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[Prohibited Transaction Exemption 80-83]

Class Exemption for Certain Transactions involving Purchase of Securities *w*here Issuer May Use Proceeds To Reduce or Retire Indebtedness To Parties In Interest

Final Exemption

AGENCY: Department of Labor

ACTION: Grant of Class Exemption

SUMMARY: This class exemption permits, under certain conditions, purchases of securities by employee benefit plans when the proceeds from the sale of such securities may be used by the issuer to reduce or retire indebtedness to persons who are parties in interest with respect to such plans. In the absence of the retroactive and prospective relief provided by this exemption, these transactions might be prohibited by the Employee Retirement Income Security Act of 1974 (the Act) and the Internal Revenue Code of 1954 (the Code).

EFFECTIVE DATE: Section I(B) of this exemption is effective December 1, 1980. The remainder of this exemption is effective January 1, 1975.

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

SUPPLEMENTARY INFORMATION: On July 27, 1979, notice was published in the Federal Register (44 FR 44286) of the pendency before the Department of Labor (the Department) of a proposal for a class exemption from the restrictions of section 406(a)(1) (A) through (D) and section 406(b)(1) and (2) of the Act, and from the taxes imposed by section 4975 (a) and (b) of the reason of section 4975(c) (1) (A) through (E) of the Code for transactions described in an application filed by the American Bankers Association (ABA).[1] The notice set forth a summary of facts and representations contained in the application, and referred interested persons to the application for a complete statement of facts and representations. The application has been available for public inspection at the Department in Washington, D.C.

Public comments and requests for a hearing with regard to the proposed class exemption were received pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975). Notice of a public hearing on the proposed exemption was published on December 21, 1979 (44 FR 75756), and the public hearing was held on January 24, 1980. The record of such hearing remained open until February 15, 1980, and additional comments were received.

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

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[1] Exemption Application No. D-690. This application was filled with both the Department and the Internal Revenue Service. However, the notice of pendency was issued and the exemption is being granted solely by the Department because, effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) transferred the authority of the Secretary of the Treasury to issue this type of exemption to the Secretary of Labor.

Description of the Proposal

The proposed class exemption contained in the notice of pendency provided conditional relief prospectively and retroactively to January 1, 1975 for transactions involving purchases of securities in a public offering by an employee benefit plan when the proceeds from such sale of securities may be used to reduce or retire indebtedness to a party in interest[2] with respect to such a plan. Section I(A) of the proposed exemption would provide relief from sections 406(a)(1)(A) through (D) of the Act and section 4975(c) (1) (A) through (D) of the Code retroactively from January 1, 1975 to the date 30 days after the publication of the final exemption. Such retroactive relief would be available for transactions in which the proceeds of the sale of securities to a plan may be used to reduce or retire indebtedness owed to a party in interest other than the plan fiduciary which made the decision to purchase such securities. Such relief would be available provided that the price paid by the plan for the securities did not exceed adequate consideration.

Section I(B) of the proposed exemption would provide prospective relief, effective 30 days after the publication of the final exemption, from the prohibitions of section 406(a)(1) (A) through (D) of the Act and section 4975(c) (1) (A) through (D) of the Code for transactions in which indebtedness owed to a party in interest other than the plan fiduciary which made the decision to purchase the securities may be reduced or retired. The prospective relief would be available provided that the conditions contained in section II(A) of the proposed exemption are met. Proposed section II(A) would require that: (1) the price paid by the plan fiduciary for the securities does not exceed the original offering price; and (2) the fiduciary, on behalf of the plan, maintains, for a period of six years, records which are sufficient to allow a determination of whether the conditions of the exemption have been met, and which are unconditionally available for examination during normal business hours by the persons listed in section II(A)(2)(b) of the proposed exemption.

For transaction in which the proceeds of the sale of securities in a public offering may be used to reduce or retire indebtedness owed to the plan fiduciary which made the decision to purchase such securities, section I(C) of the proposed exemption would provide retroactive and prospective conditional relief only when such fiduciary is a bank. Such relief from the restrictions of sections 406(a)(1)(A) through (D) and section 406(b)(1) and (2) of the Act and the taxes imposed by reason of section 4975(c) (1) (A) through (E) of the Code would be subject to the conditions in section II(A) discussed above. Such relief would also be subject to additional conditions when the fiduciary bank knows, as defined in section I(C) that proceeds will be used to benefit such fiduciary.[3] These conditions would include a three percent limitation on the amount of securities in an offering purchased on behalf of a plan; a three percent limitation on the amount of assets of a plan used to make such purchases, except that the limitation is one percent if the consideration to be paid exceeds $1million; and a ten percent limitation on the amount of securities purchased in an offering on behalf of all plans as to which the fiduciary bank has investment discretion. These conditions would also limit the type of securities which may be purchased and the type of issues which may be involved in such transactions.

