U.S. Department of Labor

Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210

OPINION NO. 84-33A
Sec. 408(a), PTE 83-1, 408(b)(4)

JUL 16 1984

Richard A. Gilbert
Orrick, Herrington & Sutcliffe
600 Montgomery Street
San Francisco, California 94111

Re: Bank of America National Trust and Savings Association (the Bank)
Identification Number: F-2808A

Dear Mr. Gilbert:

This is in reply to your letter of December 27, 1983, requesting an advisory opinion concerning the availability of Prohibited Transaction Exemption 83-1 (PTE 83-1, 48 FR 895, January 7, 1983) for certain transactions involving mortgage pools which consist of the Bank's new form of Short-Term Mortgage Loan.

You represent that the Bank has sold approximately $1 billion of mortgage pass-through certificates through mortgage pools that it maintains to investors including employee benefit plans. The Bank proposes to include in its future mortgage pools its new form of Short-Term Mortgage Loans. The initial term of the Short-Term Mortgage Loans will be either five or ten years. During this initial term, interest will be payable at a fixed annual rate. Interest payments will be due monthly and a "balloon" payment of the principal amount will be due at the end of the term. Each Short-Term Mortgage Loan will be secured by a first deed of trust on single-family residential property. At origination, the principal amount of each loan will not exceed 50% of the appraised value of the borrower's property.

Upon making a five year Short-Term Mortgage Loan, the Bank will extend to the borrower its commitment to make three subsequent five year Short-Term Mortgage Loans and a final ten year Short-Term Mortgage Loan during which term the full principal and interest amount would be amortized in 120 equal monthly installments. In the case of an initial ten year Short-Term Mortgage Loan, the Bank will offer a commitment for two subsequent ten year Short-Term Mortgage Loans with the principal and interest amount to be amortized in the last ten years. The renewal commitment would remain an obligation of the Bank and would not become part of any future mortgage pool.

In connection with the initial Short-Term Mortgage Loan, the Bank will offer to the borrower a second mortgage loan under which, similar to a line of credit, the borrower may borrow, repay and reborrow from time to time within a credit limit secured by a second deed of trust on the borrower's property. The credit limit will be established at not more than 80% of the appraised value of the borrower's property, less the amount of the outstanding Short-Term Mortgage Loan. Obligations of the borrowers under the second mortgage loans may be retained or sold by the Bank and no second mortgage loan will be included in the mortgage pools.

In each mortgage pool the Bank will include Short-Term Mortgage Loans of a single maturity of either five or ten years. The Bank will sell certificates evidencing undivided interests in the pools to investors including employee benefit plans. Although the Short-Term Mortgage Loans are renewable, renewal Short-Term Mortgage Loans made upon maturity of loans contained in the initial mortgage pool will not be included in such mortgage pool. However, such loans may be included in subsequent mortgage pools to be formed by the Bank. In time, a future mortgage pool may include both initial and renewal Short-Term Mortgage Loans having the same maturity.

Certificateholders will receive a pass-through of interest payments on the Short-Term Mortgage Loans contained in a particular pool every six months less any fees charged by the Bank for servicing such pool. Also, the Bank will offer certificateholders an option of opening a separate depositary account for voluntary mortgage principal prepayments on any of the mortgages contained in the pool in lieu of cash distributions. Such deposit will occur, in the case of an employee benefit plan certificateholder, only if a fiduciary of such plan who is independent of the Bank, the mortgage pool trustee or any insurer of the mortgage pool makes an express, affirmative election to establish such deposit account. The deposit account will have the same maturity and interest rate as the related mortgage pass-through certificate, but will be represented by a separate account agreement between the Bank and each certificateholder.

In effect, you are requesting an advisory opinion that certain features of the Short-Term Mortgage Loans to be included in the mortgage pools such as: the five or ten year renewable term, the second mortgage feature, the interest only payments by mortgagors; and the related features in the operation of the mortgage pool such as the semi-annual pass-through of interest only payments, will not result in the unavailability of the relief provided by PTE 83-1. Additionally, you request an advisory opinion that, pursuant to the election by plan fiduciaries described above, the placement of principal prepayment amounts in deposit accounts of the Bank will be exempt from the prohibited transaction provisions of section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) by virtue of section 408(b)(4) of ERISA.

