

[Federal Register: August 22, 1994]

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DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration  
[Application No. D-9662]

Proposed Class Exemption for Certain Transactions Involving  
Insurance Company General Accounts

AGENCY: Pension and Welfare Benefits Administration, Labor.

ACTION: Notice of proposed class exemption.

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SUMMARY: This document contains a notice of pendency before the Department of Labor (the Department) of a proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act (ERISA or the Act) and from certain taxes imposed by the Internal Revenue Code of 1986 (the Code). If granted, the proposed exemption would exempt prospectively and retroactively to January 1, 1975, certain transactions engaged in by insurance company general accounts in which an employee benefit plan has an interest, if certain specified conditions are met. Additional exemptive relief is proposed for plans to engage in transactions with persons who provide services to insurance company general accounts. The proposal would also permit transactions relating to the origination and operation of certain asset pool investment trusts in which a general account has an interest as a result of the acquisition of certificates issued by the trust. The proposed exemption, if granted, would affect participants and beneficiaries of employee benefit plans, insurance company general accounts, as well as other persons engaging in the described transactions.

DATES: Written comments and requests for a hearing shall be submitted to the Department before October 21, 1994. If granted, the exemption would be effective January 1, 1975.

ADDRESSES: All written comments (preferably 3 copies) and 9 hearing requests should be sent to: Pension and Welfare Benefits Administration, Office of Exemption Determinations, Room N-5649, 200 Constitution Avenue NW., Washington, DC 20210, Attention: ACLI Class Exemption Proposal. The application for exemption (Application Number D-9662), as well as all comments received from interested persons, will be available for public inspection in the Public Documents Room, Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N-5507, 200 Constitution Avenue NW., Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT:

Lyssa E. Hall, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor, Washington, DC

20210, (202) 219-8971 (not a toll-free number) or Timothy Hauser, Plan Benefits Security Division, Office of the Solicitor, (202) 219-8637 (not a toll-free number).

SUPPLEMENTARY INFORMATION: This document contains a notice of pendency before the Department of a proposed class exemption from certain of the restrictions of sections 406 and 407 of ERISA and from certain taxes imposed by section 4975 (a) and (b) of the Code, by reason of section 4975(c)(1) of the Code. The proposed exemption was requested in an application dated March 25, 1994, submitted by the American Council of Life Insurance (the ACLI)\1\ pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Code, and in accordance with procedures set forth in 29 CFR section 2570 subpart B (55 FR 32836, August 10, 1990). In addition, the Department is proposing additional relief on its own motion pursuant to the authority described above.\2\  
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\1\The ACLI is the major trade association of the life insurance business, representing 640 life insurance companies. these companies hold, in the aggregate, approximately 89% of the assets of all life insurance companies and 94% of the pension business with insurance companies.

\2\Section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), generally transferred the authority of the Secretary of the Treasury to issue exemptions under section 4975(c)(2) of the Code to the Secretary of Labor. In the discussion of the exemption, references to sections 406 and 408 of the Act should be read to refer as well as to the corresponding provisions of section 4975 of the Code.  
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#### Background

Life insurance companies issue a variety of group contracts for use in connection with employee pension benefit plans, some of which provide benefits the amount of which is guaranteed, some of which provide benefits that may fluctuate with the investment performance of the insurance company, and some of which offer elements of both. Under section 401(b)(2) of ERISA, if an insurance company issues a ``guaranteed benefit policy'' to a plan, the assets of the plan are deemed to include the policy, but do no, solely by reason of the issuance of the policy, include any of the assets of the insurance company. Section 401(b)(2)(B) defines the term ``guaranteed benefit policy'' to mean an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. In addition, in ERISA Interpretive Bulletin 75-2, 29 CFR 2509.75-2, the Department stated that if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets.

On December 13, 1993, the Supreme Court rendered its decision in John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank, 114 S. Ct. 517 (1993) (Harris Trust.) The Supreme Court held that those

funds allocated to an insurer's general account pursuant to a contract with a plan that vary with the investment experience of the insurance company are ``plan assets'' under ERISA. As a result, the Court concluded that Hancock was a fiduciary with respect to the management and disposition of such funds. Under the reasoning of this decision, a broad range of activities involving insurance company general accounts are subject to ERISA's fiduciary standards.

Prior to the Harris Trust decision, the insurance industry, following adoption of IB 75-2, operated under the assumption that general account assets were not plan assets, and thus, were not subject to ERISA's fiduciary responsibility provisions. As a result of the retroactive effect of the Supreme Court decision, numerous transactions engaged in by insurance company general accounts may have violated ERISA's prohibited transaction provisions. The insurance industry believes that, absent exemptive relief, it will be subject to significant additional litigation with respect to the operation of its general accounts.

