the transaction, whether the issuer of an obligation is a party in interest or disqualified person with respect to a plan for which the acquisition is contemplated. The comments received by the Department also made this point. *See* comments of the American Bankers Association, dated June 24, 1980, and comments made on behalf of six life insurance companies and the American Council of Life Insurance, dated June 24, 1980.

[7] Section 12(g)(2)(G) of the 1934 Act states:

(2) The provisions [requiring registration] shall not apply in respect of—

* * *

(G) any security issued by an insurance company if all of the following conditions are met:

(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

(ii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorizations in respect to securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

(iii) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 16 of this title [relating to securities transactions by certain directors, officers and principal shareholders of the issuer of such securities].

managers who exercise investment discretion over at least $100 million in publicly traded equity securities)—relate to specific occurrences or are only applicable in certain circumstances, and, therefore, many issuers of commercial paper may have no obligation to file under these requirements. The commentators also noted that application of the section 13 filing requirement would prevent plans from acquiring commercial paper issued by many privately-held companies and subsidiaries of other companies because such companies also are not required to file reports under section 13 of the 1934 Act. Finally, one commentator asserted that application of the 1934 Act filing requirement would effectively preclude a plan from investing in any commercial paper issued by a company that does not meet this requirement because in most commercial paper transactions it is not known whether the ultimate purchaser of the commercial paper is an employee benefit plan or whether the issuer or an affiliate thereof is a party in interest with respect to the plan.

In the Department's view, it is important that a plan fiduciary have access to relevant financial information regarding an issuer of commercial paper in order to make an informed decision on behalf of a plan. In addition, where such information is readily available, other interested persons will be able to monitor plan fiduciaries' investment decisions with respect to commercial paper. Nonetheless, the Department is persuaded by the comments received that commercial paper that is an appropriate investment for an employee benefit plan may be issued by companies that are not required to file reports under the 1934 Act, and that inclusion of the 1934 Act filing requirement as a condition to the exemption might unduly limit the short-term investment opportunities available to a plan. Therefore, the Department has deleted this condition in the final exemption. However, notwithstanding this change, the Department notes that a plan fiduciary has a general fiduciary duty, in determining whether to acquire commercial paper on behalf of a plan, to obtain and consider such information as is necessary to an informed decision on behalf of the plan.

D. *Stated Maturity.* One commentator noted that the condition in the proposed exemption which limited coverage to commercial paper with a stated maturity of 270 days or less appears to be derived from section 3(a)(3) of the Securities Act of 1933 (the 1933 Act), but that section 3(a)(3) contains additional language modifying the 270 day requirement which does not appear in the condition to the exemption.[8] This commentator suggested that the condition be revised to conform to the definition in the 1933 Act. The Department agrees with this comment and has revised the condition accordingly.

E. *Employer Securities.* One commentator suggested that the Department expand the exemption to include commercial paper issued by an employer of participants in a plan, or an affiliate of such an employer, provided it is a "marketable obligation" as defined in section 407(e) of ERISA and otherwise meets the percentage requirements of section 407. Another commentator suggested that the condition to the proposed exemption which required that commercial paper involved in a transaction subject to the exemption not be issued by an employer of participants in the plan (or an affiliate of such an employer) be coordinated with section 408(e) of ERISA which provides an exemption for certain transactions involving employer securities. In the Department's view, commercial paper issued by an employer of participants in a plan, or an affiliate of such an employer, may be a "marketable obligation," and, therefore, a plan's acquisition or sale of such commercial paper would be exempt from the prohibited transaction restrictions of section 406 of ERISA if the transaction meets the requirements of section 408(e).[9] Accordingly, the Department has decided not to revise the exemption in response to the commentator's suggestions because it believes that section 408(e), rather than the exemption being granted here, should govern the circumstances in which commercial paper issued by an employer may be purchased or sold by a plan.

III. *Repurchase Agreements.* Most of the commentators urged the Department to eliminate or substantially modify several of the conditions of the proposed exemption relating to repurchase agreements. These objections to the conditions and the Department's responses to the comments are discussed below.

A. *The requirement of a writing.* Four of the commentators suggested that the Department eliminate or modify the condition of the exemption that would require that a repurchase agreement covered by the exemption be embodied in, or pursuant to, a written agreement. These commentators noted that a repurchase agreement transaction, like other transactions involving short-term investments, is consummated very quickly, and, in addition, a repurchase agreement may be for as short a period as overnight. According to the commentators, the only written evidence of a separate repurchase agreement transaction may be a confirmation of the transaction, and, in the context of the market for repurchase agreements, it would be burdensome to require a written agreement for each transaction.

The condition relating to a written agreement was included in the proposed exemption because the Department had concluded that a written instrument defining the rights of the parties to the agreement was necessary both for the protection of plans (and their participants and beneficiaries) and in order to permit monitoring of a plan's compliance with the terms of the exemption. However, the Department, did not intend that a separate agreement necessarily be entered into for each repurchase agreement transaction. Therefore, the Department has modified the language of the condition to more clearly state that a transaction entered into under a "blanket" written agreement would be sufficient to satisfy the condition. In addition, the Department has revised the condition to provide that receipt of a written confirmation of a transaction will be considered sufficient to meet the requirements of the condition for transactions occurring before a date 90 days from the date of this exemption.

B. *Financial statements.* The proposed exemption included a condition that would require the bank, broker-dealer or dealer entering into the repurchase agreement (the seller) to furnish the plan with its most recent statement of financial condition prior to entering into the agreement, and to represent that there has been no material adverse change in its financial condition since the date of such statement.

Several commentators objected to the proposed condition relating to the furnishing of financial statements,

[8] Section 3(a)(3) of the 1933 Act provides as follows:

Section 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to the following classes of securities:

* * *

(3) Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

[9] The exemption granted here does not extend to conduct that is prohibited under section 406(b) of ERISA, while section 408(e) of ERISA, in certain circumstances, does provide relief from violations of sections 406(b)(1) and 406(b)(2). *See* 45 FR 51194 (August 1, 1980) (to be codified as 29 CFR § 2550.408e).

indicating that, because repurchase agreement transactions are entered into with great speed and for very short periods of time, it would be highly burdensome or impossible for a seller to comply with the condition. In addition, some of the commentators stated that the condition is not necesary for the protection of participants because sellers that are permitted to engage in repurchase agreement transactions pursuant to the terms of the exemption are highly regulated and the plan officials who are likely to engage in such transactions on behalf of a plan are sophisticated investors who would monitor the financial condition of the seller involved in a transaction.

The purpose of the condition relating to the furnishing of financial statements is similar to that underlying the condition to the proposed exemption that related to the filing of reports under the *1934 Act by issuers of commercial paper—i.e.,* to assure that plan officials entering into such transactions have access to information that is necessary to evaluate the transaction, and to assure that other interested parties can assess the propriety of a plan's short-term investment activities. The Department is not prepared, on the basis of the comments received, to conclude that furnishing statements of the financial condition of a seller who engages in repurchase agreement transactions with a plan is unnecessary to accomplish these purposes. However, the Department is persuaded that the condition as proposed would create undue administrative burdens, and that application of the condition to transactions that may have already occurred would be inequitable. Therefore, the condition has been revised to apply only to transactions that are entered into on and after a date 90 days from the date of this exemption, and, in addition, the condition has been modified to reduce the burden of complying with it. In this regard, one commentator suggested that the condition might be revised to provide that the seller, prior to entering into its first repurchase agreement transaction with the plan, undertake to furnish the plan with statements of financial condition as issued, and, in connection with each repurchase agreement transaction, represent that there has been no material adverse change in the seller's financial condition since the date of the statement last furnished to the plan. Generally, the Department has adopted this suggestion. However, the condition also permits a seller to agree in the instrument pursuant to which the repurchase agreement transaction is entered into that, by entering into such transaction, the seller represents that there has been no material adverse change in its financial condition since the date of the last financial statement furnished to the plan that has not been previously disclosed to the fiduciary with whom the written agreement is made. This change is intended to allow the individuals who engage in repurchase agreement transactions that are covered by the exemption to consummate such transactions without offering or eliciting a separate affirmative representation regarding the seller's financial condition prior to each transaction.

C. *Securities other than obligations of the United States.* Four commentators objected to that portion of a condition in the proposed exemption which required that, in order for a repurchase agreement transaction to be covered by the exemption, the plan must receive securities issued or guaranteed by the United States or its agencies (United States obligations). According to these commentators, repurchase agreements frequently involve securities other than United States obligations and, if the Department limits the availability of the exemption to transactions involving such obligations, the condition would unduly restrict the investment opportunities available to employee benefit plans. Further, one of the commentators argued that it would be inappropriate for the exemption to preclude a plan from acquiring securities in a repurchase agreement transaction that it could acquire directly in a separate transaction.

The Department has modified the condition in response to the comments received because it is persuaded that marketable obligations other than United States obligations may, as collateral, provide sufficient protection of affected plans (and of their participants and beneficiaries). Therefore, under the final exemption, repurchase agreements may involve securities other than United States obligations, as well as banker's acceptances, commercial paper and certificates of deposit,[9a] provided: (1) the direct acquisition of the securities, banker's acceptances, commercial paper or certificates of deposit would not violate the restrictions imposed by ERISA on a plan's acquisition or holding of employer securities, and (2) any securities that are subject to the Securities Act of 1933 are obligations that are not restricted securities within the meaning of Rule 144 of that act.[10]

D. *Value of securities received and requirement for the delivery of additional securities.* Under the proposed exemption, in order for a repurchase agreement transacation to be exempt, a plan was required to have received securities whose market value was at least 102% of the purchase price paid by the plan. In addition, under another condition to the proposed exemption, if, during the course of a repurchase agreement, the market value of the underlying securities fell below 102 percent of the purchase price, the plan was required to receive from the seller, by the close of business on the following business day, additional securities the market value of which, together with the market value of securities previously delivered or sold to the plan under the repurchase agreement, equaled at least 102 percent of the purchase price paid to the plan.

With respect to the requirement that a plan receive at the beginning of a repurchase agreement securities whose fair market value is equal to at least 102% of the purchase price, several commentators noted that where a repurchase agreement involves the delivery of securities the fair market value of which is in excess of the purchase price, the purchaser might be required to accept a lower effective interest rate on the transaction. In addition, these commentators indated that sellers might be reluctant to engage in repurchase agreement transactions with plans if the plan is required to receive such "excess collateral."

With respect to the requirement that a plan receive additional securities by the close of the next business day when the fair market value of securities received under a repurchase agreement falls below 102% of the purchase price, many commentators indicated that repurchase agreements are often for a one-day or overnight period, and, that under such an overnight agreement, there would be no need to comply with the requirement

[9a] The Department has specifically included banker's acceptances, commercial paper, and certificates of deposit in order to make it clear that the exemption is available for repurchase agreements that involve such instruments. However, in specifically including these instruments, the Department does not intend to express an opinion regarding whether these instruments are, or are not, securities.

[10] In determining whether to engage in a repurchase agreement transaction that involves securities or instruments other than United States obligations, a plan fiduciary, in addition to ascertaining whether direct acquisition of such securities, banker's acceptances, commercial paper or certificates of deposit would violate the restrictions relating to employer securities and determining whether the securities or instruments are of appropriate quality for use in a repurchase agreement transaction, would also be required to evaluate the additional risks of the transaction in relation to the expected return.

to deliver additional securities because the agreement would be fully performed by the close of the next business day following the day on which the market value of the securities involved fell below 102% of the purchase price. In addition, these commentators stated that the requirement of daily "marking-to-market"—*i.e.*, daily determination of the sufficiency of the market value of the securities underlying a repurchase agreement—would present substantial administrative difficulties, and, therefore, imposition of such a requirement might place employee benefit plans at a competitive disadvantage in the repurchase agreement market.

The commentators suggested several different ways of modifying the "marking-to-market" requirement. Some suggested that the requirement be applicable only with respect to repurchase agreements whose term exceeds a specified period, such as 15 or 35 days, and that additional collateral only be required upon the expiration of a period longer than one day; others suggested that the requirement that additional collateral be delivered be related to a different event, such as a substantial decline in the fair market value of the securities received by the plan, or a decline in the value of such securities to 95% or less of the purchase price. Still other commentators suggested that this requirement be deleted in its entirety but that the requirement that the securities initially delivered have a fair market value of at least 102% of the purchase price be retained.

The requirement that the securities received by a plan have a fair market value equal to at least 102% of the purchase price and the requirement that additional securities be delivered as necessary to maintain the fair market value of securities in the possession of the plan at at least 102% of the purchase price were included in the proposed exemption because such "excess collateral," in the Department's view, would provide meaningful protection to affected plans and their participants against the possibility that a seller would be unable to meet its obligations under a repurchase agreement and that the proceeds from the sale of the underlying securities would be insufficient to provide the plan with the benefit of its bargain. However, the Department also believes that plan officials should be permitted the maximum discretion in choosing repurchase agreement opportunities that is consistent with the protection of plan participants and beneficiaries.

Therefore, the Department has modified the exemption to require that, in order for a repurchase agreement transaction to be covered by the exemption, a plan must receive securities at the outset of the transaction whose fair market value is at least equal to 100 percent of the purchase price. In addition, the final exemption requires that, for future transactions, the written agreement pursuant to which the repurchase agreement transaction is entered into must provide that if, during the course of an agreement, the value of the underlying securities falls below the purchase price, the plan may require the seller to deliver, on the following business day, additional securities whose market value together with the market value of securities initially received by the plan equals at least 100 percent of the purchase price. These revisions are intended to assure that there is initially full security for the plan's investment while allowing plan fiduciaries some latitude where the market value of the securities initially received falls below the purchase price.[11]

E. *Other Matter Relating to Repurchase Agreements.* One commentator suggested that the condition providing that the exemption is not available with respect to a repurchase agreement where the seller or an affiliate of the seller has discretionary authority or control with respect to the investment of the plan assets involved in the transaction, or renders investment advice with respect to those assets, should be revised to make it clear that a determination of whether a person is providing "investment advice" will be made in accordance with the Department's regulation[12] dealing with the meaning of that phrase as it is used in the definition of the term "fiduciary" under section 3(21)(A)(ii) of ERISA. The Department has decided to adopt this suggestion, and has revised the condition accordingly. In addition, for the sake of uniformity, the Department has made the same revision to the analogous conditions of those portions of the exemption that deal with banker's acceptances, commercial paper and certificates of deposit.[13]

Another commentator noted that the securities underlying a repurchase agreement may not be held directly by the purchaser, but may be held by a third party as agent for the purchaser, or in escrow. This commentator requested that the Department make it clear that the conditions to the exemption do not require the purchaser to hold such securities directly. In the Department's view, a repurchase agreement transaction that involves the delivery of the underlying securities to an agent for the plan that is acquiring the securities pursuant to the agreement, or delivery of the securities to an independent third party in escrow, would be covered by the exemption, provided the other conditions relating to repurchase agreements are met, because, under such arrangements, the seller has relinquished possession of the securities and, in the case of an agent, the plan has control of the person who receives the securities, and, in the case of an escrow arrangement, an independent third person is obligated to deliver the securities to the plan upon the occurrence of specified events, (such as default by the seller). However, some arrangements may not actually involve a repurchase agreement. For example, an arrangement might be nominally a "repurchase agreement," but, because the securities have not been segregated, the plan would have to take legal action against the seller in order to take possession of them in the event of default, and other creditors of the seller might be able to proceed against them. Such transactions would not be covered by the exemption.

