DEPARTMENT OF LABOR

Pension and Welfare Benefit Programs

[Amendment to Prohibited Transaction Exemption 77-9 Application Nos. D-447 and D-1903; Prohibited Transaction Exemption 84-24]

Amendments to Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters

AGENCY: Pension and Welfare Benefit Programs, Labor.

ACTION: Amendment of class exemption.

SUMMARY: This document amends Prohibited Transaction Exemption 77-9 (PTE 77-9). The amendments exempt

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certain transactions similar to those previously addressed in PTE 77-9 from the prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (ERISA or the Act). The amendments affect participants and beneficiaries of employee benefit plans, fiduciaries of such plans, and persons engaging in transactions to which the exemption applies.

**EFFECTIVE DATE:** October 31, 1977.

**FOR FURTHER INFORMATION CONTACT:**

(This is not a toll free number.)

**SUPPLEMENTARY INFORMATION:** On April 9, 1982, the Department published in the Federal Register (47 FR 14688) notice of the pendency of proposed amendments to PTE 77-9. PTE 77-9 provides an exemption from the prohibited transaction restrictions of section 406 of ERISA and from the taxes imposed by sections 7975(a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1) of the Code.

The notice gave interested persons an opportunity to comment on the proposal and to request a hearing on the matter. Public comments were received pursuant to the provisions of section 400(a) of ERISA and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 7-1 (40 FR 18471, April 26, 1975). Two commenters requested a public hearing, should the Department decide whether to adopt the proposed amendments or not to resolve in favor of certain issues that they raised in their comments. The Department then determined not to hold a public hearing on the matter, as discussed below, the Department believes that the exemption, as granted, provides the relief that those commenters have requested.

**Discussion:**

L. General

In brief, PTE 77-9 provides that certain transactions, described in section III of the exemption, are exempted from the prohibited transaction provisions of section 406 of ERISA. The transactions relate to the purchases, with plan assets, of investment company securities or insurance annuity contracts and the payment of sales commissions in conjunction with such purchases. Insurance agents and brokers, pension consultants, insurance companies, investment companies, and investment company principal underwriters who are parties in interest with respect to an employee benefit plan because they either own, or are affiliated with, fiduciaries or other service providers for the plan may, subject to the conditions listed in sections IV and V, avail themselves of the exemption in order to engage in such transactions with the plan.

As is discussed more fully in the preamble to the proposed exemption, conditional relief has been available under PTE 77-9 for the purchase by a plan of securities issued by an investment company, where the investment company, its principal underwriters, or its investment adviser are parties in interest with respect to the plan. However, in this case, an affiliate of any of those entities is a trustee of the plan, such relief was available only if the transaction was one described in section III of the exemption, which is limited to situations where the party is a party in interest solely by reason of the sponsorship of a master or prototype plan, including the provision of nondiscretionary trust or custodial services in connection therewith. The amendment to section V(a) being adopted in this notice, however, will permit the broader range of transactions described in sections III(a)-(d) where the party seeking to use the exemption provides nondiscretionary trust or custodial services to the plan but does not render investment advice with respect to any assets of the plan. With the adoption of amended section III(f), moreover, relief will also be available under that section to plans other than master or prototype plans sponsored by the investment company complex. In addition, the Department is adopting as proposed a new section VI, in which the term "nondiscretionary services" is defined. The Department believes that the exemption, as granted, provides the relief that those commenters have requested.

**Discussion:**

II. Discussion of Comments Received

The Department received five written comments regarding the proposed amendments to PTE 77-9. Most of the commenters generally favored the adoption of the proposed amendments. Two commenters, however, suggested that the Department clarify, either in the preamble to the final version or in the final version of the exemption itself, that nondiscretionary custodians are to be treated in the same manner as nondiscretionary trustees and, thus, may take advantage of the exemption to the same extent as nondiscretionary trustees. These commenters requested a hearing on the matter. A third commenter noted that all of the functions described in footnote three of the proposal are nondiscretionary trust or custodial services for purposes of PTE 77-9. A fourth commenter suggested that changes be made to the exemption to accommodate concerns that the commenter expressed regarding the applicability of the exemption to transactions involving interests issued by "no-load" mutual funds—i.e., securities sold with no sales charge. The fifth commenter offered no suggestions for change to the final version.

The issues raised by the commenters are discussed below.