If the underlying assets of a general account include plan assets, persons who have engaged in transactions with such general account may be viewed as parties in interest, including fiduciaries, with respect to plans which have interests as contractholders in the general account. Lastly, the underlying assets of an entity in which a general account acquired an equity interest may include plan assets as a result of the Harris Trust decision.

#### Summary of the Application

The application contains facts and representations with regard to the requested exemption that are summarized below. Interested persons are referred to the application on file with the Department for the complete representations of the Applicant.

The ACLI represents that presently, of the \$1.5 trillion in general account assets of domestic life insurance companies, more than \$558 billion relate to life insurance, health insurance and a broad variety of annuity products purchased by employee benefit plans. General account contracts, unlike all other investment and funding vehicles offered to plans, provide risk pooling, guarantees of principal and rates of return, as well as benefit guarantees, all of which are backed by every dollar in the general account. The Applicant further states that it is this pooling and assumption of risk that distinguish insurance companies from typical investment firms and for which the state insurance regulatory agencies impose stringent reserve and capital requirements.

Like any other business, insurance companies have developed new products to compete in an ever changing marketplace. In the pension area, various forms of participating general account contracts, especially deposit administration and immediate participation guarantee contracts, were specifically developed to be responsive to the expressed needs of plan sponsors. The ACLI states that even before enactment of ERISA, participating general account contracts provided a unique balance of investment participation and protection, as well as many billions of dollars of benefits to plan participants and beneficiaries. Participating contracts allow contractholders to share in the general accounts' favorable investment, mortality and morbidity experience, to obtain protection from unfavorable experience, and to provide certainty and dependability for the payment of benefits to participants and beneficiaries. According to the ACLI, these factors

have enabled plan sponsors to fund their benefit promises and to increase the benefits to plan participants and beneficiaries.

Since the Supreme Court rendered its decision in *Harris Trust*, the legal landscape applicable to general account activities has been significantly altered. The ACLI represents that the Court's decision has created uncertainty regarding the status of general account operations and activities under ERISA-governed plans and will have a long-term adverse effect on plan participants, the U.S. economy and the insurance industry in the absence of exemptive relief.

The ACLI notes that insurance companies invest approximately \$675 billion of general account assets in the economy each year and that this is one of the largest sources of capital available in the United States, particularly for smaller and medium-sized businesses which are the source of most of the new job creation in our country. The Applicant states that the decision in *Harris Trust* has begun to slow, if not totally disrupt, the nation's capital markets. Investment bankers, brokers and banks, as well as insurance companies, are all now hesitant to engage in common, commercially reasonable and economically beneficial business transactions for fear of inadvertently violating ERISA's prohibited transaction restrictions. The Applicant believes that without the relief requested in its application, many ordinary practices of the insurance industry could be called into question.

The ACLI has requested unconditional retroactive relief from January 1, 1975, for all transactions that may be viewed as having been prohibited because insurance company general accounts may have held plan assets, as well as certain other transactions that may be viewed as having become prohibited merely as the result of an ERISA covered plan's purchase of a participating general account contract. The ACLI states that, although it is not possible to identify with specificity the types of transactions to be covered by the proposed exemption, such transactions would include (but are not limited to) the following:

(A) all internal operations of the general account (internal transactions); (B) all investment transactions involving general account assets, including transactions between the general account and a party in interest with respect to a plan that has purchased a general account contract; and (C) the purchase by the general account of securities issued by and real property leased to employers of employees covered by plans that have purchased general account contracts.

#### Internal Transactions

The ACLI represents that general accounts engage in a variety of internal activities which, given the application of ERISA, could potentially be viewed as prohibited. For example, income and losses generated by general account investments are allocated among lines of business (or, where applicable, among segments) or to surplus. Decisions must be made regarding the use of surplus, i.e., whether and to what extent to use surplus to pay dividends to policyholders or stockholders. In addition, general operational business decisions relating to salaries and benefits for the employees of the insurer, the provision of office space and materials, advertising expenses, charitable contributions, etc., could also be transactions subject to ERISA due to the pooled nature of general account assets. Thus, the ACLI represents that conceivably any of the myriad of decisions made by an insurance company regarding the structuring or internal operation of its business would need exemptive relief. In addition, the ACLI notes that many insurance companies use affiliates to provide investment

management or property management services with regard to general account properties and assets.

#### Investment Transactions With Third Parties

The Applicant represents that due to the pooled nature of general account assets, it is conceivable that general account investment transactions with persons who are parties in interest with respect to ERISA-governed plans which have purchased participating general account contracts (external transactions) could be viewed as subject to the prohibited transaction rules of ERISA. For example insurance companies are currently the most significant source of loans for smaller and mid-sized companies in today's market. Many, if not all, of those companies have party in interest relationships with plans that have purchased general account contracts. Application of ERISA's prohibited transaction provisions would have an adverse impact on the primary source of credit for these companies. The ACLI further represents that application of the prohibited transaction rules in this case could, therefore, call into question almost every investment transaction by insurance company general accounts since the January 1, 1975, effective date of the ERISA fiduciary provisions.