PTE 83-1[1] provides an exemption from the prohibited transaction provisions of ERISA for certain transactions involving the origination, maintenance and termination of mortgage pool investment trusts and the acquisition and holding of certain mortgage backed pass-through certificates in such mortgage pools by employee benefit plans. The availability of PTE 83-1 is subject to the conditions set forth in section II of PTE 83-1 and the definitions contained in section III thereof. The term "mortgage pool" is defined in section III B to mean, in part, an investment pool the corpus of which is held in trust and consists solely of interest bearing obligations secured by either first or second deeds of trust on single-family residential property. Section III C defines the term "mortgage pool pass-through certificate" to mean a certificate representing a beneficial undivided fractional interest in a mortgage pool entitling the holder of such certificate to pass-through payments of principal and interest from the pooled mortgage loans, less fees to the pool sponsor.

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[1] PTE 83-1 amended Prohibited Transaction Exemption 81-7 (PTE 81-7, 46 FR 7520, January 23, 1981), essentially to include second mortgages or deeds of trust in mortgage pools eligible for the relief provided by PTE 81-7 and to permit the giving of forward commitments to participate in such pools.

In granting PTE 83-1, the Department decided to provide flexibility under the exemption by not listing the specific types of mortgages or deeds of trust that would be eligible for inclusion in a covered mortgage pool. In response to a commentator who inquired whether the relief provided by the exemption covered pools of shared appreciation mortgages, the Department noted in the preamble to the exemption that section III B of the exemption requires only that the mortgage loans comprising the pool be interest bearing obligations secured by either first or second mortgages or deeds of trust on single-family residential property. The Department stated that this provision is intentionally general in order to provide coverage to a variety of so called "creative financing" loans. The renewable feature of the Short-Term Mortgage Loans provides the Bank with the means of adjusting what is, in effect, a thirty year mortgage loan to market interest rates during the term. With respect to the second mortgage feature of the Short-Term Mortgage Loans, nothing in section III B of PTE 83-1 suggests that property secured by a mortgage to be included in a covered mortgage pool may not also be encumbered by a second mortgage. Accordingly, it is the opinion of the Department that the Short-Term Mortgage Loans are interest bearing obligations secured by first or second mortgages or deeds of trust on single-family residential property within the meaning of section III B of PTE 83-1.

Additionally, it was not the Department's intention in section III C of PTE 83-1 to require a specific frequency of pass-through payments of principal and interest to certificateholders. In its originally proposed form section III C required such payments to be made on a monthly basis.[2] However, after consideration of the arguments of commentators, the Department deleted the requirement of monthly payments in the final exemption.[3] In the Bank's proposed mortgage pools, certificateholders are entitled to a semi-annual pass-through of interest payments made during the period. At the termination of a mortgage pool, a certificateholder is entitled to receive the return of its principal investment. Accordingly, it is the opinion of the Department that the certificates to be issued by the Bank satisfy the conditions of section III C of PTE 83-1 regarding the pass-through of principal and interest payments. Therefore, based on your facts and representations, the Department concludes that mortgage pools containing the Short-Term Mortgage Loans are eligible for the relief provided by PTE 83-1, provided the other conditions of PTE 83-1 are satisfied.

The placement of principal prepayment amounts on mortgages contained in the Bank's pool of Short-Term Mortgage Loans in separate deposit accounts of the Bank may fall outside the scope of relief provided by PTE 83-1. However, section 408(b)(4) states that the prohibitions of section 406 shall not apply to the investment of all or a part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if -- (A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or (B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliate thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment.

The implementing regulations under section 408(b)(4), 29 CFR 2550.408b-4(b)(2), provide

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[2] Proposed Class Exception for Certain Transactions Involving Mortgage Pool Investment Trusts, 45 FR 29937, 29946, May 6, 1980.

[3] 46 FR 7525 (January 23, 1981)

further clarification for plans covering employees of employers other than the bank or similar financial institution in which plan assets are deposited. The regulations require that the investment be expressly authorized by a provision of the plan or trust instrument or that the investment be expressly authorized (or made) by a fiduciary of the plan (other than the bank or similar financial institution or any of its affiliates) who has authority to make such investments, or to instruct the trustee or other fiduciary with respect to investments, and who has no interest in the transaction which may affect the exercise of such authorizing fiduciary's best judgment as a fiduciary so as to cause such authorization to constitute an act described in section 406(b) of ERISA.

Fiduciaries of investing plans unrelated to the Bank are given the option to elect that any prepayments of principal from mortgages contained in the mortgage pool be deposited in an account with the Bank. It is the opinion of the Department that the express authorization requirement contained in section 408(b)(4) and the regulations thereunder will be satisfied if the fiduciaries of investing plans unrelated to the Bank, following full disclosure regarding the election process, agree to the option to direct distributions of principal prepayments to a deposit account with the Bank.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Alan D. Lebowitz
Deputy Administrator for Program Operations