

October 22, 1975

Dear :

This is in response to your letter of March 18, 1975, to Mr. , Assistant Secretary of Labor for Labor-Management Relations, asking whether a proposed transaction between Savings and Loan Association (GWS) and the Pension Trust of Southern California (the Trust) would violate section 406 of the Employee Retirement Income Security Act of 1974 (ERISA).

The transaction is described in your letter as follows:

The transaction would involve the sale to the Trust of up to a 90% participation interest in a series of loans secured by mortgages on owner-occupied, single family dwellings in Southern California. All loans subject to the transaction would be those which had been originated by and held in its portfolio prior to the consummation of the transaction with the Trust. The Trust would purchase up to \$20 million worth of a participation interest in these loans and (GWS) would retain a 10%, or more, participation interest in these loans and would also retain the responsibility for servicing the loans. The Trust would then receive its pro rata share of monthly principal and interest payments made by the borrowers. The interest yield to the Trust would be dependent upon a number of factors and subject to arms-length negotiation among (GWS), the Trust and the Trust's investment advisors. The funds provided by the Trust as a result of their purchase would then be available to (GWS) for recycling into home mortgages in the Southern California area encompassed by the Union, thus providing a spur to construction in the area.

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Section 406(a)(1) of ERISA prohibits certain transactions, whether direct or indirect, between a plan and a party in interest. If the trust presently has no relationship with (GWS) that causes the latter to be a party in interest as that term is defined in ERISA section 3(14), the proposed sale and purchase of the participation interest would not constitute a direct transaction prohibited by section 406(a)(1).

An indirect prohibited transaction can occur where a plan engages in a transaction with a person who is not a party in interest pursuant to an agreement or understanding whereby that person is in turn to engage in a transaction with a party in interest. Thus, for example, if the trust purchases a participation interest in loans from (GWS) pursuant to an agreement or understanding that (GWS) will use the funds received from the trust or other funds of (GWS) to make loans to parties in interest, the arrangement would constitute an indirect prohibited transaction. This reasoning is consistent with ERISA IB 75-2 (copy enclosed), which addressed the application of section 406 where a plan invests in securities of a corporation or partnership and a party in interest subsequently engages in a transaction with the corporation or partnership.

Applying the above analysis to the proposed transaction, the possibility of an indirect prohibited transaction arises by virtue of the statement that the funds provided by the trust to "... would then be available to for recycling into home mortgages in the Southern California area encompassed by the Union, thus providing a spur to construction in the area." While this statement expresses a general recognition that recycling of the funds would benefit to some degree persons who are parties in interest, it alone does not indicate such an arrangement as would constitute an indirect prohibited transaction. If the funds received by merely go into its normal business operations and if there is not commitment by (GWS) to the Trust to make loans for the benefit of any party or parties in interest, the making of any loans by (GWS) which ultimately benefit any party in interest would not constitute a prohibited transaction under section 406 of ERISA.

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We wish to emphasize that the foregoing analysis is predicated upon your representation that the proposed agreement contemplates a one-time sale of the participation interest to the Trust, following which (GWS) would service the loans on behalf of the Trust. We specifically do not decide that a series of sales interspersed with the servicing of loan-shares previously acquired by the Trust from (GWS) would not result in a prohibited transaction by (GWS).

The Internal Revenue Service has advised us that it is in concurrence both with the conclusion and analysis contained in this letter.

Sincerely,