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[2] When the term “party in interest” is used in this notice, it should be read to include the term “disqualified person” as defined in section 4975(e)(2) of the Code.

[3] The applicant represent that a fiduciary bank’s employees who are responsible for investing plan assets will not ordinarily know that a prior loan by the fiduciary bank will be reduced or retired with proceeds from an issuance of securities. The applicant indicates that the commercial and trust functions of banks are kept separate to a certain extent in order to comply with regulations adopted by the Office of the Comptroller of the Currency 12CFR 9.7(d), and the Policy Statement of the Board Governors of the Federal Reserve System (43 FR 2755, March 27, 1978), which set forth guidelines to prevent the misuse of material inside information by bank trust departments in connection with the purchase or sale of securities. The applicant stated that the measures taken to prevent the flow of such material inside information are referred to within the banking industry as the construction of a “Chinese Wall” between the commercial and trust departments.

Section I(C) of the proposed exemption also contained a three part definition of knowledge. First, a fiduciary bank would be deemed to know that the proceeds will be used for its benefit if the officers or employees of such fiduciary who are authorized to be involved, or who are in fact involved, in carrying out such fiduciary investment obligations receive actual knowledge of the use of the proceeds. Second, the fiduciary bank would be deemed to have such knowledge of the use of the proceeds. Second, the fiduciary bank would be deemed to have such knowledge if such officers or employees possess information reasonably sufficient to cause them to believe that the proceeds will be used to benefit such fiduciary. Third, the fiduciary bank would be deemed to know that the proceeds would be used for its benefit if such knowledge or information is received by employees or agents of the fiduciary and such knowledge or information should, in the normal course of business, be communicated to the fiduciary bank's officers or employees who are authorized to be involved, or who are in fact involved, in carrying out the fiduciary's investment duties.

Section I(D) of the proposed exemption provided retroactive and prospective relief from the prohibitions of section 406(a)(1) (A) through (D) and 406(b) (1) and (2) of the Act, and the taxes imposed by reason of section 4975(c) (1) (A) through (E) of the Code for the receipt by a party in interest of any of the proceeds from the sale of securities when such proceeds may be used to reduce or retire indebtedness owed to that party in interest.

Discussion of Comments

A. Sections I(A) and I(B)

The Department received one comment regarding section I(A) of the exemption. The commentator addressed the requirement that, in order to qualify for retroactive relief when the proceeds of a sale of securities to a plan are used to benefit a party in interest other than the plan fiduciary, the price paid by the plan for such securities does not exceed adequate consideration. The term "adequate consideration" was not defined in the exemption as proposed and the commentator suggest that the Department adopt the definition of this term provided in section 3(18)(B) of the Act. The Department has decided to adopt this suggestion, and has modified the exemption accordingly. No comments were received on section I(B).

B. Section I(C)

The largest number of comments received by the Department dealt with the provisions of section I(C) of the proposed exemption. The specific issues raised by the comments with regards to the relief proposed in section I(C) are discussed below.

1. Limitation to Bank Fiduciaries. Two commentators suggested that the relief in section I(C) be expanded to include transactions in which the proceeds of the sale of securities are used to reduce or retire indebtedness owed not only to the fiduciary bank but also to corporate affiliates of such bank or of the bank holding company controlling such fiduciary bank. As the Department noted in the preamble to the proposed exemption (44 FR 44286, 44288), the relief in section I(C) was limited to bank fiduciaries because the record before the Department at that time was insufficient to support the proposal of relief for fiduciaries which are not banks. The commentators have indicated that bank affiliates are similar to banks both in their involvement in the types of transactions covered by the proposed exemption, and in the application of "Chinese Wall" procedures to their internal operations. Therefore, when a bank affiliate is a fiduciary with respect to a plan, the employees of the affiliate who are responsible for investing plan assets may not know that a prior extension of credit from the bank or from the affiliate will be reduced or retired with the proceeds from an issuance of securities.

