AGENCY DOCUMENTS
DOL Prohibited Transaction Exemptions

DOL Prohibited Transaction Exemptions 86-128

11/18/1986

PTE 86–128

Final Exemption

51 Fed. Reg. 41686 (Nov. 18, 1986)

[Prohibited Transaction Exemption 86–128]

Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker–Dealers

AGENCY: Department of Labor.

ACTION: Grant of class exemption.

SUMMARY: This document contains an exemption which allows persons who serve as fiduciaries for employee benefit plans to effect or execute securities transactions under certain circumstances. The exemption also allows sponsors of pooled separate accounts and other pooled investment funds to use their affiliates to effect or execute securities transactions for such accounts when certain conditions are met. The exemption will replace Prohibited Transaction Exemption 79–1 and Prohibited Transaction Exemption 84–46. It affects participants and beneficiaries of, and fiduciaries with respect to, employee benefit plans which invest in securities, and other persons who engage in the described transactions.

EFFECTIVE DATE: The later of December 18, 1986, or the date on which the Office of Management and Budget approves the information collection requests contained in this exemption under the Paperwork Reduction Act of 1980.

FOR FURTHER INFORMATION CONTACT: Daniel J. Maguire, Esq., Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, DC 20210, (202) 523–9595 (not a toll free number)or Mark Greenstein, Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, (202) 523–8671 (not a toll free number).

SUPPLEMENTARY INFORMATION: On January 24, 1985, notice was published in the Federal Register (50 FR 3427) of the pendency before the Department of Labor (the Department) of a proposed class exemption to replace PTE 79–1[1] and PTE 84–46[2] which exempted certain transactions from the restrictions of section 406 of the

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Employee Retirement Income Security Act of 1974 (ERISA or the Act) and from the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code(the Code) by reason of Code section 4975(c)(1) (A) through (F)[3] Notice was also given of the pendency before the Department of the proposed revocation of PTE 79–1 and PTE 84–46. The proposed class exemption was requested in part in an application filed by the Securities Industry Association (SIA) on behalf of its members, by letters to the Department dated November 29, 1982, April 22, 1983, May 24, 1983 and July 23, 1984. The proposal also contained provisions put forward by the Department on its own motion pursuant to its authority under section 408(a) of the Act and section 4975(c)(2) of the Code. Fifteen comments were received pursuant to those provisions, and in accordance with the procedures set forth in ERISA Procedure 75–1.[4] No requests for a hearing on the proposal were received.

Upon consideration of the entire record in the matter including the comments received, the Department is granting the exemption as proposed but with certain modifications.

Description of the Exemption

This exemption provides relief similar to that provided by Prohibited Transaction Exemption 79–1 (PTE 79–1) and Prohibited Transaction Exemption 84–46 (PTE 84–46), from the restrictions of section 406(b) of the Act and from the taxes imposed by section 4975 (a)and (b) of the Code. The exemption conditions the effecting or executing of securities transactions on behalf of a plan by a plan fiduciary upon the fiduciary's complying with a number of specific requirements designed to protect the interests of plan participants and beneficiaries. The exemption is generally available to fiduciaries with respect to employee benefit plans, except when a person is a fiduciary with respect to a plan by reason of being a plan trustee, plan administrator or sponsoring employer. The exemption is also available to managers of pooled investment funds in which plans invest, with certain restrictions applicable to those funds in which plans covering employees of the manager invest.

The exemption requires that a person engaging in a covered transaction must receive written authorization, executed in advance, from a fiduciary independent of such person. Thereafter, the authorized person must notify the plan at least annually that the authorization is terminable at will and without penalty by the plan. Such notice must include both a statement to the effect that failure to terminate the authorization will result in its continuation and a form on which to effect such a termination.

As in PTE 84–46, the exemption contains special authorization provisions and withdrawal rights for plans participating in pooled arrangements in order to accommodate the needs of funds or accounts in which the assets of many plans are collectively invested.

Persons effecting or executing securities transactions on behalf of plans pursuant to this exemption must disclose periodically certain information to the authorizing plan fiduciary. The exemption provides that a person engaging in covered transactions must furnish the authorizing fiduciary with either (1) confirmation slips containing the information described in Rule 10b–10 (17 CFR 240.10b–10) under the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. 78a et seq., or (2) quarterly reports. The quarterly reports are compilations of the information that would have been provided by the confirmation slips and, specifically, must disclose the total of all charges incurred by the plan in connection with covered transactions during the reporting period, and the portion thereof that the authorized person has paid to others in connection with covered transactions. Annual reports are required of all persons engaging in covered transactions. The annual reports summarize the information required by the confirmation slips and, in addition, provide information regarding portfolio turnover and the use of brokerage commissions to pay for investment research services.

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The exemption continues the recapture provisions of PTE 79–1. Under those provisions, any fiduciary may execute or effect securities transactions for a plan if he or she credits all profits earned in connection with the transaction to the plan. Persons generally excluded from coverage under the remainder of the exemption—that is, plan trustees, plan administrators and sponsoring employers—may engage in covered transactions on behalf of plans in such "recapture" situations.

In addition to special authorization provisions to accommodate the needs of pooled investment funds, the exemption provides, as to such funds in which plans covering employees of the pool manager or its affiliates participate, that the manager may engage in covered transactions on a "recapture" basis or may receive commissions based on the provision of brokerage services to the pool if the participation in the pool of plans covering employees of the pool sponsor is limited to twenty percent of the pool and the commissions received from all pools in which plans covering employees of the pool sponsor participate is limited to five percent of the aggregate amount of brokerage commissions received by the manager from all sources during the calendar year.

The exemption gives the authorizing fiduciary the right to request and receive any reasonably available information necessary for such fiduciary to determine whether the authorization should be made. In addition, the exemption places a corresponding duty on the authorized person to furnish the authorizing fiduciary with any additional information reasonably necessary and available to make this determination.

Finally, certain types of agency cross transactions are permitted under the exemption, under specified conditions.

Discussion of the Comments

A. Replacement of Annual Authorization Requirements

PTE 79–1 requires that persons engaging in a covered transaction on behalf of a plan obtain, at least annually, written authorization to engage in such transactions from an independent fiduciary with respect to that plan. In the interest of eliminating unnecessary costs to the authorized persons and the plans, it was proposed that this requirement be replaced with a provision whereby the independent fiduciary would be sent a form at least annually allowing it to terminate the authorization with respect to the plan; accompanying instructions would notify the plan that failure to return the form would result in continued authorization of the person to engage in covered transactions on behalf of the plan. Comments received on this aspect of the proposed exemption were generally favorable. Most commentators agreed with representations made by the SIA in its exemption application that such a modification would reduce paperwork as well as other compliance expenses.

One commentator requested that, instead of sending a form, the authorized person be allowed to supply a simple notice containing the name and address of the person to contact if the plan desired to terminate the authorization. The commentator argued that this would reduce costs even further; it was acknowledged, however, that furnishing a form was not a significant burden. Accordingly, the Department believes that requiring the person seeking continued authorization to supply a termination form to the authorizing fiduciary, rather than requiring the authorizing fiduciary to prepare such a termination letter, is a proper allocation of the minimal burden involved.

In the final exemption, section III(g) of the proposed exemption, relating to the termination form, has been incorporated into section III(c) so that all conditions relating to authorization are grouped together.

B. Amendments to the Reporting Requirements

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(1) Confirmation Slips and Quarterly Reports

Under PTE 79–1, authorized persons are required to supply the authorizing fiduciary with quarterly reports which disclose certain information related to the total of all transaction–related charges incurred by the plan in connection with covered transactions, the allocation of such charges among various persons, as well as a conspicuous statement about the negotiability of brokerage commissions and an estimate of future commission rates.

Pursuant to representations made by the SIA, the proposed exemption eliminated the requirements of PTE 79–1 as to the statement concerning the negotiability of brokerage commissions and the estimate of future commission rates. Various commentators agreed that the inclusion of these items in the quarterly reports provided little useful information to plan fiduciaries in evaluating the performance or services of the authorized persons.

The proposed exemption also provided that the authorized person was to supply the independent fiduciary with a "confirmation slip"for each securities transaction instead of quarterly reports. It was represented by the SIA that the contents of the confirmation slip would include information sufficient for the authorizing fiduciary to evaluate the execution services provided, and that the combination of confirmation slips and annual summaries would provide the plan fiduciaries with information more useful in monitoring the execution of securities trades than the quarterly reports had provided.

While many commentators agreed that confirmation slips would be as informative to the plans and less costly to the authorized person, several persons requested that the Department retain the quarterly reporting provision, or at least some other alternative, as a means of compliance. One commentator noted, for example, that where an investment adviser is required to maintain a segregated escrow fund (SEF) pursuant to Rule 206(4)–2(17 CFR 275.206(4)–2), under the Investment Advisers Act of 1940, 15 U.S.C. 80b–1 et seq., confirmation slips for securities transactions are issued only to the adviser and not to the fiduciary of a particular plan client of the adviser. It was argued that issuing confirmation slips to the authorizing fiduciary of each plan participating in the SEF would be much more burdensome than the quarterly reporting requirement of PTE 79–1. In consideration of these comments, the Department has decided to expand the availability of the option, proposed for pooled investment funds, to allow the provision to the authorizing fiduciary of either confirmation slips or quarterly reports.[5]

Those commentators who endorsed the "confirmation slip"aspect of the proposed exemption generally objected to the condition contained in proposed section III(e)(2), that the time of the transaction be included on the confirmation slip. Several commentators noted that Rule 10b–10 under the 1934 Act does not require that the exact time of the trade be included on the slip; rather, under that rule, the slips are to state that the time of the trade will be supplied upon the request of the customer. It was argued that supplying the independent fiduciary with the time of the trade provided no useful information and would entail costly adjustments to computerized reporting systems. Finally, one commentator argued that Rule 10b–10 has been revised and updated in recent years and most likely will continue to be modified in the future.

In consideration of these comments, the Department has modified this aspect of the exemption to state that confirmation slips provided to the authorizing fiduciary must contain the information described in Rule 10b–10 under the 1934 Act. This provision contemplates that, as the Securities and Exchange Commission (SEC) may amend and revise Rule 10b–10, the confirmation slips supplied to the authorizing fiduciaries pursuant to this class exemption will be correspondingly amended and revised, to the extent required by the changes in Rule 10b–10.

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(2) Annual Reporting Requirements

(a) Allocation of transaction related charges. PTE 79–1 requires that the reports furnished to the authorizing fiduciary disclose both the total charges relating to covered transactions incurred by the plan during the period to which the report relates, as well as the amount of the transaction–related charges retained by the authorized person and the amount of such charges paid to other persons for execution or other services. The proposed exemption retained the requirement that this information be disclosed, either annually (for those issuing confirmation slips) or in quarterly reports otherwise. Some commentators stated that they had no objection to this requirement. A few commentators, however, objected to its inclusion. It was argued that the requirement provides the independent plan fiduciary with no useful information, as his or her concern should be with the aggregate charges and not with any additional breakdown. Another commentator analogized to the statutory reporting requirement under ERISA; it was noted that whereas section 103(e)(2) of ERISA requires a breakdown of how an insurance company disposes of premiums received from a plan, Congress imposed no such reporting requirements on broker–dealers.[6]

The Department is not persuaded by these arguments. While it agrees that this is information not required under ERISA's annual reporting requirements, the Department believes that it is entirely appropriate, in the context of this class exemption, to require disclosure of certain information by the exempted person so as to reduce the need for the independent fiduciary to make independent inquiry into the actions of that person. In this case, the breakdown of remuneration charges enables the authorizing fiduciary to ascertain whether, and if so, to what extent the authorized person is the one actually performing the services for which the plan has contracted.[7] It appears to the Department that such information would be helpful to independent fiduciaries generally in their evaluation of the management and brokerage services provided. Accordingly, the Department has decided to retain this requirement.[8]

(b) Disclosure of charges for research and other services. The proposed exemption contained a provision requiring annual disclosure of whether any transaction–related charges were attributable to consideration for research, other nonbrokerage services or goods and, if so, a detailed description of such services or goods. Many commentators objected to this section of the proposal. Some commentators argued that the Department lacks the legal authority to require such disclosure and that only the SEC has jurisdiction over such matters. Others interpreted this section as inhibiting the payment of monies for research services in contravention of section 28(e) of the 1934 Act. Several commentators represented that compliance with the proposed requirement was impracticable because research and other services may not be directly attributable to specific trades for specific accounts.

In adopting amendments to several forms and a proxy rule under the Investment Company Act, the SEC addressed similar concerns[9] while still reflecting its longstanding position that "such brokerage placement practices, although permissible, should be disclosed to investors."[10] Amendments were adopted which required disclosure of whether persons acting on behalf of an investment company are authorized to pay a broker a brokerage commission in excess of that which another broker might have charged for effecting the same transaction, in recognition of the value of brokerage or research services provided by the broker.[11]

In addition, amendments to the "brochure rule" under the Investment Advisers Act of 1940 required certain investment advisers to provide a narrative description about their brokerage placement practices.[12]

Several commentators responding to the proposed exemption recommended that the Department rely on the disclosures required by the SEC in the rules discussed above.

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In consideration of the comments, the Department has decided to modify the reporting provisions relating to charges that are attributable in part to consideration for goods or nonbrokerage services.