Finally, one commentator suggested that the Department revise the condition of the proposed exemption which required that a plan receive "interest at a rate no less than it would receive in a comparable transaction with an unrelated party" to provide that the condition would be satisfied if the fiduciary acquiring the security, acting in good faith, reasonably believes that the interest rate is no less than that which would be available at the time from unrelated parties. The Department has not adopted this suggestion because it believes that a fiduciary who causes a plan to engage in a repurchase agreement transaction of the kind described in the applications and in the comments received should have no difficulty in establishing his compliance with the condition as it was proposed.

[11] The revised exemption does not prevent a plan from negotiating a repurchase agreement that provides for more stringent initial "collateralization" and "marking-to-market" terms—or both, and, depending on the financial condition of the seller and the character of the underlying securities, a fiduciary may be obligated to obtain such terms before engaging in the transaction. *See* section 404(a) of ERISA.

[12] 29 CFR 2510.3-21(c).

[13] See the discussion below regarding the inclusion in the final exemption of certain bank certificates of deposit.

IV. *Scope of the exemption.*

A. *Section 406(b).* One commentator suggested that the proposed exemption be expanded to permit a plan to invest in commercial paper or banker's acceptances issued by a plan fiduciary with respect to the assets involved in the transaction as well as to permit a plan to enter into a repurchase agreement with such a fiduciary. According to the commentator, the short-term investments that are permitted by the exemption are analogous to bank deposits described in section 408(b)(4) of ERISA, which provides an exemption that permits a fiduciary bank to invest plan assets in its own deposits in certain circumstances, and the proposed exemption should therefore be expanded to include relief for transactions involving banker's acceptances that is similar to that provided for deposits by section 408(b)(4). The commentator also stated that such relief would be appropriate because a short-term investment that involves a fiduciary with respect to the plan assets involved in the transaction (or an affiliate of such a fiduciary) may be the best investment available to the plan, and excluding such investments would result in a lower overall yield to the plan than would otherwise be available.

In addition, another commentator suggested that those portions of the exemption dealing with banker's acceptances and commercial paper be expanded to include relief from sections 406(b)(1) and 406(b)(2) of ERISA for transactions where a party in interest acquires such an instrument on behalf of a plan pursuant to the direction of another person. The commentator noted that, in most cases involving a "directed account" transaction, the fiduciary with authority to make the investment decision directs the party executing the trade to purchase commercial paper or a banker's acceptance, but does not require that the commercial paper be issued by a particular person or that the banker's acceptance be that of a particular bank. In such circumstances, the commentator stated, the directed fiduciary should not be required to "screen" the persons involved in its purchase of commercial paper on behalf of the plan in order to determine whether the purchase would violate sections 406(b)(1) or 406(b)(2). Accordingly, the commentator suggested that the exemption should extend to those sections as well as section 406(a) with respect to transactions of the kind described, provided that the directed fiduciary was precluded from purchasing its own instruments or from its own portfolio.

The Department has not expanded the scope of the exemption to allow a plan to make short-term investments in a person who is fiduciary with respect to the plan assets involved in the transaction because it does not believe that the kinds of investments permitted by this exemption are sufficiently analogous to the bank deposits described in section 408(b)(4) of ERISA to justify providing relief from the restrictions on fiduciary conduct in section 406(b) without additional independent safeguards.

With respect to directed accounts, a fiduciary who receives general investment instructions from another person, but who has discretion to choose from among several specific investments, may have interests that prevent him from exercising his independent judgment as a fiduciary in connection with an investment in the person from whom he receives his instructions.[14] In addition, since the person effecting the short term investment on behalf of the plan must necessarily be aware of the fiduciary from whom he receives investment instructions, it should not be burdensome for him to identify that fiduciary and the affiliates of that fiduciary. Therefore, the Department has also decided not to revise the exemption to provide relief from section 406(b) for short-term investment transactions that involve a fiduciary who receives investment instructions from another.

One commentator noted that a fiduciary, such as a bank, may receive funds belonging to a plan at a time at which access to markets for short-term investments is limited or non-existent (such as a Friday afternoon or the afternoon of a day preceding a legal holiday), and, according to the commentator, in these circumstances it might substantially benefit the plan to enter into a repurchase agreement with the fiduciary who receives the funds. The Department has not revised the exemption to provide relief for the transactions described by the commentator because it does not believe that the comment provides information sufficient to establish a basis for class relief regarding the circumstances in which it might be necessary for a fiduciary to cause a plan to engage in a repurchase agreement with itself in order to discharge its fiduciary obligations to the plan.

Another commentator noted that an issuer, seller or guarantor of a short-term investment might also manage a portion of the assets of a plan on whose behalf such investment is made (and would thus be a plan fiduciary), even though such issuer, seller or guarantor has no control over the assets involved in the transaction. The commentator expressed concern that such an issuer, seller or guarantor might, in such circumstances, be regarded as dealing with plan assets in its own interest or for its own account in violation of section 406(b)(1) of ERISA and 4975(c)(1)(E) of the Code, or acting on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan in violation of section 406(b)(2) of ERISA. Therefore, the commentator requested that the Department either specifically state that the conduct described would not constitute a violation of section 406(b)(1) and 406(b)(2) of ERISA (and 4975(c)(1)(E) of the Code), or that it expand the scope of the exemption to include relief from those provisions.

In the Department's view, if a fiduciary issues, sells, or guarantees a short term investment that is acquired by a plan, and if such fiduiciary uses none of the authority, control or responsibility that makes him a fiduciary in connection with the acquisition of the short term investment by the plan, he has not engaged in a transaction described in section 406(b)(1) of ERISA (and section 4975(c)(1)(E) of the Code). In addition, where a fiduciary issues, sells or guarantees a short-term obligation that is acquired by a plan, and such fiduciary is a fiduciary solely because he is an investment manager or provides investment advice with respect to plan assets other than the assets involved in the transaction, and does not use any of the authority, control or responsibility that makes him a fiduciary in connection with the plan's acquisition of the obligation, he has not engaged in a transaction that is prohibited under section 406(b)(2) of ERISA.

The same commentator also expressed concern that where a fiduciary with respect to a plan receives a fee for guaranteeing a short-term obligation that is issued by another person, and the investment is acquired by the plan, the fiduciary might be considered to have received

[14] For example, a fiduciary in such circumstances may be affiliated with the person from whom he receives instructions; or the person giving the instructions may have discretion regarding the plan's continued use of the fiduciary's services, and those relationships may influence the fiduciary's decisions regarding the investment of plan assets in instruments issued or sold by the directing fiduciary or one of its affiliates. However, see the discussion below regarding certain transactions involving a fiduciary that do not violate sections 406(b)(1) or 406(b)(2) of ERISA.

consideration for his own personal account from a party dealing with the plan in a transaction involving the assets of the plan in violation of section 406(b)(3) of ERISA (and section 4975(c)(1)(F) of the Code) even though the fiduciary used none of his authority, control or responsibility as a fiduciary to cause the plan to acquire the obligation. In the Department's view, the mere receipt by a fiduciary of a fee for guaranteeing a short-term investment that is offered in an open market and is ultimately acquired by a plan does not constitute a violation of section 406(b)(3) of ERISA (or a transaction described in section 4975(c)(1)(F) of the Code) because the fiduciary received the fee for guaranteeing the investment and not in connection with the transaction that involved the assets of the plan (*i.e.* the plan's acquisition of the investment).[15] Therefore, no revisions have been made to the exemption in response to the request.

B. *Retroactivity.* Several commentators, while agreeing with the proposed January 1, 1975, effective date of the exemption, urged the Department to apply various conditions to the exemption only prospectively. As discussed above, the Department has made several revisions to the exemption in response to these comments.

C. *Certificates of Deposit.* One commentator suggested that the Department revise the exemption to permit the acquisition of a certificate of deposit that is issued by a bank which is supervised by the United States or a State if neither the bank nor any affiliate of the bank has discretionay authority or control with respect to the investment of plan assets involved in the transaction or renders investment advice with respect to the assets. In regard to this suggestion, the commentator noted that section 408(b)(4) of ERISA (and section 4975(d)(4) of the Code) provides an exemption from the prohibited transaction provisions of ERISA for the investment of a plan's assets in deposits of a bank or similar financial institution that is a fiduciary of the plan if the plan covers only employees of the bank or financial institution or if the investment is expressly authorized by a provision of the plan or by a fiduciary (other than the bank or similar financial institution or affiliate thereof) who is expressly empowered by the plan to so instruct the trustee with respect to the investment. The commentator also noted that although the Department's regulations under section 408(b)(4)[16] describe what will constitute sufficient authorization of a plan's investment in a bank or other financial institution that makes the investments in its own deposits or in deposits of an affiliate, the regulation provides no guidance with respect to authorization of transactions occurring after November 1, 1977, where the deposit is with a party in interest bank or other financial institution other than the institution making the deposit (or an affiliate of that institution). Therefore, the commentator suggested, it would be appropriate for the Department to include such certificates of deposit in the scope of the exemption in order to make it clear that they are permitted.

The Department has, in general, adopted the commentator's suggestion and has revised the exemption accordingly. However, the Department has not adopted a portion of the commentator's suggested revision to the exemption which merely reiterates the requirements of the Department's regulations under section 408(b)(4).

D. *Other Matters.* One commentator urged the Department to expand the exemption to include investments in, among other things, loans for development of alternative energy sources, and loans that would promote employee ownership of corporations. These matters are outside the scope of the exemption.

**General Information**

The attention of interested persons is directed to the following:

1. The fact that a transaction is the subject of an exemption granted under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary of a plan to which the exemption is applicable from certain other provisions of the Act, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act which, among other things, require a fiduciary to discharge his duties with respect to the plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act.

2. The exemption granted here does not extend to transactions prohibited under section 406(b) of the Act and sections 4975(c)(1) (E) and (F) of the Code.

3. The exemption set forth herein is supplemental to, and not in derogation of, any other provisions of the Act, including statutory 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.

4. The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

5. In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record, including the written comments submitted in response to the notice of April 25, 1980, 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 participants and beneficiaries of plans.

**Exemption**

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75–1 (40 FR 18471, April 28, 1975).

Effective January 1, 1975, the restrictions of sections 406(a)(1)(A), (B) and (D) of the Act, and the taxes imposed by reason of section 4975(c)(1)(A), (B) and (D) of the Code shall not apply to an investment of employee benefit plan assets which involves the purchase or other acquisition, holding, sale, exchange or redemption by or on behalf of an employee benefit plan of the following:

I. *Banker's Acceptances.* A banker's acceptance that is issued by a bank if:

A. The banker's acceptance has a stated maturity date of one year or less from date of issue or has a maturity date of one year or less from the date of purchase on behalf of the plan;

B. Neither the bank nor any affiliate of the bank has discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets;

C. The terms of the transaction are at least as favorable to the plan as those of an arm's length transaction with an unrelated party would be; and,

D. With respect to transactions occurring on or after April 23, 1981 the bank issuing the banker's acceptance is

[15] However, receipt of such a fee could constitute a violation of section 406(b)(3) in certain circumstances; for example, a violation of section 406(b)(3) might occur where it is specifically contemplated by the parties at the time the fiduciary receives the fee for guaranteeing the obligation, that the plan will acquire the short-term investment.

[16] 29 CFR 2550.408b–4.

supervised by the United States or a State.

II. *Commercial Paper.* Commercial paper if:

A. It is not issued by an employer any of whose employees are covered by the plan or by an affiliate of such employer;

B. It has a stated maturity date of nine months or less from the date of issue, exclusive of days of grace, or is a renewal of an issue of commercial paper the maturity of which is likewise limited;

C. Neither the issuer of the commercial paper, any guarantor of the commercial paper, nor an affiliate of such issuer or guarantor, has discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets;

D. With respect to an acquisition or holding of commercial paper (including an acquisition by exchange) occurring on or after April 23, 1981, at the time it is acquired, the commercial paper is ranked in one of the three highest rating categories by at least one nationally recognized statistical rating service.

III. *Repurchase Agreements.* A repurchase agreement (or securities or other instruments under cover of a repurchase agreement) in which the seller of the underlying securities or other instruments is a bank which is supervised by the United States or a State; a broker-dealer registered under the Securities Exchange Act of 1934; or a dealer who makes primary markets in securities of the United States government or any agency thereof and reports daily to the Federal Reserve Bank of New York its position with respect to government securities and borrowings thereon, if each of the following conditions are satisfied.

A. The repurchase agreement is embodied in, or is entered into pursuant to, a written agreement the terms of which are at least as favorable to the plan as an arm's length transaction with an unrelated party would be. For transactions occurring before April 23, 1981 a written confirmation of a repurchase agreement whose terms were at least as favorable to the plan as an arm's length transaction with an unrelated party would have been will be deemed to satisfy this condition.

B. The plan receives interest at a rate no less than that which it would receive in a comparable transaction with an unrelated party.

C. The repurchase agreement has a duration of one year or less.

D. The plan receives securities, banker's acceptances, commercial paper, or certificates of deposit having a market value equal to not less than 100 percent of the purchase price paid by the plan.

E. Upon expiration of the repurchase agreement and return of the securities or other instruments to the bank, broker-dealer or dealer (seller), the seller transfers to the plan an amount equal to the purchase price plus the appropriate interest.