[A] Nondiscretionary Custodians

Two commenters noted that, under the proposed amendments, PTE 77-9 would provide relief for transactions described in sections III(a)-(d) of the exemption where a trustee of the plan is affiliated with the investment company (or with its adviser or principal underwriter), provided that the trustee's duties are nondiscretionary. See section V(a) of the exemption. They argue, however, that since sections 401(f) and 408(h) of the Code provide that custodians shall be deemed to be custodians for certain purposes, 2 PTE 77-9 may not be available for purchases by plans of mutual fund shares where the mutual fund complex provides nondiscretionary custodial services to such plans through persons who are not trustees. Because of this concern, the commenters requested that a hearing be held on the matter unless the Department made clear that the provision by a mutual fund complex of such "in-house" custodial services would not operate as a bar to the availability of the exemption.

In the Department's opinion, the conditions contained in section V(a) of 1
the exemption as amended herein do not create the difficulties perceived by the commenters. The availability of the exemption as amended to a person providing nondiscretionary custodial services to a plan is not affected by the person's designation as a trustee or custodian to the extent that the services are limited in the manner described in sections V(a) and VI(g) of the exemption.6

(B) List of Nondiscretionary Trust Services

On the matter of providing assurances regarding specific services, the Department cannot state categorically that certain services in all cases are nondiscretionary for purposes of PTE 77-9. Whether or not a particular trust or custodial service is nondiscretionary in nature generally will depend on the facts and circumstances surrounding the provision of the service. These services listed in footnote three of the proposal were described in a submission by one of the applicants as typical nondiscretionary trust or custodial services and, thus, "ministerial in nature." The Department believes that the provision of such services is within the scope of the definition of "nondiscretionary trust services" contained in section VI(g) of the exemption, if they are in fact ministerial in nature.6

(C) Additional Services and No-Load Mutual Fund Complexes

The Department received one comment on behalf of a no-load mutual fund complex, requesting the Department to amend the definition of "nondiscretionary trust services" to include any additional services described in section 408(b)(2) of ERISA. This would allow the provision of all such services in connection with a transaction described in section III(b) by any party qualifying for the exemption under that section. According to the commenter, no-load complexes in particular would benefit from such an amendment, as explained below. As an alternative, the commenter requested an amendment to section III(c) so that no-load mutual fund complexes which, according to the commenter, do not necessarily engage a principal underwriter and the form is defined in section 2(a)(29) of the Investment Company Act of 1940 (the 1940 Act). In its determination of whether or not the exemption is included in sections 408(b)(2) of ERISA, no-load complexes will be more limited in their ability to provide additional services to employee benefit plans under PTE 77-9 than load complexes. By comparison, load mutual fund complexes, because they engage a principal underwriter, qualify for the exemptions in III(b) and (c). Consequently, they are able to provide any additional services described in section 408(b)(2) of the 1940 Act and, notwithstanding the terms of the exemption, the Department argues that it was not the intent of PTE 77-9 to allow load mutual fund complexes to engage in certain transactions with employee benefit plans and provide certain additional services while not similarly permitting no-load complexes to engage in those same transactions and provide those same services.

After careful consideration, the Department has decided not to adopt the requested changes. The suggestion of the commenter with regard to amending the definition in section VI(g) of the employer, plan trustee, participants, or beneficiaries;

(f) Deliver to participants or their employer all notices, prospectuses, and proxy statements, and vote proxies in accordance with the participants' instructions;

(g) Maintain records of all contributions, investments, distributions, and other transactions and report them to the employer and participants;

(h) Make necessary filings with the Internal Revenue Service and other government agencies:

(1) Keep custody of the plan's assets;

(2) Pay taxes on or otherwise dispose of the plan's assets; and

(3) Prevent any breach of trust.

The commenters also indicate that the definition of "principal underwriter" as set forth in section 2(a)(29) of the 1940 Act is inadequate because it is not clear authority. The Department has determined that only the conditions contained in Section IV (and not those contained in Section V) of the exemption need be satisfied in connection with transactions described in III(f). Thus, the provision of additional services to the plan in connection with a transaction described in section III(f), such as services described in ERISA section 408(b)(2), is not within the
intended scope of the exemption provided under that section.

As to the suggestion to amend section III(c), it should be noted that the proposed exemption in this matter did not include a proposal to amend that paragraph. The Department has no way of knowing, on the basis of one individual request, whether the factual situation described by the commenter regarding its own method of operation (which may be unique or at least unusual) is sufficiently representative of all parties potentially affected by such an amendment to justify the relief requested on a class basis, especially since it is not certain that additional relief is necessary (see note 4, supra).

The Department believes it inappropriate to proceed along the lines requested in the absence of information that would provide a basis for determining how any such changes would affect employee benefit plans and the mutual fund industry as a whole.