In light of this, the Department has determined that it is appropriate to expand the relief provided in section I(C) as the commentators have requested. Accordingly, section I(C) is modified to apply to situations in which the proceeds from the purchase of securities on behalf of a plan by a plan fiduciary which is a bank or a bank affiliate may be used to reduce or retire indebtedness owed to such fiduciary bank or an affiliate thereof.

In addition, the Department is modifying section II(B) by the addition of a definition of the term “affiliate.” Under this definition, “affiliate” of a bank means any entity directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the bank.

2. Condition I(C)(3). Condition I(C) (3) of the exemption as proposed required that when the fiduciary knows, as defined in section I(C), that the proceeds of a sale of securities may be used to benefit such a transaction only if continuous operation for at least three years, unless the securities are highly rated, noncovertible debt securities. One commentator has suggested the deletion of this condition. The commentator states that this condition has no substantial relationship to the exemption’s purpose of protecting plans from abuse due to fiduciary self-dealing. The commentator argues that the only effect of this condition would be to burden capital markets for newly formed companies.

The Department’s intention in including this condition in the proposed exemption was to protect plans from situations in which bank fiduciaries, having loaned funds used to establish a company, then used plan monies to allow the new company to pay off its initial indebtedness. The commentator has not indicated why such a situation would be free from the possibility for abuse. Therefore, the Department is not persuaded to delete this requirement and retains this condition in the final class exemption.

3. Percentage Limitations. In the exemption as proposed, the condition contained in paragraphs I(C)(4), I(C)(5) and I (C)(6) limited the extent to which plans may purchase securities in an issue when a fiduciary bank knows, as defined in section I(C), that the proceeds from such sales may be used for its benefit. Paragraph I(C)(4) of the proposal provided that the amount of such securities purchased by the fiduciary bank on behalf of any individual plan may not exceed three percent of the total issue. Paragraph I(C)(5) of the proposal provided that consideration paid by any plan to purchase such securities may not exceed three percent of the value of the assets of such plan as of the last day of the most recent fiscal quarter of the plan prior to such transaction, except when such consideration exceeds $1 million, in which case such consideration may not exceed one percent of the value of plan assets. Paragraph I(C)(6) as proposed provided that the total amount of securities purchased by a fiduciary bank on behalf of all plans as to which such bank acts as a fiduciary may not exceed ten percent of the issue.

The Department has received a number of comments criticizing these percentage limitations and suggesting either a general revision or specific modifications of these conditions. The commentators suggesting a general revision of these provisions state their belief that, by these paragraphs, the Department is attempting to establish a *de minimis* standard. While these commentators agree on the desirability of such a standard, they assert that the limitations proposed by the Department would unduly restrict fiduciaries in the exercise of their investment discretion. As an alternative to the conditions proposed by the Department, the commentators suggest that the Department exempt transactions where the fiduciary knows, as defined in paragraph I(C), that the proceeds of a sale of securities will be used for its benefit so long as no more than twenty percent of the gross proceeds of the issue are used to reduce or retire indebtedness to such fiduciary bank.

Upon consideration of these comments, the Department is not convinced that the suggested substitute provision would be sufficiently protective to permit the Department to make the findings required by section 408(a) of the Act and section 4975(c)(2) of the Code. The conditions proposed by the Department were intended to limit the use of plan assets to purchase securities when the fiduciary bank knew that the proceeds from such purchases would accrue to its benefit. The suggested substitute provision would supply a supposed *de minimis* standard for the extent to which the proceeds of a securities issue could be used to reduce or retire indebtedness owed to a fiduciary bank. The suggested substitute fails to account for the degree to which plan assets may be committed to achieve this supposed *de minimis* level of repayment. The applicants’ argument that a fiduciary receiving less than 20 percent of the proceeds of an issue would have an interest in that issue insufficient to create the possibility of abuse is not persuasive, since (1) a fiduciary bank might use a substantial amount of plan assets in such a transaction and (2) a substantial amount of the bank’s indebtedness might be retired in connection with the purchase of such securities. Therefore, the Department does not adopt this suggested substitute and has determined to retain the structure of these paragraphs as proposed.

