P/OPINION 77-35

3(18)
404(a)(1)
404(c)
408(e)

April 22, 1977

Dear

This is in reply to your letter of July 21, 1976, addressed to the Department of Labor and the Internal Revenue Service regarding proposed transactions involving the trust under the Employees' Profit-Sharing Plan of (named) Bank and Affiliates (the "Plan").

You have represented the facts of the proposed transactions to be as follows:

The Plan is a qualified Plan under the Internal Revenue Code of 1954, as amended (the "Code"), and the most recent determination letter received from the Internal Revenue Service was dated December 10, 1974.

Each participant in the Plan with three or more years of service is presently entitled to elect to have his deferred account invested by the trustee under the Plan (the "Trustee") in one or more investment funds comprising the trust fund, presently called Funds A, B, and C. Fund A is invested in fixed-income securities, Fund B is invested in (named) Common Stock, and Fund C is invested in stock and convertible securities (other than stock or convertible securities of (named).

A fourth fund is proposed, called Fund D, which will be invested solely in "Book Value Shares" of (named) Common Stock. The purpose of Fund D is to provide an investment vehicle for the plan participants to invest in (named) stock that will be less subject to market fluctuations than an investment in Fund B. Fund D will be established, be operated and be subject to the same rights and benefits of the participants in the Plan as apply to Funds A, B and C except in a few respects as outlined below. The purchase price for each Book Value Share will be the "Book Value Per Share" of a share of (named) Common Stock

on the date of purchase. The term "Book Value Per Share" means (i) the common stockholders' equity, as stated in the consolidated financial statements of (named) at any Fiscal Quarter Date, divided by (ii) the number of shares of (named) Common Stock outstanding as of such Fiscal Quarter Date (which calculation shall be made before giving effect to any sale or repurchase of Book Value Shares on such Fiscal Quarter Date).

Book Value Shares will have the same voting, dividend and liquidation rights of unrestricted shares and differ only in that the Book Value Shares are not transferable except to (named) and are subject to the repurchase provisions described below.

All purchases and sales of Book Value Shares by the Trustee will be to and from (named) and will be made as of Fiscal Quarter Dates (March 31, June 30, September 30 or December 31, or such other dates as (named) may from time to time elect) on which dates the Book Value Per Share will be calculated. Thus, although the transfers will take effect on a Fiscal Quarter Date, they may not be computed and physically take place until a short time after such dates.

Articles VI and VII of the Plan contain provisions that a participant may be paid out from Funds A, B, and C at certain specified times in cash or in kind. Those Articles will be amended as appropriate to provide that, when a participant is to receive a distribution from Fund D, he may be paid, at the discretion of the Committee, in cash or in unrestricted shares of (named) Common Stock, and also to provide that any distributions from Fund D shall only be made as of a Fiscal Quarter Date.

In order to convert any Book Value Shares directly into unrestricted shares of (named) Common Stock, the Trustee will transfer to (named) Book Value Shares having a value, determined in accordance with the Book Value Share Agreement, equal to the fair market value of unrestricted shares of (named) Common Stock received therefor, plus any cash paid by (named) to effect Fund D distributions under the Plan. Alternatively, the Committee may direct the

Trustee to transfer the Book Value Shares to (named) for their equivalent fair market value in cash or for a combination of cash and unrestricted shares of (named) Common Stock, although, as noted below, the Board of Directors of (named) will have the final judgment as to whether payment for Book Value Shares will be in cash, unrestricted shares of (named) Common Stock or both.

Since the fair market value of each Book Value Share will be deemed to be the "Book Value Per Share" as above described, the number of unrestricted shares of (named) Common Stock received by the Trustee will ordinarily be different from the number of Book Value Shares surrendered therefor. In addition, the Book Value Per Share, for purposes of (named)'s repurchase of the Book Value Shares from the Trustee, may be adjusted to preserve the benefit of the arrangement for the trust and its beneficiaries. Thus, (named) will insulate Fund D from book value fluctuations caused by extraordinary corporate events. An adjustment in book value for extraordinary events will be contained in the agreement between the Trustee and (named) substantially in the form set forth as Exhibit E to your letter.

The Trustee and (named) will also agree that (named) will repurchase Book Value Shares within 90 days from the earlier of (i) a request by the Board of Directors of (named), or (ii) a request by the Trustee. As noted above, the repurchase will be in cash, in unrestricted shares of (named) Common Stock, or a combination of both. The determination of the medium of payment will be made by the Committee, as the administrator of the Plan, but subject to the final judgment of the Board of Directors of (named). If (named) pays unrestricted shares for Book Value Shares, the Trustee may sell those shares in the open market. If (named) pays cash for Book Value Shares, the Trustee may purchase unrestricted shares of (named) in the open market.

In the event that (named) shall determine to redeem all of the Book Value Shares then held by Fund D, in accordance with the terms of the agreement, then the Trustee shall give notice of such repurchase to the Participants in Fund D and shall transfer all proceeds received to such

other Fund or Funds as the Participants shall direct. Absent any such direction from a Participant, the Trustee shall transfer such proceeds to Fund B, to be invested in the same manner as other Fund B assets, i.e., in unrestricted shares of (named) Common Stock, subject to the rights of the participant to otherwise or subsequently direct the investment of his account.