Rather than impose an annual reporting requirement, the final exemption requires that, as part of the initial authorization, the person requesting authorization provide the authorizing fiduciary with a description of the person's brokerage placement practices. Compliance with the brokerage placement practice disclosures required by Form ADV of the Advisers Act will satisfy this requirement of section III(d) of this exemption.[13] Subsequent to this initial disclosure, additional information regarding the person's brokerage placement practices need only be supplied in the summary provided pursuant to section III(f)(3) of the exemption when there is a material change in those practices.

As to pooled accounts, the final exemption has been amended to include a parallel reporting provision in section IV(d)(1)(B). Under this provision, the person requesting authorization must provide the authorizing fiduciary with a description of the person's brokerage placement practices along with other information necessary to determine whether the authorization should be made. Material changes in such brokerage placement practices must be disclosed to authorizing fiduciaries in the summaries provided pursuant to section III(f) of the exemption.

The Department notes that sections III(d) and IV(d)(1)(B)of the exemption continue the requirements of PTE 79–1 and PTE 84–46 that the authorized person is required to furnish the authorizing fiduciary with any reasonably available information necessary to determine whether the authorization should be made or continued. The Department further notes that, under ERISA section 404(a)(1)(B), the authorizing fiduciary has an obligation to be prudent in the selection, and in monitoring the performance of, the investment manager authorized to provide services under the exemption.[14] In this regard, the authorizing fiduciary may wish to request more information from the person concerning brokerage placement practices than is supplied with the initial authorization materials in order to satisfy his or her duties as the authorizing fiduciary.

With respect to the comments questioning the Department's authority to impose these disclosure requirements, the Department notes that the transactions covered by the exemption would, but for the exemption, be proscribed by ERISA's prohibited transaction provisions, for reasons that are unrelated to section 28(e). In the Department's view, the authority to grant exemptions from those provisions carries with it the authority to grant exemptions subject to conditions that the Department determines to be appropriate.

(c) Disclosure of portfolio turnover. Section III(f)(4)of the proposed exemption provided that the annual summary furnished to the authorizing fiduciary contain a calculation of the annualized portfolio turnover ratio as a percentage of the plan assets consisting of securities or cash for which the authorized person had investment discretion. That section provided a formula by which to make this calculation.

Several persons commented on this aspect of the proposed exemption. Some argued that the formula was so simple that the information it provided would be at best meaningless, and at worst misleading, to the authorizing fiduciary. Others stated that the calculation was so complex as to be burdensome for the authorized person. One commentator suggested that the final exemption contain a definition of "portfolio turnover" consistent with that contained in Form N–SAR pursuant to the Investment Company Act of 1940.[15]

In consideration of these comments, the Department has decided to eliminate the requirement that the specific formula as set forth in this exemption must be used in computing the portfolio turnover ratio. Instead, the Department has determined that the authorizing fiduciary and the manager should be permitted to agree on a different method of computation that is reasonably designated to provide the authorizing fiduciary with the

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information needed to assist in discharging its duty of prudence. However, the formula as proposed, with certain technical modifications described below in response to the comments received, remains as a "safe harbor" method of satisfying the requirement of section III(f)(4).

The Department has modified the formula to eliminate from the computation the effects of short–term cash management—that is, management of debt securities with maturity at acquisition of one year or less. This was done to eliminate a "masking" effect that might otherwise result from high portfolio turnover ratios that can be the result of short–term cash management. In addition, explicit instructions for computing the "monthly average of the market value of the portfolio" have been provided. Both of these modifications were made to conform the method of computation to the method set forth in Form N–SAR, cited above. The formula does depart from that set forth in Form N–SAR, however, in that it adds an annualizing factor to account for the possibility that managers may serve for periods of varying durations.

As adopted, the "safe harbor" formula provides that a non–annualized portfolio turnover ratio is first calculated, by dividing the lesser of the aggregate dollar amounts of purchases or sales of portfolio securities during the relevant periods by the monthly average of the market value of the portfolio securities during such periods. The monthly average is obtained by totaling the market values of the portfolio securities as of the beginning and end of each period and as of the end of each month that ends within such periods, and dividing the sum by the number of valuation dates so used. As is noted above, all debt securities whose maturities at the time of acquisition were one year or less are excluded from both the numerator and the denominator. The annualized portfolio turnover ratio is then obtained by multiplying the portfolio turnover ratio described above by an annualizing factor. The annualizing factor is obtained by dividing the number twelve by the aggregate duration of the relevant management periods expressed in months (and fractions thereof).

The Department has added a section to the final exemption,(section V), containing examples which illustrate the use of this formula. The Department believes that, with the adoption of the formula as a "safe harbor", affected parties are provided with both the certainty and the flexibility necessary to comply with this condition of the class exemption.

In response to another comment, the Department has eliminated the requirement to supply the computation in cases where the authorized person has not, during the period covered by the report, exercised any discretionary authority over trading in the account. In those cases, the Department has concluded that the potential for self–dealing by means of causing the plan involved to engage in excessive trading, thereby generating unwarranted brokerage commissions, is substantially reduced if not eliminated. In other cases, however, the Department has decided to retain the requirement. The commentators who generally objected to the requirement argued that many factors, such as the types of securities contained in the portfolio and a given plan's investment objectives, would substantially affect the degree of portfolio turnover. The Department believes that a plan's authorizing fiduciary should be aware of these factors and, therefore, will be able to evaluate the portfolio turnover computation in light of them. Authorized persons may provide whatever supplemental explanatory material they believe to be necessary to make the calculation more meaningful and not misleading to the authorizing fiduciary in the annual report.

C. Clarification of the Scope of the Exemption

PTE 79–1 provides an exemption from both sections 406(a) and 406(b) of ERISA. The proposed exemption provided relief only from the restrictions of section 406(b). The reason for this modification is that the Department believes that any relief from section 406(a) that may be necessary in connection with transactions covered by this

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exemption is provided by the statutory exemption for the provision of services to a plan by a party in interest contained in section 408(b)(2) of ERISA.

Several commentators objected to this aspect of the proposed exemption. Some of these commentators included an argument that section 408(b)(2)provides an exemption from all of section 406, not just 406(a). The Department does not share this view of the scope of section 408(b)(2).[16]

Neither this class exemption, nor PTE 79–1 or PTE 84–46, provides relief for direct or indirect sales, or other underlying transactions, described in section 406, in which a plan and a party in interest participate. Rather, this exemption provides relief from the restrictions of section 406(b) only for those service transactions that are covered by section II of the exemption and the receipt of compensation therefor by a plan fiduciary. For example, if a plan fiduciary purchases securities from a person he knows to be a party in interest for the plan in an agency cross transaction and receives a commission from the party–in–interest for effecting that transaction, this exemption provides relief from section 406(b)(3) for the receipt of the commission by such fiduciary (provided that the conditions of the exemption are met)but does not provide relief from section 406(a)(1)(A), which generally prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction that constitutes a direct or indirect sale or exchange of any property between a plan and a party in interest. In the absence of other exemptive relief, this latter transaction would be prohibited.

This exemption specifically excludes relief for acts of"churning." In this regard, section II(a) of the proposed exemption stated that relief was provided for the described transactions, "but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency."

Several commentators objected to this language. Some commentators noted that whether an account is in fact "churned" depends on all the facts and circumstances, not merely the amount or frequency of securities trades. Others stated they feared that the Department would be developing or imposing a set of standards regarding what constitutes "churning" that differs from standards that would apply under the federal securities laws.

Upon consideration of the comments, the Department has decided to adopt the provision as proposed. The conduct of a plan fiduciary in managing a securities account must be measured according to ERISA's fiduciary responsibility standards; excessive trading in the account is one respect in which the fiduciary might breach the general fiduciary responsibilities, including that of prudence, imposed on him or her by section 404(a)(1) of ERISA. While the Department does not consider it appropriate to condition the availability of the exemption on adherence by the fiduciary to all facets of these fiduciary duties (including those related to the merits of the underlying transaction), the generation of excessive fees through inappropriately high portfolio turnover rates is an abuse with which the Department is concerned in implementing this class exemption. Thus, the Department could conclude that a fiduciary had violated ERISA's prudence requirement where an account had been "churned", despite the fact that the resulting composition of the plan's portfolio, viewed by itself without regard to the impact of excessive transaction costs, was beyond challenge. The Department does not wish to suggest that the exemption in any way relieves fiduciaries of the obligation not to cause the plan to pay excessive transaction costs.[17]

D. Agency Cross Transactions

The proposed exemption contained specific provisions relating to the conditions under which an authorized person could affect or execute agency cross transactions on behalf of its plan clients. Generally, an agency cross transaction is a transaction in which both the buyer and the seller of a security use the same broker. It was represented by the applicant that such transactions would save plans money and that SEC regulations are sufficient

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to protect plans from any potential abuse. The proposed conditions were derived from two SEC rules: (1) Rule 206(3)–2 under the Investment Advisers Act of 1940 (17 CFR 275.206(3)–2), and (2) Rule 17a–7 under the Investment Company Act of 1940 (17 CFR 270.17a–7).

As a general matter, the Department received no comments objecting to the inclusion in the exemption of the section on agency cross transactions. Rather, comments were addressed to particular aspects of that section of the proposed exemption; these comments are discussed below.

(1) Price. Section III(h)(5) of the proposed exemption required that agency cross transactions be effected at a price "no less favorable to any plan involved in the transaction than the `current market price' of the security, as . . . defined in Rule 17a–7(b)." That subsection of Rule 17a–7 contains four possible means of determining "current market price" depending on such factors as whether the security is a reported security and whether its principal market is an exchange.

Four commentators objected to this subsection of the proposed exemption. It was argued that the condition in the proposed exemption would operate so as to require a broker–dealer to execute such transactions at the last sale price for certain reported securities, unless there were no reported transactions on that day, which could result in a transaction taking place at a price either higher or lower than the current market price for those securities. The commentators suggested that this condition be revised to require that agency cross transactions be effected or executed at any price at or between the current bid and current ask quotations. The commentators represented that their proposed condition, in conjunction with section III(h)(4)of the proposed exemption (which limits agency cross transactions to situations where market quotations for a security are readily available), would be sufficiently protective of the interests of the plan.

The Department agrees with the commentators' concerns. The Department has, therefore, adopted the suggested revision to the price condition, with the additional condition that the bid and ask quotations be independent.

(2) Transactions Where Discretion Exists on Both Sides

The preamble to the proposed exemption stated that relief was neither requested nor proposed by the Department to extend to agency cross transactions where a broker–dealer has discretionary authority or renders investment advice with respect to both sides of the transaction, in view of the additional potential for abuse that exists in such situations.

In response to this aspect of the proposed exemption, the Department received two comments. Specifically, it was requested that the proposed exemption be revised to permit agency cross transactions between two employee benefit plans, or between a plan and a mutual fund, when the transaction is recommended or effected by a person who serves as an adviser or fiduciary to both parties to the transaction. It was argued that normal portfolio adjustments necessary for liquidity needs as well as individual and overall investment strategies may result in the not unusual situation where an adviser/fiduciary has one client account for which he wishes to sell a particular security at the same time that he has another client account for which he wishes to buy that same security. It was represented that extending relief under the proposed exemption to allow the authorized person to effect the transaction for both sides would be beneficial to plans, both because, under the commentators' proposals, only limited fees would be charged and because the buyer and seller may obtain a better, less distorted price than that otherwise available on the open market.

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Both commentators suggested that exemptive relief modeled after Rule 17a–7 of the Investment Company Act of 1940 would safeguard plans involved in such transactions against potential abuse. As to mutual funds, that rule provides an exemption for certain purchase or sale transactions between a mutual fund and certain "affiliated persons" thereof under specified conditions. Those conditions include quarterly determinations by the mutual fund's board of directors (including a majority of the directors who are not"interested persons" of the fund) that all purchases or sales made during the quarter pursuant to the Rule were in compliance with procedures reasonably designed to provide that the requirements of the Rule are met. Further, subsection(d) of the Rule provides, that "no brokerage commission, fee (except for customary transfer fees), or other remuneration [may be] paid in connection with the transaction." One commentator noted, however, that "customary transfer fees"may be indicated as "commissions" on the brokerage confirmation. This commentator further advised that "broker–dealers may charge what is termed `commissions'for an agency cross transaction since broker–dealers' costs and risks associated with such transactions may fluctuate with the amount of securities involved."

The other commentator stated that it was unable to define the term "customary transfer fee". It did state that such fees were understood to include such things as custodial transaction fees, out–of–pocket expenses, transfer agent transaction fees, and charges incurred pursuant to governmental reporting requirements. This commentator advised, however, that the Department should not attempt to define or limit the type of fees that may be charged in such transactions in order not to restrict unnecessarily the flexibility of investment advisers. The commentator also argued against restriction of the expanded relief it requested to transactions involving reported securities or securities principally marketed on an exchange.

After consideration of these comments, the Department has decided not to extend relief in the final exemption to agency cross transactions where the authorized person has discretionary authority with respect to both sides of the transaction.