Several commentators made suggestions regarding specific revisions of the proposed percentage limitations. Two commentators argue that all of the percentages are too low and would unduly restrict fiduciary investment discretion. However, these commentators have not suggested higher levels they would consider acceptable, nor have they presented evidence or arguments in support of such changes or the need therefor. In the absence of such a basis, the Department has decided not to raise the percentage limitations generally.

With regard to the provisions of paragraphs I(C)(5), which limit the percentage of plan assets which may be used to purchase securities, one commentator suggests that the percentage should apply only to the assets under management of the fiduciary bank. This same commentator suggests that plan assets should be valued as of the most recent valuation date preceding the transaction. The Department has decided to adopt these comments and has modified this paragraph accordingly.

Also regarding this paragraph, this commentator suggests the elimination of the one percent limitation on plan assets used to purchase securities when the consideration for such purchase exceeds $1 million. The commentator notes that a plan with assets valued between $33 million and $100 million cannot utilize the three percent limitation contained in this paragraph without exceeding the $1 million limit, and at the same time would be forced to commit less than $1 million when held to the one percent limitation. Therefore, the commentator argues that the one percent limitation discriminates against plans with assets valued between $33 million and $100 million, and should be eliminated. Upon consideration of this comment and the purposes served by the limitation, the Department has decided to delete the one percent limitation.

With regard to the provisions of paragraph I(C)(6), one commentator states that the limitation of purchases by any fiduciary bank on behalf of all plans as to which it is a fiduciary to ten percent of an offering discriminates against large fiduciary banks. The commentator states that the effect of this condition is to prevent a bank acting as a fiduciary to more than three plans from purchasing for each plan to maximum amount of securities allowed under former paragraph I(C)(4), which limits a plan’s purchase to three percent of an issue. The Department notes, however, that the ten percent limitation assures that no fiduciary can gain repayment of its loans or those of an affiliate by using the assets of the plans as to which it is a fiduciary to purchase all, or a substantial portion of, the securities in an issue. The commentator also has presented nothing to indicate how the proposed ten percent limitation would be disruptive of or require changes in existing sound bank investment practices. Accordingly, the Department does not adopt this comment.

Finally, several commentators have requested that, if the Department decided to retain the percentage limits as proposed, the Department should take the position that securities purchased by commingled or collective trusts in which a plan participates should be attributed to that plan proportionally on the basis of its participation in the fund. The Department has decided to adopt this comment, and has therefore added a new subsection II(B)(3), which provides that each plan participating in a collective or commingled fund shall, for the purpose of this exemption, be considered to own the same proportionate undivided interest in each asset of the collective investment fund as its proportionate interest in the total assets of the collective investment fund as calculated on the most recent preceding valuation date of the fund.

4. Knowledge. Paragraph I(C)(7) of the exemption as proposed defined the three instances in which a fiduciary bank will be deemed to know that the proceeds of a sale of securities will be used to reduce or retire indebtedness owed to such fiduciary bank or any affiliate thereof. The commentators generally agree with the provisions of subparagraph (a) of this paragraph, which stated that a fiduciary will be deemed to possess the requisite knowledge if such knowledge is actually communicated to the fiduciary bank’s officers and employees who are involved in making investment decisions. With regard to subparagraph (b), which deemed a fiduciary to possess the requisite knowledge if the fiduciary bank’s officers and employees involved in the investment process possess information reasonably sufficient to cause belief that the proceeds will be used to benefit the fiduciary bank, one commentator stated that this standard is so vague that banks would be forced to comply, in all cases, with the restrictive conditions set forth in section I(C). However, this commentator offered no constructive suggestions for modifying subparagraph (b). The Department has re-examined this subparagraph in light of this comment, and has determined that the provision is not so vague as to produce the results described by this commentator. The Department, therefore, does not accept this comment.

The same commentator criticized subparagraph (c) of the proposal, which deemed a fiduciary bank to know that the proceeds will be used for its benefit if such knowledge or information is received by employees or agents of such fiduciary, and such knowledge or information should, in the normal course of business, be communicated to the bank's officers and employees involved in the investment process. This commentator indicated that the provisions of that paragraph would require banks to undertake detailed investigations which might breach the so-called "Chinese Wall" established pursuant to deferral guidelines designed to prevent the flow of material information between the corporate loan and trust departments of banks.