The Applicant states that the relief needed for general account investment transactions would be similar to the broad relief provided in Prohibited Transaction Exemption 78-19, 43 Fed. Reg. 59915 (December 22, 1978), as amended and redesignated in PTE 90-1, 55 Fed. Reg. 2891, (January 29, 1990). PTE 90-1 provides conditional relief for certain transactions between insurance company pooled separate accounts in which plans have an interest and parties in interest with respect to those plans.\3\  
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\3\Section I(a) of PTE 90-1 exempts from the restrictions of sections 406(a), 406(b)(2) and 407(a) of ERISA and the taxes imposed by section 4975(a) and (b) of the Code, by reason of section 4975 (c)(1)(A) through (D) of the Code:

Any transaction between a party in interest with respect to a plan and an insurance company pooled separate account in which the plan has an interest, or any acquisition or holding by the pooled separate account of employer securities or employer real property, if the party in interest is not the insurance company which holds the plan assets in its pooled separate account, any other separate account of the insurance company, or any affiliate of the insurance company, and if, at the time of the transaction, acquisition or holding, either;

(1) The assets of the plan (together with the assets of any other plans maintained by the same employer or employee organization) in the pooled separate account do not exceed--

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(iii) 10 percent of the total of all assets in the pooled separate account, if the transaction occurs on or after July 1, 1988; or \* \* \*

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#### Additional Transactions

In addition to broad relief for transactions between parties in interest and general accounts, the ACLI represents that various other transactions would need retroactive relief as a result of the potential plan asset treatment of general account assets.

Over the years, there have been literally thousands of persons and entities that have provided services to insurance companies. According to the ACLI, because of the size of insurance company general accounts, the number of service providers raises the possibility of countless, technical prohibited transactions which have posed no possibility of abuse. Thus, the ACLI requests relief for transactions that would be prohibited merely because a person is deemed to be a party in interest to a plan solely by reason of providing services to the general account (or who has a relationship with such service providers described in sections 3(14) (F), (G), (H), or (I) of ERISA).

The ACLI further represents that, under the Department's plan assets regulation, 29 CFR Sec. 2510.3-101(f)(2)(iii), an insurance company investing general account assets could be viewed as a ``benefit plan investor'' for the purposes of calculating the 25 percent significant participation test in section 2510.3-101(f)(1) of the regulation. This could increase the number of entities that would hold plan assets as the result of a general account equity investment in an entity, and thereby also increase the number of possible prohibited transactions.\4\ The ACLI notes that, as a further consequence of the general account's investment in an entity, the manager of the entity (and other service providers to the entity) might be deemed to be fiduciaries or other parties in interest under section 3(14) of ERISA. Therefore, the ACLI requests broad relief for transactions that would be prohibited solely because an entity has significant participation by benefit plan investors as a result of equity investments by general account(s).

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\4\It is the Department's view that, for purposes of determining whether equity participation in an entity by benefit plan investors is ``significant'' within the meaning of the significant participation test contained in the plan assets regulation, 29 CFR Sec. 2510.3-101(f), only the proportion of an insurance company general account's equity investment in the entity that represents plan assets should be taken into account. Therefore, the proportion of that investment that represents plan assets would equal the proportion of the insurance company general account as a whole that constitutes plan assets.

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#### Employer Securities and Employer Real Property

The Applicant represents that the breadth of general account investment activities over the last 20 years makes it likely that insurance companies have purchased and continued to hold for their general accounts, securities issued by or properties leased to employers of employees covered by plans that purchased general account contracts. Because insurance companies have made such investments with the understanding that general account assets were not plan assets, it is possible that general account investments include securities issued by employers, and real property leased to employers, that do not meet

the standards set forth in section 407(a) of ERISA. The ACLI also believes that relief is necessary for the acquisition or holding of qualifying employer securities or qualifying real property by a plan under circumstances where the acquisition or holding contravenes sections 406 and 407(a) solely by reason of being aggregated with employer securities or employer real property held by an insurance company general account in which the plan holds an interest as a contractholder. The Applicant notes that the relief requested for such ``excess holdings'' is similar to the relief provided for pooled separate accounts in section I(c) of PTE 90-1.\5\

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\5\PTE 90-1, Section I(c) provides relief for:

Any acquisition or holding of qualifying employer securities or qualifying employer real property by a plan (other than through a pooled separate account) if--

(1) The acquisition or holding contravenes the restrictions of sections 406(a)(1)(E), 406(a)(2) and 407(a) of the Act solely by reason of being aggregated with employer securities or employer real property held by an insurance company pooled separate account in which the plan has an interest, and

(2) The requirements of either paragraph (a) or paragraph (b) of this section are met.