In addition to uncertainty regarding both the fees that would be charged for such transactions and the bases for those fees, the comments received indicate that strict application of Rule 17a–7's pricing provisions may not be appropriate in all cases. The requested augmentation of the exemption, even if modified to allow the pricing flexibility that appears to be necessary or at least desirable, as is discussed above, would provide to the transaction—possibly on both sides—would be obtaining a price commensurate with what arm's–length bargaining would have produced. Accordingly, the Department has not been persuaded that, on balance, the potential benefits that may inure to plans outweigh the possibility of abuse that exists when a plan fiduciary acts on behalf of both the plan and a party whose interests are adverse to those of the plan.

E. Recapture Provision

Section IV(c) of the proposed exemption continued the provision from PTE 79–1 which allows a fiduciary to effect securities transactions for a plan with respect to which the fiduciary is a plan trustee, plan administrator or employer of employees covered by the plan, provided that all profits resulting from the brokerage function are recaptured on behalf of the plan. The Department received two comments requesting modification of section III(a) and IV(c) of the proposal so as to allow plan trustees to engage in covered transactions on a non–recapture basis.

The Department received one comment requesting that all trustees, including those with discretion with respect to plan investments, be allowed to engage in covered transactions. It was argued that PTE 79–1 and the exemption as proposed placed banks at a competitive disadvantage, "for no apparent reason", in relation to both insurance companies and investment advisory affiliates of broker–dealers, where a plan sponsor has "elected the

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stability, experience, and security offered...by a bank trustee."

The Department has previously expressed concern that, as a general matter, the position of a plan trustee may carry with it so great an influence over the general operation of the plan that an independent fiduciary may not be effective in examining critically and objectively multiple service arrangements.[18]

Although that comment did not address the Department's previously expressed concern, another commentator requested that the Department clarify the definition of trustee by explicitly excluding custodial or "non–discretionary"trustees who possess no investment discretion with respect to any assets of the plan. Custodial functions were described as including the provision of plan documents and necessary amendments to comply with applicable law, the safekeeping of securities, the disbursement of benefits, and the reporting of information required by the Internal Revenue Service. This commentator noted that the Department's Advisory Opinion #82–12A discussed the situation where, by operation of Code sections 401(f) or 408(h), a custodial account may be treated as a qualified trust, and as a result, the custodian is treated as the trustee of such account. On the basis of the representations made in that opinion request, the Department concluded that the custodian of the participant–directed plans would not be treated as a trustee for purposes of PTE 79–1.

This commentator also noted that the Comptroller of the Currency allows banks without fiduciary powers to "combine the functions of custodian and the purchasing of securities upon the direction of the principal."[19] In addition, the Federal Deposit Insurance Corporation recently amended its rules to permit certain banks that do not exercise trust powers to act as trustee or custodian of Individual Retirement Accounts and Simplified Employer Pensions under certain conditions; these conditions include: (1)The bank's duties as trustee or custodian must be essentially custodial in nature, (2) the bank must invest the funds from such plans only in its own time or savings deposits or in any other assets at the direction of the customer,(3) the bank may not exercise any investment discretion or provide any investment advice with respect to such accounts, and (4) the bank's acceptances such accounts without trust powers must not be contrary to state law.[20]

In addition, this commentator argued that the Department's rationale for excluding trustees from those persons eligible to engage in transactions under this exemption—that is, that such persons may have so great an influence over the operation of the plan that adequate independent examinations of any multiple service arrangement involving the trustee may not exist—was not applicable in situations where a trustee has very little or no discretion respecting the investment of the assets of the plan. On the basis of these comments, the Department has concluded that persons who are trustees, but whose duties are limited in a manner similar to those of the non–trustee custodians discussed above, should be excepted from the condition that the person engaging in the covered transaction must not be a plan trustee.[21] Section III(a) of the exemption, as adopted, excludes "nondiscretionary trustees" from that condition, and new section I(i) defines the term "nondiscretionary trustee" in the same manner as that term is defined in PTE 77–9 as amended.[22] In other respects, the Department has decided to retain the condition of PTE 79–1 that trustees may provide brokerage services under this exemption only in recapture situations.[23]

F. Special Rule for Pooled Funds

PTE 84–46 allows an affiliate of an insurance company maintaining a pooled separate account to provide brokerage services for that account. The authorization provisions of that exemption are designed to accommodate the needs of funds or accounts in which the assets of many plans are collectively invested. The proposed exemption made these alternative methods of authorization available to any account or fund for the collective

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investment of the assets of more than one plan without requiring the recapture of brokerage profits on behalf of that account or fund. The Department received no criticism of this provision and thus has retained it in the final.

Under PTE 79–1 and the exemption as proposed, persons who are plan trustees, plan administrators, or employers of employees covered by a plan, are generally prohibited from engaging in covered transactions on behalf of such plans other than in recapture situations. In response to that proposal, the Department received one comment requesting that the sponsors of pooled accounts or their affiliates be allowed, under certain conditions, to engage in covered transactions on a non–recapture basis where plans covering employees of the pool sponsors or their affiliates (in–house plans)participate in the pool. The suggested conditions included that the participation of in–house plans in a pool be limited to a certain percentage of the fair market value of the total assets of the pool. Furthermore, the commentator noted that limits could be placed on the total commissions received from all such pooled funds in which in–house plans participate. It was asserted that the interests of the in–house plans would be adequately protected because independent investors representing a substantial portion of the assets of a pooled fund would be scrutinizing the provision of brokerage services by the affiliated broker–dealer. In addition, the commentator noted that a limitation on commissions receivable with respect to pools in which in–house plans participate, similar to that contained in, for example, ERISA section 408(b)(5), would provide additional protection to such plans.

It was argued that the Department has granted similar exemptive relief in the past. In PTE 77–3, the Department exempted from the prohibited transaction provisions of the Act and the Code the acquisition and sale of shares of a mutual fund by the fund's in–house plan.[24] This relief, in turn, was modeled on the statutory exemptions for banks and insurance companies contained in ERISA sections 408(b) (4)and (5). As the Conference Report explains in relation to those statutory exemptions, it would be contrary to normal business practice for a bank to invest the assets of its in–house plan in another bank, or for a plan covering employees of an insurance company to purchase its insurance from another company.[25]

Based on these comments, the Department has decided to modify the exemption in the manner requested so as to allow in house plans to participate in such pools subject to certain protective conditions. Upon consideration, the Department has determined that a five percent limitation on the total commissions received with respect to those pooled funds in which in–house plans participate is an appropriate limitation.[26] In addition, the Department believes that further protection would be provided to such in–house plans where the value of their investment is limited to twenty percent of the fair market value of the pool, as determined on the first day of each fiscal year of the pool. The twenty percent figure is consistent with a similar condition in PTE 84–14, Class Exemption for Plan Asset Transactions Determined by Independent Qualified Professional Asset Managers (49 FR 9494, March 13, 1984), and adequately addresses the concerns expressed by the commentator. A determination of whether a pooled fund meets the twenty percent limit during the course of the pool's fiscal year must be made in a manner similar to that by which the percentage of a plan's holding of employer securities is made under the Department's regulations at 29 CFR 2550.407a–2 and 2550.407a–3; that is, (1)an in–house plan may not acquire any additional interests in a pool if, immediately after such acquisition, the fair market value of all in–house plans' interests would exceed 20% of the fair market value of the total assets of the pool; and (2) such pool fund will be in initial compliance with the 20% requirement for a fiscal year if it satisfies the requirement on the first day of that fiscal year notwithstanding any subsequent increase in such percentage limitation which occurs merely as a result of the withdrawal of other participants in the pool.

G. Transitional Rule and Effective Date

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The proposed exemption provided that the replacement exemption would become effective thirty days after its publication in the the Federal Register. Further, the proposal indicated that the Department intended to revoke PTE 79–1 and PTE 84–46 at the same time. The Department received several comments requesting clarification of the effective date provisions, as well as comments requesting an additional period of time before the revocation of the existing class exemptions.

Two commentators requested that the annual fiduciary authorizations obtained pursuant to PTE 79–1 be allowed to satisfy the initial authorization requirement of the new exemption without any further action by the authorized person. It was suggested that at the expiration of this annual authorization, the authorized person would then be required to include as part of the next annual report to the independent plan fiduciary all the information that would be required under the new exemption.

Another commentator requested that PTE 79–1 not be revoked for at least six months so as to allow time for agreements and contracts executed pursuant to that exemption to be modified in order to comply with the new exemption.

In consideration of these comments, the Department has made the following determinations: An authorized person may continue to rely on authorizations obtained pursuant to PTE 79–1 or PTE 84–46 to engage in covered transactions under the new exemption, provided that: (1) The authorization complies with the applicable authorization requirements of the new exemption, and (2) before the authorized person begins operating under the new exemption, the authorizing fiduciary is provided with the information required by section III(d) or IV(d)(1)(B), whichever is applicable (including a copy of this exemption) and the form for terminating the authorization. In addition, PTE 79–1 and PTE 84–46 will not be revoked until April 1, 1987, so as to allow authorized persons and authorizing fiduciaries ample time in which to adjust their authorization and reporting procedures. It should be noted, however, that this provision does not operate so as to relieve persons who continue to act pursuant to the "old" exemptions from any of the conditions imposed thereunder, including the reporting provisions. Authorized persons are reminded that they are required, under PTE 79–1 and PTE 84–46, to supply reports with respect to any three–month period in which they engaged in any covered transactions; upon availing themselves of the new exemption, therefore, such persons must still send the authorizing fiduciary any reports required under the old exemptions.

In addition, the effective date of the exemption has been changed to the later of thirty days after publication in the Federal Register or the date on which the Office of Management and Budget approves the information collection requests contained in the exemption under the Paperwork Reduction Act of 1980. When the exemption is effective, the Department will publish a notice in the Federal Register notifying interested persons of that fact.

H. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1980(Pub. L. 96–511), the disclosure provisions that are included in this exemption have been submitted to the Office of Management and Budget.

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

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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. That section requires, among other things, that a fiduciary discharge his or her 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. This exemption also does not 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 January 24, 1985, the Department makes the following determinations:

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

(b) It is in the interests of plans and 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.

Section I: Definitions and Special Rules

The following definitions and special rules apply to this exemption:

(a) The term "person" includes the person and affiliates of the person.

(b) An "affiliate" of a person includes the following:

(1) Any person directly or indirectly controlling, controlled by, or under common control with, the person;

(2) Any officer, director, partner, employee, relative(as defined in section 3(15) of ERISA), brother, sister, or spouse of a brother or sister, of the person;

(3) Any corporation or partnership of which the person is an officer, director or partner.

A person is not an affiliate of another person solely because one of them has investment discretion over the other's assets. The term "control"means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(c) An "agency cross transaction" is a securities transaction in which the same person acts as agent for both

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any seller and any buyer for the purchase or sale of a security.

(d) The term "covered transaction" means an action described in section II (a), (b) or (c) of this exemption.

(e) The term "effecting or executing a securities transaction"means the execution of a securities transaction as agent for another person and/or the performance of clearance, settlement, custodial or other functions ancillary thereto.

(f) A plan fiduciary is independent of a person only if the fiduciary has no relationship to or interest in such person that might affect the exercise of such fiduciary's best judgment as a fiduciary.

(g) The term "profit" includes all charges relating to effecting or executing securities transactions, less reasonable and necessary expenses including reasonable indirect expenses (such as overhead costs) properly allocated to the performance of these transactions under generally accepted accounting principles.

(h) The term "securities transaction" means the purchase or sale of securities.

(i) The term "nondiscretionary trustee" of a plan means a trustee or custodian whose powers and duties with respect to any assets of the plan are limited to (1) the provision of nondiscretionary trust services to the plan, and (2) duties imposed on the trustee by any provision or provisions of the Act or the Code. The term "nondiscretionary trust services" means custodial services and services ancillary to custodial services, none of which services are discretionary. For purposes of this exemption, a person does not fail to be a nondiscretionary trustee solely by reason of having been delegated, by the sponsor of a master or prototype plan, the power to amend such plan.

Section II: Covered Transactions

Effective the later of December 18, 1986, or the date on which the Office of Management and Budget approves the information collection requests contained in this exemption under the Paperwork Reduction Act of 1980, if each condition of section III of this exemption is either satisfied or notapplicable under section IV, the restrictions of section 406(b) of ERISA and the taxes imposed by sections 4975 (a) and (b) of the Code by reason of section 4975(c)(1) (E)or (F) or the Code shall not apply to—

(a) A plan fiduciary's using its authority to cause a plan to pay a fee for effecting or executing securities transactions to that person as agent for the plan, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency;

(b) A plan fiduciary's acting as the agent in an agency cross transaction for both the plan and one or more other parties to the transaction;or

(c) The receipt by a plan fiduciary of reasonable compensation for effecting or executing an agency cross transaction to which a plan is a party from one or more other parties to the transaction.

Section III: Conditions

Except to the extent otherwise provided in section IV of this exemption, section II of this exemption applies only if the following conditions are satisfied:

(a) The person engaging in the covered transaction is not a trustee (other than a nondiscretionary trustee) or an administrator of the plan, or an employer any of whose employees are covered by the plan.

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(b) The covered transaction is performed under a written authorization executed in advance by a fiduciary of each plan whose assets are involved in the transaction, which plan fiduciary is independent of the person engaging in the covered transaction.

