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DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

[Prohibited Transaction Exemption 94-20]

Application Number D-5700

Class Exemption Relating to Certain Employee Benefit Plan

Foreign Exchange Transactions

AGENCY: Pension and Welfare Benefits Administration, Labor

ACTION: Grant of Class Exemption

SUMMARY: This document contains a final exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (the Act) and from certain taxes imposed by the Internal Revenue Code of 1986 (the Code). The class exemption permits the purchase and sale of foreign currencies between an employee benefit plan and a bank or a broker-dealer or an affiliate thereof which is a party in interest with respect to such plan.

The exemption affects participants and beneficiaries of employee benefit plans involved in such transactions, as well as banks and broker-dealers and their affiliates which act as dealers in foreign exchange.

EFFECTIVE DATES: Section I(a) of PTE 94-20 is effective for transactions occurring from January 1, 1975 to June 18, 1991.

Section I(b) of PTE 94-20 is effective for transactions occurring on or after June 18, 1991.

FOR FURTHER INFORMATION CONTACT: Ms. Lyssa Hall, Pension and Welfare Benefits Administration, Office of Exemption Determinations, U.S. Department of Labor, Washington, D.C. 20210, (202) 219-8971 (not a toll-free number) or Susan Rees, Plan Benefits Security Division, Office of the Solicitor, (202) 219- 9141 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Exemptive relief for the transactions described herein, as well as for other transactions not covered by the proposed exemption, was requested in an application dated July 18, 1984 (Application No. D-5700) submitted by the American Bankers Association (ABA) pursuant to section 408(a) of ERISA and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

In a letter to the ABA dated December 28, 1984, the Department of Labor (the Department) tentatively denied the application. By letter dated June 21, 1985, the ABA modified its application in response to the Department's tentative denial, explaining that it was no longer seeking exemptive relief for foreign exchange transactions between banks and plans where the banks or their affiliates have investment management discretion over the plan assets involved in the transactions. On September 15, 1986, the Department published a notice in the Federal Register (51 FR 32695), requesting additional information from the public on various issues being considered by the Department in deciding whether to propose a foreign exchange class exemption in response to the ABA application. The comment period ended on February 24, 1987. Seventeen substantive responses to the solicitation of comments were received.[1]

On March 20, 1991, the Department published a notice in the Federal Register (56 FR 11757) of the pendency of a proposed class exemption from the restrictions of section 406(a)(1)(A) through (D) of the Act and from the taxes imposed by section 4975(a) and (b) of the Code by reason of certain transactions described in section 4975(c)(1)(A) through (D) of the Code. The notice of pendency invited all interested persons to submit written comments concerning the proposed class exemption by May 20, 1991. The Department received nine public comments requesting, among other things, that the Department broaden the scope of the exemption to provide relief for transactions entered into pursuant to standing instructions. In view of those comments, the Department published a notice of public hearing in the Federal Register (56 FR 46806 (September 16, 1991)). The hearing was held on October 3, 1991. Upon consideration of all of the comments received and testimony offered at the public hearing, the Department has determined to grant the proposed class exemption, subject to certain modifications. These modifications and the major comments are discussed below.

Discussion of the Comments

The proposed exemption provided retroactive and prospective relief from section 406(a)(1)(A) through (D) of the Act and section 4975(c)(1)(A) through (D) of the Code for foreign exchange transactions between a party in interest bank or affiliate thereof and an employee benefit plan.

One commentator urged the Department to expand the final exemption to permit broker-dealers who are registered under the Securities Act of 1934 (1934 Act) and their affiliates to engage in foreign exchange transactions with plans. According to this commentator, the same reasons for granting the exemption to banks apply with equal force to broker-dealers and their affiliates. Broker-dealers act as custodians and provide other services to plans which cause them to be parties in interest as defined in section 3(14) of the Act. In addition, broker-dealers may also participate in foreign exchange transactions. Accordingly, absent the availability of an exemption, many major money market broker-dealers and their affiliates might not be able to deal with plans with respect to foreign exchange transactions. The commentator also asserts that in order for the "general" arm's length test contained in the exemption to work effectively, the exemption must include significant participants in the foreign exchange market. Finally, the commentator notes that broker- dealers which are registered under the 1934 Act are subject to extensive regulatory control consisting of a panoply of federal, self-regulatory organization and state regulations and supervisory structures. The Department has considered this comment and determined that it would be appropriate to include broker-dealers which are registered under the 1934 Act and their affiliates within the scope of relief provided by the final class exemption. Accordingly, the final exemption has been modified in this regard.