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#### The Proposed Exemption

The scope of the exemption being proposed by the Department differs from that requested by the Applicant. As previously noted, the Department has granted a class exemption for insurance company pooled separate accounts that provides relief from ERISA's prohibited transaction provisions for a variety of transactions between separate accounts and parties in interest with respect to plans participating in such accounts. The Department has decided to propose similar relief, as described below, with respect to insurance company general account transactions to the extent that it believes that the requirements of section 408(a) of ERISA would be met. On its own motion, the Department is also proposing relief for certain transactions involving the operation of certain asset pool investment trusts. However, as more fully discussed below, the Department is not prepared at this time to propose several additional exemptions requested by the Applicant.

#### Internal Transactions

After considering the ACLI's requested exemption for activities in connection with the internal operation of general accounts, the Department has determined that it does not have sufficient information regarding the operation of such accounts to make the findings required by section 408(a)\6\ of ERISA. In a letter dated May 20, 1994, the Department has requested from the ACLI the necessary information by posing a number of questions concerning the internal operations of general accounts. In that letter, the Department indicated that it would proceed with its review of their application as it pertains to the external transactions while awaiting their response to the questions.

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    \6\Section 408(a) of ERISA provides, among other things, that the Department may grant an exemption from the prohibited transaction rules only if finds that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of such plan.  
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Therefore, the Department is not proposing relief for transactions involving the internal operation of general accounts at this time.

#### Additional Transactions

In addition to requesting broad retroactive relief for general account transactions, the ACLI application also requests relief for certain other transactions that may be viewed as being prohibited under the Supreme Court's analysis in Harris Trust merely as a result of a plan's purchase of a participating general account contract. As previously noted, the significant participation test contained in the plan asset regulation (section 2510.3-101) is a ``safe harbor'' provision which provides that the assets of an entity will be considered to include plan assets only if equity participation by ``benefit plan investors'' is ``significant''. The ACLI represents that, under regulation section 2510.3-101(f)(2), an insurance company investing general account assets in an entity could be viewed as a benefit plan investor for the purposes of calculating the 25 percent significant participation test. As a result, transactions between the entity and a party in interest to a plan with an interest in the general account could be prohibited under section 406 of ERISA.\7\ Accordingly, the ACLI seeks broad exemptive relief for transactions that would be prohibited solely because an entity is deemed to hold plan assets under the significant participation test as the result of an insurance company general account investment in such entity.  
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\7\In addition, the general partner of a partnership (or any other person with discretion over the assets of the entity) may be viewed as a fiduciary under ERISA which could raise issues under section 406(b) of ERISA.  
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Based upon its consideration of the ACLI application and supporting documentation, the Department does not believe that it has sufficient information regarding the impact of the Harris Trust decision on entities that conducted their business operations in accordance with the significant participation exception contained in the plan asset regulation. Specifically, while the ACLI application generally identifies the potential impact of the Harris Trust decision on such entities, the application provides no specific information, either from the affected entities themselves or other independent sources concerning the makeup of such entities, a description of the

transactions for which exemptive relief is necessary, or the standards and safeguards upon which exemptive relief for such transactions should be conditioned.

The Department believes that it is important that the standards and safeguards incorporated in any class exemption be feasible, effective, and protective of plans, participants and beneficiaries. Accordingly, this notice is intended to provide interested persons with an opportunity to submit written comments which will be considered by the Department in deciding whether to propose additional exemptive relief.

The following is a list of some of the issues that have been identified by the Department. The list does not purport to identify all issues relevant to the development of exemptive relief, and comments on other matters raised by this portion of the ACLI request are also invited.

#### A. Need for Exemptive Relief

1. A description of the entities that may be affected by the Harris Trust decision in operating under the significant participation test by reason of an insurance company's investment of general account assets in such entity.

2. What types of transactions would require exemptive relief if the underlying assets of the entity include plan assets as a result of the Harris Trust decision? In this regard, please distinguish between transactions involving the internal operation of the entity and external transactions involving the entity and parties in interest with respect to plan contractholders of the general account investor.

3. What costs or hardships, if any, would result for plans if the Department does not provide relief for these transactions?

#### B. Standards and Safeguards

1. Describe whether any of such entities are subject to federal or state regulatory oversight. The response should include a brief description of the specific regulatory environment applicable to the entity and how the particular regulatory scheme serves as a constraint on the exercise of discretion by the persons responsible for the management of the entity.

2. What limitations or safeguards should a class exemption contain in order to reduce the potential for abuse of discretionary authority? For example, what limitations, if any, should be included with respect to:

- (i) The types of transactions for which relief is provided?
- (ii) Transactions which inure to the direct or indirect benefit of the entity manager or an affiliated person?
- (iii) The scope of discretion exercised by the entity manager?