(c) The authorization referred to in paragraph (b) of this section is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice of termination. A form expressly providing an election to terminate the authorization described in paragraph (b) of this section with instructions on the use of the form must be supplied to the authorizing fiduciary no less than annually. The instructions for such form must include the following information:

(1) The authorization is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice from the authorizing fiduciary or other plan official having authority to terminate the authorization; and

(2) Failure to return the form will result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the plan.

(d) Within three months before an authorization is made, the authorizing fiduciary is furnished with any reasonably available information that the person seeking authorization reasonably believes to be necessary for the authorizing fiduciary to determine whether the authorization should be made, including (but not limited to) a copy of this exemption, the form for termination of authorization described in section III(c), a description of the person's brokerage placement practices, and any other reasonably available information regarding the matter that the authorizing fiduciary requests.

(e) The person engaging in a covered transaction furnishes the authorizing fiduciary with either:

(1) a confirmation slip for each securities transaction underlying a covered transaction within ten business days of the securities transaction containing the information described in Rule 10b–10(a)(1–7)under the Securities Exchange Act of 1934, 17 CFR 240.10b–10; or

(2) at least once every three months and not later than 45 days following the period to which it relates, a report disclosing:

(A) A compilation of the information that would be provided to the plan pursuant to subparagraph (e)(1) of this section during the three–month period covered by the report;

(B) the total of all securities transaction related charges incurred by the plan during such period in connection with such covered transactions;and

(C) the amount of the securities transaction–related charges retained by such person and the amount of such charges paid to other persons for execution or other services.

For purposes of this paragraph (e), the words "incurred by the plan" shall be construed to mean "incurred by the pooled fund" when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

(f) The authorizing fiduciary is furnished with a summary of the information required under paragraph (e)(1) of this section at least once per year. The summary must be furnished within 45 days after the end of the period

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to which it relates, and must contain the following:

(1) The total of all securities transaction–related charges incurred by the plan during the period in connection with covered securities transactions.

(2) The amount of the securities transaction–related charges retained by the authorized person and the amount of these charges paid to other persons for execution or other services.

(3) A description of the person's brokerage placement practices, if such practices have materially changed during the period covered by the summary.

(4)(i) A portfolio turnover ratio, calculated in a manner which is reasonably designed to provide the authorizing fiduciary with the information needed to assist in discharging its duty of prudence. The requirements of this paragraph (f)(4)(i) will be met if the "annualized portfolio turnover ratio", calculated in the manner described in paragraph (f)(4)(ii), is contained in the summary.

(ii) The "annualized portfolio turnover ratio" shall be calculated as a percentage of the plan assets consisting of securities or cash over which the authorized person had discretionary investment authority, or with respect to which such person rendered, or had any responsibility to render, investment advice (the "portfolio") at any time or times ("management period(s)") during the period covered by the report. First, the "portfolio turnover ratio" (not annualized) is obtained by dividing (A) the lesser of the aggregate dollar amounts of purchases or sales of portfolio securities during the management period(s) by (B) the monthly average of the market value of the portfolio securities during all management period(s). Such monthly average is calculated by totaling the market values of the portfolio securities as of the beginning and end of each management period and as of the end of each month that ends within such period(s), and dividing the sum by the number of valuation dates so used. For purposes of this calculation, all debt securities whose maturities at the time of acquisition were one year or less are excluded from both the numerator and the denominator.

The "annualized portfolio turnover ratio" is then derived by multiplying the "portfolio turnover ratio" by an annualizing factor. The annualizing factor is obtained by dividing (C) the number twelve by (D) the aggregate duration of the management period(s) expressed in months (and fractions thereof).

Examples of the use of this formula are provided in section V of this exemption.

(iii) The information described in this paragraph (f)(4)is not required to be furnished in any case where the authorized person has not exercised discretionary authority over trading in the plan's account during the period covered by the report.

For purposes of this paragraph (f), the words "incurred by the plan" shall be construed to mean "incurred by the pooled fund" when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

(g) If an agency cross transaction to which section IV(b)does not apply is involved, the following conditions must also be satisfied:

(1) The information required under section III(d) or IV(d)(1)(B)of this exemption includes a statement to the effect that with respect to agency cross transactions the person effecting or executing the transactions will have a potentially conflicting division of loyalties and responsibilities regarding the parties to the transactions;

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(2) The summary required under section III(f) of this exemption includes a statement identifying the total number of agency cross transactions during the period covered by the summary and the total amount of all commissions or other remuneration received or to be received from all sources by the person engaging in the transactions in connection with those transactions during the period;

(3) The person effecting or executing the agency cross transaction has the discretionary authority to act on behalf of, and/or provide investment advice to, either (A) one or more sellers or (B) one or more buyers with respect to the transaction, but not both.

(4) The agency cross transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available; and

(5) The agency cross transaction is executed or effected at a price that is at or between the independent bid and independent ask prices for the security prevailing at the time of the transaction.

Section IV: Exceptions From Conditions

(a) Certain plans not covering employees. Section III of this exemption does not apply to covered transactions to the extent they are engaged in on behalf of individual retirement accounts meeting the conditions of 29 CFR 2510.3–2(d), or plans, other than training programs, that cover no employees within the meaning of 29 CFR 2510.3–3.

(b) Certain agency cross transactions. Section III of this exemption does not apply in the case of an agency cross transaction, provided that the person effecting or executing the transaction:

(1) Does not render investment advice to any plan for a fee within the meaning of section 3(21)(A)(ii) of ERISA with respect to the transaction;

(2) is not otherwise a fiduciary who has investment discretion with respect to any plan assets involved in the transaction, see 29 CFR 2510.3–21(d); and

(3) does not have the authority to engage, retain or discharge any person who is or is proposed to be a fiduciary regarding any such plan assets.

(c) Recapture of profits. Section III(a) of this exemption does not apply in any case where the person engaging in a covered transaction returns or credits to the plan all profits earned by that person in connection with the securities transactions associated with the covered transaction.

(d) Special rules for pooled funds. In the case of a person engaging in a covered transaction on behalf of an account or fund for the collective investment of the assets of more than one plan (pooled fund):

(1) Sections III (b), (c) and (d) of this exemption do not apply if—

(A) The arrangement under which the covered transaction is performed is subject to the prior and continuing authorization, in the manner described in this paragraph (d)(1), of a plan fiduciary with respect to each plan whose assets are invested in the pooled fund who is independent of the person. The requirement that the authorizing fiduciary be independent of the person shall not apply in the case of a plan covering only employees of the person, if the requirements of section IV(d)(2) (A) and (B) are met.

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(B) The authorizing fiduciary is furnished with any reasonably available information that the person engaging or proposing to engage in the covered transactions reasonably believes to be necessary to determine whether the authorization should be given or continued, not less than 30 days prior to implementation of the arrangement or material change thereto, including(but not limited to) a description of the person's brokerage placement practices, and, where requested, any reasonably available information regarding the matter upon the reasonable request of the authorizing fiduciary at any time.

(C) In the event an authorizing fiduciary submits a notice in writing to the person engaging in or proposing to engage in the covered transaction objecting to the implementation of, material change in, or continuation of, the arrangement, the plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the pooled fund, without penalty to the plan, within such time as may be necessary to effect the withdrawal in an orderly manner that is equitable to all withdrawing plans and to the nonwithdrawing plans. In the case of a plan that elects to withdraw under this subparagraph (d)(1)(C), the withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a plan electing to withdraw.

(D) In the case of a plan whose assets are proposed to be invested in the pooled fund subsequent to the implementation of the arrangement and that has not authorized the arrangement in the manner described in subparagraphs(d)(1) (B) and (C) of this section, the plan's investment in the pooled fund is subject to the prior written authorization of an authorizing fiduciary who satisfies the requirements of subparagraph (d)(1)(A).

(2) Section III(a) of this exemption, to the extent that it prohibits the person from being the employer of employees covered by a plan investing in a pool managed by the person does not apply if—

(A) The person is an "investment manager" as defined in section 3(38) of ERISA, and

(B) Either (i) the person returns or credits to the pooled fund all profits earned by the person in connection with all covered transactions engaged in by the person on behalf of the fund, or (ii) the pooled fund satisfies the requirements of paragraph IV(d)(3).

(3) A pooled fund satisfies the requirements of this paragraph for a fiscal year of the fund if—

(A) On the first day of such fiscal year, and immediately following each acquisition of an interest in the pooled fund during the fiscal year by any plan covering employees of the person, the aggregate fair market value of the interests in such fund of all plans covering employees of the person does not exceed twenty percent of the fair market value of the total assets of the fund; and

(B) The aggregate brokerage commissions received by the person, in connection with covered transactions engaged in by the person on behalf of all pooled funds in which a plan covering employees of the person participates, do not exceed five percent of the total brokerage commissions received by the person from all sources in such fiscal year.

Section V: Examples Illustrating the Use of the Annualized Portfolio Turnover Ratio Described in Section III(f)(4)(ii)

(a) A, an investment manager affiliated with a brokerdealer that A uses to effect securities transactions for the accounts that it manages, exercises investment discretion over the account of plan P for the period January 1,

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1987, through June 30, 1987, after which the relationship between A and P ceases. The market values of P's account with A at the relevant times(excluding debt securities having a maturity of one year or less at the time of acquisition) are:

Date	Market value ($ millions)
January 1, 1987	10.4
January 31, 1987	10.2
February 28, 1987	9.9
March 31, 1987	10.0
April 30, 1987	10.6
May 31, 1987	11.5
June 30, 1987	12.0
Sum of market value	74.6

Aggregate purchases during the 6–month period were$850,000; aggregate sales were $1,000,000, excluding in each case debt securities having a maturity of one year or less at the time of acquisition.

For purposes of section III(f)(4) of this exemption, A computes the annualized portfolio turnover as follows:

A=$850,000 (lesser of purchases or sales)

B=$10,657,143 ($74.6 million divided by 7, i.e., the number of valuation dates)

Annualizing factor = C/D =12/6=2

Annualized portfolio turnover ratio=2X(850,000/10,657,143)=0.160=16.0 percent

(b) Same facts as (a), except that A manages the portfolio through July 15, 1987 and, in addition, resumes management of the portfolio on November 10, 1987 through the end of the year. The additional relevant valuation dates and portfolio values are:

Dates	Market value ($ millions)

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July 15, 1987................	12.2
November 10, 1987...........	9.4
November 30, 1987...........	9.6
December 31, 1987...........	9.8
Sum of Market Values.....	

Annualizing factor = C/D = 12/(6.5+1.67)=1.47

annualized portfolio turnover ratio=1.47X(1,400,000/10,509,091)=0.196=19.6 percent.

Section VI. Effective Dates and Transitional Rule

(a) This exemption will be effective on the later of December 18, 1986, or the date on which the Office of Management and Budget approves the information collection requests contained in this exemption under the Paperwork Reduction Act of 1980.

(b) PTE 79–1 and PTE 84–46 are revoked effective April 1, 1987.

Signed at Washington, DC, this 5th day of November, 1986.

Dennis M. Kass,

Assistant Secretary, Pension and Welfare Benefits Administration.

[FR Doc. 86–25951 Filed 11–17–86; 8:45 am]

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Footnotes

[1] 44 FR 5963 (January 30, 1979).

[2] 49 FR 22157 (May 25, 1984).

[3] 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 exemptions of the type granted herein to the Secretary of Labor. For the sake of clarity, the remainder of the preamble refers only to Title I of ERISA, although these references also apply to the corresponding provisions of section 4975 of the Code.

[4] 40 FR 18471 (April 28, 1975).

[5] Persons who elect the quarterly reporting option may incorporate any such report into a contemporaneous summary provided pursuant to section III(f) of the exemption.

[6] Another commentator objecting to this provision argued that the breakdown of remuneration charges was information not currently required to be provided to "customers".

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The requirement to provide the breakdown to independent plan fiduciaries is, however, currently required under section II(e)(ii) of PTE 79–1.

[7] The Department notes that, as the definition of "person"includes affiliates of the person, the exempted person need not disclose a breakdown of amounts paid to its affiliates. The Department also notes that, in other cases where precise figures are not available, a reasonable approximation of the allocation of fees will satisfy this condition (See, Preamble to PTE 79–1, 44 FR at 5966 (footnote 15)).

[8] One commentator stated that while it is feasible to provide this information, it is "not possible" to do so on the confirmation slips. Disclosure of this information on the confirmation slips themselves is not required; the remuneration breakdown is to be provided annually (for those supplying confirmation slips) or in quarterly reports for others.

[9] In 1976, the SEC had proposed a rule (proposed Rule 28e(2)–1 under the 1934 Act) which would have required investment advisers and others to disclose certain information concerning research services obtained in return for brokerage commissions, including a description of such services and an estimate of their fair market value. In addition, the SEC specifically invited comments on the feasibility and desirability of requiring disclosure of specific dollar amounts paid through brokerage commissions. See SEC Release Nos. 33–5772, 34–13024, IC–9547, IA–554 (41 FR 53356, December 6, 1976).

In response to this proposed rule, the Commission received numerous comments similar to those received by the Department: that it was impossible to attribute specific research to specific trades, that it was not practical to place a value on those services, and that it was not feasible to separate commissions into research and brokerage charges. SEC Release Nos. 33–6019, IC–10569, IA–665 (44 FR 7864, February 7, 1979). See also, SEC Release Nos. 34–15541, IA–664 (44 FR 7870, February 7, 1979).