In addition, this commentator joined with others in criticizing the provisions of proposed subparagraphs I(C)(7) (b) and (c) as establishing a "constructive knowledge" test which would be difficult to administer. As a substitute, these commentators suggest that, in the absence of actual knowledge, the terms of the prospectus pursuant to which the securities are offered should be determinative. In other words, the commentators state that if the prospectus is silent as to the use of proceeds, or if the prospectus states that the proceeds will be used to reduce or retire indebtedness but does not identify the persons to whom such indebtedness is owed, the fiduciary bank, in the absence of actual knowledge, should be deemed not to possess the requisite knowledge and should therefore avoid the application of the restrictive conditions contained in section I(C) of the exemption.

With regard to this proposed substitute, the Department notes that testimony given at the public hearing concerning the proposed exemption indicates that it is not customary for a prospectus to identify specific lenders who would be repaid from the proceeds of the sale of securities. It would, therefore, appear that the proposed substitute would be applicable only in an extremely limited number of cases. In light of this, and upon consideration of the other arguments advanced in support of this proposed substitute, the Department has decided not to adopt these comments and has retained the proposed structure of this paragraph.

The Department has, however, decided to delete subparagraph (c). The Department recognized, as the comments have indicated, the difficulty confronting banks in conducting an inquiry to determine whether the terms of that subparagraph have been met. The Department also notes that this provision as proposed fails to take into account situations in which an employee, though possessing the requisite information, does not communicate such information to persons involved in the bank's investment process. Although the Department has decided to eliminate this provision, it is the Department's view that the possession of such knowledge or information by a fiduciary bank's employee or agent who would, in the normal course of business, communicate this knowledge or information to persons involved in the bank's investment process is a factor to be considered when determining whether a fiduciary bank knows, within the meaning of this section, that the proceeds of the sale will be used to reduce or retire indebtedness owed to that bank fiduciary.

5. *Retroactivity.* Section I(C) of the exemption as proposed would provide retroactive and prospective conditional relief. Two commentators, while stating that retroactive relief is necessary, object to the fact that the conditions contained in section I(C) would also apply retroactively. These commentators state that fiduciaries could not have reasonably anticipated the expansive definition of "knowledge" contained in the proposed exemption, or the conditions that apply when a fiduciary bank possesses such knowledge. One commentator suggests that past abuses in transactions covered by section I(C) are unlikely due to the widespread use of "Chinese Wall" procedures, and that, therefore, the Department should provide retroactive relief under section I(C) so long as the plan paid no more than adequate consideration for the securities.

As indicated above, the Department has modified the definition of "knowledge" in this exemption. This modified definition is more limited in scope than the definition in the proposal. The only situation in which the restrictions in section I(C) would have retroactive effect are those cases in which fiduciary bank personnel involved in the bank's investment process either received actual knowledge that the proceeds from the sale of securities would be use to reduce or retire indebtedness owed to the fiduciary bank, or possessed information reasonably sufficient to cause such a belief. If, as the commentators have stated, "Chinese Wall" procedures are widely followed in the banking community, it appears unlikely that banks would often meet the modified knowledge standard. When a fiduciary bank possessed such knowledge and still entered the transaction, the Department does not believe that the broad retroactive relief requested by the commentators would be warranted for such self-dealing. However, because the exemption allows some investment of plan funds even when a fiduciary bank actually knew, or possessed knowledge reasonably sufficient to cause the belief, that the proceeds from a sale of securities will be used to reduce or retire indebtedness owed to such fiduciary bank, the Department does not believe that retroactive application of the conditional relief in section I(C) would be onerous. In addition, as noted by the Department in the preamble to the proposed exemption (44 FR 44286, 44288 n.2), a transaction not qualifying for the conditional retroactive relief provided by this class exemption could be considered for an individual exemption upon submission of an application for exemption in accordance with ERISA Proc. 75-1 (40 FR 18471, April 28, 1975). Therefore, the Department does not accept these comments.

C. Section I(D)

As proposed, section I(D) would provide retroactive and prospective relief for the receipt by a party in interest of proceeds from a sale of securities when such proceeds are used by the issuer to reduce or retire indebtedness owed to the party in interest. The Department stated in the preamble to the proposal that this relief would not be limited to transactions involving banks, and would exempt transactions involving fiduciaries.