F. Neither the seller nor an affiliate of the seller has discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets.

G. The securities, banker's acceptances, commercial paper or certificates of deposit received by the plan—

(1) Could be acquired directly by the plan in a transaction not covered by this section III without violating sections 406(a)(1)(E), 406(a)(2) or 407(a) of the Act; and,

(2) If the securities are subject to the provisions of the Securities Act of 1933, they are obligations that are not "restricted securities" within the meaning of Rule 144 under that act.

H. With respect to transactions occurring on or after *April 23, 1981,*

(1) If the market value of the underlying securities or other instruments falls below the purchase price at any time during the term of the agreement, the plan may, under the written agreement required by paragraph A of this section, require the seller to deliver, by the close of business on the following business day, additional securities or other instruments the market value of which, together with the market value of securities previously delivered or sold to the plan under the repurchase agreement, equals at least 100 percent of the purchase price paid by the plan;

(2) If the seller does not deliver additional securities or other instruments as required above, the plan may terminate the agreement, and, if upon termination or expiration of the agreement, the amount owing is not paid to the plan, the plan may sell the securities or other instruments and apply the proceeds against the obligations of the seller under the agreement, and against any expenses associated with the sale; and,

(3) The seller agrees to furnish the plan with the most recent available audited statement of its financial condition as well as its most recent available unaudited statement, agrees to furnish additional audited and unaudited statements of its financial condition as they are issued and either: (A) agrees that each repurchase agreement transaction pursuant to the agreement shall constitute a representation by the seller that there has been no material adverse change in its financial condition since the date of the last statement furnished that has not been disclosed to the plan fiduciary with whom such written agreement is made; or (B) prior to each repurchase agreement transaction, the seller represents that, as of the time the transaction is negotiated, there has been no material adverse change in its financial condition since the date of the last statement furnished that has not been disclosed to the plan fiduciary with whom such written agreement is made.

(4) In the event of termination and sale as described in (2) above, the seller pays to the plan the amount of any remaining obligations and expenses not covered by the sale of the securities or other instruments, plus interest at a reasonable rate.

If a seller involved in a repurchase agreement covered by this exemption fails to comply with any condition of this exemption in the course of engaging in the repurchase agreement, the plan fiduciary who caused the plan to engage in such repurchase agreement shall not be deemed to have caused the plan to engage in a transaction prohibited by section 406(a)(1)(A) through (D) of the Act solely by reason of the seller's failure to comply with the conditions of the exemption.

IV. *Certificates of Deposit.* A certificate of deposit that is issued by a bank which is supervised by the United States or a State if neither the bank nor any affiliate of the bank has discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets.

For purposes of this exemption the term "affiliate" is defined in 29 CFR 2510.3–21(e).

Signed at Washington, D.C., this 16th day of January.

**Ian D. Lanoff,**

*Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, U.S. Department of Labor.*

[FR Doc. 81–2583 Filed 1–22–81; 8:45 am]

BILLING CODE 4510–29–M

## Proposed Class Exemption To Permit Payment of Compensation To Plan Fiduciaries for the Provision of Securities Lending Services

**AGENCY:** Department of Labor.

**ACTION:** Notice of proposed class exemption.

**SUMMARY:** This document contains a notice of pendency before the Department of Labor (the Department) of a proposed class exemption from the prohibitions of section 406(b)(1) of the Employee Retirement Income Security Act of 1974 (the Act) and from the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1)(E) of the Code. The proposed class exemption, if granted, will exempt certain compensation arrangements for the provision of securities lending services by a plan fiduciary to an employee benefit plan, if the conditions of the proposed exemption are met. If granted, the proposed exemption would affect participants and beneficiaries of employee benefit plans, and fiduciaries who provide securities lending services to such plans.

**DATES:** Written comments and requests for a public hearing must be received by the Department on or before February 23, 1981. If adopted, it is proposed that this class exemption will be effective upon the date of its publication in the **Federal Register.**

**ADDRESSES:** All written comments and requests for a hearing (preferably three copies) should be addressed to the Office of Fiduciary Standards, Pension and Welfare Benefit Programs, Room C-4526, U.S. Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20216, Attention: "Securities Lending Services".

The comments received will be available for public inspection in the Public Documents Room of Pension and Welfare Benefit Programs, U.S. Department of Labor, Roon N-4677, 200 Constitution Avenue, N.W., Washington, D.C.

**FOR FURTHER INFORMATION CONTACT:** Roger Thomas, Esq., Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, (202) 523-8602. (This is not a toll-free number.)

**SUPPLEMENTARY INFORMATION:** Notice is hereby given of the pendency before the Department of a proposed class exemption from the restrictions of section 406(b)(1) of the Act and from the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c)(1)(E) of the Code.

By notice appearing elsewhere in this issue of the **Federal Register**, the Department has granted a class exemption (PTE 81-6) to permit the lending of securities by employee benefit plans to banks and broker-dealers who are parties in interest with respect to such plans, if the conditions specified in the exemption are met. PTE 81-6 provides an exemption from the restrictions of section 406(a)(1) (A) through (D) of the Act and the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c)(1) (A) through (D) of the Code.

In the preamble to the proposal that became PTE 81-6, the Department described one type of compensation arrangement for the provision of securities lending services that could give rise to a violation of section 406(b)(1).[1] The Department indicated in the preamble that, although the Department was not proposing relief from section 406(b)(1), the exemption provided by section 408(b)(6) might be available for the payment of compensation under such arrangement.

As explained in greater detail in the preamble to PTE 81-6, a number of commentators requested that the proposed exemption be expanded to cover section 406(b)(1) because of the uncertain availability and limited scope of section 408(b)(6). Since the Department had not previously proposed relief from section 406(b)(1), and since the Department was desirous of not delaying the grant of the proposed relief from section 406(a), the Department decided to adopt PTE 81-6 and to propose a class exemption from the prohibitions of section 406(b)(1) of the Act and 4975(c)(1)(E) of the Code to permit, under certain conditions designed to protect the plans involved, compensation for the provision of securities lending services to employee benefit plans.

The conditions of the exemption proposed herein do not limit the form that the compensation may take, although the compensation must be reasonable. In addition, the compensation must be paid in accordance with the terms of a written instrument. The compensation arrangement must be approved by an independent plan fiduciary, who may terminate the arrangement at any time without prior notice or penalty to the plan. The proposed exemption also provides that the fiduciary to be compensated (the "lending fiduciary") must provide the approving fiduciary with any reasonably available information which the lending fiduciary reasonably believes to be necessary to determine whether the authorization should be made or continued, as well as any other information that the approving fiduciary may reasonably require.

[1] Under this type of arrangement a fiduciary receives, as compensation, a portion of the "rental fee" for the loaned securities received by the lender. In these circumstances, the amount of the fee received by the fiduciary would depend both on the aggregate market value of the securities on loan, and on the duration of the loan. The amount of such fee would, therefore, be under the control of the fiduciary. The Department has taken the position that such an arrangement would violate the provisions of section 406(b)(1). See, letter to Arthur Sporn (Advisory Opinion 79-1111A, February 23, 1979).

**Notice to Interested Persons**

Because all plan participants and beneficiaries whose plans invest in securities could conceivably be considered interested persons, the Department has determined that the only practical form of notice is publication in the **Federal Register.**

**General Information**

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject to an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest of disqualified person from certain other provisions of the Act and the Code. These provisions include any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; 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) Before any exemption may be granted under section 408(a) of the Act and section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interests of the plan(s) and of their participants and beneficiaries, and protective of the rights of the participants and beneficiaries of the plan(s);

(3) This exemption does not extend to transactions prohibited under section 406(b) (2) and (3) of the Act and section 4975(c)(1)(F) of the Code;

(4) This exemption is supplemental to and not in derogation of any other provisions of the Act or 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; and

(5) If granted, the pending class exemption will be applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

**Written Comments and Hearing Request**

All persons are invited to submit written comments or requests for a hearing on the proposed exemtion to the address and within the time period set forth above. All comments will be made a part of the record. Comments and requests for a hearing should state the reasons for the writer's interest in the proposed exemption. Comments received will be available for public inspection with the applications for exemption at the address set forth above.

*I. Exemption*

Effective [date of publication of the final class exemption], the restrictions of section 406(b)(1) of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by sections 4975 (a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1)(E) of the Code shall not apply to the payment by an employee benefit plan to a fiduciary (the "lending fiduciary") of compensation for services rendered in connection with loans of plan assets that are securities, provided that:

(a) The loan of securities is not prohibited by section 406(a) of the Act;

(b) The lending fiduciary is authorized to engage in securities lending transactions on behalf of the plan;

(c) The compensation is reasonable and is paid in accordance with the terms of a written instrument;

(d) The arrangement under which the compensation is paid is subject to the prior authorization of a plan fiduciary (the "authorizing fiduciary"), who is independent of the lending fiduciary and of any affiliate thereof, and may be terminated by the authorizing fiduciary at any time without prior notice to the lending fiduciary and without penalty to the plan; and

(e) No such authorization is made or renewed unless the lending fiduciary shall have furnished the authorizing fiduciary with any reasonably available information which the lending fiduciary reasonably believes to be necessary to determine whether such authorization should be made or renewed, and any other reasonably available information regarding the matter that the authorizing fiduciary may reasonably request.

*II.*

For purposes of this exemption, the term "affiliate" of another person means:

(i) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such other person;

(ii) Any officer, director, partner, employee or relative (as defined in section 3(15) of the Act) of such other person; and

(iii) Any corporation or partnership of which such other person is an officer, director or partner.

For purposes of this paragraph, the term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual.

Signed in Washington, D.C. this 16th day of January 1981.

**Ian D. Lanoff,**

*Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, U.S. Department of Labor.*

[FR Doc. 81-2584 Filed 1-22-81; 8:45 am]

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**[Prohibited Transaction Exemption 81-7]**

## Class Exemption for Certain Transactions Involving Mortgage Pool Investment Trusts

**AGENCY:** Department of Labor.

**ACTION:** Grant of Class Exemption.

**SUMMARY:** This class exemption permits, under certain conditions, transactions between plans and parties in interest with respect to those plans related to the origination, maintenance and termination of mortgage pool investment trusts (mortgage pools), and the acquisition and holding of certain mortgage-backed pass-through certificates (certificates) of mortgage pools by plans. In the absence of the retroactive and prospective relief provided by this exemption, these transactions might be prohibited by the Employee Retirement Income Security Act of 1974 (the Act) and the Internal Revenue Code of 1954 (the Code).

**EFFECTIVE DATE:** January 1, 1975.

**FOR FURTHER INFORMATION CONTACT:** William J. Flanagan, Esq., Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, (202) 523-7925. (This is not a toll free number.)

**SUPPLEMENTARY INFORMATION:** On May 6, 1980, notice was published in the Federal Register (45 FR 29937) of the pendency before the Department of Labor (the Department) of a proposal for a class exemption from the restrictions of sections 406(a), 406(b) and 407 of the Act, and from the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c) of the Code. The exemption was proposed on the basis of four individual applications filed by Bank of America National Trust and Savings Association (D-1448), Crocker National Bank (D-1449), Wells Fargo Bank, National Association (D-1357), and PMI Mortgage Corporation (D-1447). The notice set forth a summary of facts and representations contained in these applications, and referred interested persons to the applications for a complete statement of facts and representations. The applications have been available for public inspection at the Department in Washington, D.C.

Public comments and requests for a hearing with regard to the proposed class exemption were received pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975). Notice of a public hearing on the proposed class exemption was published on August 1, 1980 (45 FR 51318), and the public hearing was held on September 9, 1980. The record of this hearing remained open until September 23, 1980 and additional comments were received.

Upon consideration of all of the comments submitted and testimony received, the Department has determined to grant the proposed class exemption, subject to certain modifications. These modifications and the major comments are discussed below.

**Description of the Proposal**

The proposed class exemption contained in the notice of pendency provided conditional relief prospectively and retroactively to January 1, 1975 for transactions involving the origination, maintenance and termination of mortgage pools, and the acquisition and holding by plans of certificates issued by mortgage pools. Section I(A) of the proposed exemption would provide relief from the restrictions of section 406(a) and 407 of the Act and section 4975(c)(1) (A) through (D) of the Code for the sale, exchange or transfer of certificates between a plan and a pool sponsor when the pool sponsor or pool trustee is a party in interest with respect to such plan. Section I(A) also would provide such relief for a variety of listed transactions necessary to fulfill the terms of the pooling and servicing agreement governing each pool. This list of transactions was derived from the applicants' descriptions of the operations of their mortgage pools. The

specific conditions pertaining to each listed transaction were also taken from the representations of the applicants.

Section I(B) of the proposal would provide conditional relief from section 406(b) (1) and (2) of the Act and section 4975(c)(1)(E) of the Code for the sale exchange or transfer of certificates between a plan and a pool sponsor when the pool sponsor or pool trustee is a fiduciary with respect to such plan. Such relief would be available provided that: (1) a fiduciary who is independent of the pool sponsor and pool trustee and who has the authority to manage and control the assets of the plan approves the purchase of certificates; (2) the plan pays no more for the certificates than would be paid by an unrelated third party in an arm's-length transaction; (3) the plan pays no investment management, investment advisory, sales commission or similar fee to the pool sponsor with regard to such sale or acquisition; and (4) the total value of certificates purchased by all plans with respect to which the pool sponsor or pool trustee is a fiduciary shall not exceed 10% of the amount of the offering.

Section I(C) of the proposed exemption would provide relief from the restrictions of section 406(b)(1) of the Act and section 4975(c)(1)(E) of the Code for the collection, holding and investment of individual mortgage payments by the pool sponsor prior to the date of disbursement to certificate holders, and the retention of a specified portion of the interest by the pool sponsor as part of its compensation for organizing and servicing the mortgage pool. Relief for the retention of prepayment, late payment and assumption fees by the pool sponsor would be provided by section I(D) of the proposal.