One commentator requested that the exemption be expanded to provide relief for individual retirement accounts (IRAs) and Keogh plans which are not employee benefit plans covered by title I of the Act.[2] The Department does not believe that a sufficient showing has been made regarding the demand for exemptive relief for non-title I IRAs and Keogh Plans. Therefore, the Department is unable to conclude

that the final exemption should be expanded as requested.

The proposed exemption contained a condition requiring that the bank maintain written policies and procedures regarding the handling of foreign exchange transactions with plans which assure that the person acting for the bank knows that he or she is dealing with a plan.

One commentator expressed concern that requiring the person acting for the bank to know that he or she is dealing with an ERISA plan will require the institution of new procedures at foreign exchange desks which will increase the cost of transactions for ERISA plans. The commentator stated that it treats all client transactions in a uniform manner. Finally, the commentator stated that it does not believe that the condition will achieve beneficial results for plan transactions at its facility.

While the commentator states that all client transactions at its facility are treated in a uniform manner, the Department notes that purchases and sales of foreign currency between an employee benefit plan and a party in interest bank or broker- dealer are prohibited in the absence of exemptive relief. The purpose of the above-noted condition is to put persons who act for the bank or broker-dealer on notice that they are dealing with a plan in order that any additional steps or procedures that are necessary to comply with the conditions of the exemption may be implemented. The Department believes that the identification of the client as a plan will help assure compliance with the conditions of the exemption. Accordingly, the Department has determined not to revise the final exemption in this regard.

Section III(c)(6) of the proposed exemption required the issuance of a written confirmation statement for each covered transaction. The proposal required that the confirmation statement disclose the amount of U.S. dollars purchased or sold. A commentator noted that U.S. dollars are not involved in every foreign currency transaction. In response to this comment, the Department has modified section III(c)(6) to require disclosure of the currencies purchased and sold pursuant to the final exemption.

The proposed exemption included a recordkeeping requirement which provided that the bank, broker-dealer or affiliate must maintain within territories under the jurisdiction of the United States Government, the records necessary to determine whether the applicable conditions of the exemption have been met. Several commentators objected to the requirement that records be maintained within territories under the jurisdiction of the U.S. Government. In this regard, they represented that this requirement creates difficulties for those banks who maintain foreign exchange trading desks in a country or countries other than the United States. In addition, one commenter suggested that the recordkeeping requirement may result in higher costs to plans involved in foreign exchange transactions.

The ABA suggested that the recordkeeping requirement should permit the required records to be maintained on an computer system located at a foreign facility which would be accessible in the United States. These systems could print out any information requested and produce a hard copy to anyone who is authorized to have such information. These systems would contain all the bank's foreign exchange transactions on a daily basis for employee benefit plans as well as other entities. In this way, all information needed to test for compliance would be available in the United States. Other commenters suggested that requirements similar to those provided in the regulations under section 404(b) of the Act regarding the maintenance of the indicia of ownership of plan assets should be adopted. Specifically, they requested that the exemption permit the required records to be maintained at foreign locations described under the section 404(b) regulations.

The Department notes that the purpose of the record maintenance requirement is to ensure that the persons described in paragraph III(e) of the exemption will have access to bank, broker-dealer or affiliate records involving covered foreign exchange transactions. The Department is unable to determine how the alternatives for holding securities, which are described in the regulations under

section 404(b) of the Act, would operate in the context of a record maintenance requirement. If the records were maintained outside of the jurisdiction of the United States Government and became unavailable for reasons beyond the control of the bank, broker-dealer or affiliate, there would be no comparable records available for determining compliance with the terms of this exemption. Accordingly, the Department is not persuaded that the conditions described in the regulations under section 404(b) of the Act would be appropriate with respect to the record maintenance requirement.

The Department has considered the ABA's suggestion to modify the final exemption to include records which are maintained on a foreign computer system that could be accessed in the United States. We note, however, that the ABA is unable to represent that such records could always be accessed on a foreign computer system without the risk of restriction by a foreign government. Accordingly, the Department is unable to conclude that the final exemption should be modified to include this method of recordkeeping.