#### C. Miscellaneous

1. Describe any agreements that limit the discretionary authority of the entity manager with respect to the management or operation of the entity. For example, to what extent do investors independent of the manager retain any decision-making responsibility or authority?

2. Describe the methods used to determine the compensation of the entity manager and related persons for services provided to the entity. For example, does the manager have the ability to affect the timing and/or amount of its compensation?

3. To what extent would transactions prohibited as a result of the Harris Trust decision be covered by any existing statutory or administrative exemptions?

4. Describe whether the entity managers are affiliated with general account investors or other fiduciaries of plans that are accountholders of such general account investors.

5. What information does the entity provide to investors? For example, does the entity provide information regarding the internal operation of the entity prior to investment, and periodic disclosures during the period of investment?

6. What other standards should be included in a class exemption in addition to an arm's-length requirement? For example, should an exemption condition relief upon some degree of sophistication and financial accountability on the part of the entity manager?

#### General Exemption

The proposed exemption consists of six separate parts. Section I sets forth the basic exemption and enumerates certain conditions applicable to transactions described therein. Sections II and III of the proposal set forth three specific exemptions. Section IV contains the general conditions applicable to transactions described in sections I and II. Section V contains definitions for certain terms used in the proposed exemption. Section VI sets forth the effective date of the exemption.

#### Section I

The general exemption set forth in section I would provide an exemption from the restrictions of sections 406(a) and 407(a) for: (1) any transaction between a party in interest with respect to a plan and an insurance company general account, in which the plan has an interest as a contractholder; (2) any acquisition or holding by the general account of employer securities or employer real property; and (3) any acquisition or holding of qualifying employer securities or qualifying employer real property by a plan (other than through an insurance company general account) if the acquisition or holding contravenes the restrictions of sections 406(A)(1)(E), 406(a)(2) and 407(a) of ERISA solely by reason of being aggregated with employer securities or employer real property held by an insurance company general account. The above exemptions are subject to the requirement that the plan's participation in the general account as measured by the amount of the reserves arising from the contract held by the plan, (determined under section 807(d) of the Code) does not exceed 10% of all liabilities of the general account.

The ACLI stated that it would be unfair to retroactively impose a percentage limitation in the requested exemption. In this regard, the Applicant represents that the level of insurance company general account investments activities and the breadth of general account holdings are so great that it would effectively preclude any single plan contractholder from exerting any undue influence over the decisions of an insurance company. Nevertheless, the Department has decided to reject the ACLI's recommendation that a percentage limitation not be imposed as a condition to broad exemptive relief. In the past, the Department has conditioned the availability of a number of class exemptions providing similar broad relief on a plan's interest in a collective fund or account not exceeding a specified percentage

amount. The Department continues to believe that a plan that provides a significant percentage of an entity's business would, in many cases, be in a position to improperly influence the investment decisions of the entity. In any event, it does not appear that compliance with such a condition would be difficult in light of the apparent size of most general accounts.

## Section II

Section II is divided into two subparts. Section II(a) of the proposed exemption would permit transactions involving persons who are parties in interest to a plan solely by reason of providing services to an insurance company general account in which the plan has an interest as a contractholder.

Based on precedents established in several class and individual exemptions the Department is proposing an exemption, in section II(b), that permits the furnishing of services, facilities and any goods incidental to such services and facilities by a place of public accommodation owned by an insurance company general account to parties in interest if the services, facilities and incidental goods are furnished on a comparable basis to the general public.

In the regular operations of places of public accommodation, such as hotels and motels, that may be purchased by an insurance company general account, many people, including parties in interest with respect to plans which have participating contracts with the general account, may receive use of such rooms, service, food, etc. Such hotels and motels will typically be managed by hotel management companies who probably would not be aware of the relationship of the hotel and motel guests to the insurance company and the plans who purchased general account contracts.

## Section III

Subsequent to the filing of the ACLI exemption application, the Department has received several suggestions with respect to any exemption that may result from the Department's consideration of the ACLI request. While expressing general endorsement for the exemption requested by the ACLI with respect to the operation of entities that are deemed to hold plan assets under section 2510.3-101(f) as a result of an insurance company general account investment, one commenter specifically focused on the impact of the Harris Trust decision on a number of exemptions previously granted by the Department for the operation of asset pool investment trusts that issue asset-backed, pass-through certificates to plans.