Section II of the proposal contained four general conditions applicable to all of the transactions listed in Section I. Condition 1 provided that the certificates must have been issued in a public offering registered under the Securities Act of 1933 pursuant to a firm commitment underwriting. Condition 2 required the maintenance of a system for insuring or otherwise protecting the pooled mortgage loans and the property securing such loans up to an amount not less than the greater of one percent of the aggregate principal value of the pooled loans, or the principal value of the largest pooled loan. The condition went on to specify the ways in which such a system must be structured. These specifications were based on the applicants' representations. Condition 3 required that the pool trustee not be an affiliate of the pool sponsor. Condition 4 provided that the sum of all payments made to and retained by the pool sponsor in connection with a mortgage pool, and all funds inuring to the benefit of the pool sponsor as a result of the administration of the mortgage pool, must represent not more than adequate consideration for selling the mortgage loans plus reasonable compensation for services provided by the pool sponsor to the pool.

Section III of the proposal contained definitions of the terms "pool sponsor," "mortgage pool," "mortgage pool pass-through certificate," and "affiliate." These definitions generally reflected the representations of the applicants.

**Discussion of the Comments**

*A. Structure of the Exemption*

As noted above, the proposed class exemption would provide detailed relief in response to the applicants' requests. This was especially true in section I of the proposal, which listed the individual transactions exempted along with the specific conditions applicable to each transaction. It was the Department's intention that this specificity provide the basis for a detailed analysis of the ways in which the provisions of the Act affected investments in mortgage pools.

While praising the thoroughness of the Department's proposal, many commentators noted serious problems with this specific, transaction-based approach. Most indicated that the mortgage pool investment industry is still relatively young and is constantly developing new methods of operation. The commentators argued that the Department's proposal would, if finalized in the same form, require rigid adherence to the present modes of operation, thus preventing possibly beneficial innovation.

Several commentators also indicated the difficulties inherent in drafting and administering an exemption in the form proposed. In order to demonstrate the problems in basing a class exemption on a supposedly comprehensive list of transactions, the commentators brought to the Department's attention a number of transactions omitted from the list. The commentators further noted that mortgage pools maintained by sponsors other than the applicants may vary in certain minor ways from the applicants' pools. While these variations may not be sufficient to undermine the basis for granting class relief, the effect of such differences could render a specific, transaction-based exemption inapplicable to transactions posing no greater possibility for abuse than those associated with the pools described in the applications.

The Department has carefully reviewed these comments and has decided to restructure the final class exemption in the more generalized manner suggested by the commentators. Thus, section I of the final exemption provides relief for several types of transactions, but does not list those transactions individually. Section II contains several conditions applicable to the relief provided in section I. These conditions are designed to assure certain levels of protection for investing plans, rather than to require strict conformance to a specifically described program. Section III contains definitions designed to provide exemptive relief for a broader spectrum of entities involved in the mortgage pool investment industry. The provisions of these sections, and the ways in which they reflect modifications made in response to comments received regarding the proposal, are discussed below.

*B. Section I(A)*

Section I(A) of the final exemption provides relief from sections 406(a) and 407 of the Act and section 4975(c)(1) (A) through (D) of the Code for the direct or indirect sale, exchange or transfer of mortgage pool certificates between the sponsor of the mortgage pool and an employee benefit plan when the sponsor, trustee or insurer of the pool is a party in interest with respect to such plan. Such relief is available provided the plan pays no more than fair market value for such certificates, and the rights and interests evidenced by such certificates are not subordinated to the rights and interests evidenced by other certificates of the same mortgage pool. Section I(A) of the final exemption also provides relief for the continued holding by a plan of such certificates.

This section of the final exemption is essentially similar to paragraph I(A)(1) of the proposal. However, the Department has received several comments regarding this provision. First, certain commentators questioned whether the relief would extend to transactions in the secondary market. In response, the Department notes that it intended the relief provided in this section to apply only to the initial sale of certificates. In order to clarify this, the Department has modified this paragraph to apply only to the sale, exchange or transfer of certificates in the initial issuance of certificates. Also, in this regard, the Department notes that several other commentators have indicated that they anticipate that transactions in the secondary market would be so-called "blind transactions."

As such, these transactions would not be subject to the prohibited transaction provision of the Act. *See* H.R. Rept. 93-1280, 93d Cong., 2d Sess. 307 (1974). To the extent a sale of certificates between a plan and a party in interest in the secondary market is not, for whatever reason, a blind transaction, such transaction is not exempted under the provisions of this class exemption, and would be a prohibited transaction.

Second, at the request of several commentators, the final exemption provides relief for the continued holding by a plan of certificates purchased or otherwise acquired in accordance with the other provisions of section I(A). Such relief had been omitted from the proposal.

Third, section I(A) of the final exemption provides relief when the pool sponsor, trustee or insurer is a party in interest with respect to a plan purchasing certificates. The proposal referred only to the pool sponsor or trustee. One commentator argued that relief might be necessary when an insurer of the pool is a party in interest with respect to an investing plan. Another commentator objected to the reference to the pool trustee since, in the commentator's belief, the trustee is a totally disinterested party with respect to the sale of certificates. The Department has decided to provide relief when either the insurer or the trustee is a party in interest since such relief has been requested. The fact that such relief is available, however, is not dispositive of whether such transactions are in fact prohibited.

*C. Section I(B)*

Section I(B) of the final exemption provides conditional relief from the restrictions of section 406(b) (1) and (2) of the Act and section 4975(c)(1)(B) of the Code for the direct or indirect sale, exchange or transfer of certificates between the sponsor of a mortagage pool and a plan when the pool sponsor, insurer or trustee is a fiduciary with respect to the plan assets invested in such certificates. This section is based on section I(B) of the proposal, but with several important modifications made in response to comments received.

First, the proposal referred to fiduciaries with investment discretion with respect to an investing plan. Several commentators stated that this formulation was too broad for the perceived prohibited transaction since many plans have more than one fiduciary with investment authority. Thus, for example, a pool sponsor might be a fiduciary with investment discretion with respect to a portion of plan assets other than those invested in pool certificates, and would therefore not need an exemption from sections 406(b) (1) and (2). In light of these comments, the Department has modified the provisions of section I(B) to refer to situations in which the pool sponsor, insurer or trustee is a fiduciary with respect to the plan assets invested in pool certificates.

Second, section I(B)(1) of the final exemption contains five conditions on the purchase of certificates when the pool sponsor, trustee or insurer is a fiduciary with respect to an investing plan. The proposal contained four conditions. Condition (1) of the proposed exemption required that the decision to purchase certificates be made by an independent fiduciary with the authority to manage and control plan assets. Proposed condition (2) required that the plan pay no more for the certificates than would be paid by an unrelated third party in an arm's-length transaction. Both of these conditions have been adopted without change.

The third condition in the proposal required that the plan pay no investment management, investment advisory, sales commission or similar fee to the pool sponsor with regard to the acquisition of certificates. One commentator indicated that the condition could be interpreted to prohibit the pool sponsor from collecting either its investment management fee from the plan or its servicing compensation from the pool. The Department intended that this condition would prohibit the direct or indirect payment by a plan to a plan fiduciary of double fees for the same services. To the extent that a pool sponsor is a fiduciary with respect to a plan, and the services furnished by the pool sponsor to the plan which give rise to the investment management fee are different from those giving rise to the pool servicing compensation, the Department does not believe that this condition would prohibit the collection of both fees. Therefore, in light of these clarifications, this condition has been adopted as proposed.

The fourth condition in the proposal provided that the total value of all certificates purchased by all plans with respect to which the pool sponsor or trustee is a fiduciary shall not exceed 10% of the amount of the offering. A large number of commentators argued that this condition was too restrictive and would rob pool sponsors of the flexibility necessary to market pool certificates. These commentators stated further that such a condition would discriminate against pool sponsors who might be fiduciaries for a large number of plans. Because of these comments, and in light of the new conditions adopted in section I(B)(1) of the final exemption, the Department has decided to delete this condition.

In the final exemption, the Department has adopted new conditions (d) and (e). These conditions parallel the provisions of section 407(e)(2) of the Act, which define, in part, the term "marketable obligation." One of the commentators suggested this approach as a means to accomplish the Department's original aims in this class exemption in a way that would not be disruptive of current practices. Thus, condition (d) provides that the total value of the certificates purchased by a plan must not exceed 25% of the amount of the issue. Condition (e) requires that at least 50% of the issue is accquired by persons independent of the pool sponsor, trustee or insurer. (The term "persons independent of the pool sponsor, trustee or insurer" is difined in section III(F), discussed below.) The Department believes that these conditions guard against the potential abuse of "dumping" certificates on a plan, while at the same time allowing pool sponsors sufficient financial flexibility. In the Department's view, they also reduoce the possiblility that pool certificates will be sold to plans at an unfair price by providing for an independent assessment of that price.

*D. Section I(C)*

Section I(C) of the final exemption provides conditional relief from the restrictions of sections 406(a) and (b) and 407 of the Act and section 4975(c) of the Code for all transactions in connection with the servicing and operation of mortgage pools. Section I(C) is designed specifically to meet requests that the exemption be more broadly drafted. Aside from the sales of certificates covered by sections I(A) and I(B) of the final class exemption, all of the transactions listed in the proposal, and most of the additional transactions suggested by the commentators, occur as a result of the internal functioning of the mortgage pool investment trust. As described by the applicants and commentators, these functions are primarily ministerial in nature, involving such responsibilities as the collection and processing of payments, the organization of indemnification procedures, and the investigations necessary to assure that warranties have been met. All of these functions are governed by the terms of the pooling and servicing agreement under which the pool is organized. As noted previously, because such pooling and servicing agreements may vary in certain technical ways, it becomes

difficult to list comprehensively all of the transactions which may occur pursuant to such agreement and which may be eligible for exemptive relief.

As a result, the Department has decided to dispense with the technique of listing individual transactions in this case and to provide more general relief. It should be understood that relief contained in section I(C) of the final exemption is intended to extend to all thsoe transactions listed in sections I(A)(2) through (15), I(C), and I(D) of the proposal. However, this relief is not limited to transactions so listed.[1] Further, the only conditions applicable to such relief are those actually listed in the final exemption, and not those indicated only in the proposal.

The relief contained in section I(C) of the final class exemption is provided subject to two conditions. First, the transactions must be carried out in accordance with the terms of a binding pooling and servicing agreement which governs the operation of the pool. Second, the pooling and servicing agreement must be made available to investors before they purchase pool certificates. These conditions are simply corollaries of the representations of the applicants and commentators that the terms of the pooling and servicing agreement afford adequate protection for all certificate-holders and that the terms of the agreement generally are disclosed prior to the time certificates are purchased. These conditions assure that an investment plan will be aware of the terms of the pooling and servicing agreement, and that those terms will in fact govern the operation of the pool.

It should, of course, be noted that these conditions must be read in light of the conditions contained in sections I(A) and I(B) of the final exemption. Since the price of a certificate should reflect, amoung other things, the quality of the protections afforded investors under the pooling and servicing agreement, then the fair market value, arm's-length, and percentage limitations in section I(A) and I(B) will operate along with the conditions in section I(C) to provide an acceptable level of protection for investing plans.

[1] For example, among the transactions not listed in the proposal but covered by this final class exemption are transactions peculiar to variable rate mortgages. As noted in the preamble to the proposal, 45 FR at 29939, n.9, the Department intended to provide relief for pools composed in whole or in part of variable rate mortgages. Nevertheless, some commentators questioned whether the exemption would cover such pools. The Department believes that the provisions of the final exemption are broad enough to deal with the specific issues raised by variable rate mortgage pools, and that no special provisions for these pools are necessary.

*E. Section I(D)*

Serveral commentators noted that the proposed exemption provided no reflief for situations in which prohibited transactions may arise solely because a plan owns a pool certificate. These commentators stated that, subsequent to purchasing a certificate, a plan may, for example, have dealings with the pool sponsor regarding matters having nothing to do with the mortgage pool. The commentators indicated that, under such circumstances, a large number of inadvertant, technical prohibited transactions could result when no potential for abuse existed. These commentators have therefore requested general exemptive relief for such "external" transactions.

The Department has carefully considered this comment in light of its past practice regarding similar requests. In Class Exemption 80–51 (45 FR 49709, July 25, 1980) for Certain Transactions Involving Bank Collective Investment Funds, the Department provided, among other things, broad relief for certificate transactions between a collective investment fund and a service provider with respect to a plan investing in such a fund. Similar relief was provided in Class Exemption 78–19 (43 FR 59915, December 22, 1978) for Certain Transactions Involving Insurance Company Pooled Separate Accounts. The present request would extend beyond relief for service providers and would apply to a potentially large number of unspecified transactions.

It has been represented and the Department believes that an investment in a mortgage pool is fundamentally different from an investment in a bank collective investment fund or an insurance company pooled separate account. A mortgage pool is a fixed pool of loans; these assets generally are not subject to change once the certificates have been sold, except as mortgages are paid off and the principal and interest passed through to certificate-holders. Although the pooled loans are held in trust for the benefit of certificateholders, included investing plans, the Department does not believe that the mere existence of such an arrangement, or the provision of the services attendent upon an investment in a mortgage pool, would, absent other factors, pose such a potential for abuse as to preclude exemptive relief.

In addition, the Department notes that the structure of the mortgage pool relationship provides additional safeguards against the potential for abuse. The pooling and servicing agreement requires that certain services must be provided with regard to the pool regardless of the identity of individual certificateholders. When a plan contemplates investing an an issue of pool certicates, this exemption requires that the pooling and servicing agreement be made available to the plan prior to the purchase of certificates. When the pool sponsor is also a fiduciary with repect to an investing plan, this exemption requires that an independent fiduciary decide whether to purchase pool certificates upon consideration of the pooling and servicing agreement and other relevant information. Thus, the relationship established by the purchase of a pool certificates is far more attenuated than the usual, direct relationship established by the purchase of a pool certificate is far more attenuated than the usual, direct relationship between a plan and a service provider.

Therefore, the Department has decided to adopt this comment and has added section I(D) to the exemption. Section I(D) provides relief from the restrictions of section 406(a) and 407 of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1) (A) through (d) of the Code for any transactions to which such restrictions and taxes would otherwise apply merely because a person is deemed to be a party in interest (including a fiduciary) with repect to a plan who provides services to the plan, or who has a relationship to a service provider described in section 3(14) (F), (G), (H) or (I) of the Act, solely by reason of the ownership of a certificate by such plan. The Department notes, however, that this exemption would not be available if such person were a party in interest with respect to the plan because of any other pre-existing or subsequent relationship with the plan.[2]

*F. Section II–General Conditions*

Section II of the final class exemption contains three conditions applicable to the relief provided in Section I. Each of these conditions is based on one of the conditions contained in the proposal.

