

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210



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96-23A
ERISA SEC. 401(b)

Mr. Edwin M. Jones
Bentley, Mosher, Babson & Lambert, P.C.
20 Dayton Avenue
P.O. Box 788
Greenwich, Connecticut 06836-0788

Dear Mr. Jones:

This is in response to your request on behalf of the CBA Mortgage Corporation (CBA) for an advisory opinion regarding the application of the plan assets regulation (29 C.F.R. 2510.3-101) under the Employee Retirement Income Security Act of 1974 (ERISA) to the purchase by employee benefit plans of interests in a trust. The trust in question has been established to hold mortgages acquired by CBA. Specifically you ask whether an employee benefit plan's investment in certain "pass-through certificates" representing interests in the trust would constitute "equity interests," as that term is used in the plan assets regulation.

You represent that CBA is a Delaware corporation organized for the purpose of acquiring mortgage assets, establishing trusts to hold the assets, and selling interests therein. These interests are represented by various classes of certificates, some of which have been registered under the Securities Act of 1933. The certificates constitute, in the aggregate, the entire beneficial ownership of the trust. Your request pertains to a limited group of certificates, all of which are registered under the Securities Act of 1933 and which represent interests in a "mortgage pool" consisting of 144 new mortgage loans that provide for interest payments until maturity on December 1, 2003, a 76% unsubordinated participation interest in a first priority mortgage loan that provides for deferral of all accrued interest until its scheduled maturity date, and a single second mortgage loan that is subordinate in lien priority to the lien of the first mortgage that underlies the 76% participation interest.

In general, the plan assets regulation provides that, in the case of a plan's investment in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940, its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless the entity is an operating company or equity participation in the entity by benefit plan investors is not significant. You assert that an employee benefit plan's investment in the trust through purchase of the pass-through certificates should not be considered an "equity interest," within the meaning of the plan assets regulation, inasmuch as the rights acquired by the purchaser are merely to claim a portion of the interest paid on the underlying debt instruments from the trust at the times and in the amount specified in the certificate.

The Department's regulation section 2510.3-101(b)(1) generally defines the term "equity interest" as "any interest in an entity other than an instrument that is treated as indebtedness under applicable local law and which has no substantial equity features." However, that section of the regulation also contains a special plan asset "look-through rule" which expressly provides that a "profits interest in a partnership, an undivided ownership interest in property and a beneficial interest in a trust are equity interests." The look-through rules are based on the premise that, with

certain exceptions not here relevant,¹ when a plan indirectly retains investment management services by investing in a pooled investment vehicle, the assets of the vehicle should be viewed as plan assets and managed in accordance with the fiduciary responsibility provisions of ERISA. Under the special look-through rule addressing beneficial interests in a trust, the nature of the underlying assets held by the trust is not relevant to the determination of the nature of the interest acquired through sale of trust certificates. Accordingly, it is the view of the Department that the pass-through certificates representing a beneficial interest in the trust described above constitute equity interests within the meaning of the plan assets regulation.

The same result would obtain, moreover, even if CBA structured the mortgage pool without using the vehicle of the trust. Regulation section 2510.3-101(g) provides that "where a plan jointly owns property with others, or where the value of a plan's equity interest in an entity relates solely to identified property of the entity, such property shall be treated as the sole property of a separate entity." The regulation section 2510.3-101(j)(10) provides the following pertinent example:

In a private transaction, a plan, P, acquires a 30 percent participation in a debt instrument that is held by a bank. Since the value of the participation certificate relates solely to the debt instrument, that debt instrument is, under paragraph (g), treated as the sole asset of a separate entity. Equity participation in that entity by benefit plan investors is significant since the value of the plan's participation exceeds 25 percent of the value of the instrument. In addition, the hypothetical entity is not an operating company because it is primarily engaged in the investment of capital (i.e., holding the debt instrument). Thus, P's assets include the participation and an undivided interest in the debt instrument, and the bank is a fiduciary of P to the extent it has discretionary authority or control over the debt instrument.

Inasmuch as a plan's participation interest in the mortgage pool property relates solely to certain identified property, such property would be treated as the sole property of a separate entity for purposes of regulation section 2510.3-101(g). Further, because CBA is primarily engaged in the investment of capital (i.e., the holding of the mortgages), if the value of interests in the entity held by benefit plan investors exceeds 25 percent of the value of the mortgages, an investing plan's assets would include its interest in the entity and an undivided interest in the underlying mortgages.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (41 Fed. Reg. 36281, Aug. 27, 1976). Section 10 of the Procedure describes the effect of advisory opinions.

Sincerely,

Bette J. Briggs
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

¹ It appears from your submission, and we assume for purposes of this opinion, that the trust certificates in question are not publicly-offered or issued by a registered investment company, that the trust is not an operating company and that equity participation in the trust by benefit plan investors will be significant.