The Department recognizes that confusion may have resulted from the manner in which this proposed section and the parts of the preamble relating thereto are presented. It is possible to read proposed section I(D) as undermining or supplanting the conditional relief provided in sections I (A) through (C) of the exemption. In order to avoid this unintended possibility, the Department has decided to make certain changes clarifying the scope of relief provided by section I(D). Accordingly, section I(D) as modified states that, effective January 1, 1975, the restrictions of section 406(a)(1) (A) through (D) and 406 (b)(1) and (2) of the Act and the taxes imposed by reason of section 4975(c)(1) (A) through (E) of the Code shall not apply to the receipt by a party of interest of any of the proceeds resulting from the issuance, in a public offering (as defined in section II(B) of the exemption), of securities merely because such proceeds are used by the issuer to reduce or retire indebtedness owed to the party in interest, provided that, when such party in interest is a fiduciary acquiring such securities on behalf of a plan, such fiduciary must be a bank or an affiliate thereof (as defined in section II(B) of the exemption) which meets the provisions of section I(C) of the exemption.

D. Section II(A)

Section II(A) contains general conditions applicable to the transactions described in section I(B) and I(C) of the exemption. The Department has received one comment regarding section II(A)(2)(b), which states that records necessary for a determination of whether the conditions of the exemption have been met must be made “unconditionally available” to certain designated persons. This commentator stated that it would be financially burdensome to make such records unconditionally available. The commentator also notes that banks are required to keep many records of this type confidential. The commentator suggests that these problems would be solved by changing the section to require that such records be “reasonably available.” The purpose of the requirement contained in the proposal, which has been included in other proposals containing recordkeeping requirements, is to prevent the imposition of conditions on the availability of the records that would preclude an interested person from examining such records. However, the Department does not interpret this condition as necessarily requiring the instantaneous production of all such records upon demand under all circumstances. In addition, in light of the concerns expressed in the comments, the Department has modified this condition to provide that the examination rights do not extend (other than in the case of a duly authorized representative of the Department or the Internal Revenue Service) to a bank’s trade secrets, or to commercial or financial information which is privileged or required to be kept confidential.

E. Directed Trustees and Custodians.

In footnote 5 of the preamble to the proposed exemption (44 FR 44286, 44288 n. 5), the Department invited comments as to the need for special relief for banks which serve as custodians or directed trustees of assets of employee benefit plans, with responsibility to carry out proper investment instructions given by a named fiduciary. The Department noted that it assumed such custodians and directed trustees generally would not possess a level of knowledge sufficient to subject them to the restrictive provisions of section I(C) of the proposed exemption.

All of the comments received by the Department regarding this issue request that the exemption be modified to make clear that, for the purpose of this exemption, directed trustees and custodians will not be treated as fiduciaries. These commentators have described generally the functions and responsibilities of custodians and directed trustees in order to illustrate that these entities should not be considered fiduciaries. At the same time, however, testimony at the hearing indicated that the duties and responsibilities of a custodian or a directed trustee are governed primarily by the terms of its agreement with the named fiduciary of a plan, and that the terms of such agreements vary.

In soliciting comments in this area, the Department had hoped that the commentators would provide sufficient information upon which to base generalized treatment of custodians and directed trustees under this exemption. However, such information was not forthcoming. As a result, the Department has determined not to adopt any special relief for custodians and directed trustees in this exemption. Accordingly, a determination of whether a particular custodian or directed trustee is a fiduciary, as defined in section 3(21) of the Act and regulations adopted pursuant thereto, must be made in each individual case. However, as noted in the preamble to the proposed exemption, custodians and directed trustees may still possess insufficient knowledge concerning the transactions involved to subject them to the restrictive conditions in section I(C) of the exemption even where they are deemed to be fiduciaries.