[2] It should be noted that this commentator also requested relief from the provisions of section 406(b) of the Act and section 4975(c)(1)(E) and (F) of the Code of transactions between a plan and person deemded to be a fiduciary with respect to that plan solely be reason of a the plan's ownership of a certificate. Neither the applicants nor the commentators have identified any transaction outside of the mortgage pool relationship which would be prohibited under these sections merely because the pool sponsor exercised fiduciary authority conferred solely by reason of the plan's ownership of pool certificates. As a result, section I(D) of the exemption provides no relief from section 406(b) of the Act or section 4975(c)(1)(E) and (F) of the Code.

(1) *Insurance and Indemification.* Condition 1 requires the establishment for each pool of a system for insuring or otherwise protecting the pooled mortgage loans and the property securing such loans, and for indemnifing certificateholders against reductions in pass-through payments due to loan defaults or property damage. The minimum amount for such coverage must be not less than the greater of the one percent of the aggregate principal balance of the covered loans, or the principal balance of the largest covered loan.

This condition is based on paragraph II(A)(2) of the proposal, but has been modified in response to comments in two ways. First, the proposal required that this protection be provided by one of the systems listed in subparagraphs II(A)(2) (a) through (d) of the proposal. A large number of commentators stated that this stipulation of methods rendered this provision overly restrictive. They argued that is would prevent development of safer, more efficient methods to accomplish the same level of protection. Upon consideration of these comments, the Department has eliminated this provision.

Second, the proposal required that when a pool sponsor purchased hazard and mortgage insurance from a private insurer, such insurer could not be an affiliate of the pool sponsor or pool trustee. One of the applicants, PMI Mortgage Corporation, had requested relief for pools using an affiliated insurer, but had not, in the Department's opinion, provided sufficient information on which to base the findings required by section 408(a) of the Act for the proposal of an exemption under those circumstances. However, after the publication of the proposal, PMI and the other commentators argued that it would be inconsistent to prohibit the use of an affiliated insurer while allowing a pool to self-insure, as proposed, through a system of subordinated certificates and a reserve fund. They also noted that an affiliated insurer would be subject to state insurance regulation. In light of these comments, the Department has deleted this prohibition from the final exemption.

(2) *Independent Trustee.* Condition 2 requires generally that the pool trustee not be an affiliate of the pool sponsor. This condition is the same as paragraph II(A)(3) of the proposal with one modification. In its comment, the Federal National Mortgage Association indicated that, as a public entity which might possible establish mortgage pools, it was prohibited by statute from transferring mortgages from its portfolio into the control of an independent trustee. The Department, in recognition of the public policy expressed by such statutory provisions and of the additional safeguards usually present when a public entity is the pool sponsor, has adopted this comment and made the independent trustee requirement inapplicable in the case of a governmental or quasi-governmental entity such as the Federal National Mortgage Association.

(3) *Funds retained by the pool sponsor.* The third condition listed in Section II provides that the sum of all payments made to and retained by the pool sponsor, and all funds inuring to the benefit of the pool sponsor as a result of the administration of a mortgage pool, must represent not more than adequate consideration for selling the mortgage loans plus reasonable compensation for services provided by the pool sponsor to the pool. This condition is identical to paragraph II(A)(4) of the proposal. One commentator criticized this condition as unnecessary, and said that the Department should let the marketplace determine the pool sponsor's remuneration. However, as the Department explained in the preamble to the proposal (45 FR 29937, 29939 n. 10), this condition does nothing more than repeat the requirement for the continued applicability of the exemptive relief accorded the provision of certain services under section 408(b)(2) of the Act and section 4975(d)(2) of the Code when no more than reasonable compensation is paid by the plan for such services.[3] Accordingly, the Department is adopting this condition as proposed.

(4) *Public Offerings.* The proposal contained a general condition requiring that all certificates purchased by plans pursuant to a final exemption be issued in a public offering registered under the Securities Act of 1933 pursuant to a firm commitment underwriting. All of the commentators addressing this provision opposed its adoption. Many noted that public offerings must be fairly large in order to be profitable, and this requirement would eliminate all but the largest entities as potential pool sponsors due to the increased cost. Other commentators contended that public offerings are inflexible investment vehicles and would not allow sponsors and investors alike to take advantage of market trends. Other commentators noted that private placements offer no significant additional risk for investors. These commentators made similar statemnts with regard to the firm commitment underwriting requirement.

The Department notes that the applications upon which the proposal was based focused primarily on publicly offered pools distributed through firm commitment underwritings. Although mention was made of other marketing methods, there was insufficient information in the record upon which to base relief for private placements even if such relief had been requested. In the case of any exemption application, the applicants bear the burden of bringing before the Department the information necessary to make the findings required by section 408(a) of the Act.

In response to the proposal, the commentators have supplied the Department with copious information regarding the advisability of private placements of pool certificates. They have indicated that the mortgage industry has traditionally used private placements, although the applicants have not consistently used this method for offering pool certificates. The commentators have also made a number of helpful suggestions for additional safeguards if the Department believed such extra protection to be necessary in the case of private placements. As explained above, the Department has adopted several of these suggestions.

As a result, the Department has deleted the public offering, firm commitment underwriting provision. The Department believes that the conditions contained in the final exemption provide sufficient protections for plan participants.[4]

*G. Section III. Definitions*

Section III of the final exemption contains definitions of terms used elsewhere in the exemption. These

[3] For a fuller discussion of this point, see the Preamble to the proposed exemption, 45 FR 29937, 29942 n. 17–18.

[4] As a related matter, one of the applicants had requested that the Department grant relief for the use of an affiliated underwriter to market pool certificates. In the preamble to the proposal, 45 FR 29937, 29941 n.15, the Department refused to propose such relief. The Department did not believe at that time it had sufficient information upon which to base such relief. A number of commentators have furnished the Department with additional information in support of this request for relief. However, due to the changes made in the final exemption which provide relief regardless of the method in which the certificates are marketed, specific relief in this area is no longer necessary. The exemption has been revised, in view of the relief which will now be available for transactions involving fiduciaries, to provide that no underwriting fee or similar compensation can be paid to the pool sponsor or its affiliate regarding the acquisition of pool certificates when such persons are fiduciaries with respect to the assets involved in the transaction. In these circumstances, the Department does not believe the commentators have demonstrated that there is justification for such compensation.

definitions are based on those contained in the proposal, with several changes and additions in response to comments.

(1) *Pool Sponsor.* Section III(A) defines the term "pool sponsor." This definition has been modified in two ways from the proposal. First, the proposal indicated in part that the pool sponsor was the entity which organizes and continues to service the pool. Several commentators noted that the pool sponsor often delegates the servicing of the fund to an affiliate, or to the institutions from which the sponsor purchased the pooled loans. These commentators suggested that the definition be modified to apply to entities which organize or service the pool. However, this formulation would raise all service providers with respect to the pool to the status of pool sponsor. In order to avoid this anomolous result, and at the same time to accommodate the concerns expressed by the commentators, the Department has modified this provision to refer to the entity which organizes, and either continues to service or supervises the provision of services to, a mortgage pool.

Second, the proposal limited the definition of pool sponsor to those entities which made the pooled loans or purchased such loans from the original lender. Several commentators noted that, in the case of so-called "conduit" pool sponsors, loans may not be purchased directly from the lender but from brokers or other third parties. They indicated that the proposal would prevent them from participating in the mortgage pool market. The Department originally proposed this definition to provide an accurate description of the pool sponsor as represented in the applications. In light of the commentators' concerns, the Department has decided to delete this restriction.

(2) *Mortgage Pool.* Section III(B) defines the term mortgage pool. This section contains one minor modification from the proposal. The proposal referred only to deeds of trust. In light of the fact that many states do not permit the use of deeds of trust, the Department has expanded this reference to include mortgages.

The Department has received a number of comments regarding various provisions of this section. First, the proposal would apply only to pools of first mortgages or first deeds of trust. Two commentators requested that this be expanded to include junior lien loans. They indicated that junior lien loans often have a better loan to value ratio than first mortgages, and also provide a higher return over a shorter period of time. They indicated that it was their belief that a pool of junior lien loans would be a higher quality investment and should, therefore, be accorded exemptive relief.

The Department notes that the proposal was based on information regarding pools of first mortgage loans. The applications, comments and hearing testimony all indicated that first mortgage pools have a structural uniformity which makes class relief possible. The Department has not received similar information concerning second mortgage pools. While there is nothing on the record reflecting adversely upon the quality of investment in second mortgages and second mortgage pools, the record is similarly silent regarding the extent to which second mortgage pools differ as a general matter, from first mortgage pools. Different conditions may be necessary for pools of second mortgage loans. In the absence of sufficient information upon which to base class exemptive relief, the Department has decided not to adopt this comment and the final exemption is restricted to pools of first lien loans.

Second, one commentator requested that the definition, which is restricted to pools organized as trusts, be expanded to include limited partnerships. With regard to this suggestion, the Department notes that the structure of the exemption and the presence of certain conditions, such as the independent trustee requirement, are premised on the trust format. The Department at this time does not know to what extent the partnership format would pose additional problems or involve additional prohibited transactions. The Department is also unaware of the extent to which limited partnership mortgage pools require class relief. Therefore, the Department does not accept this comment. This does not, however, preclude the commentator from seeking individual relief.

Similarly, the Department received two comments requesting relief for the commentators' specific programs. Both differed significantly from the other programs described to the Department. One involved the issuance of debt securities to finance mortgage purchases. The other involved a program to provide mortgage and construction financing in a specified geographic area. Rather than radically modify the terms of the proposal to accommodate these commentators, the Department invites them to seek individual relief.

(3) *Certificates.* Section III(C) defines the term "mortgage pool pass-through certificates." The proposal required that such certificates provide monthly, pass-through payments. Several commentators noted that some pools provide quarterly or other periodic payments. Upon consideration of these comments, the Department has decided to adopt this comment and has deleted the reference to monthly payments.

(4) *Single-Family, Residential Property.* In response to requests by several commentators, the Department has adopted a new section, III(E), which defines "single-family residential property." This definition states that single-family residential property is non-farm property comprising one to four dwelling units, and also includes condominiums. This provision basically follows the industry definition previously noted in the preamble to the proposal. 45 FR 29937, 29938 n.6.

(5) *Independent Person.* New section III(F) defines the term "person independent of the pool sponsor, trustee or insurer." This term is used in section I(B)(1)(e) of the final exemption, which requires that 50 percent of an issue of certificates must be purchased by such persons in order to achieve relief from the restrictions of section 406(b) of the Act and section 4975(c)(1)(E) of the Code. This provision, based on section 407(e) of the Act, was suggested by a commentator, but the Department believes that a further definition of this term is necessary. Therefore, section III(F) states that a person will be "independent of the pool sponsor, trustee or insurer" only if: (1) such person is not an affiliate of the pool sponsor, trustee or insurer; and (2) neither the pool sponsor, trustee, insurer, nor any affiliate thereof, is a fiduciary who has investment management authority or renders investment advice with respect to any of the assets of such person. The Department has chosen this formulation to assure that a truly independent assessment of the worth of mortgage pool certificates takes place.

### H. Other Comments

The Department has received one written comment referring to the possibility of "forward commitment" or "forward placement" of mortgage pool certificates. Testimony elicited at the hearing also referred to this subject. The Department does not have sufficient information at this time to identify this practice completely, to ascertain the frequency of its use in the mortgage pool industry, or to determine what, if any, abuses may be involved with such practices. The Department does not believe that it would be beneficial at this time to reopen the comment period

regarding this subject and thereby delay adoption of a final class exemption.

The Department notes that the class exemption adopted today applies to the sale, exchange, transfer or other acquisition by a plan of certificates representing undivided beneficial ownership interests in a pool of mortgage loans. The structure of this class exemption is predicated upon the provisions of a pooling and servicing agreement referring to a specific pool, and the presence of safeguards designed to protect the owner of a pool certificate. Therefore, to the extent that so-called "forward placements" or "forward commitments" involve transactions which precede the formation of a mortgage pool, such transactions are beyond the scope of this class exemption. To the extent that members of the public believe that relief is appropriate for such transactions, they are invited to file with the Department an application for relief in accordance with the provisions of ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

**General Information**

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption granted under section 408(a) of the Act and section 4975 (c)(2) of the Code does not relieve a fiduciary or other party in interest with respect to a plan to which the exemption is applicable from certain other provisions of the Act 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 the Act which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that a plan must operate for the exclusive benefit of participants and beneficiaries.

(2) This exemption is supplemental to, and not in derogation of, any other provision of the Act and the Code, including statutory 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.

(3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

**Exemption**

In accordance with section 408(a) of the Act and section 4975(c)(2) of the code, and based upon the entire record including the written comments submitted in response to the notice of May 6, 1980, and the testimony given at the public hearing of September 9, 1980, the Department makes the following determinations:

(a) The class exemption set forth herein is administratively feasible;

(b) it is in the interests of plans of their participants and beneficiaries; and

(c) it is protective of the rights of participants and beneficiaries of plans.

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1.

*I. Transactions*

A. Effective January 1, 1975, the restrictions of sections 406(a) and 407 of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1)(A) through (D) of the Code shall not apply to the following transactions involving mortgage pool investment trusts (mortgage pools) and pass-through certificates evidencing interests therein (certificates):

(1) The direct or indirect sale, exchange or transfer of certificates in the initial issuance of certificates between the sponsor of a mortgage pool and an employee benefit plan when the sponsor, trustee or insurer of such pool is a party in interest with respect to such plan, provided that the plan pays no more than fair market value for such certificates, and provided further that the rights and interests evidenced by such certificates are not subordinated to the rights and interests evidenced by other certificates of the same mortgage pool;

(2) The continued holding of certificates acquired pursuant to subparagraph (1), above, by an employee benefit plan.