The ABA, as well as a number of other commentators, requested that the Department expand the proposed exemption to include retroactive and prospective relief for foreign exchange transactions entered into pursuant to a standing authorization, hereinafter "standing instruction." Similarly, many of those commenters also requested that the Department amend the definition of the term "directed transaction" by modifying the requirement that the independent plan fiduciary effect the foreign exchange transaction at a specific exchange rate.

The commentators represent that the utilization of a standing instruction is an integral component in foreign exchange transactions involving employee benefit plans. They further indicate that standing instructions are necessary to repatriate relatively minor amounts of income such as dividend and interest payments routinely generated by foreign securities which are held by plans. In this regard, they state that obtaining individual directions for each income receipt would be impractical and that plan beneficiaries would lose investment income due to the time that it would take to receive directions from investment managers and convert the payments. In addition, many investment managers who wish to effectuate a foreign exchange transaction do not contact the foreign exchange desk directly, but instead leave their trading instructions with their account managers in the bank's trust or global area. Transactions effected in this manner can be bulked or added together with other transactions from employee benefit plans as well as other trusts and custodial accounts so as to obtain a more beneficial exchange rate. Under the circumstances described above, foreign exchange transactions would not meet the definition of "directed" as set forth in the proposed exemption because of the inability to comply with the requirement that the independent plan fiduciary designate a specific exchange rate.

The Department notes that a bank or broker-dealer engages in violations of section 406(b) of the Act whenever it uses its fiduciary authority or control with respect to the plan assets involved in the transaction to increase the amount of its compensation by determining the timing or the specific exchange rate for the foreign exchange transaction. The Department did not propose relief with respect to such transactions because it was unable, at the time, to make the findings required under section 408 (a) of the Act. Specifically, the Department was unable to conclude that the conditions proposed by the ABA would effectively and consistently address the potential for abuse of discretion by party in interest banks or broker-dealers in setting exchange rates for foreign exchange transactions.

The commenters have responded to the Department's concerns by suggesting additional conditions which would limit the amount of discretion that a bank or broker-dealer would have in executing the foreign exchange transactions pursuant to standing instructions. Thus, some of the commenters suggested that the class exemption could limit relief to those situations where the triggering event, such as the receipt of cash dividends, would not be within the control of the bank or broker-dealer. In addition, the exchange transaction would have to take place within a short period of time following the

triggering event. As a further limitation on the bank or broker-dealer, a commenter suggested that the exchange rate could be set daily prior to execution of the covered foreign exchange transaction using objective criteria which would be disclosed to and approved by a plan fiduciary independent of the bank or broker-dealer. Finally, it was represented that conditions relating to the information which must be provided or made available to the independent plan fiduciary could require very detailed disclosures which would enable such fiduciary to determine the reasonableness of the foreign exchange rates paid by the plan.

On the basis of the comments received following publication of the proposed exemption, the Department believes that it may be appropriate, under certain circumstances, to provide relief from section 406(b)(1) of the Act. Pursuant to the requirements of section 408(a) of the Act, however, the Department is required to offer interested persons an opportunity to present their views and an opportunity for a hearing before granting an exemption from section 406(b) of the Act. Therefore, in order not to delay the publication of an exemption from section 406(a) of the Act for foreign exchange transactions, the Department has decided to grant the exemption described herein while it continues to consider additional exemptive relief for foreign exchange transactions between a plan and a party in interest bank, broker- dealer or affiliate thereof where such transactions are engaged in pursuant to a "standing instruction."

Miscellaneous

One commenter requested that the Department clarify that the term "foreign exchange transaction" which is defined in section IV(a) of the proposed exemption as "the exchange of the currency of one nation for the currency of another nation or a contract for such exchange" includes options to buy or sell foreign currency. The commenter is concerned that a footnote to the supplementary information accompanying the proposed exemption which describes foreign exchange transactions as "generally ... either 'spot', 'forward', or 'split'" delimits the scope of the literal language of the exemption.