PTE 83-1 (48 FR 895, January 7, 1983) provides conditional relief for the operation of certain mortgage pool investment trusts and the acquisition and holding by plans of certain mortgage-backed pass-through certificates evidencing interests therein. The Department also granted a large number of individual exemptions (e.g., PTE 89-88 [54 FR 42581, October 17, 1989]), each of which provides substantially identical relief for the operation of certain asset pool investment trusts and the acquisition and holding by plans of certain asset-based pass-through certificates representing interests in those trusts (collectively, the Underwriter Exemptions).

PTE 83-1 and the Underwriter Exemptions are conditioned, among other things, upon the certificates purchased by plans not being subordinated to other classes of certificates issued by the same trust.

The commenter further noted that, in a typical asset pool investment trust, one or more classes of subordinated certificates are often issued. Underwriters and issuers will sell senior certificates to plans in reliance on PTE 83-1 and the Underwriter Exemptions, but will not knowingly sell any of the subordinated certificates to plans. Thus, the Above-described exemptions provide relief for the operation of a pool that sells senior certificates to plans, but provide no relief for the same acts of the pool trustee and servicer if plans purchase subordinated certificates issued by the same trust.

The commenter stated that life insurance companies have been significant purchasers of subordinated certificates. The Harris Trust decision raises the potential for servicers and trustees of pools to be subject to excise taxes and civil penalty liability for the same acts involving the operation of trusts which would be exempt if the certificates were not subordinated. Accordingly, the commenter believes that exemptive relief is especially appropriate in situations where insurance company general account investments in subordinated classes of certificates causes plan ownership of such classes to equal or exceed 25 percent. In support of this request for specific relief, the commenter provided the following reasons: (1) asset pool investment trusts are fixed pools, the assets of which are generally not subject to change once the certificates are sold; (2) the pool sponsor's discretion and the servicer's discretion with respect to assets included in a trust are severely limited and are governed by a written pooling and servicing agreement that is available to investors prior to purchasing a certificate; (3) the assets in the trusts represent secured obligations; and (4) trustees of asset pool investment trusts must be independent of the pool sponsors. Moreover, the commenter argued that the fact that the certificates acquired by a general account are subordinated should not preclude the Department from providing exemptive relief since the certificates will have been analyzed by insurance company purchasers, who are presumptively sophisticated investors.

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In this regard, see 29 CFR 2510.3-101(f) for a description of the "significant participation test" contained in the plan assets regulation.

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The Department believes that the commenter's recommendation has merit and has determined to propose exemptive relief on its own motion. Section III of the proposal would provide relief from sections 406(a), 406(b), and 407(a) of ERISA for the operation of asset pool investment trusts in which the insurance general account has an interest as a result of the acquisition of subordinated certificates. The proposal requires that the conditions of either PTE 83-1 or an applicable Underwriter Exemption be met other than the requirements that the certificates acquired by the general account not be subordinated and receive a rating that is in one of the three highest generic rating categories from an independent rating agency. In addition, the Department has proposed additional relief for the operation of such trusts where a plan acquired subordinated certificates in a transaction that was not prohibited or otherwise satisfied the conditions of PTE 75-1. The department has proposed this exemption in recognition that no

relief would be available for the operation of a trust if a plan purchased subordinated certificates in a transaction that was not prohibited (or was otherwise covered by PTE 75-1) and the underlying assets of the trust includes plan assets under the analysis adopted in the Harris Trust decision as a result of the application of the significant participation test under the plan asset regulation (section 2510.3-101(f)) to the general account's investment in such subordinated certificates.

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\9\The Department notes that Section I of the proposed exemption provides relief for the acquisition, sale and holding of asset-backed pass-through certificates representing a beneficial ownership interest in a pool of obligations.

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Section IV contains general conditions which are applicable to all transactions described in sections I and II of the proposed exemption. Transactions must be at least as favorable to the insurance company general account as arm's-length transactions between unrelated parties. The proposal would also require that the transaction not be part of any agreement, arrangement, or understanding designed to benefit a party in interest. Lastly, the party in interest entering into the transaction cannot be the insurance company, any pooled separate account of the insurance company, or any affiliate of the insurance company.

#### 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) Before an exemption may be granted under section 408(a) of the Act and section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of the participant and beneficiaries;

(3) If granted, the proposed class exemption will be applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption; and

(4) The proposed exemption, if granted, will be supplemental to, and not in derogation of, any other provisions of the Code and Act, 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.

#### Written Comments and Hearing Requests

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

#### Proposed Exemption

The Department has under consideration the grant of the following class exemption 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 29 CFR Part 2570, subpart B (55 FR 32836, August 10, 1990).

Section I--Basic Exemption. The restrictions of sections 406(a) and 407(a) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A) through (D) of the Code, shall not apply to the transactions described below if the applicable conditions set forth in section IV are met.