B. Effective January 1, 1975, the restrictions of section 406(b) (1) and (2) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975 (c)(1)(E) of the Code shall not apply to the following transactions involving mortgage pools and certificates evidencing interests therein:

(1) The direct or indirect sale, exchange or transfer of certificates in the initial issuance of certificates between the sponsor of a mortgage pool and an employee benefit plan when the sponsor, trustee or insurer of such pool is a fiduciary with respect to the plan assets invested in such certificates provided:

(a) such sale, exchange or transfer is expressly approved by a fiduciary independent of the pool sponsor, trustee or insurer who has authority to manage and control those plan assets being invested in such cerrificates;

(b) the plan pays more for the certificates than would be paid in an arm's length transaction with an unrelated party;

(c) no investment management, advisory, or underwriting fee or sales commission or similar compensation is paid to the pool sponsor with regard to such sale, exchange or transfer;

(d) the total value of certificates purchased by a plan does not exceed 25% of the amount of the issue; and

(e) at least 50% of the aggregate amount of the issue is acquired by persons independent of the pool sponsor, trustee or insurer;

C. Effective January 1, 1975, the restrictions of section 406(a) and 407 of the Act and the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c) of the Code shall not apply to transactions in connection with the servicing and operation of the mortgage pool provided that: (1) such transactions are carried out in accordance with the terms of a binding pooling and servicing agreement; and (2) such pooling and servicing agreement is made available to investors before they purchase certificates issued by the pool.

D. Effective January 1, 1975, the restrictions of section 406(a) and 407 of the Act and the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c)(1) (A) through (D) of the Code shall not apply to any transactions to which such restrictions or taxes would otherwise apply merely because a person is deemed to be a party in interest (including a fiduciary) with respect to a plan by virtue of providing services to the plan (or who has a relationship to such service provider described in section 3(14) (F), (G), (H) or (I) of the Act), solely because of the ownership of a certificate evidencing an interest in a mortgage pool by such plan.

*II. General Conditions*

A. The relief provided under section I, above, is available only if the following conditions are met:

(1) The sponsor and trustee for each mortgage pool must maintain a system for insuring or otherwise protecting the

pooled mortgage loans and the property securing such loans, and for indemnifying certificateholders against reductions in pass-through payments due to defaults in loan payments or property damage. This system must provide such protection and indemnification up to an amount not less than the greater of one percent of the aggregate principal balance of all covered pooled mortgages, or the principal balance of the largest covered mortgage;

(2) Except in the case of a governmental or quasi-governmental entity such as the Federal National Mortgage Association, the trustee for each mortgage pool must not be an affiliate of the sponsor of such pool, provided, however, that the trustee shall not be considered to be an affiliate of the pool sponsor solely because the trustee has succeeded to the rights and responsibilities of the pool sponsor pursuant to the terms of the pooling and servicing agreement providing for such succession upon the occurrence of one or more events of default by the pool sponsor; and

(3) The sum of all payments made to and retained by the pool sponsor in connection with a mortgage pool, and all funds inuring to the benefit of the pool sponsor as a result of the administration of the mortgage pool, must represent not more than adequate consideration for selling the mortgage loans plus reasonable compensation for services provided by the pool sponsor to the pool.

*III. Definitions*

A. For the purposes of this exemption the terms "sponsor" or "pool sponsor" mean:

(1) the entity which organizes, and either continues to service or supervises the provision of services to, a mortgage pool comprised of mortgage loans either made or purchased by such entity; and

(2) any successor thereto.

B. For the purposes of this exemption, the term "mortgage pool" means an investment pool the corpus of which

(1) is held in trust; and

(2) consists solely of

(a) interest bearing obligations secured by first mortgages or deeds of trust on single-family, residential property;

(b) property which had secured such obligations and which has been acquired by foreclosure; and

(c) undistributed cash.

C. For the purposes of this exemption, the terms "mortgage pool pass-through certificate," or "certificate" means a certificate representing a beneficial undivided fractional interest in a mortgage pool and entitling the holder of such certificate to pass-through payment of principal and interest from the pooled mortgage loans, less any fees retained by the pool sponsor.

D. For the purposes of this exemption, the term "affiliate" of another person means:

(i) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such other person;

(ii) Any officer, director, partner, employee or relative (as defined in section 3(15) of the Act) of such other person; and

(iii) Any corporation or partnership of which such other person is an officer, director or partner.

For purposes of this paragraph, the term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual.

E. For the purposes of this exemption, the term "single-family, residential property" means non-farm property comprising one to four dwelling units, and also includes condominiums.

F. For the purposes of this exemption, a person will be "independent of the pool sponsor, trustee, or insurer" only if:

(1) such person is not an affiliate (as defined in paragraph III(D) of this exemption) of the pool sponsor, trustee, or insurer; and

(2) neither the pool sponsor, trustee, insurer, nor any affiliate thereof, is a fiduciary who has investment management authority or renders investment advice with respect to any of the assets of such person.

Signed at Washington, D.C. this 16th day of January, 1981.

**Ian D. Lanoff,**

*Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, U.S. Department of Labor.*

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[Prohibited Transaction Exemption 81-6]

## Class Exemption To Permit Certain Loans of Securities by Employee Benefit Plans

**AGENCY:** Department of Labor.

**ACTION:** Grant of class exemption.

**SUMMARY:** This exemption will allow the lending of securities by employee benefit plans to banks and broker-dealers who are parties in interest with respect to such plans, if the conditions specified in the exemption are met. The exemption affects participants and beneficiaries of employee benefit plans, persons who manage the assets of such plans, and parties in interest who might engage in securities lending transactions with such plans. In the absence of this exemption, securities lending transactions between a plan and a party in interest would be prohibited by the Employee Retirement Income Security Act of 1974 (the Act) and the Internal Revenue Code of 1954 (the Code).

**EFFECTIVE DATE:** January 23, 1981. For purposes solely of Prohibited Transaction Exemption 79-23 (the Grumman Corp. Pension Trust, 44 FR 31750, June 1, 1979), the final disposition of this class exemption will be deemed to occur on February 23, 1981.

**FOR FURTHER INFORMATION CONTACT:** Roger Thomas, Esq., Office of the Solicitor, U.S. Department of Labor, (202) 523-8602. (This is not a toll-free number.)

**SUPPLEMENTARY INFORMATION:** On April 11, 1980, notice was published in the Federal Register (45 FR 24946) of the pendency before the Department of Labor (the Department) of a proposed class exemption from the restrictions of section 406(a)(1)(A) through (D) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A) through (D) of the Code.[1] Four applications were filed requesting individual exemptions concerning the lending of securities by employee benefit plans. These applications were filed by Grumman Corporation Pension Trust (D-762), Morgan Guaranty Trust Company (D-1102), Salomon Brothers (D-1108) and Fischer, Francis, Trees and Watts, Inc. (D-1130). In addition, the American Bankers Association filed an application (D-1323) requesting a class exemption covering the lending of securities by employee benefit plans to parties in interest with respect to such plans. The above applications were filed pursuant to section 408(a) of the Act and in accordance with procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

As stated in ERISA Procedure 75-1, an application for an individual exemption is not ordinarily considered separately if a class exemption which might encompass the transaction described in the individual application is under consideration by the Department. Accordingly, the Department notified each individual applicant of the fact that its application would not be considered separately from the proposed class exemption, and that its comments with

[1] Hereafter, references to provisions of the Act shall include references to parallel provisions of the Code.

respect to the proposed class exemption were sought by the Department.[2]

Section 102 of Reorganization Plan 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978, transferred the authority of the Secretary of the Treasury for granting exemptions of the type granted herein to the Secretary of Labor. Therefore, although the four applications for individual exemptions were filed with both the Department and the Internal Revenue Service, the notice of pendency was issued and the exemption is being granted solely by the Department.

Upon consideration of all the public comments submitted, the Department has determined to grant the proposed class exemption, subject to certain modifications. These modifications and the major comments are discussed below.

**Discussion of Comments**

*A. Paragraph 1*

The proposed exemption included a condition that for a securities lending transaction between a plan and a party in interest to be exempted, neither the borrower nor an affiliate of the borrower could be a fiduciary with respect to the plan assets being loaned. One commentator suggested that the Department clarify that this requirement is meant to refer only to fiduciaries with investment authority or who render investment advice for a fee. Another commentator similarly request the Department's clarification as to which parties would be permitted to utilize this exemption.

In order to remove any uncertainty, this condition of the exemption has been changed to provide that neither the borrower not any affiliate of the borrower (1) has any discretionary authority or control with respect to the investment of the plan assets involved in the transaction, or (2) renders investment advice (within the meaning of 29 CFR § 2510.3-21(c)) with respect to those assets.

*B. Paragraph 2*

1. *Simultaneous Delivery*

The Department received many comments regarding a condition of the proposed exemption which would have required the simultaneous delivery of securities to the borrower and receipt of corresponding collateral by the plan. Some of the commentators asserted that complex administrative and operational processes involved in transferring securities and collateral make it difficult to determine, in a precise manner, when delivery of the securities and collateral in question would occur.

Another commentator noted that the actual time of receipt of the securities and collateral, after their transfer is initiated, might also depend upon the nature of the securities and collateral involved, and upon the efficiency of the parties' transfer agents. A few of the commentators indicated that transfers of securities and collateral are generally made through different channels, which would also cause uncertainty as to the exact time of delivery. Most of the commentators suggested that the Department modify the exemption so that it is conditioned upon delivery of collateral to the lender by the close of the lender's business on the day the borrowed securities are delivered to the borrower. On the basis of the comments, the Department has adopted this suggestion.

A few of the commentators also noted that certain transfers are always made through "book entry" systems of securities depositories. In these instances, "physical" delivery of the securities or collateral is impossible. In other cases, for the purpose of convenience, transfers are also made through book entries. Although, in these cases, physical delivery of securities or collateral might also be possible, the Department has decided, on the basis of the comments, that it is not necessary to require physical delivery of certificates. As a result, the final exemption provides that transfers of collateral made through such book entries will satisfy the delivery requirements of this exemption.

2. *Types of Collateral*

Another requirement of the proposed exemption stated that the plan as lender must receive from the borrower collateral consisting of cash or securities issued or guaranteed by the United States Government or its agencies, or any combination thereof. A number of commentators urged that the exemption be expanded to include bank letters of credit as permissible collateral. The commentators noted that bank letters of credit are customarily used in securities lending transactions, and that their omission from the exemption would put plans at a competitive disadvantage with respect to other lenders of securities. The Department, having considered these comments, has determined to expand the exemption so as not to preclude the use of bank letters of credit as collateral, provided that the letter of credit is irrevocable and is issued by a person other than the borrower or an affiliate of the borrower. Paragraph 2 of the exemption has been modified accordingly. This modification, of course, does not relieve a plan fiduciary from its responsibilities under section 404(a) of the Act that its decision to secure a loan with a bank letter of credit as well as its decision regarding the terms of the letter of credit are, among other things, "prudent" decisions.

3. *Amount of Collateralization*

Under the proposal, in order for a securities lending transaction to be exempt, the lending plan would have been required to receive collateral whose market value, at the time of the transaction, is equal to at least 102 percent of the then market value of the securities loaned. In addition, if, during the term of the securities loan, the market value of the collateral were less than 102 percent of the market value of the borrowed securities, the plan would have been required to receive from the borrower by the close of business on the following business day additional collateral the market value of which, together with the market value of other loan collateral previously delivered to the plan, equals at least 102 percent of the market value of the securities borrowed.

Five commentators stated that they supported the Department's requirement of 102 percent collateralization. However, most of these commentators suggested that the 102 percent minimum should apply to initial collateralization only, and recommended that additional collateral should be required to be posted by the borrower only when the market value of the collateral already given falls below 100 percent of the market value of the borrowed securities. In conjunction with this recommendation, it was further suggested that when the borrower did post additional collateral the amount of collateralization should be restored to the 102 percent level. The commentators pointed out that initial collateralization of the 102 percent, combined with a two percent margin, minimizes administrative burdens and transaction costs because a borrower would otherwise be required to make frequent deliveries of collateral to maintain 100 percent collateralization where insignificant variations in the market value of the borrowed securities had occurred.

Four commentators suggested that this 102-percent minimum is an artificial and unjustified standard that would limit the ability of plans to lend securities. Most of these commentators indicated that the amount of collateral should be determined by the "market place" (*i.e.*, the amount other prudent investment

[2] The Department granted a temporary individual exemption to permit the lending of securities to broker-dealers and banks by Grumman Corporation Pension Trust (44 FR 31750, June 1, 1979). Under its terms, that individual exemption will terminate upon the final disposition of this class exemption.

advisers would require for the same or similar securities).

The Department is not persuaded to permit transactions with collateralization of less than 100 percent. However, it does find persuasive the arguments of the commentators that a two percent margin (or some other margin) may be in the interests of all the parties to a securities lending transaction. The Department has decided, therefore, to revise this condition to require that a securities loan maintain a minimum collateralization or 100 percent throughout the term of the loan. This revision should provide adequate protection to plans while offering the parties the flexibility to negotiate whatever marigin is appropriate under the circumstances.

*C. Former Paragraph 3—Regulation T Purposes*

The proposed exemption included a condition that would require that securities borrowed are used solely for purposes described in section 6(h) of Regulation T of the Federal Reserve Board (12 CFR §220.6(h)). This condition was based upon the submissions of the applicants, some of which described the reasons why broker-dealers would customarily borrow securities from others (including plans with respect to which they are parties in interest). Under section 6(h) of Regulation T, borrowing of securities is permitted for "* * * the purpose of making delivery of securities in the case of short sales, failure to receive securities [the broker-dealer] is required to deliver, or other similar cases * * *"

A few commentators indicated that they objected to limiting the purposes for which securities could be borrowed to those encompassed by Regulation T. One commentator suggested that plans which lend securities are not affected by how those securities are used by borrowers, and that the plan is protected by the borrower's financial resources (as evidenced by the required financial disclosures) and the requirement that the loan be fully collateralized. Another commentator indicated that the language in paragraph 3 could result in liability to an intermediary broker-dealer or bank who borrows securities from a plan and subsequently lends the securities to a third party for Regulation T purposes, if the third party, in fact, uses them for another purpose.

The Department has considered these comments and has decided that a specific condition in the exemption regarding the purposes for which securities are borrowed is not necessary for the protection of plans in light of the other safeguards contained in the exemption. Accordingly, the condition in paragraph 3 of the proposal has been omitted from the exemption as adopted.