F. Technical Changes

The Department has made certain technical modifications suggested by the commentators and certain non-substantive changes designed to avoid confusion. First, in order to clarify the scope of the “knowledge” standard, and to reflect more exactly the scope of the exemption, the Department has deleted the term “to benefit” and replaced it with the phrase “by the issuer of the securities to reduce or retire indebtedness owed to” in section I(C). Second, the reference in subparagraph II(B)(2)(b) to a “common or contract” carrier and section 20(a) of the Interstate Commerce Act has been changed to “motor” carrier and section 214 of the Interested Commerce Act. Third, paragraph I(C)(1) has been changed to refer to the first business day after securities are offered rather than the first business day after the final terms of securities are fixed and announced. Fourth, paragraph I(C)(2) has been modified. This paragraph as proposed seemed to indicate that there were three separate and distinct ways in which securities could be offered or purchased under condition I(C)(2). The modification is designed to make it clear that the provisions in subparagraphs (b) and (c) are exceptions to the general firm commitment underwriting procedure which also satisfy the condition stated in that paragraph.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption granted under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest with respect to a plan to which the exemption is applicable from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the plan’s participants and beneficiaries and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that a plan must operate for the exclusive benefit of participants and beneficiaries.
(2) This exemption is supplemental to, and not in derogation of, any other provision of the Act and the Code, including statutory exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.
(3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

Exemption

In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record including the written comments submitted in response to the notice of July 27, 1979, and the testimony given at the public hearing of January 24, 1980, the Department makes the following determinations:

(a) The class exemption set forth herein is administratively feasible;
(b) It is in the interests of plans 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.

I. Transactions

A. Effective January 1, 1975 the restrictions of section 406(a)(1) (A) through (D) of the Act and the taxes imposed by reason of section 4975(c)(1) (A) through (D) of the Code shall not apply to the purchase or other acquisition prior to December 1, 1980 in a public offering (defined in Section II(B)) of securities by a fiduciary on behalf of an employee benefit plan solely because the proceeds from the sale were or were to be used by the issuer of the securities to retire or reduce indebtedness owed to a party in interest with respect to the plan other than the fiduciary, *provided that* the price paid for the plan for the securities does not exceed adequate consideration as defined in section 3(18) of the Act.

B. Subject to the conditions described in section II(A), effective December 1, 1980, the restrictions of sections 406(a)(1) (A) through (D) of the Act and the taxes imposed by reason of section 4975(c)(1) (A) through (D) of the Code shall not apply to the purchase or other acquisition in a public offering (defined in section II(B)) of securities by a fiduciary on behalf of an employee benefit plan solely because the proceeds from the sale may be used by the issuer of the securities to retire or reduce indebtedness owed to a party in interest of the plan other than the fiduciary.

C. Subject to conditions described in section II(A), effective January 1, 1975, the restrictions of sections 406(a)(1) (A) through (D) and 406(b)(1) and (2) of the Act and the taxes imposed by reason of section 4975(c)(1)(A) through (E) of the Code shall not apply to the purchase or other acquisition in a public offering (defined in section II(B)) of securities by a fiduciary, which is a bank or an affiliate thereof, on behalf of an employee benefit plan solely because the proceeds from the sale may be used by the issuer of the securities to retire or reduce indebtedness owed to such fiduciary or any affiliate thereof, *provided that,* if such fiduciary of the plan knows (as defined in paragraph 7) that the proceeds of this issue will be used in whole or in part by the issuer of the securities to reduce or retire indebtedness owed to such fiduciary or affiliate thereof, the transaction shall have complied with the conditions set forth in paragraph 1 through 6 below:

1. Such securities are purchased prior to the end of the first full business day after the securities have been offered to the public, except that –

a. If such securities are offered for subscription upon exercise of rights, they may be purchased on or before the fourth day preceding the day on which the rights offering terminates; or

b. If such securities are debt securities, they may be purchased on a day subsequent to the end of such first full business day, if the effective interest rates on comparable debt securities offered to the public subsequent to such first full business day and prior to the purchase are less than effective interest rate of the debt securities being purchased;

2. Such securities are offered by the issuer pursuant to an underwriting agreement under which the members of the underwriting syndicate are committed to purchase all of the securities being offered, except if the securities

a. Are purchased by others pursuant to a rights offering, or

b. Are offered pursuant to an overallotment option;

3. The issuer of such securities has been in continuous operation for not less than three years, including the operations of any predecessors, unless such securities are non-convertible debt securities rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization;

4. The amount of securities purchased or otherwise acquired on behalf of the plan by the fiduciary does not exceed three percent of the total amount of the securities being offered;

5. The consideration to be paid by any plan in purchasing or otherwise acquiring such securities does not exceed three percent of the fair market value, as of the most recent valuation date of the plan prior to such transaction, of the plan assets which are subject to the management and control of such fiduciary;