[10] 44 FR at 7864.

[11] See, e.g., 17 CFR 270.20(a)(7)(vi).

[12] See 17 CFR 275.204–3. See also, Securities and Exchange Commission Release No. IA–991 (50 FR 42903, October 23, 1985).

[13] However, under this exemption, such a description must be supplied regardless of whether the authorized person is subject to the"brochure rule."

[14] See generally, discussion of ongoing responsibilities of a fiduciary at 29 CFR 2509.75–8, FR–17, and, more particularly, ERISA Technical Release 86–1, issued May 22, 1986.

[15] See SEC Release No. 34–21633, IC–14299, dated January 4, 1985 (50 FR 1442, 1479, January 11, 1985).

[16] If that argument were correct, the necessity for this exemption would be called into question. Regulations promulgated pursuant to section 408(b)(2) provide, however, that that section does not provide an exemption for acts described in section 406(b). These regulations have been at issue in litigation and have been upheld. In Marshall v. Kelly, 465 F. Supp. 341(W.D. Okla., 1978), the court held:

Section 408(b)(2) of ERISA, 29 U.S.C. 1108(b)(2), provides no exemption from the provisions

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of section 406(b). Although the language of section 408(b)(2) appears to provide an exemption from all of the prohibitions of section 406, a closer look at the statutory language and purpose has led the Department of Labor to the position expressed in an interpretative regulation, 29 CFR 2550.408b–2(a) and (e), that section 408(b)(2)provides no exemption from the provisions of section 406(b). Since this construction by the agency charged with the enforcement of ERISA resolves inconsistencies in the statutory language and preserves a fundamental purpose of ERISA, i.e. to prevent a fiduciary from acting in matters in which he has an interest which might affect his judgment, this Court should give it great weight, Udall v. Tallman, 380 U.S. 1 (1965). In addition, the Court has itself reviewed the statutory language and legislative history and has independently concluded that section 408(b)(2) should not be construed to provide an exemption from the prohibitions of section 406(b).

See also, Gilliam v. Edwards, 492 F. Supp. 1255 (D.N.J. 1980).

[17] One commenter argued that, in the case where a participant directs trading in his account, the fiduciary following those instructions should not be liable for any excise taxes that might be imposed if this condition of the exemption is not satisfied. The commentator correctly pointed out that while section 404(c) of ERISA (relating to relief from fiduciary liability in the case of participant–directed pension plan accounts) might provide relief from the prohibited transaction provisions of Title I of ERISA in such cases, there is no counterpart in the Code to section 404(c). If the fiduciary does not use its authority to cause the plan to pay additional fees for brokerage services, this exemption from the provisions of section 406(b)(1) of the Act and its counterpart in the Code is not necessary. See note 22, infra. The situation described by the commentator, however, also raises questions under section 406(a) of the Act and its counterpart in the Code. The extent to which the statutory exemptions in the Act and Code for the provisions of services apply to the situations described by the commentator is an interpretive matter that depends, in part, on the facts and circumstances surrounding the series of transactions directed by the participant. It should also be noted that, pursuant to section 102(a)(iii)of Reorganization Plan No. 4 of 1978 (43 FR 47713, Oct. 17, 1978), the authority to grant exemptions from the excise taxes imposed by section 4975 " . . . with respect to transactions that are exempted by subsection 404(c) from the provisions of Part 4 of . . . Title I of ERISA . . ." was not transferred from the Internal Revenue Service to the Department. See also, however, PTE 75–1 (40 FR 50845, Oct. 31, 1975), Section I(b). PTE 75–1 was issued by both the Department and the Internal Revenue Service.

[18] See, preamble to PTE 79–1, 44 FR at 5964 (footnote 11).

[19] Opinion of the Comptroller, November 21, 1983.

[20] 12 CFR 333.101(b), 50 FR 10753 (March 18, 1985).

[21] The Department will consider, for purposes of this exemption, the power to amend plan documents solely to comply with changes in applicable law as a non–discretionary trustee or custodial function. The Department expresses no opinion, however, on whether the power to amend plan documents in a more substantive manner would indicate the opposite result.

[22] 49 FR 13208 (April 3, 1984). The distinction between "nondiscretionary"trustees and trustees generally was made in that exemption for reasons similar to those for which it is made here.

[23] It should be noted, however, that the Department has issued two advisory opinions which

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held that the subject banks would not violate ERISA section 406(b)(1) by the use of their in–house brokerage services in circumstances where(1) the banks would effect securities transactions only upon the express direction of a participant or an independent investment manager, and (2) the banks did not exercise any of the authority, control or responsibility that made them fiduciaries to cause the plans to pay any additional fees for the provision of such services. See DOL Advisory Opinions Nos. 85–15A, 85–16A (April 4, 1985). In other cases, section 404(c) of ERISA might provide adequate relief from the prohibited transaction provisions of Title I. However, it should be noted that the authority to grant administrative exemptions from the corresponding provisions of section 4975 of the Code remains with the Internal Revenue Service under Reorganization Plan No. 4 of 1978, there being no Code counterpart to section 404(c).

[24] Class Exemption Involving Mutual Fund In–House Plans, 42 FR 18734 (April 8, 1977).

[25] ERISA Conference Report, H.R. Rep. No. 93–1280, 93d Cong., 2d Sess. 313, 314 (1974).

[26] See also, PTE 79–60, 44 FR 59018 (October 12, 1979).

PTE 86–128

Proposed Exemption

50 Fed. Reg. 3427 (Jan. 24, 1985)

DEPARTMENT OF LABOR

Office of Pension and Welfare Benefit Programs

[Application No. D–3970]

Proposed Class Exemption To Replace PTE 79–1 and PTE 84–46 for Certain Transactions Involving Employee Benefit Plans and Securities Broker–Dealers

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

ACTION: Proposed class exemption, and proposed revocation of existing class exemptions.

SUMMARY: This document contains a notice of pendency before the Department of a proposed class exemption and of a proposed revocation of existing class exemptions. If adopted, the proposed class exemption would replace Prohibited Transaction Exemption (PTE) 79–1, which permits broker–dealers(or their affiliates) who serve as fiduciaries of employee benefit plans to exercise discretionary authority to effect or execute securities brokerage transactions on behalf of their plan clients without violating section 406 of the Employee Retirement Income Security Act of 1974 (ERISA), and PTE 84–46, which provides similar relief in the case of life insurance company pooled separate accounts that recapture brokerage profits generated by securities transactions effected by affiliates of the insurance company. The exemption and proposed revocation would affect those with an interest in the investments of employee benefit plans. The proposed exemption would provide conditional relief that differs, in some respects, from that provided by PTE 79–1 and PTE 84–46.

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DATES: Written comments and requests for a public hearing should be received by the Department before March 25, 1985. The replacement exemption would be effective 30 days following publication of the final grant notice in the Federal Register.

ADDRESSES: All written comments and requests for a hearing(preferably 3 copies) should be sent to: Office of Regulations and Interpretations, Office of Pension and Welfare Benefit Programs, Room C–4526, 200 Constitution Ave. NW, Washington, DC 20210, Attn: Brokerage Exemption Revisions. The application for exemption, as well as all comments and requests for a public hearing, will be available for public inspection in the Public Documents Room, Office of Pension and Welfare Benefits Programs, U.S. Department of Labor, Room N–4677, 200 Constitution Ave. NW, Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: E.F. Williams, Office of Regulations and Interpretations, Room C–4526, Washington, D.C. 20210,(202) 523–8194 (this is not a toll–free number).

SUPPLEMENTARY INFORMATION: Notice is hereby given of the pendency before the Department of a proposed class exemption that would replace PTE 79–1[1] and PTE 84–46,[2] which are class exemptions from the restrictions of section 406 of ERISA and from the taxes imposed by section 4975 (a)and (b) of the Internal Revenue Code (the Code) by reason of certain transactions described in Code sections 4975(c)(1) (A) through (F)[3] Notice is also hereby given of the pendency before the Department of a proposed revocation of PTE 79–1 and PTE 84–46. In part, this proposal is the Department's response to an application filed by the Securities Industry Association (SIA), a trade association for securities broker–dealers. The application was filed under section 408(a) of ERISA and in accordance with the procedures set forth in ERISA Procedure 75–1 (40 FR 18471, April 28, 1975) by letters to the Department from the SIA dated November 29, 1982, April 22, 1983, May 24, 1983 and July 23, 1984. In addition, the document contains proposals that the Department is making on its own motion pursuant to the authority described above.

Section 406(a) of ERISA prohibits, among other things, the provision of services between a plan and parties in interest (including fiduciaries) with respect to that plan and the transfer of plan assets to a party in interest unless a statutory or administrative exemption applies to the transaction. In addition, unless exempted, section 406(b) of ERISA prohibits, among other things, a fiduciary's dealing with the assets of a plan in his or her own interest. Although section 408(b)(2) of ERISA provides a conditional statutory exemption permitting plans to make resonable contractual arrangements with parties in interest for the provision of services necessary for the plan's operations, that exemption does not extend to acts of self–dealing described in section 406(b) of ERISA.[4] A fiduciary performing both investment management and brokerage services for the same plan is in a position where his or her decision, as an exercise of fiduciary discretion, to engage in a portfolio trade on behalf of the plan would result in the plan's paying the fiduciary and additional fee for performance of the brokerage services. In the Department's view, such decision involves an act of self–dealing prohibited by section 406(b) of ERISA and not exempt by section 408(b)(2) of ERISA.

PTE 79–1 is intended to provide relief from the restrictions of section 406 in order to permit a plan fiduciary to act as both investment manager and securities broker for the same plan, under conditions designed as appropriate safeguards to ensure the protection of the plan assets involved in the transactions. Those safeguards rely heavily on the prior authorization and monitoring of the fiduciary's activities by a second plan fidicuary [fiduciary], who is independent of the first. PTE 84–46 is similar to PTE 79–1 but was designed to alleviate practical problems presented by certain conditions of PTE 79–1 as they apply to insurance company pooled separate accounts. For a more complete discussion of the relief provided by PTE 79–1 and PTE 84–46, interested

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persons are referred to the exemptions themselves as published in the Federal Register and cited above.

The principal respects in which the proposed exemption would, if adopted, provide relief that differs from that provided by the two class exemptions it would replace are discussed below.

A. Replacement of Annual Authorization Requirement

Sections II (b) and (c) of PTE 79–1 require that a transaction must be performed pursuant to a written authorization executed by a fiduciary of the plan who is independent of the person engaging in the transaction, and that the continuance of such authorization for more than one year must be similarly authorized at least annually by the independent fiduciary. The Department required annual authorizations when it granted PTE 79–1 because it believed that these requirements would provide a continuing safeguard against the conflict of interest which exists when a plan fiduciary can select itself to provide brokerage services for a plan at a profit.[5]

1. Summary of the SIA's Representations Concerning the Costs and Benefits of the Annual Authorization Requirement

In its application, the SIA represents the following: Based on its members' experience since the adoption of PTE 79–1, it fails to perceive any benefit to plan participants from the annual authorization requirement. It does not know of any instance in which an independent fiduciary, having initially authorized a broker–dealer fiduciary to execute trades for a plan, has failed ultimately to renew the authorization. However, the independent fiduciaries are very slow in responding to requests for annual authorizations.

If annual authorizations are not received in time because of administrative delays, plan accounts are denied the benefits of obtaining brokerage services from broker–dealer fiduciaries. For example, if a broker–dealer aggregates orders from various accounts, plan accounts for which renewals have not been received are denied the lower commission rates and better executions derived from that aggregation because a broker–dealer fiduciary must place orders to buy or sell securities for those plans with another brokerage firm. Generally, if a broker–dealer fiduciary places a securities order for a plan with another firm, the chances of an optimal execution are substantially reduced because of the inability of the broker–dealer fiduciary to control order flow.

Moreover, if the annual authorization is not received from a plan, some brokerage firms will close the plan's account because they are not structured to manage plan accounts and execute trades through another firm. Other firms will charge the plan a higher rate for management without brokerage. In addition, certain brokerage firms have simply decided not to offer brokerage services to their managed plan accounts because of the administrative burdens and costs of complying with the annual authorization requirement.

Compliance with the annual authorization requirement is costly and unnecessarily burdensome. These costs and burdens stem from the printing and mailing of the annual authorization forms and, more importantly, from the time spent by account executives or other firm employees ensuring compliance with the requirement.

In general, broker–dealer fiduciaries must mail two or three renewal forms to the relevant independent fiduciaries prior to securing renewal authorizations. Second mailings are virtually mandatory, and it is estimated that approximately 50% of the relevant accounts return their renewal forms thereafter. The "success rate" of renewal form returns after the third mailing is approximately 78%. After a third mailing, repeated phone calls are necessary to obtain completed renewal forms, and sometimes account executives must pick up renewal forms on personal visits to the clients.