Based upon the above representations, you have requested rulings that:

1. The purchase and sale of Book Value Shares in the proposed Fund D by the Trustee under the Plan and the acquisition by the Trustee of unrestricted shares of (named) Common Stock in exchange for Book Value Shares in transactions involving (named) will not constitute prohibited transactions under section 406(a) of the Employee Retirement Income Security Act of 1974 (the "Act") or under section 4975(c) of the Code because they would meet the criteria of section 408(e) of the Act and section 4975(d)(13) of the Code.

2. The provisions of the Plan with respect to the control by each participant over the assets in his individual account, and the investment thereof, including the right to direct or change the investment in the proposed Fund D, operate to relieve the Trustee and the Commitee from fiduciary liability with respect to any loss resulting from such exercise of control, pursuant to Section 404(c) of the Act.

3. The creation and operation of Fund D under the Plan will not cause the Plan to be deemed not operated for the exclusive benefit of the participants and their beneficiaries under Section 401(a) of the Code and Section 404(a)(1) of the Act.

Based upon the facts and representations set forth in your letter, we have concluded:

With respect to the first requested ruling, that the transaction would meet the criteria of section 408(e) of the Act and section 4975(d)(13) of the Code, we agree with

you that the Book Value Shares are "qualifying employer securities", as defined in section 407(d)(5) of the Act and that the plan is an "eligible individual account plan", as defined in section 407(d)(3) of the Act. Inasmuch as no commission is to be charged with respect to such purchases and sales, the exemption for such purchases and sales contained in section 408(e) of the Act and Section 4975(d)(13) of the Code would be available if the purchases and sales are for "adequate consideration" as defined in section 3(18) of the Act.

As your letter notes, the Act defines the term "adequate consideration", in the case of an asset other than a security for which there is a generally recognized market, as the fair market value of the asset as determined in good faith by the Trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Department of Labor. The Department has not as yet issued such regulations and, as stated in section 5.02(a) of its ERISA Advisory Opinion Procedure (ERISA Proc. 76-1, 41 Federal Register 36381, August 27, 1976) will not ordinarily make advance determinations as to adequate consideration in the case of individual purchases and sales of stocks. Such guidelines as will be issued will be general guidelines in the form of regulations under section 3(18) of the Act.

In view of the fact that no regulations have been issued under section 3(18), the Trustee should make a good faith determination with respect to the fair market value of the Book Value Shares, utilizing recognized methods of determining the value of such shares. The ruling received by the Trustee from the Internal Revenue Service as to whether the method of determining fair market value of the Book Value Shares was a reasonable method of determining fair market value for purposes of section 1.421-7(e)(2) of the Income Tax Regulations would be considered as evidence that the Trustee's determination of fair market value was made in good faith.

The second requested ruling is that election by a participant of the Plan to invest in Fund D constitutes the exercise of control over assets in his individual account so that section 404(c) of the Act operates to relieve the Committee and the Trustee from any liability with respect to any loss resulting from such exercise of control.

Your letter notes that section 404(c) of the Act provides that a participant's exercise of "control" over assets in his account will not cause the participant to be treated as a fiduciary by reason of such exercise, and provides that no person who is otherwise a fiduciary (such as the Trustee or the Committee in your case) shall be held liable for any loss resulting from such exercise of control by the participant. You further note that, in sections 1 and 3 of Article VI of the Plan, as proposed to be amended, any participant who is credited with three or more years of service will be able to elect that his deferred share of a profit sharing contribution for that year be invested in Fund D, or any one or more other Funds. In addition, such participant may withdraw sums allocated to his account (including sums held in Fund D) on the conditions provided in Sections 9 and 10 of Article VI and also upoon the termination of his employment as provided in Section 12 of Article VI. You have stated that because the participant can, in effect, direct the Trustee to invest his share of profit sharing contributions in Book Value Shares by making the election to participate in Fund D described above, and because such participant has broad rights of withdrawal from Fund D, he has "control" over the assets of his account in Fund D within the meaning of Section 404(c) of the Act. This means that neither the Trustee nor the Committee will be liable for any losses in Fund D to the participants therein and their beneficiaries.

As you are aware, however, section 404(c) contemplates the issuance of regulations by the Secretary of Labor for determining what constitutes the exercise of control by a participant or beneficiary over the assets in his account. Such regulations have not yet been issued. In the absence of such regulations, the Department is unable to issue the

ruling which you request. However, in the absence of regulations, you may wish to consult the Conference Report accompanying the Act (H.R. Rep. No. 93-1280, 93d Cong., 2d Sess. (1974), at pages 305-306), which provides some guidance for interpreting section 404(c) of the Act which may be helpful to you.

Finally, the third ruling requested is that the creation and operation of Fund D will not violate the requirement of section 404{a)(1) of the Act that a fiduciary of a plan must discharge his duties solely in the interest of the participants and beneficiaries and the requirement of section 401(a) of the Code that a qualified plan be operated for the exclusive benefit of participants.

The Department has determined that it will not ordinarily make rulings as to the application of section 404(a) to particular conduct. See ERISA Proc. 76-1, section 5.02(0).

Because the first and third questions contained in your letter also raise questions under the Code, we have conferred with representatives of the Internal Revenue Service and they have authorized us to inform you that they concur in the views set forth above as they apply to the first question contained in your letter. By letter dated October 29, 1976, they responded to your request for a ruling under section 401(a) of the Code.

Sincerely,