6. The total amount of securities in any single offering purchased by the fiduciary on behalf of the plan together with the total amount of such securities purchased by such fiduciary acting as a fiduciary on behalf of any other employee benefit plan subject to Title I of the Act does not exceed 10 percent of the amount of the offering;

7. As used in this section I(C), a fiduciary will be deemed to know that the proceeds of an issuance of securities will be used in whole or in part by the issuer of the securities to reduce or retire indebtedness owed to such fiduciary or an affiliate thereof, if

a. Such knowledge is actually communicated to, or

b. Information reasonably sufficient to cause belief that the proceeds will be used in whole or in part by the issuer of the securities to reduce or retire indebtedness owed to the fiduciary, or an affiliate thereof, is possessed by, the officers or employees of the fiduciary, who are authorized to be involved in carrying out the investment responsibilities, obligations, or duties of the fiduciary, or who in fact are involved in carrying out such responsibilities, obligations, or duties, regarding the purchase or other acquisition.

D. Effective January 1, 1975, the restrictions of sections 406(a)(1) (A) through (D) and 406(b)(1) and (2) of the act and the taxes imposed by reason of section 4975(c)(1)(A) through (E) of the Code shall not apply to the receipt by a party in interest of any of the proceeds resulting from the issuance, in a public offering (as defined in section II(B)), of securities merely because such proceeds are used by the issuer of the securities to retire or reduce indebtedness owed to the party in interest *provided that*, when such party in interest is a fiduciary acquiring such securities on behalf of a plan, such fiduciary is a bank or an affiliate thereof (as defined in section II(B)) which meets the provisions of section I(C) of this exemption.

II. General Conditions

A. The following conditions apply to the transactions described in section I(B) and (C) above:

1. The price paid by the plan fiduciary for the securities shall not be in excess of the offering price described in an effective registration statement under the Securities Act of 1933 covering such securities, or in the case of securities described in section II(B)(1)(b), in the offering circular required under applicable federal law;

2. (a) The fiduciary, on behalf of the plan, maintains for a period of six years from the date of the transaction the records necessary to enable the persons described in section II(A)(2)(b) below to determine whether the conditions of this exemption have been met, except that a prohibited transaction will not be deemed to have occurred if, dues to circumstances beyond the control of the fiduciary, the records are lost or destroyed prior to the end of the six year period;

(b) Notwithstanding any provisions of subsections (a)(2) and (b) of section 504 of the Act, the records referred to in section II(A)(2)(a) above are unconditionally available at their customary location for examination during normal business hours by:

(i) Any duly authorized employee or representative of the Department of Labor or the Internal Revenue Service,

(ii) Any fiduciary of a plan who has authority to manage and control the assets of the plan, or to allocate to another fiduciary the authority to manage and control the assets of the plan, or any duly authorized employee or representative of such fiduciary,

(iii) Any contributing employer to the plan or representative of such employer,

(iv) Any participant or beneficiary of the plan or any duly authorized employee or representative of such participant or beneficiary.

(v) None of the persons described in paragraph (ii) through (iv) of this paragraph shall be authorized to examine any fiduciary's trade secrets or required to be kept commercial or financial information which is privileged or required to be kept confidential.

B. For the purpose of the exemptions contained in Part I.

1. The term "public offerings" means

a. The offerings of securities registered under the Securities Act of 1933 (Securities Act), or

b. The offerings of securities exempt from registration under the Securities Act which are

(i) Issued by a bank,

(ii) Issued by a motor carrier if such issuance is subject to the provisions of section 214 of the Interstate Commerce Act, as amended,

(iii) Exempt from the registration requirements of the Securities Act pursuant to a federal statute other than the Securities Act, or

(iv) The subject of a distribution and of a class which is required to be registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C 781), and the issuer of which has been subject to the reporting requirements of section 13 of that Act (15 U.S.C. 78m) for a period of at least 90 days immediately preceding the sale of securities and has filed all reports required to be filed thereunder with the Securities and Exchange Commission during the preceding 12 months.

2. An "affiliate" of a bank means any entity directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such bank.

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

3. Each plan participating in a collective or commingled fund shall be considered to own the same proportionate undivided interest in each asset of the collective investment fund as its proportionate interest in the total assets of the collective investment fund as calculated on the most recent preceding valuation date of the fund.

Signed at Washington, D.C., this 30th day of October, 1980.

Ian D. Lanoff
Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, Department of Labor.

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