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 of a plan to which the exemption is applicable from certain other provisions of the Act, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404(a) of the Code, which, among other things, require a fiduciary to discharge his duties with respect to 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 Code if it does not affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the plan and their beneficiaries.

2. The exemption set forth herein is supplemental to, and not in derogation of, any other provisions of the Act or Code, including statutory exemptions and transactional 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 all transactions to which it applies only if the transaction satisfies the conditions specified in the class exemption.

4. 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 April 6, 1982, the Agency makes the following determination:

(a) The class exemption set forth herein is administratively feasible;
(b) It is in the interest of plans and of their participants and beneficiaries; and
(c) It is protective of the rights of participants and beneficiaries of the plans.

Exemption

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Employee Retirement Income Security Act of 1974 (the Act) and section 4975(c)(2) of the Internal Revenue Code of 1954 (the Code), and in accordance with the procedures set forth in ERISA Proceedings 75-1 (FR 18477, April 28, 1975). For the sake of convenience, the entire exemption is reprinted here, including the amendments to sections III(f) and V(a) and new section VII(g) adopted in this notice.

Section I—Retroactive Application

The restrictions of sections 408(a)(1)(A) through (D) and 408(b) of the Act and the taxes imposed by section 4975 of the Code do not apply to any of the transactions described in section III of this exemption in connection with purchases made before November 1, 1977, if the conditions set forth in sections IV and V are met.

Section II—Prospective Application

The restrictions of section 408(a)(1)(A) through (D) and 408(b) of the Act and the taxes imposed by section 4975 of the Code do not apply to any of the transactions described in section III of this exemption in connection with purchases made after October 31, 1977, if the conditions set forth in sections IV and V are met.

Section III—Transactions

(a) The receipt, directly or indirectly, by an insurance agent or broker of a commission from an insurance company in connection with the purchase of an investment company security is not in excess of reasonable compensation within the contemplation of sections 408(b)(2) and 408(c)(2) of the Act and sections 4975(d)(1) and 4975(d)(10) of the Code. If such total is in excess of reasonable compensation, the amount involved for purposes of the civil penalties of section 502(f)(3) of the Act and the excise taxes imposed by
section 4975 (a) and (b) of the Code is the amount of compensation in excess or "reasonable compensation."

Section V—Conditions for

Transactions Described in Section III

(a) Through (d). The following conditions apply solely to a transaction described in paragraphs (a), (b), (c) or (d) of section III:

(a) the insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter is not (1) a trustee of the plan (other than a nondiscretionary trustee who does not render investment advice with respect to any assets of the plan), (2) a plan administrator (within the meaning of section 3(19)(A) of the Act and section 414(g) of the Code), (3) a fiduciary who is expressly authorized in writing to manage, acquire or dispose of the assets of the plan on a discretionary basis, or (4) for transactions described in sections III (a) through (d) entered into after December 31, 1973, an employer any of whose employees are covered by the plan.

(b) (1) With respect to a transaction involving the purchase with plan assets of an insurance or annuity contract or the receipt of a sales commission thereon, the insurance agent or broker or pension consultant provides to an independent fiduciary with respect to the plan prior to the execution of the transaction the following information in writing and in a form calculated to be understood by a plan fiduciary who has no special expertise in insurance or investment matters:

(A) If the agent, broker, or consultant is an affiliate of the insurance company whose contract is being recommended, or if the ability of such agent, broker or consultant to recommend insurance or annuity contracts is limited by any agreement with such insurance company, the nature of such affiliation, limitation, or relationship.

(B) The sales commission, expressed as a percentage of the dollar amount of the plan's gross payments and of the amount actually invested, that will be received by the insurance company to the agent, broker or consultant in connection with the purchase of the recommended contract;

(C) For purchases made after June 30, 1979, a description of any charges, fees, discounts, penalties or adjustments which may be imposed under the recommended contract in connection with the purchase, holding, exchange, termination or sale of such contract.

(2) Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the independent fiduciary acknowledges in writing receipt of such information and approves the transaction on behalf of the plan. Such fiduciary may be an employer of employees covered by the plan, but may not be an insurance agent or broker, pension consultant or insurance company involved in the transaction. Such fiduciary may not receive, directly or indirectly (e.g., through an affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the plan in connection with the transaction.