The commenter represents that options contracts operate in a manner similar to that of forward contracts. For example, a forward contract to sell a specified sum of Yen for dollars would enable a party to sell Yen at the agreed upon rate even if the value of Yen declined over the time period covered by the forward contract; the same forward contract would require the counterparty to buy Yen from the party at a rate favorable to the counterparty if the Yen appreciated during the same time period. A similar economic result could be achieved if the party had bought an option to sell Yen at the forward contract rate, and sold an option to buy Yen at the same rate.

After considering this comment, the Department has decided to amend the final exemption to specifically include options to buy or sell currency.

One commenter requested that the Department expand the final exemption to include relief from section 406(b)(1) & (b)(2) of the Act and section 4975(c)(1)(E) of the Code so that it would be clear that a fiduciary bank would not violate those provisions when it engaged in a foreign exchange transaction if it did not exercise its fiduciary authority to cause the plan to pay it an additional fee. The regulations at 29 CFR § 2550.408b-2(e)(2) specifically state that a fiduciary does not engage in an act described in section 406(b)(1) of the Act if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary. Accordingly, the Department has determined that it is unnecessary to modify the final exemption as requested.

Finally, for purposes of clarity, the Department has added a definition to section IV of the class exemption. Paragraph (g) defines the term "employee benefit plan" for purposes of this class exemption.

General Information

The attention of interested persons is directed to the following:

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

(2) The exemption, will not extend to transactions prohibited under section 406(b) of the Act and section 4975(c)(1)(E) and (F) of the Code;

(3) In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record, the Department finds that the exemption is administratively feasible, in the interests of plans and of their participants and beneficiaries and protective of the rights of the participants and beneficiaries of plans.

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

(5) The exemption is applicable to a transaction only if the conditions specified in the exemption are met.

Exemption

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

Section I. Transactions

(a) For the period from January 1, 1975 to June 18, 1991, the restrictions of section 406(a)(1)(A) through (D) of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1986 (the Code) by reason of Code section 4975(c)(1)(A) through (D) shall not apply to any foreign exchange transaction between a bank or broker-dealer or an affiliate thereof and an employee benefit plan with respect to which the bank or broker- dealer or affiliate thereof is a trustee, custodian, fiduciary or other party in interest, provided that (i) the transaction is directed (within the meaning of section IV(e)) on behalf of the plan by a fiduciary which is independent of the bank, the broker- dealer, and any affiliate thereof, and (ii) the conditions set forth in section II are met.

(b) Effective June 18, 1991, the restrictions of section 406(a)(1)(A) through (D) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of Code section 4975(c)(1)(A) through (D)

shall not apply to any foreign exchange transaction between a bank or broker-dealer or an affiliate thereof and an employee benefit plan with respect to which the bank or broker-dealer or an affiliate thereof is a trustee, custodian, fiduciary, or other party in interest, provided that (i) the transaction is directed (within the meaning of section IV(e)) on behalf of the plan by a fiduciary which is independent of the bank, the broker-dealer, and any affiliate thereof, and (ii) all of the conditions set forth in sections II and III are met.

Section II. General Conditions

Section I of this exemption applies only if the following conditions of this section II are satisfied. In the case of transactions described in section I(b), all of the conditions specified in section III below must also be satisfied.

(a) At the time the transaction is entered into, the terms of the transaction are not less favorable to the plan than the terms generally available in comparable arm's length foreign exchange transactions between unrelated parties.

(b) Neither the bank, the broker-dealer, nor any affiliate thereof has any discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of 29 CFR §2510.3-21(c)) with respect to the investments of those assets.

Section III. Specific Conditions

Section I(b) of this exemption applies only if the conditions specified in section II above and the following conditions are satisfied:

(a) At the time the transaction is entered into, the terms of the transaction are not less favorable to the plan than the terms afforded by the bank, the broker-dealer, or any affiliate thereof in comparable arm's length foreign exchange transactions involving unrelated parties.

(b) The bank, or broker-dealer, maintains at all times written policies and procedures regarding the handling of foreign exchange transactions with plans with respect to which the bank or broker-dealer is a trustee, custodian, fiduciary or other party in interest or disqualified person which assure that the person acting for the bank or broker-dealer knows that he or she is dealing with a plan.

(c) A written confirmation statement is issued with respect to each covered transaction to the independent plan fiduciary who directs the transaction for the plan.