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A typical procedure for compliance with the annual consent requirement involves the following: One month prior to the termination of an annual consent, renewal forms are printed and mailed to the independent fiduciaries. An employee is assigned to tabulate the results and to determine which plans have returned their renewals and which plans must receive second or third renewal forms. In certain firms, the particular account executives also track the renewal process with regard to the plan accounts to which they are assigned. They communicate with the independent fiduciaries of plan accounts to remind them of the renewal requirement. The expenditure of time by account executives in such "non–productive" activities can constitute a major cost of the renewal process to various firms.

Based upon reasonable best estimates available to the SIA, the costs of following this procedure amounts to $15,000 a year for a brokerage firm with approximately 40 small plan accounts and $75,000 for a firm with approximately 450 institutional–size plan accounts.

2. The SIA's Request for an Alternative Requirement

The SIA states in its application that a better approach towards accomplishing the objective of the authorization requirement at a smaller cost to the securities industry would be to require a broker–dealer fiduciary to send to the independent fiduciary annually a form for terminating the authorization of the broker–dealer to effect agency transactions for the plan. This form would state in a prominent manner that the authorization is terminable at will by the plan, without penalty, upon receipt by the broker–dealer of written notice from the plan. This form would be accompanied by instructions making clear that failure to return the form would result in the continued authorization of the broker–dealer to effect agency transactions for the plan. This approach would not penalize the plan and broker–dealer if the independent fiduciary fails to respond to a request for continued authorization. In addition, the deletion of an annual affirmative renewal by the plan would be more consistent with SEC Rule 11a2–2(T) under the Securities Exchange Act of 1934 (the 1934 Act).[6]

3. The Department's Responses

On the basis of the SIA's representations, the Department has tentatively concluded that the benefits derived from the current annual authorization requirement compared with those that would be derived from an alternative such as suggested by the SIA, are not sufficiently greater that they warrant the annual authorization requirement's additional costs. Therefore, the Department is proposing to replace the annual authorization requirement with a requirement that the annual report to the authorizing fiduciary required by proposed section III(f) (and discussed below) be accompanied by a form that the authorizing fiduciary may return at any time in order to terminate the authorization. In addition, such a form must be supplied to the authorizing fiduciary before the initial authorization is made. See section III (c), (d)and (g) of the proposed exemption

B. Amendments to Reporting Requirements.

Sections II (e) through (g) of PTE 79–1 require that reports be sent to independent plan fiduciaries not less than quarterly disclosing:the total charges related to exempt transactions in the past quarter, including a breakdown between the portion of those charges retained by the person covered by the exemption and the portion paid to other persons for execution or other services; rates for transaction–related charges anticipated to be made in the coming three months for transactions normally entered into by the plan;and a statement to the effect that brokerage commission in the United States are not fixed by any stock exchange of other authority and are subject to negotiation.

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1. Summary of the SIA's representations concerning the costs and benefits of the quarterly reports

In its application, the SIA represents the following: It fails to see the benefits derived by plan participants from the requirement that independent fiduciaries be sent reports quarterly. With the information from the confirmation provided under SEC Rule 10b–10, the plan can closely monitor its agency transactions performed by a broker–dealer.[7]

With regard to the contents of the report, the SIA points out that SEC Rule 11a2–2(T) does not require estimates of future costs or a statement concerning the negotiability of brokerage commission rates. The SIA has no objections to the requirement that its members disclose the total transaction charges incurred by a plan and the amount of those charges retained by the broker–dealer or its affiliates. However, it is unnecessary to state that commissions are no longer fixed as the advent of negotiated rates in 1975 has been well publicized. Moreover, in the current era of negotiated commission rates, it is extremely difficult to predict accurately the transaction–related charges to a plan at some future date. Such a prediction may be misleading because actual charges would depend on the specific nature of the transaction and a variety of competitive factors.

The SIA contends that the costs involved in preparing the quarterly reports are unduly high, considering that they duplicate much of the information received in Rule 10b–10 confirmations. This is especially true for those firms that utilize outside service bureaus to handle back–office processing operations, since those bureaus do not usually provide a service to comply with the quarterly report requirements of PTE 79–1. Other firms must compile the data manually because it would be costly to redesign their own computer systems to perform a special run to comply with the requirement. The average time devoted to this requirement is approximately two weeks on the part of a brokerage firm employee before the end of each quarter. Estimates of the cost for a brokerage firm to comply with the quarterly report requirement range from $2,500 to $5,000 per year on a regular basis, plus the time and expense involved in developing a special computer or manual system to handle this requirement.

2. The SIA's Request for an Alternative Requirement and Related Representatives.

The SIA requests in its application that reporting be required at least annually rather than quarterly. It suggests that the Department specifically include as a condition to the exemption that an independent fiduciary of a plan receive a confirmation under SEC Rule 10b–10 for each trade executed or effected for that plan by a broker–dealer or affiliated adviser that serves as an ERISA fiduciary to the plan. It also requests the elimination of the requirements of estimates of future costs and of the statement concerning the negotiability of commission rates.

The SIA makes the following representations relating to these requests: If a plan is an advisory client of a broker–dealer or an investment adviser controlled by or under common control with a broker–dealer, an independent fiduciary of the plan will receive a confirmation of each securities trade effected or executed by the broker–dealer for that plan because the plan is considered the "customer" under the confirmation delivery requirement in SEC Rule 10b–10. The information in the confirmations is sufficient to allow an independent fiduciary to evaluate the execution services provided by a broker–dealer. From the viewpoint of the plan, the critical elements of an execution are the price of the security bought, the total commission charges, and the date and time of the trade. These elements are all required by SEC Rule 10b–10 to be included in the confirmation. While the quarterly report summarizes the commission charges received by the broker–dealer during the quarter, such a summary can easily be constructed by an independent fiduciary from the confirmations. While it is true that the confirmations do not delineate the allocation of the commissions between the broker–dealer and its sub–agents,

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an independent fiduciary should be primarily interested in the total commissions charged to the plan, not the allocation. According to the SIA, as long as the total commissions are acceptable to the plan, it is of little relevance how the broker–dealer organizes its business relationships to achieve those commission levels. In any event, an independent fiduciary would receive at least annually a summary of the total commissions paid by the plan to the broker–dealer fiduciary and the amount of those commissions retained by the broker–dealer.

3. The Department's Response.

On the basis of the SIA's representations, the Department has tentatively concluded that in cases where transaction–by–transaction confirmations are supplied to independent fiduciaries, the benefits derived from the current reporting requirements compared with those that would be derived from the reporting requirements proposed in this document are not great enough to justify the current reporting requirements' additional costs.

However, the Department is not certain that in all cases the confirmations required by Rule 10b–10 are normally provided to the independent plan fiduciaries referred to above. For example, the Department believes it should assume, for purposes of this proposed exemption, that there are entities established for the collective investment of plan assets that would themselves, rather than the plans that invest in them, be considered the "customers" of broker–dealers effecting securities transactions on behalf of the entities. Where the managers of such entities are affiliated with the broker–dealers and, therefore, not independent, the substitution of the SIA's suggested reporting requirement for the quarterly reporting requirement contained in PTE 79–1 would impose an obligation on these collection investment entities to send a confirmation of every trade to every plan invested in the entity. The Department believes that this would increase, rather than decrease, the reporting burdens imposed on these entities. The Department, therefore, proposes to retain the quarterly reporting requirement as an alternative option for fiduciaries with respect to such entities who prefer to comply with it rather than with the SIA's proposed substitute. Section IV(d) of the proposal was designed to address the situation where the manager of the entity and the broker–dealer are affiliates. Conversely, if the manager of the entity is not affiliated with the broker–dealer, and the broker–dealer is not otherwise a person in whom the manager has an interest that might affect the manager's best judgement as a fiduciary, such manager would be an appropriate independent fiduciary for purposes of the authorization and reporting requirements under the proposal. In the latter case, it is expected that the broker–dealer could comply with the basic requirements contained in section III of the proposal.

The Department has also considered whether the proposed quarterly reporting option should be modified to require reporting on a less frequent basis. While the Department believes that an annual summary of securities–related transactions, discussed in greater detail below, is appropriate in all cases, it also believes that the annual summaries alone would not provide sufficient up–to–date information to enable the independent plan fiduciaries responsible for monitoring the performance of the broker–dealer to discharge that responsibility adequately.[8] By its tentative decision to retain the quarterly reporting requirement on an optional basis (for pooled funds), the Department does not intend to suggest that in all cases quarterly reporting will provide information sufficient under the circumstances to permit adequate review under section 404 of ERISA by appropriate independent plan fiduciaries. Rather, the Department believes that it is reasonable to require, in the context of a class exemption, a uniform standard that may obviate, to a substantial degree, the necessity for monitoring fiduciaries to request additional information at what they believe to be reasonable intervals during the periods between receipt of the annual summaries.

With regard to the annual summaries, the Department has tentatively decided to retain certain information presently required under PTE 79–1 that does not necessarily appear in the confirmation slips: A breakdown of the

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charges retained by the authorized person and any portion paid to other persons. In addition, the Department proposes to require certain additional information in those summaries that it believes will make the other information provided more meaningful to the authorizing fiduciary.

First, the Department believes that portfolio turnover calculations should be provided in the annual summaries. Second, the Department's current view is that it will be difficult, if not impossible, for monitoring fiduciaries to review adequately the performance of an investment manager unless the summary discloses the nature of any research services or other goods or services (in addition to brokerage services) that the investment manager has received in consideration for commissions paid.[9]

In view of the foregoing, the Department is proposing to make the following changes: (i) Substituting annual reporting and the furnishing of confirmation slips for securities trades (proposed sections III(e) and(f)) for the quarterly reporting requirement of PTE 79–1; (ii) adding annual summaries of the confirmations and portfolio turnover calculations to the contents of the periodic reports (proposed section III(f)); and (iii) requiring that disclosure be made, in the annual report, as to the nature of any research services provided in exchange for brokerage commissions paid by the plan (proposed section III(f)(3)). The Department also proposes to eliminate the required statement concerning the negotiability of commissions (section II(f) of PTE 79–1), in view of the time that has elapsed since the advent of the negotiated rate system.

C. Changes in the Scope of the Exemption

PTE 79–1 provides an exemption from both section 406(a) and section 406(b) of ERISA. The proposed exemption, on the other hand, provides relief only from the restrictions of section 406(b). The Department believes that any relief from the provisions of section 406(a) that may be required in connection with the transactions covered by the exemption should be provided in accordance with the conditions contained in section 408(b)(2), the statutory exemption for the provision referred to above. One principal consequence of the proposed modification would be to make it clear that if the fiduciary engages in portfolio trading that is excessive under the circumstances("churning"), the conditions of section 408(b)(2) would fail to be satisfied,[10] and there would be no exemption for the fiduciary's violation of section 406(a) of ERISA.

In addition, restricting the relief in the manner proposed should help make clear that the Department does not intend that the exemption will apply to underlying securities transactions that are prohibited by section 406(a) (such as the sale of securities by a plan to a party in interest) merely because the fiduciary causing the plan to engage in the transaction is also acting as the plan's broker therefor.

D. Agency Cross Transactions

Agency cross transactions are transactions in which both a buyer and a seller of a security use the same broker. Submissions on behalf of the Investment Company Institute, the First Manhattan Company (a securities broker–dealer), and the SIA indicate that it is important to plans for broker–dealers who are fiduciaries to be able to effect or execute securities agency cross transactions on behalf of their plan clients. It is represented that SEC regulations adequately protect plans and that agency cross transactions often save clients money.

The SIA has sought either clarification that agency cross transactions are covered by PTE 79–1 or an amendment to the exemption that would remove any uncertainty regarding the applicability of the exemption to such transactions.

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A broker–dealer that is not a fiduciary of a plan for which it is acting as an agent in an agency cross transaction does not need an exemption from the prohibitions of section 406(b) of ERISA, because that section applies only to acts by fiduciaries. Therefore, nothing in this exemption would apply to that situation.

However, a broker–dealer may be a fiduciary of a plan under the following circumstances. First, the broker–dealer may be a plan fiduciary for reasons unrelated to the transaction in question, so that he or she does not have the authority or control to cause plan assets to be involved in the transaction. In that situation, the broker–dealer is merely executing the transaction pursuant to appropriate instructions by another plan fiduciary but,[11] because of the broker–dealer's status as fiduciary, may be in violation of section 406(b)(3) of ERISA by receiving a commission from a party to the transaction other than the plan.[12] The Department believes that the potential for abuse to the plan by the broker–dealer under such circumstances in minimal. Therefore, the Department proposes that the relief provided for such transactions be unconditional. See section IV(b)of the proposed exemption.

Second, the broker–dealer may be a fiduciary with respect to the plan assets involved in the transaction but neither exercises investment discretion nor provides investment advice with respect to any assets proposed to be committed to the transaction by any person on the "other side"of the transaction (i.e., sellers if the plan is a buyer, or buyers if the plan is a seller). Under these circumstances, subject to the conditions set forth in section III(h) of the proposal, section II(b) and (c) of the proposal provide the exemptive relief necessary to permit plans to participate in agency cross transactions.