*D. Paragraph 3 (as renumbered)—Financial Statements*

The proposed exemption included a condition that would require the bank or broker-dealer who intends to borrow securities to furnish the plan, prior to the loan, its most recent statement of financial condition and a representation that there has been no material adverse change in its financial condition since the date of such statement. Many commentators objected to this condition, and indicated that since the need for securities changes on a daily basis, the timing of securities lending transactions is critical, and compliance with this condition would be onerous or impossible for each separate loan. In addition, some commentators stated that it was a common practice for the borrower to supply its most recent financial statement together with a basic written loan agreement,[3] which would cover a series of loan transactions, and then to furnish additional financial statements on a quarterly basis or, alternatively, when available or as requested by the lender. Further, the commentators indicated that, for individual security loans under such a basic agreement, it is customary for the borrower to confirm the terms of the loan and assure the lender that there has been no material adverse change in its financial condition since its most recent financial statement.

One of the commentators suggested that the requirement to furnish the lender with the borrower's most recent statement of its financial condition is generally unnecessary and would impose a burden on borrowers in securities loan transactions without a corresponding benefit or protection to plan participants and beneficiaries. This commentator further stated that a fiduciary representing lenders of securities would normally deal only with borrowers whom it believes to be solvent, and argued that since all securities loans must be fully collateralized in cash or government securities, the requirement of furnishing financial statements is unnecessary and redundant. The Department, however, believes that the borrower's financial condition would be of importance to the plan fiduciary in evaluating possible securities lending transactions. It is in the interest of the lending plan, for example, to know whether a borrower is in weak financial condition since the borrower's inability to produce additional collateral, if required, could result in adverse consequences for the plan.

On the basis of the comments received, the Department is not prepared to conclude that the furnishing of financial statements is unnecessary. Nevertheless, the Department does believe that the condition, as proposed, might create undue burdens for the borrower. With regard to the requirement of furnishing the most recent financial statements, several commentators suggested that the condition be modified to require the borrower to furnish its most recent audited financial statement. The Department accepts this comment. However, since audited financial statements may be prepared on a relatively infrequent basis, the Department has modified the exemption so that, prior to the making of the loan by the plan, the borrower shall have provided the lending plan fiduciary with (1) its most recent available audited financial statement, (2) its most recent available unaudited financial statement, if more recent than the audited statement, and (3) a representation that, as of the time the loan is negotiated, there has been no material adverse change in the borrower's financial condition since the date of the financial statement last furnished to the plan. These changes are intended to allow persons covered by the exemption to engage in such transactions without providing separate financial statements prior to each transaction.

*E. Paragraph 4 Arm's length requirement*

Under the proposed exemption, in order for a securities lending transaction to be exempt, the loan is required to be made pursuant to a written loan agreement, the terms of which are at least as favorable to the plan as would be an arm's length transaction between the borrower and an unrelated party. A few commentators recommended that, in order to facilitate securities lending transactions, the Department consider permitting the use of a master or basic written loan agreement which could cover a series of loan transactions between a particular borrower and an employee benefit plan. One commentator stated that the use of such an agreement would eliminate the need for the parties to execute an agreement for each individual loan transaction with the same borrower, which would

[3] The utilization of a basic written loan agreement is discussed in more detail, *infra*, in connection with the conditions set forth in paragraph 5 of the proposal.

be burdensome because of the rapidity with which loan transactions are consummated. Several commentators also indicated that the use of a master agreement is a customary practice.

The Department accepts this comment and has modified the exemption accordingly. In addition, the Department has revised the condition to permit, in lieu of a written agreement for each transaction, written confirmation of each transaction covered by a "master" written agreement.

Two commentators also suggested that the Department eliminate the condition that the terms of the securities loan agreement be "at least as favorable to the plan as an arm's length transaction between the borrower and an unrelated party would be."

One of the commentators asserted that it would be difficult for the plan to document the terms of arm's length transactions between a borrower and unrelated third parties. In addition, the commentator stated that each loan is "unique" and that no reported loan transactions are available for comparison by the plan fiduciary. Another commentator suggested that this condition would be difficult for the borrower to monitor since it would require that all agreements entered into with employee benefit plans be compared with all other agreements negotiated at arms's length.

The Department believes that an arm's length standard is necessary for the protection of plan participants. However, in light of these comments, the Department has modified this condition of the exemption to require that the terms of the written loan agreement are at least as favorable to the plan as an arm's length transaction with an unrelated party would be. The Department believes that a fiduciary who causes a plan to engage in a securities lending transaction, as contemplated in this exemption, should be able to comply with the terms of the condition as adopted.

*F. Paragraph 5—Reasonable Fee*

Many commentators objected to that portion of the condition contained in paragraph 6 of the proposed exemption that requires, in order for a securities lending transaction to be covered by the exemption, that the plan must receive "a reasonable fee that is related to the value of the borrowed securities and the duration of the loan * * *" Several of the commentators stated that it was their belief that this condition implies either that the borrower will make a specifically defined payment to the plan which is dependent on the value of the borrowed securities and the duration of the loan, or, in the case of cash collateral, that a specfied rate of return will be provided or guaranteed by the borrower. The commentators indicated that if the plan receives cash collateral from the borrower, it would not, in that case, receive a "reasonable fee" from the borrower. Instead, the amount of compensation the plan would realize from its securities loan would depend upon the plan's ability to invest the collateral during the term of the loan.[4]

Some commentators suggested that because of the use of cash collateral, the exemption should be modified so that the concept of a "reasonable fee" includes the opportunity for the plan to receive a return generated by the investment of the cash collateral, regardless of whether any return is, in fact, achieved.

In view of the recognized practice of providing compensation to lenders through the lenders' investment of cash collateral, the Department has modified the exemption to provide that an arrangement in which a plan derives its compensation through the investment of cash collateral is a compensation method contemplated by the exemption. In instances where the plan has the opportunity to use cash collateral for investments, the Department has further modified the exemption to permit the payment of a loan rebate fee by the plan, if such fee is not greater than the plan would pay in a comparable transaction with an unrelated party.

The Department has made these changes because it recognizes that the opportunity to invest cash collateral may be of value to a lending plan, and to that extent could be considered part or all of the consideration for the lending of securities. However, the Department notes that, where the lending plan agrees to pay to the borrower a periodic rebate fee in the form of a fixed percentage of the value of the collateral, the value of that obligation must be offset against the less certain value of the possible return that the plan may obtain through investment of the collateral in order to ascertain the value of the consideration derived by the plan in the arrangement. Plan fiduciaries, therefore, should be mindful of the above in deciding whether to engage in a securities lending transaction that involves the payment of a fixed loan rebate or similar fee.

*G. Paragraph 6—Report of Market Value*

The first portion of paragraph 7 of the proposed exemption contained a condition that would require the borrower in a securities lending transaction to furnish to the lending plan by the close of each business day, during the term of the loan, a report of the market value of all collateral and the market value of all borrowed securities at the close of trading on the previous business day. Regarding this condition, the Department stated in the preamble to the proposed exemption that while it believed that daily reporting would be an important protection for plan participants, it appeared to the Department that requiring daily reports from the borrower might not be necessary in all securities lending arrangements.

The Department specifically invited comments on this aspect of the proposal. Most of the commentators stated that the requirement of a daily determination by the borrower of the sufficiency of the market value of the borrowed securities and of the underlying collateral ("marking-to-market") would be an unjustified delegation to the borrower of the plan fiduciary's responsibility, and would place the borrower in a conflict of interest position. Moreover, several commentators indicated that a prudent plan fiduciary would verify the accuracy of the borrower's determinations and that, therefore, requiring the borrower to mark-to-market would result in a duplication of effort.

Some commentators also indicated that it is customary practice in securities lending transactions for the lender or some third party to perform the marking-to-market. In addition, several commentators indicated that if the borrower were required to provide market valuations to the lender, the additional paperwork and time involved would place employee benefit plans at a competitive disadvantage. Finally, several commentators stated that it was their belief that the requirement of daily marking-to-market was unnecessary for the plans' protection and unduly burdensome for the borrower.

On the basis of the comments, the Department has decided to delete the condition requiring daily reports. The Department's decision to eliminate this requirement, however, does not relieve the plan fiduciary of its general fiduciary responsibility to monitor the market value of the loaned securities and the collateral to ensure that the plan is

[4] However, in consideration for the lending plan's right to invest the cash collateral and to retain the proceeds of such investment, the lender customarily agrees to remit a fee (generally called a "loan rebate fee") which is established by negotiation between the parties prior to the securities loan, and generally is expressed as an annualized percentage of the cash collateral (which is fixed for the term of the loan). The loan rebate fee is payable in full and is not dependent upon the income which the lender realizes by investing the collateral.

adequately protected during the term of the loan.

*H. Paragraph 7—Return of Securities Upon Termination*

Under the proposed exemption, the securities loan may be terminated by the plan at any time, whereupon the borrower is required to deliver to the plan certificates for securities that are identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) within the customary delivery period for such securities, or five business days, whichever is lesser. The Department received three comments concerning this condition. One of the commentators suggested, in view of the fact that deliveries of securities are frequently made through depositories by book entries, with no physical delivery involved, that the Department should modify this condition to permit "delivery" of certificates through the use of book entries. In light of this comment, the Department has revised this condition to permit "delivery" of borrowed securities through the use of book entries. This change is consistent with the modifications, discussed above, relating to delivery of securities at the beginning of the loan transaction.

Another commentator suggested that the condition requiring delivery of certificates identical to the borrowed securities or "the equivalent thereof" is ambiguous, and should be modified to require only the return of certificates for securities which are "identical" to the borrowed securities. The purpose of the condition in the proposal concerning "equivalent" securities is to encompass situations in which the issuer of the borrowed securities has experienced a recapitalization, merger or other reorganization during the term of the loan. In these situations, it is possible that certificates "identical" to those borrowed either no longer exist or do not fully represent, at the time of termination of the loan, the rights of the holders of the borrowed securities. For example, in the instance of a stock split in which two new shares of stock are issued in place of one share of original stock, delivery by the borrower of the original number of shares lent by the plan would not satisfy this condition of the exemption. Consequently, the Department has decided not to accept this comment.

One commentator recommended that the lending plan be required to notify the borrower in writing of its desire to terminate a particular loan. The commentator stated that the purpose of this recommendation is to insure that an accurate record is available to complement the written loan agreement. It is the Department's belief that this suggestion would not necessarily be in the interests of the plan involved, because such a requirement might, in some instances, cause an unnecessary delay in notifying the borrower of the plan's desire to terminate the loan. Therefore, the Department has determined not to revise the exemption in this regard.

One commentator also suggested that the Department shorten the amount of time within which the borrower must return the securities to three business days, because one of the events that would trigger a termination of the lending arrangement by the plan would be a sale by the plan of the borrowed securities. Since the customary delivery period for corporate stocks and bonds is five business days, the commentator stated that a shortened time for delivery would enable the plan to be assured that it has the securities necessary to complete a contemplated sale transaction.

Nevertheless, the Department understands that it is customary in securities lending transactions for a lender to require delivery of borrowed securities within five business days. The Department is not persuaded that is is necessary to require, under all circumstances, a shortened period of time for delivery of securities as a condition of the exemption, although the terms of the exemption do not prevent the parties to a securities lending transaction from negotiating a shorter delivery period. Therefore, the Department has determined not to adopt this suggestion.

*I. Paragraph 8—Failure to Return Securities Upon Termination*

The conditions in this paragraph, as proposed, provided that in the event the loan is terminated, and the borrower fails to return the borrowed securities or the equivalent thereof within the customary delivery period for such securities or five business days, whichever is lesser, (1) the plan may, under the terms of the loan agreement, purchase securities identical to the borrowed securities (or their equivalent as described above) and may apply the collateral to the payment of the purchase price, any other obligations of the borrower under the agreement, and any expenses associated with the sale and/or purchase, and (2) the borrower must pay to the plan the amount of any remaining obligations and expenses not covered by the collateral, plus interest at a reasonable rate.

The Department received one comment on this paragraph. The commentator suggested that in the event of a termination of the loan and the failure of the borrower to return the borrowed securities, the borrower be expressly given the option, as a condition of the exemption, of replacing any non-cash collateral held by the plan with cash collateral equal to the then current market value of the securities borrowed. Although the Department has no objection to allowing the replacement of non-cash collateral with cash, it believes such an exchange should be permissible (and has revised the exemption accordingly) only if (1) the cash received by the plan is equal to or greater than the market value of the collateral at the time of the exchange, and (2) the exchange is approved by the plan fiduciary.

The Department also has made a minor change to this condition to require the borrower to deliver securities in less than either the customary delivery period or five business days, if such shorter period is negotiated by the parties to the securities lending transaction.

*J. Fee Arrangement*

The furnishing of services to a plan for a fee by a party in interest, including a trustee or other fiduciary, is prohibited by sections 406(a)(1)(C) of the Act. Section 408(b)(2) of the Act and the regulations promulgated thereunder provide exemptions from the restrictions of sections 406(a) for the provision of services to a plan by a party in interest if certain conditions are met.[5] The Department explained in the preamble to the proposed exemption that certain arrangements for the provision of securities lending services may also involve violations of section 406(b)(1) of the Act, which prohibits a fiduciary of a plan from dealing with the assets of the plan in its own interest or for its own account.[6] The exemption provided by section 408(b)(2) does not, however, provide relief from the prohibitions of sections 406(b)(1).[7] Nevertheless, section 408(b)(6) of the Act exempts from the restrictions of sections 406(a) and 406(b)(1) the provision of ancillary services by a bank or similar financial institution to a plan for which it is a fiduciary, if certain conditions are met.[8]

The Department stated in the preamble to the proposed exemption that it is its position, based on

[5] 29 CFR 2550.408b-2.

[6] *See*, ERISA Advisory Opinion 79-111A, dated February 23, 1979.

[7] *See*, regulation cited in note 5, supra.

[8] See 29 CFR 2550.408b-6.

information contained in the applications, that the provision of securities lending services to a plan by a bank or similar financial institution that exercises discretionary authority or control respecting management of the plan's assets which include securities, is an ancillary service within the meaning of section 408(b)(6) of the Act.

Therefore, the Department concluded, a trustee or other fiduciary may provide securities lending services to a plan for an additional fee if: (1) the transaction meets the requirements of section 408(b)(2) and does not constitute a violation of sections 406(b), or (2) the fiduciary is a bank or similar financial institution, the transaction meets the requirements of section 408(b)(6) and the transaction does not constitute a violation of section 406(b)(3).

The Department noted that it had made no determination as to whether any particular fee arrangement, or class thereof, would satisfy the conditions of section 408(b)(6). The Department also stated that whether a fee arrangement satisfies the conditions of either of the statutory exemptions discussed above would depend on the facts and circumstances surrounding that arrangement.