The confirmation shall disclose the following information:

(1) account name;

(2) transaction date;

(3) exchange rates;

(4) settlement date;

(5) currencies exchanged:

(i) identity of the currency sold;

(ii) the amount sold;

(iii) identity of the currency purchased;

(iv) the amount purchased.

The confirmation shall be issued in no event more than 5 business days after execution of the transaction.

(d) The bank or broker-dealer, or affiliate thereof, maintains within territories under the jurisdiction of the United States Government, for a period of six years from the date of the transaction, the records necessary to enable the persons described in paragraph (e) of this section to determine whether the applicable conditions of this exemption have been met. Notwithstanding these recordkeeping requirements, a prohibited transaction will not be considered to have occurred if, due to circumstances beyond the bank's or broker-dealer's control, the records are lost or destroyed prior to the end of the six-year period, and no fiduciary of a plan who is independent of the bank or broker-dealer or any affiliate thereof, which engages in a transaction covered by the exemption, shall be subject to the civil penalty that may be assessed under 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, solely because the records are not maintained by the bank, the broker- dealer, or its affiliate, or are not made available for examination by the bank or broker-dealer or affiliate as required by paragraph (e) below.

(e)(i) Except as provided in subparagraph (ii) of this paragraph and notwithstanding any provisions of subsection (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (d) of this Section are available at their customary location for examination, upon reasonable notice, during normal business hours by:

(A) Any duly authorized employee or representative of the Department of Labor or the Internal Revenue Service.

(B) Any fiduciary of a plan who has authority to acquire or dispose of the assets of the plan involved in the foreign exchange transaction or any duly authorized employee and representative of such fiduciary.

(C) Any contributing employer to the plan involved in the foreign exchange transaction or any duly authorized employee or representative of such employer.

(ii) None of the persons described in subparagraphs (B) and (C) shall be authorized to examine a bank's or broker-dealer's trade secrets or commercial or financial information of a bank or broker-dealer or an affiliate thereof which is privileged or confidential.

Section IV. Definitions and General Rules

For purposes of this exemption.

(a) A "foreign exchange transaction" means the exchange of the currency of one nation for the currency of another nation, or a contract for such an exchange. The term foreign exchange transaction includes options contracts on foreign exchange transactions.

(b) A "bank" means a bank which is supervised by the United States or a State thereof, or any affiliate thereof.

(c) A "broker-dealer" means a broker-dealer registered under the Securities Exchange Act of 1934, or any affiliate thereof.

(d) An "affiliate" of a bank or broker-dealer means any entity directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such bank or broker-dealer.

(e) The term "control" means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(f) A foreign exchange transaction involving assets of an employee benefit plan shall be considered "directed" only where the independent plan fiduciary who has not been appointed by the bank or broker-dealer or affiliate thereof, directs such bank or broker-dealer or affiliate thereof to effect the purchase or sale of a specific amount of currency at a specific exchange rate.

(g) For purposes of this exemption, the term "employee benefit plan" refers to a pension plan described in 29 CFR §2510.3-2 and/or a welfare benefit plan described in 29 CFR §2510.3-1.

Signed at Washington, D.C., this 10th day of February, 1994.

ALAN D. LEBOWITZ
Deputy Assistant Secretary
for Program Operations
Pension and Welfare Benefits
Administration

U.S. Department of Labor

[1]For a discussion of those comments, see the proposed exemption at 56 Fed. Reg. 11761 (March 20, 1991).

[2]29 CFR 2510.3-2(d) explains that IRAs described in section 408(a) of the Code will not be considered pension plans subject to title I of ERISA, provided that: (1) no contributions to the plan are made by the employer or employee association; (2) participation is completely voluntary for employees or members; (3) the sole involvement of the employer or employee organization is without endorsement to permit the sponsor to publicize the program, to collect contributions on behalf of the sponsor through payroll deductions or dues checkoffs and to remit them to the sponsor; and (4) the employer or employee organization receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions or dues checkoffs.

29 CFR 2510.3-3(b) explains that for purposes of title I of ERISA, "employee benefit plan" shall not include a Keogh Plan under which no employees are covered under the plan. In this regard, 29 CFR 2510.3-3(c) states that for purposes of the above referenced section: (1) an individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse; and (2) a partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

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