The first three conditions in section III(h) are derived from Rule 206(3)–2 under the Investment Advisers Act of 1940 (17 CFR 275.206(3)–2, which relates to the effecting of agency cross transactions for an advisory client by registered investment advisers or by registered broker–dealers affiliated with any such adviser. These conditions differ in some respects from (but are not inconsistent with) the corresponding provisions of Rule 206(3)–2. Conditions III(h) (1) and (2) require that the information accompanying a request for authorization of the broker–dealer to effect agency cross transactions on behalf of the plan includes a statement to the effect that the person effecting the transactions will have a potentially conflicting division of loyalties and responsibilities regarding the parties to the transactions, and that the annual summary of transactions discussed above, separately identify the number of agency cross transactions and the renumeration from all sources received or to be received in connection therewith by the broker–dealer. Condition III(h)(3) requires, in summary, that the broker–dealer cannot have investment management authority or investment advisory responsibilities with respect to both sides of the transaction. This condition is designed to limit the applicability of the exemption to the situation described above.

Conditions III(h) (4) and (5) are derived from Rule 17a–7 under the Investment Company Act of 1940 (17 CFR 270.17a–7). They require that the security that is the subject of the transaction be one for which market quotations are readily available, and that the transaction be effected at a price no less favorable to any plan involved in the transaction than the "current market price" as defined in paragraph (b) of Rule 17a–7.[13] These conditions are designed to provide an independent objective standard for the fairness to the plan of the underlying transaction and to assist the authorizing fiduciary in monitoring these transactions.

The SIA states that a broker–dealer executing an agency cross transaction performs services in addition to those that would be required if the broker–dealer were acting as agent for only one side of the transaction, and that the receipt of commissions from parties on both sides of any agency transaction is, therefore, warranted. The Department has not been persuaded, however, that agency cross transactions are not more profitable to the broker–dealer, taking into account the effort and expense involved, than other transactions. It believes, therefore, that the

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broker–dealer may be presented with a greater conflict of interest in agency cross transactions, even though the potential for abuse is less than if the broker–dealer had, for example, discretionary authority over both sides of the transaction. Accordingly, the Department has tentatively concluded that these additional conditions are warranted to restrict the ability of the broker–dealer to effect transactions for its own benefit.

Finally, there may be instances in which a broker–dealer has discretionary authority or renders investment advice with respect to both sides of the transaction. The SIA has not specifically requested, and the Department is not proposing to provide, relief in this situation. Proponents of any such exemptive relief will have the burden of demonstrating why and under what conditions such relief would be appropriate, in view of the additional potential for abuse that would appear to be present in such a situation.

E. Changes in the Definition of Affiliate

In addition to nonsubstantive language simplification changes, the Department has added a sentence to the end of the definition of the term"affiliate" stating explicitly that a person is not an affiliate of another person merely because the other person has investment discretion over the person's assets. Under the subdivision labeled (1) at the end of PTE 79–1 and section I(a) of the proposed exemption, a "person" includes affiliates of the person. Under the definitions of "affiliate" in the two documents, a person "controlled by" another person is an affiliate of the other person. The new sentence clarifies that a transaction between a plan and an entity whose assets are managed by a fiduciary of the plan is not considered to be a principal transaction between the plan and that fiduciary merely because of the fiduciary's investment discretion over the entity's assets.

F. Recapture Provisions

Section II(h) of PTE 79–1 permits a fiduciary broker to effect or execute transactions for a plan for which he or she is a trustee, etc., without annual authorizations from an independent fiduciary if that person returns or credits all profits he or she earns in connection with the transactions to the plan. The substance of the provision is in section IV(c) of the proposed exemption.

G. Special Rules for Pooled Funds

As indicated above, the Department has granted a class exemption, PTE 84–46, relating to insurance company pooled separate accounts. The applicants in that matter had requested relief that would permit an affiliate of the insurance company maintaining the pooled separate account to provide brokerage services for the account. The applications stated that the affiliated broker would return or credit to the account all profits derived from those brokerage activities.

The applicants stated that it was not possible, as a practical matter, for them to comply with the requirements of PTE 79–1 relating to authorizations and terminations of such authorizations. Under PTE 79–1, the required authorizations were ineffective unless and independent fiduciary with respect to every plan invested in the account authorized the use of the affiliated broker–dealer. In addition, if the arrangements were authorized, termination of the authorization by a single plan fiduciary would serve to terminate the authorization for the entire account. As adopted, PTE 84–46 provides relief similar to that provided by the recapture exemption under PTE 79–1, but with an alternative method for obtaining and continuing authorization for the use of a broker–dealer affiliated with the insurance company that was designed ot accommodate the needs of funds or accounts in which the assets of many plans are collectively invested. The substance of these alternative requirements, modified to take into account other proposed changes to PTE 79–1 previously discussed, are incorporated in section IV(d) of

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the proposed exemption. In addition, for the reason stated above, the Department proposes to make the alternative authorization method available in the case of any account or fund for the collective investment of the assets of more than one plan without requiring the recapture of brokerage profits on behalf of that account or fund.

The elimination, in PTE 84–46, of the requirement that the authorizing fiduciary be independent of the insurance company in the case of a plan covering only employees of the insurance company has been extended in the proposal to apply to plans covering only employees of the investment manager (as defined in section 3(38) of EISA) that maintains a pooled fund for the collective investment of plan assets, provided that such manager recaptures brokerage profits on behalf of the pooled fund.

In the preamble to PTE 84–46, the Department stated that it would be willing to consider elimination of the quarterly reporting requirement and clarification of the term "profit" in that exemption with respect to transactions covered by the exemption in the course of this current proceeding.

As is discussed above, the Department has considered whether, as a general matter, the quarterly reporting option should be modified where independent plan fiduciaries do not receive transaction–by–transaction confirmations, and has tentatively concluded that it should not. In the context of a managed account in favor of which brokerage profits are recaptured, the Department is not persuaded that recapture necessarily eliminates the necessity for independent performance review on a basis more frequent than annual. In part, the Department's concern arises from the fact that the recapture of"profit," as that term is used for purposes of PTE 79–1 and as is defined in PTE 84–46, allows recoupment by the manager of not only direct, but also indirect, expenses.[14] The applicants and commentators in the proceeding that culminated in the granting of PTE 84–46 have raised additional questions concerning what is, or should be, included within the scope of the term "profits," such as whether losses in one year can be carried over to later years in computing amounts to be recaptured. Resolution of these questions may well have some bearing on whether the frequency of reporting should be reduced. Tentatively, however, the Department has concluded that the recapture of profits (as defined)does not necessarily result either in superior brokerage services being provided or in elimination of all motivation for excessive trading. Therefore, the Department has decided to invite interested parties to file comments setting forth changes they would like to see to the reporting requirements as they relate to the provisions relating to life insurance company pooled separate accounts (or other pooled investment funds), together with an explanation of why, in the absence of transaction–by–transaction confirmations to plan fiduciaries independent of the life insurance company (or other pool manager) involved, less frequent reporting would be appropriate.

H. Notice to Interested Persons

Because all plan participants and beneficiaries whose plans might authorize a broker to approve transactions between himself or herself and the plans could conceivably be considered interested persons, the Department has determined that the only practical form of notice is publication in the Federal Register.

I. General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of ERISA does not relieve a fiduciary or other party in interest from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of ERISA. That section requires, among other things, that a fiduciary discharge his or her

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duties respecting a plan solely in the interests of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of ERISA. In addition, it does not affect the requirement of section 401(a) of the Code that a plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries.

(2) Before an exemption may be granted under section 408(a) of ERISA, the Department must find that the exemption is administratively feasible, in the interests of the affected plans and of their participants and beneficiaries, and protective of the rights of those participants and beneficiaries.

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

(4) The proposed exemption, if granted, will not extend to transactions described in section 406(a) of ERISA.

J. Written Comments and Hearing Request

All persons are invited to submit written comments or requests for a public hearing on the proposed exemption or the proposed revocation of PTE 79–1 and PTE 84–46 to the address and within the time period set forth above. All comments will be made a part of the appropriate record. Comments and requests for a hearing should state the reasons for the writer's interest in the matter. Comments received will be available for public inspection with the application for exemption at the address set forth above.

K. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1980(Pub. L. 96–511), the reporting provisions that are included in this proposed class exemption are being submitted to the Office of Management and Budget for its review and approval.

Proposed Exemption

On the basis of the facts and representations set forth in the application and this document, the Department proposes the following exemption under ERISA Procedure 75–1 and sections 408(a) of ERISA and 4975(c)(2) of the Code to read as follows:

Section I. Definitions and Special Rules

The following definitions and special rules apply to this exemption:

(a) The term "person" includes the person and affiliates of the person.

(b) An "affiliate" of a person includes the following:

(1) Any person directly or indirectly controlling, controlled by, or under common control with, the person.

(2) Any officer, director, partner, employee, relative(as defined in section 3(15) of ERISA), brother, sister, or spouse of a brother or sister, of the person.

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(3) Any corporation or partnership of which the person is an officer, director or partner.

A person is not an affiliate of another person solely because one of them has investment discretion over the other's assets. The term "control"means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(c) An "agency cross transaction" is a securities transaction in which the same person acts as agent for both any seller and any buyer for the purchase or sale of a security.

(d) The term "covered transaction" means an action described in section II (a), (b) or (c) of this exemption.

(e) The term "effecting or executing a securities transaction"means the execution of a securities transaction as agent for another person and/or the performance of clearance, settlement, custodial or other functions ancillary thereto.

(f) A plan fiduciary is independent of a person only if the fiduciary has no relationship to or interest in such person that might affect the exercise of such fiduciary's best judgment as a fiduciary.

(g) The term "profit" includes all charges relating to effecting or executing securities transactions, less reasonable and necessary expenses—including reasonable indirect expenses (such as overhead costs) propertly allocated to the performance of these transactions under generally accepted accounting principles.

(h) The term "securities transaction" means the purchase or sale of securities.

Section II. Covered transactions

Effective [insert date 30 days after date final exemption is published in the Federal Register], if each condition of section III of this exemption is either satisfied or not applicable under section IV, the restrictions of section 406(b) of ERISA and the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c)(1)(E) or (F) or the Code shall not apply to—

(a) A plan fiduciary's using its authority to cause a plan to pay a free for effecting or executing securities transactions to that person as agent for the plan, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency;

(b) A plan fiduciary's acting as the agent in an agency cross transaction for both the plan and one or more other parties to the transaction;or

(c) The receipt by a plan fiduciary of reasonable compensation for effecting or executing an agency cross transaction to which a plan is a party from one or more other parties to the transaction.

Section III. Conditions

Except to the extent otherwise provided in section IV of this exemption, section II of this exemption applies only if the following conditions are satisfied:

(a) The person engaging in the covered transaction is not a trustee or administrator of the plan or an employer any of whose employees are covered by the plan.

(b) The covered transaction is performed under a written authorization executed in advance by a fiduciary

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of each plan whose assets are involved in the transaction, which plan fiduciary is independent of the person engaging in the covered transaction.

(c) The authorization referred to in paragraph (b) of this section is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice of termination.

(d) Within three months before an authorization is made, the authorizing fiduciary is furnished with any reasonably available information that the person seeking authorization reasonably believes to be necessary for the authorizing fiduciary to determine whether the authorization should be made, including a copy of this exemption, the form for termination of authorization described in section III(g), and any other reasonably available information regarding the matter that the authorizing fiduciary reasonably requests.

(e) The authorizing fiduciary is furnished with a confirmation slip for each securities transaction underlying a covered transaction within 10 business days of the securities transaction containing the following information:

(1) A statement that the person effecting or executing the securities transaction is acting as an agent for the plan, and whether the person is also acting as agent for some other person.

(2) The date and time of the securities transaction.

(3) The identity, price and quantity of securities traded.

(4) The amount of remuneration to be received by the person effecting or executing the securities transaction from the plan in connection with the securities transaction.

(5) The source and amount of any other remuneration received or to be received by the person effecting or executing the securities transaction in connection with the securities transaction.

(f) The authorizing fiduciary is furnished with a summary of the information required under paragraph (e) of this section at least once per year. The summary must be furnished within 45 days after the end of the period to which it relates, and contain the following:

(1) The total of all securities transaction–related charges incurred by the plan during the period in connection with covered securities transactions.

(2) The amount of the securities transaction–related charges retained by the authorized person and the amount of these charges paid to other persons for execution or other services.

(3) A statement disclosing whether the securities transaction–related charges are attributable in any part to consideration for any goods or services other than effecting or executing the transactions, and, if so, a detailed description of those goods and services and the amounts paid therefor.

(4) The annualized portfolio turnover ratio calculated as a percentage of the plan assets consisting of securities or cash the authorized person had discretionary investment authority over (or rendered, or had any responsibility to render, investment advice with respect to) (the "portfolio")at any time during the period covered by the report. For purposes of this paragraph, the "annualized portfolio turnover ratio" is obtained by dividing the product of (A) twelve and (B) the lesser of the aggregate dollar amount of purchases or sales of securities in the portfolio during such time or times during the period that the authorized person had such authority or responsibility, by the product of (C) the aggregate duration of such time or times, expressed in months (and

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fractions thereof) and (D) the monthly average of the market value of the portfolio during such time or times.

(g) A form must accompany each summary referred to in paragraph(f) of this section expressly providing an election to terminate the authorization described in paragraph (b) of this section with instructions on the use of the form. The instructions must include the following information:

(1) The authorization is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice from the authorizing fiduciary or other plan official having authority to terminate the authorization.