Since none of the applicants requested relief from any specific prohibited transaction provision of the Act or Code for the provision of securities lending services to a plan by a trustee or other fiduciary for a fee, and because the Department was not persuased, on the basis of the applications, that any relief, beyond that provided by the statutory exemptions discussed above, was necessary or appropriate, no such relief was included in the proposed class exemption.

The Department received many comments concerning the discussion in the preamble regarding the provision of securities lending services by a fiduciary for an additional fee. One commentator asserted that since the Department has not issued "specific guidelines" for section 408(b)(6) purposes, reliance on the statutory exemption provided in that section exposes banks or similar financial institutions to "second-guessing" as to what the guidelines will be and provides no assurance as to the availability of the exemption. Two commentators suggested that the exemption should expressly provide for the payment of reasonable compensation to trustees and other fiduciaries for the provision of securities lending services to plans. The commentators stated that it was their belief that trustees and other fiduciaries might be reluctant to undertake the additional costs necessary to establish and maintain a securities lending program without the Department's express assurance that such an arrangement would be exempt from the prohibitions of sections 406(b)(1).

Several commentators also noted that to the extent section 408(b)(6) does provide relief from sections 406(b)(1) for the provision of securities lending services by banks or similar financial institutions, this interpretation would provide such institutions with a competitive advantage over other institutional fiduciaries.

In view of the uncertainty concerning the availability of the exemption provided by section 408(b)(6), the Department has decided it may be appropriate to provide administrative relief from section 406(b)(1) for the payment of compensation for the provision of securities lending services.

However, the Department did not propose relief from section 406(b)(1) at the time the class exemption was proposed, and, pursuant to the requirements of section 408(a) of the Act, the Department is required to offer interested persons an opportunity to present their views and an opportunity for a hearing before granting an exemption from section 406(b). Therefore, in order not to delay the publication of an exemption from section 406(a) to permit securities lending transactions, the Department has decided to grant the exemption described herein, and to simultaneously publish elsewhere in this issue of the **Federal Register** notice of a class exemption from section 406(b)(1) for the payment of compensation in connection with the provision of securities lending services.

*K. Effective Date*

The individual class exemption regarding securities lending granted to the Grumman Corp. Pension Trust (Grumman) (Prohibited Transactions Exemption 79–23, 44 FR 31750, June 1, 1979) provides, by its terms, that it would terminate upon the "final disposition" of this class exemption. In order that Grumman is given sufficient notice to make any necessary changes in its securities lending program, the "final disposition" of this class exemption, for purposes of Prohibited Transaction Exemption 79–23, will be deemed to occur 30 days after the effective date of this class exemption.

**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 the Act 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 the Act and the Code. These provisions include any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; 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) This exemption does not extend to transactions prohibited under section 406(b) of the Act and section 4975(c)(1)(E) and (F) of the Code;

(3) This exemption is supplemental to and not in derogration of any other provisions of the Act or the Code, including statutory or adminstrative 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; and

(4) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

**Exemption**

In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record including the written comments submitted in response to the notice of proposed class exemption published on April [illegible], 1980, and to the notice of a reopening of the comment period published June 24, 1980, the Department makes the following determinations:

(a) The class exemption set forth herein is administratively feasible;

(b) it is in the interest of plans and of their participants and beneficiaries; and

(c) it is protective of the rights of participants and beneficiaries of plans.

Accordinly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75–1. Neither the borrower nor an affiliate of the borrower has discretionary authority or control with respect to the investment of the plan assets involved in the transaction, or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to those assets;

2. The plan receives from the borrower (either by physical delivery or by book entry in a securities depository) by the close of the lending fiduciary's business on the day in which the securities lent are delivered to the borrower, collateral consisting of cash, securities issued or guaranteed by the United States Government or its agencies, or irrevocable bank letters of credit issued by a person other than the borrower or an affiliate thereof, or any combination thereof, having, as of the close of business on the preceding business day, a maket value equal to not less than 100 percent of the then market value of the securities lent;

3. Prior to the making of any such loan, the borrower shall have furnished the lending fiduciary with (1) the most recent available audited statement of the borrower's financial condition, (2) the most recent available unaudited statement of its financial condition (if more recent than such audited statement), and (3) a representation that, at the time the loan is negotiated, there has been no material adverse change in its financial condition since the date of the most recent financial statement furnished to the plan that has not been disclosed to the lending fiduciary. Such representation may be made by the borrower's agreeing that each such loan shall constitute a representation by the borrower that there has been no such material adverse change;

4. The loan is made pursuant to a written loan agreement, the terms of which are at least as favorable to the plan as an arm's-length transaction with an unrelated party would be. Such agreement may be in the form of a master agreement covering a series of securities lending transactions;

5. (a) The plan (1) receives a reasonable fee that is related to the value of the borrowed securities and the duration of the loan, or (2) has the opportunity to derive compensation through the investment of cash collateral. Where the plan has that opportunity, the plan may pay a loan rebate or similar fee to the borrower, if such fee is not greater than the plan would pay in a comparable transaction with an unrelated party;

(b) The plan receives the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including, but not limited to, cash dividends, interest payments, shares of stock as a result of stock splits and rights to purchase additional securities;

6. If the market value of the collateral at the close of trading on a business day is less than 100 percent of the market value of the borrowed securities at the close of trading on that day, the borrower shall deliver, by the close of business on the following business day, an additional amount of collateral (as described in paragraph 2) the market value of which, together with the market value of all previously delivered collateral, equals at least 100 percent of the market value of all the borrowed securities as of such preceding day.

Notwithstanding the foregoing, part of the collateral may be returned to the borrower if the market value of the collateral exceeds 100 percent of the market value of the borrowed securities, as long as the market value of the remaining collateral equals at least 100 percent of the market value of the borrowed securities;

7. The loan may be terminated by the plan at any time, whereupon the borrower shall deliver certificates for securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the plan within (1) the customary delivery period for such securities, (2) five business days, or (3) the time negotiated for such delivery by the plan and the borrower, whichever is lesser; and

8. In the event the loan is terminated, and the borrower fails to return the borrowed securities or the equivalent thereof within the time described in paragraph 7, above, (i) the plan may, under the terms of the loan agreement, purchase securities identical to the borrowed securities (or their equivalent as described above) and may apply the collateral to the payment of the purchase price, any other obligations of the borrower under the agreement, and any expenses associated with the sale and/or purchase, and (ii) the borrower is obligated, under the terms of the loan agreement, to pay, and does pay to the plan the amount of any remaining obligations and expenses not covered by the collateral plus interest at a reasonable rate.

Notwithstanding the foregoing, the borrower may, in the event the borrower fails to return borrowed securities as described above, replace non-cash collateral with an amount of cash not less than the then current market value of the collateral, provided such replacement is approved by the lending fiduciary.

If the borrower fails to comply with any condition of this exemption in the course of engaging in a securities lending transaction, the plan fiduciary who caused the plan to engage in such transaction shall not be deemed to have caused the plan to engage in a transaction prohibited by section 406(a)(1) (A) through (D) of the Act solely by reason of the borrower's failure to comply with the conditions of the exemption.

For purposes of this class exemption the term "affiliate" of another person shall include: (i) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such other person; (ii) Any officer, director, or partner, employee or relative (as defined in section 3(15) of the Act) of such other person; and (iii) Any corporation or partnership of which such other person is an officer, director or partner. For purposes of this definition the term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual.

Signed in Washington, D.C. this 16th day of January, 1981.

**Ian D. Lanoff,**

*Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, U.S. Department of Labor.*

[FR Doc. 81-2606 Filed 1-21-81; 11:39 am]

BILLING CODE 4510-29-M

## Office of Federal Contract Compliance Programs

## Compliance Responsibility for Equal Employment Opportunity; Correction

**AGENCY:** Office of Federal Contract Compliance Programs, Department of Labor.

**ACTION:** Final Notice, correction.

**SUMMARY:** On October 3, 1980, the Department of Labor published a Notice and attached Appendix B-80 to 41 CFR Part 60-4 (45 FR 65979) which set employment goals for minority workers in the construction industry. This notice makes corrections to Appendix B-80 published on October 3, 1980.

**EFFECTIVE DATE:** January 23, 1981.

**FOR FURTHER INFORMATION CONTACT:**

James Cisco, Acting Director, Division of Program Policy, Office of Federal Contract Compliance Programs, Room C-3324, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, D.C. 20210, Telephone (202) 523-9426.

Correction of Publication: The following corrections to Appendix B-80, 45 FR 65984, are made as follows:

1. In Economic area 012, New York, N.Y. SMSA 5460, the goal is 5.8.

2. In Economic Area 012, New York, N.Y., SMSA 5600, delete "NY New York City" following "Westchester."

3. In Economic Area 012, New York, N.Y., SMSA 5600, the goal is 22.6.

4. In Economic Area 154, Missoula, MT., SMSA 154, insert"; MT Lake" after "MT Silver Bow."

5. In Economic Area 005, Non-SMSA Counties, "IR" is corrected to "RI".

6. In Economic Area 034, Non-SMSA Counties, "Collecton" is corrected to "Collection".

7. In Economic Area 106, "MO Boone" is the line following "1740 Columbia, MO" rather than preceding it.

8. In Economic Area 111, Non-SMSA Counties, on the sixth line, "Spring" is corrected to "Springs".

9. In Economic Area 124, on the sixth line, "5TX" is corrected to "TX".

10. In Economic Area 126, on the sixth line, "4TX" is corrected to "TX".

Ray Marshall,

*Secretary of Labor*

Donald Elisburg,

*Assistant Secretary, Employment Standards Administration.*

Weldon J. Rougeau,

*Director, Office of Federal Contract Compliance Programs.*

Signed at Washington, D.C.,

[FR Doc. 81-2188 Filed 1-16-81; 2:18 pm]

BILLING CODE 4510-27-M

## Office of the Secretary

### Labor-Management Research Advisory Committee; Establishment

In accordance with the provisions of the Federal Advisory Committee Act and Office of Management and Budget Circular A-63 of March 1974, and after consultation with GSA, the Secretary of Labor has determined that the establishment of the Labor-Management Research Advisory Committee is in the public interest in connection with the responsibilities vested in the Department by the Act creating the Department of Labor, 29 U.S.C. 551 et seq., and subsequent enactments.

The Committee will advise the Secretary of Labor by (1) developing a richer dialogue among researchers, policymakers, and practitioners active in the area of labor-management relations and making recommendations for strengthening research efforts; and (2) helping update and advising on implementation of the research agenda of the Department and making recommendations on research reports.

The Committee will consist of 19 members: six academic researchers, six management representatives, six labor representatives, and the Assistant Secretary for Labor-Management Relations or his designee.

The Committee will function solely as an advisory body and in compliance with the provisions of the Federal Advisory Committee Act. Its charter will be filed under the Act on February 9, 1981.

Interested persons are invited to submit comments regarding the establishment of the Labor-Management Research Advisory Committee to Mrs. Ruth Morgenstern, Departmental Committee Management Officer, Department of Labor, Room S2517, 200 Constitution Avenue, N.W., Washington, D.C. 20210.

Signed at Washington, D.C., this 16th day of January 1981.

Ray Marshall,

*Secretary of Labor.*

[FR Doc. 81-2460 Filed 1-19-81; 4:54 pm]

BILLING CODE 4510-29-M

[TA-W-7498, 7499, 7499A]

### Americana Glass Company, Inc., et al.; Negative Determination on Reconsideration

On October 17, 1980, the Department issues an Affirmative Determination Regarding Application for Reconsideration for workers and former workers producing souvenir decals at Americana Glass Company and for workers producing decorative earthenware products at Queens China Company. Americana Art China Company is the selling arm of these two affiliates.

The petitioners claimed that increased imports of decals are causing declines in jobs in the Company's artistry department, and at Queens China, loss of jobs was due to increased Company imports of pottery to fill orders of merchandise normally filled with products made at Queens China.

The Department's review showed that workers at the Sebring, Ohio facilities of Americana Glass Company, Queens China Company and Americana Art China Company did not meet the "contribute importantly" criterion of the Trade Act of 1974 with respect to souvenir decals and decorated earthenware products. A customer survey revealed that customers who decreased purchases from Americana Art China and increased import purchases represented a very small portion of the Company's sales decline during the periods covered by the survey. The Department also conducted a survey with those customers purchasing decorated pottery directly from Queens China. The survey showed that these customers did not purchase imported earthenware pottery.

On reconsideration, the Department found that although Americana Art China and its affiliated facilities imported some merchandise over a period of years, most of the merchandise was imported because these facilities were unable to produce those items for various reasons. In the periods from 1978 through 1980, these imports represented less than one percent of the Companies' total purchases.

With respect to decals, the Department found that Americana Art China Company did import some decals, but only because those decals were not available locally. Further, Company-imported products did not replace those items produced by the Company.

#### Conclusion

After reconsideration, I reaffirm the original Notice of Determination Regarding Eligibility to Apply for Worker Adjustment Assistance to workers and former workers of Americana Glass Company, Inc., Queens China Company, Inc., and Americana Art China Company, Inc., Sebring, Ohio.

Signed at Washington, D.C. this 9th day of January 1981.

James F. Taylor,

*Director, Office of Management Administration and Planning.*

[FR Doc. 81-1893 Filed 1-22-81; 8:45 am]

BILLING CODE 4510-28-M

[TA-W-8861]

### Anchor Fasteners, Inc.; Negative Determination Regarding Application for Reconsideration

By letter of November 16, 1980, (copy attached), one of the petitioners for the workers requested administrative reconsideration of the Department of Labor's Negative Determination Regarding Eligibility to Apply for Worker Adjustment Assistance for workers and former workers of Anchor Fasteners, Inc., Bedford Heights, Ohio. The determination was published in the Federal Register on October 31, 1980, (45 FR 72364).

Pursuant to 29 CFR 90.18(c), reconsideration may be granted under the following circumstances:

(1) if it appears on the basis of facts not previously considered that the determination complained of was erroneous;

(2) if it appears that the determination complained of was based on a mistake in the determination of facts previously considered; or

(3) if, in the opinion of the Certifying Officer, a misrepresentation of facts or of the law justifies reconsideration of the decision.

One of the petitioners claims in his application for reconsideration that the reduction in domestic automobile manufacturing because of imported cars