(a) General Exemption. Any transaction between a party in interest with respect to a plan and an insurance company general account, in which the plan has an interest as a contractholder, or any acquisition or holding by the general account of employer securities or employer real property, if at the time of the transaction, acquisition or holding, the amount of the reserves for the contract(s) held by or on behalf of the plan, (determined under section 807(d) of the Code) together with the amount of the reserves for the contracts held by or on behalf of any other plans (determined under section 807(d) of the Code) maintained by the same employer or (affiliate thereof as defined in section V(a)(1)) or by the same employee organization in the general account do not exceed 10% of the total of all liabilities of the general account.

(b) Excess Holdings Exemption for Employee Benefit Plans. Any acquisition or holding of qualifying employer securities or qualifying employer real property by a plan (other than through an insurance company general account, if:

(1) The acquisition or holding contravenes the restrictions of section 406(a)(1)(E), 406(a)(2) and 407(a) of the Act solely by reason of being aggregated with employer securities or employer real property held by an insurance company general account in which the plan has an interest; and

(2) The percentage limitation of paragraph (a) of this section is met.

Section II--Specific Exemptions (a) Transactions with persons who are parties in interest to the plan solely by reason of being certain service providers or certain affiliates of service providers. 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 section 4975(c)(1) (A) through (D) of the Code, shall not apply to any transaction to which the above restrictions or taxes would otherwise apply solely because a person is deemed to be a party in interest (including a fiduciary) with respect to a plan as a result of providing

services to an insurance company general account in which the plan has an interest as a contractholder (or as a result of a relationship to such service provider described in section 3(14) (F), (G), (H) or (I) of the Act or section 4975(e)(2) (F), (G), (H) or (I) of the Act or section 4975(e)(2) (F), (G), (H), or (I) of the Code), if the applicable conditions set forth in section IV are met.

(b) Transactions involving place of public accommodation. The restrictions of sections 406(a)(1) (A) through (D) and 406 (b)(1) and (b)(2) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1) (A) through (E) of the Code shall not apply to the furnishing of services, facilities and any goods incidental to such services and facilities by a place of public accommodation owned by an insurance company general account, to a party in interest with respect to a plan, that has an interest as a contractholder in the insurance company general account, if the services, facilities and incidental goods are furnished on a comparable basis to the general public.

Section III--Specific Exemption for Operation of Asset Pool Investment Trusts. The restrictions of sections 406(a), 406(b) and 407(a) of the Act and the taxes imposed by section 4975 (a) and (b) of the Code by reason of section 4975(c) of the Code, shall not apply to transactions in connection with the servicing, management and operation of a trust in which an insurance company general account has an interest as a result of its acquisition of certificates issued by the trust, provided:

(1) The trust is described in Prohibited Transaction Exemption 83-1 (48 FR 895, January 7, 1983) or in one of the Underwriter Exemptions (as defined in section V(g) below);

(2) The conditions of either PTE 83-1 or the relevant Underwriter Exemption are met, except for the requirements that:

(A) the rights and interests evidenced by the certificates acquired by the general account are not subordinated to the rights and interests evidenced by other certificates of the same trust; and

(B) the certificates acquired by the general account have received a rating at the time of such acquisition that is in one of the three highest generic rating categories from either Standard & Poor's Corporation (S&P), Moody's Investor's Service, Inc. (Moody's), Duff & Phelps Inc. (D&P), or Fitch Investors Service, Inc. (Fitch).

Notwithstanding the foregoing, the exemption shall apply to a transaction described in this section III if: (i) a plan acquired certificates in a transaction that was not prohibited, or otherwise satisfied the conditions of Part II or Part III of PTE 75-1 (40 FR 50845, October 31, 1975), (ii) the underlying assets of a trust include plan assets under section 2510.3-101(f) of the plan assets regulation with respect to the class of certificates acquired by the plan as a result of an insurance company general account investment in such class of certificates, and (iii) the requirements of this section III (1) and (2) are met, except that the words ``acquired by the general account'' in section III(2) (A) and (B) should be construed to mean ``acquired by the plan''.

Section IV--General Conditions. (a) At the time the transaction is entered into, and at the time of any subsequent renewal thereof that requires the consent of the insurance company, the terms of the transaction are at least as favorable to the insurance company general account as the terms generally available in arm's length transactions between unrelated parties.

(b) The transaction is not part of an agreement, arrangement or

understanding designed to benefit a party in interest.

(c) The party in interest is not the insurance company, any pooled separate account of the insurance company, or an affiliate of the insurance company.

Section V--Definitions. For the purpose of this exemption:

(a) An ``affiliate'' of a person means--

(1) any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the person;

(2) Any officer, director, employee (including, in the case of an insurance company, an insurance agent thereof, whether or not the agent is a common law employee of the insurance company), or relative of, or partner in, any such person; and

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

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

(c) The term ``employer securities'' means ``employer securities'' as that term is defined in Act section 407(d)(1), and the term ``employer real property'' means ``employer real property'' as defined in Act section 407(d)(2).