(c) [1] With respect to a transaction involving the purchase with plan assets of securities issued by an investment company or the receipt of a sales commission thereon by an investment company principal underwriter, the investment company principal underwriter provides to an independent fiduciary with respect to the plan, prior to the execution of the transaction, the following information in writing and in a form calculated to be understood by a plan fiduciary who has no special expertise in insurance or investment matters:

(A) If the person recommending the securities issued by an investment company is the principal underwriter of the investment company whose securities are being recommended, the nature of such relationship and of any limitation it places upon the principal underwriter's ability to recommend investment company securities;

(B) The sales commission, expressed as a percentage of the dollar amount of the plan's gross payment and of the amount actually invested, that will be received by the principal underwriter in connection with the purchase of the recommended securities issued by the investment company;

(C) For purchases made after December 31, 1978, a description of any charges, fees, discounts, penalties or adjustments which may be imposed under the recommended securities in connection with the purchase, holding, exchange, termination or sale of such securities.

(2) Following the receipt of the information required to be disclosed in paragraph (c)(1), and prior to the execution of the transaction, the independent fiduciary approves the transaction on behalf of the plan. Unless facts or circumstances would indicate the contrary, such approval may be presumed if the fiduciary permits the transaction to proceed after receipt of the written disclosure. Such fiduciary may be an employer of employees covered by the plan, but may not be a principal underwriter involved in the transaction. Such fiduciary may not receive, directly or indirectly (e.g., through an affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the plan in connection with the transaction.

(d) With respect to additional purchases of insurance or annuity contracts or securities issued by an investment company, the written disclosure required under paragraphs (b) and (c) of this section V need not be repeated, unless—

(1) More than three years have passed since such disclosure was made with respect to the same kind of contract or securities;

(2) The contract or securities being recommended for purchase or the investment company with respect thereto is materially different from that for which the approval described in paragraphs (b) and (c) of this section was obtained.

(e) (1) In the case of any transaction described in paragraphs (a), (b), or (c) of section III, the insurance agent or broker (or the insurance company whose contract is being described if designated by the agent or broker), pension consultant or investment company principal underwriter shall retain or cause to be retained for a period of six years from the date of such transaction, the following:

(A) The information disclosed pursuant to paragraphs (b), (c), and (d) of this section V;

(B) Any additional information or documents provided to the fiduciary described in paragraphs (b) and (c) of this section V with respect to such transaction; and

(C) The written acknowledgement described in paragraph (b) of this section.

(2) A prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the insurance agent or broker, pension consultant, or principal underwriter, such records are lost or destroyed prior to the end of such six-year period.

(3) Notwithstanding anything to the contrary in sections 504 (a)(2) and (b) of the Act, such records are unconditionally available for examination during normal business hours by duly authorized employees or representatives of the Department of Labor, the Internal Revenue Service, plan participants and beneficiaries, and any employee of plan participants and beneficiaries, any employee organization any of whose members are covered by the plan.

Section VI—Definitions. For purposes of this exemption:
(a) The term "principal underwriter" is defined in the same manner as that term is defined in section 2(a)(29) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(29)).

(b) The terms "insurance agent or broker," "pension consultant," "insurance company," "investment company," and "principal underwriter" mean such persons and any affiliates thereof.

(c) The term "affiliate" of a person means:

(1) Any person directly or indirectly controlling, controlled by, or under common control with such person;

(2) Any officer, director, employee (including, in the case of principal underwriter, any registered representative thereof, whether or not such person is a common law employee of such principal underwriter), or relative of any such person, or any partner in such person or

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

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

(e) The term "relative" means a "relative" as that term is defined in section 3(35) 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, a sister, or a spouse of a brother or a sister.

(f) The term "master or prototype plan" means a plan which is approved by the Service under Rev. Proc. 72-7, 1972-1 C.B. 715, or Rev. Proc. 72-8, 1972-1 C.B. 716, or their successors.

(g) The term "nondiscretionary trust services" means custodial services and services ancillary to custodial services, none of which services are discretionary, and the term "nondiscretionary trustee" of a plan means a trustee whose powers and duties with respect to any assets of the plan are limited to (1) the provision of nondiscretionary trust services to the plan, and (2) duties imposed on the trustee by any provision or provisions of the Act or the Code. For purposes of this exemption, a person who is otherwise a nondiscretionary trustee will not fail to be a nondiscretionary trustee solely by reason of his having been delegated, by the sponsor of a master or prototype plan, the power to amend such plan.

Signed at Washington, D.C. this 26th day of March 1984.

Alan D. Lebowitz,
Assistant Administrator for Fiduciary Standards, Pension and Welfare Benefit Programs, Labor Management Services Administration, U.S. Department of Labor.

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