(2) Failure to return the form would result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the plan.

(h) If an agency cross transaction to which section IV(b)does not apply is involved, the following conditions must also be satisfied:

(1) The information required under section III(d) or IV(d)(1)(B)of this exemption includes a statement to the effect that with respect to agency cross transactions the person effecting or executing the transactions will have a potentially conflicting division of loyalties and responsibilities regarding the parties to the transactions.

(2) The summary required under section III(f) or IV(d)(2)of this exemption includes a statement identifying the total number of agency cross transactions during the period covered by the summary and the total amount of all commissions or other remuneration received or to be received from all sources by the person engaging in the transactions in connection with those transactions during the period.

(3) The person effecting or executing the agency cross transaction neither has (A) the authority to cause both any seller and any purchaser to engage in the transaction, nor (B) provides any investment advice with respect to the transaction to both any seller and any purchaser engaged in the transaction.

(4) The agency cross transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available.

(5) The agency cross transaction is effected at a price no less favorable to any plan involved in the transaction than the "current market price" of the security, as that term is defined in Rule 17a–7(b)under the Investment Company Act of 1940 (17 CFR 270.17a–7(b)).

Section IV. Exceptions From Conditions

(a) Certain Plans Not Covering Employees. Section III of this exemption does not apply to covered transactions to the extent they are engaged in on behalf of individual retirement accounts meeting the conditions of 29 CFR § 2510.3–2(d), or plans, other than training programs, that cover no employees within the meaning of 29 CFR §2510.3–3.

(b) Certain agency cross transactions. Section III of this exemption does not apply in the case of an agency cross transaction, provided that the person effecting or executing the transaction (1) does not render investment advice to any plan for a fee within the meaning of section 3(21)(A)(ii) of ERISA with respect to the transaction; (2) is not otherwise a fiduciary who has investment discretion with respect to any plan assets involved in the transaction, see 29 CFR § 2510.3–21(d);and (3) does not have the authority to engage, retain or discharge any

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person who is or is proposed to be a fiduciary regarding any such plan assets.

(c) Recapture of profits. Section III(a) of this exemption does not apply in any case where the person engaging in a covered transaction returns or credits to the plan all profits earned by that person in connection with the securities transactions associated with the covered transaction.

(d) Special rules for pooled funds. In the case of a person engaging in a covered transaction on behalf of an account or fund for the collective investment of the assets of more than one plan (pooled fund):

(1) Sections III (b), (c) and (d) of this exemption do not apply if—

(A) The arrangement under which the covered transaction is performed is subject to the prior and continuing authorization, in the manner described in this paragraph (d)(1), of a plan fiduciary with respect to each plan whose assets are invested in the pooled fund who is independent of the person. The requirement that the authorizing fiduciary be independent of the person shall not apply in the case of a plan covering only employees of the person, if the person (i) is an "investment manager" as defined in section 3(38) of ERISA, and (ii) returns or credits to the pooled fund all profits earned by the person in connection with all covered transactions engaged in by the person on behalf of the fund.

(B) The authorizing fiduciary is furnished with any reasonably available information that the person engaging or proposing to engage in the covered transactions reasonably believes to be necessary to determine whether the authorization should be given or continued, not less than 30 days prior to implementation of the arrangement or material change thereto, and, where requested, with any reasonably available information regarding the matter upon the reasonable request of the authorizing fiduciary at any time.

(C) In the event an authorizing fiduciary submits a notice in writing to the person engaging in or proposing to engage in the covered transaction objecting to the implementation of, material change in, or continuation of, the arrangement, the plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the pooled fund, without penalty to the plan, within such time as may be necessary to effect the withdrawal in an orderly manner that is equitable to all withdrawing plans and to the nonwithdrawing plans. In the case of a plan that elects to withdraw under this subparagraph (d)(1)(C), the withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a plan electing to withdraw.

(D) In the case of a plan whose assets are proposed to be invested in the pooled fund subsequent to the implementation of the arrangement and that has not authorized the arrangement in the manner described in subparagraphs(d)(1) (B) and (C) of this section, the plan's investment in the pooled fund is subject to the prior written authorization of an authorizing fiduciary who satisfies the requirements of subparagraph (d)(1)(A).

(2) Section III(e) of this exemption does not apply if the report described in section III(f) of this exemption and a compilation of the information described in section III(e) are furnished to the authorizing fiduciary of each plan whose assets are invested in the pooled fund at least once every three months and within 45 days after the end of the period to which it relates.

Proposed Revocation of Existing Exemptions

On the basis of the material referred to in this document, the Department is considering revoking PTE 79–1 and PTE 84–46, effective 30 days after notice of the revocation is published in the Federal Register.

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Signed at Washington, DC, this 18th day of January, 1985.

Robert A.G. Monks,

Administrator, Office of Pension and Welfare Benefit Programs.

[FR Doc. 85–1778 Filed 1–23–85; 8:45 am]

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Footnotes

[1] 44 FR 5963 (January 30, 1979).

[2] 49 FR 22157 (May 25, 1984).

[3] 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 exemptions of the type requested to the Secretary of Labor. For the sake of clarity, the remainder of the preamble refers only to Title I of ERISA. However, these references apply to the corresponding provisions of section 4975 of the Code as well.

[4] For a more complete explanation of the provisions of section 408(b)(2) and its relationship to section 406, see generally the Department's regulations at 29 CFR 2550.408b–2.

[5] 44 FR at 5965 (January 30, 1979).

[6] 17 CFR 240.11a2–2(T). In general, a member of a national securities exchange may not effect securities transactions on that exchange for an account with respect to which it or any associated person thereof exercises investment discretion without complying with Rule 11a2–2(T). That rule requires annual reports of these securities transactions by the investment adviser to the "person or persons authorized to transact business for the account,"but does not require annual reauthorization to effect the transactions.

[7] SEC Rule 10b–10 under the 1934 Act, 17 CFR 240.10b–10, already requires a broker–dealer to provide each of its customers, with certain specific exceptions, with a confirmation for each securities transaction the broker–dealer effects for the account of the customer. This confirmation for an agency securities transaction must include: (1) A statement disclosing whether the broker–dealer is acting as an agent for the customer, for some other person, or for both; (2) the date and time of the securities transaction(or the fact that this information will be provided on request); (3) the identity, price and number of securities traded; (4) the amount of remuneration to be received by the broker–dealer from the customer in connection with the securities transaction; and (5) certain other information about remuneration received by the broker–dealer from other sources in connection with the securities transaction.

[8] For a brief discussion of the responsibility of appointing fiduciaries to review the performance of other fiduciaries they appoint, see Question and Answer FR–17 in ERISA Interpretive Bulletin 75–8(29 CFR 2509.75–8). Fiduciaries with responsibilities regarding the obtaining or performing of brokerage services to plans are under a duty to obtain best execution for the plans, as part of their obligations under section 404(a) of ERISA. The proposed

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exemption, if adopted, would not diminish those obligations. See section I of the preamble, General Information, infra.

[9] Section 28(e) of the 1934 Act provides, in part, that no person, in the exercise of investment discretion with respect to an account, shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law solely by reason of his or her having caused the account to pay a broker an amount of commission for effecting a securities transaction in excess of the amount of commission another broker would have charged for effecting that transaction, if that person determined in good faith that the amount of commission was reasonable in relation to the value of brokerage and research services provided by that broker.

[10] The statutory exemption for services applies only in the case of "legal, accounting, or other services necessary for the establishment or operation of the plan". See section 408(b)(2) of ERISA. The Department's regulation 29 CFR 2550.408b–2 identifies such services as those that are "appropriate and helpful to the plan. . . in carrying out the purposes for which the plan is established or maintained". The exemption is further conditioned on the plan's paying no more than reasonable compensation for the services. "Churning" would result in the plan's paying excessively high compensation for brokerage services. The Department similarly proposes that the scope of the exemption from the prohibitions of section 406(b) not extend to fiduciary acts that result in "churning". See proposed section II(a).

[11] See 29 CFR 2510.3–21.

[12] Section 406(b)(3) provides that a fiduciary with respect to a plan shall not receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

[13] Rule 17a–7(b) defines "current market price" to mean:

(1) If the security is a "reported security" as that term is defined in rule 11Ac3–1 under the Securities Exchange Act of 1934[17 CFR 240.11Ac3–1], the last sale price with respect to such security reported in the consolidated transactions reporting system ("consolidated system") or the average of the highest current independent bid and lowest current independent offer for such security (reported pursuant to rule 11Aa1–1 under the Securities Exchange Act of 1934 [17 CFR 240.11Aa1–1] if there are not reported transactions in the consolidated system that day; or

(2) If the security is not a reported security, and the principal market for such security is an exchange, then the last sale on such exchange or the average of the highest current independent bid and lowest current independent offer on such exchange if there are no reported transactions on such exchange that day; or

(3) If the security is not a reported security and is quoted in the NASDAQ System, then the average of the highest current independent bid and lowest current independent offer reported on Level 1 of NASDAQ; or

(4) For all other securities, the average of the highest current independent bid and lowest current independent offer determined on the basis of reasonable inquiry.

[14] See the preamble to PTE 79–1, note 12 (44 FR at 5964).

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 ISSN 1544-0575

PTE 86–128

Notice of Effective Date

52 Fed. Reg. 8676 (Mar. 19, 1987)

DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

[Prohibited Transaction Exemption 86–128]

Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker–Dealers

AGENCY: Pension and Welfare Benefits Administration, Labor.

ACTION: Notice of effective date of Prohibited Transaction Exemption 86–128 and extension of the revocation date of Prohibited Transaction Exemption 79–1 and Prohibited Transaction Exemption 84–46.

SUMMARY: This document contains the effective date for Prohibited Transaction Exemption 86–128 (51 FR 41686) and a revised revocation date for Prohibited Transaction Exemption 79–1 (44 FR 5963) and Prohibited Transaction Exemption 84–46 (49 FR 22157). Prohibited Transaction exemption 86–128 allows persons who serve as fiduciaries for employee benefit plans to effect or execute securities transactions under certain circumstances. The exemption also allows sponsors of pooled separate accounts and other pooled investment funds to use their affiliates to effect or execute securities transactions for such accounts when certain conditions are met. The effective date provision of Prohibited Transaction Exemption 86–128 provided for an effective date of the later of December 18, 1986, or the date on which the Office of Management and Budget approved the information collection requests in the exemption under the Paperwork Reduction Act of 1980. The Department stated in the preamble to the exemption that it would publish a notice in the Federal Register notifying interested persons when the exemption became effective. This notice serves that purpose. It also provides for a postponement of the effective date of revocation of the two other Prohibited Transaction Exemptions referred to above until June 1, 1987.

EFFECTIVE DATES: The effective date of Prohibited Transaction Exemption 86–128 is February 12, 1987. Prohibited Transaction Exemptions 79–1 and 84–46 are revoked effective June 1, 1987.

FOR FURTHER INFORMATION CONTACT: Daniel J. Maguire, Esq., Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, DC 20210, (202) 523–9595 (not a toll free number)or Mark A. Greenstein, Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, (202) 523–8671 (not a toll free number).

SUPPLEMENTARY INFORMATION: On November 18, 1986, the Department of Labor (the Department) published a notice in the Federal Register (51 FR 41686) containing the grant of Prohibited Transaction Exemption

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86–128, which exempts certain transactions from the restrictions of section 406(b)of the Employee Retirement Income Security Act of 1974, and from the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code (the Code)by reason of Code section 4975(c)(1)(E) or (F). That notice also contained a provision (Section VI(b)) for the revocation of Prohibited Transaction Exemptions 79–1 and 84–46 effective April 1, 1987.

The Office of Management and Budget has approved the paperwork requests contained in Prohibited Transaction Exemption 86–128 effective February 12, 1987 and has approved them for use through February 29, 1988. In addition, the Department has decided to extend the revocation date of Prohibited Transaction Exemptions 79–1 and 84–46 from April 1, 1987 to June 1, 1987 so as to allow authorized persons and authorizing fiduciaries sufficient time in which to adjust their authorization and reporting procedures.

A complete discussion of the transitional rules relating to these exemptions can be found in the preamble to Prohibited Transaction Exemption 85–128 (51 FR 41694).

Notice of effective Dates

Notice is hereby given that the Office of Management and Budget (OMB) has approved the information collection requests under the Paperwork Reduction Act of 1980 for Prohibited Transaction Exemption 86–128 (published at 51 FR 41686, November 18, 1986), which exempts certain transactions from the restrictions of section 406(b) of the Employee Retirement Income Security Act of 1974 and from the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code (the Code) by reason of Code section 4975(c)(1) (E) or (F). The date of OMB approval was February 12, 1987 and thus the effective date of Prohibited Transaction Exemption 86–128 is February 12, 1987. The information collection requests under Prohibited Transaction Exemption 86–128 have been assigned OMB control number 1210–0059 and are approved for use through February 29, 1988.

Notice is also hereby given that the revocation date for Prohibited Transaction Exemption 79–1 and Prohibited Transaction Exemption 84–46 has been extended from April 1, 1987 to June 1, 1987.

Signed at Washington, DC, this 11th day of March 1987.

Dennis M. Kass,

Assistant Secretary, Pension and Welfare Benefits Administration, U.S. Department of Labor.

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