(d) The term ``insurance company'' means an insurance company authorized to do business under the laws of more than one state.

(e) The term ``insurance company general account'' means all of the assets of an insurance company that are not legally segregated and allocated to separate accounts under applicable state law.

(f) The term ``party in interest'' means a person described in Act section 3(14) and includes a ``disqualified person'' as defined in Code section 4975(e)(2).

(g) The term ``relative'' means a ``relative'' as that term is defined in section 3(15) of the Act (or a ``member of the family'' as that term is defined in section 4975(e)(6) of the Code), or a brother, sister, or a spouse of a brother or sister.

(h) The term ``Underwriter Exemption'' refers to the following individual Prohibited Transaction Exemptions (PTEs)--

PTE 89-88, 54 FR 42582 (October 17, 1989); PTE 89-89, 54 FR 42569 (October 17, 1989); PTE 89-90, 54 FR 42597 (October 17, 1989); PTE 90-22, 55 FR 20542 (May 17, 1990); PTE 90-23, 55 FR 20545 (May 17, 1990); PTE 90-24, 55 FR 20548 (May 17, 1990); PTE 90-28, 55 FR 21456 (May 24, 1990); PTE 90-29, 55 FR 21459 (May 24, 1990); PTE 90-30, 55 FR 21461 (May 24, 1990); PTE 90-31, 55 FR 23144 (June 6, 1990); PTE 90-32, 55 FR 23147 (June 6, 1990); PTE 90-33, 55 FR 23151 (June 6, 1990); PTE 90-36, 55 FR 25903 (June 25, 1990); PTE 90-39, 55 FR 27713 (July 5, 1990); PTE 90-59, 55 FR 36724 (September 6, 1990); PTE 90-83, 55 FR 50250 (December 5, 1990); PTE 90-84, 55 FR 50252 (December 5, 1990); PTE 90-88, 55 FR 52899 (December 24, 1990); PTE 91-14, 55 FR 48178 (February 22, 1991); PTE 91-22, 56 FR 03277 (April 18, 1991); PTE 91-23, 56 FR 15936 (April 18, 1991); PTE 91-30, 56 FR 22452 (May 15, 1991); PTE 91-39, 56 FR 33473 (July 22, 1991); PTE 91-62, 56 FR 51406 (October 11, 1991); PTE 93-6, 58 FR 07255 (February 5, 1993); PTE 93-31, 58 FR 28620 (May 5, 1993); PTE 93-32, 58 FR 28623 (May 14, 1993); PTE 94-29, 59 FR 14675 (March 29, 1994) and any other exemption providing similar relief to the extent that the Department expressly determines, as part of the proceeding to grant such exemption, to include the exemption within this definition.

(i) For purposes of this exemption, the time as of which any

transaction, acquisition, or holding occurs is the date upon which the transaction is entered into, the acquisition is made or the holding commences. In addition, in the case of a transaction that is continuing, the transaction shall be deemed to occur until it is terminated. If any transaction is entered into, or acquisition made, on or after January 1, 1975, or any renewal that requires the consent of the insurance company occurs on or after January 1, 1975, and the requirements of this exemption are satisfied at the time the transaction is entered into or renewed, respectively, or at the time the acquisition is made, the requirements will continue to be satisfied thereafter with respect to the transaction or acquisition and the exemption shall apply thereafter to the continued holding of the securities or property so acquired. This exemption also applies to any transaction or acquisition entered into or renewed, or holding commencing prior to January 1, 1975, if either the requirements of this exemption would have been satisfied on the date the transaction was entered into or acquisition was made (or on which the holding commenced), or the requirements would have been satisfied on January 1, 1954 if the transaction had been entered into, the acquisition was made, or the holding had commenced, on January 1, 1975. Notwithstanding the foregoing, this exemption shall cease to apply to a transaction or holding exempt by virtue of section I(a) or section I(b) at such time as the interest of the plan in the insurance company general account exceeds the percentage interest limitation contained in section I(a), unless no portion of such excess results from an increase in the assets allocated to the insurance company general account by the plan. For this purpose, assets allocated do not include the reinvestment of general account earnings. Nothing in this paragraph shall be construed as exempting a transaction entered into by an insurance company general account which becomes a transaction described in section 406 of the Act or section 4975 of the Code while the transaction is continuing, unless the conditions of the exemption were met either at the time the transaction was entered into or at the time the transaction would have become prohibited but for this exemption.

(j) The term ``reserves'' has the same meaning as the term ``life insurance reserves'' as described in section 816(b) of the Code.

Section VI--Effective date. If granted, the exemption would be effective January 1, 1975.

Signed at Washington, DC, this 17th day of August, 1994.  
Ivan L. Strasfeld,  
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