

[Application No. D-447 and Application No. D-1903]

Proposed Amendments to Prohibited Transaction Exemption 77-9

AGENCY: Office of Pension and Welfare Benefit Programs Labor.

ACTION: Notice of Proposed Amendments to Prohibited Transaction Exemption 77-9.

SUMMARY: This document contains a notice of pendency before the Department of Labor (the Department) of proposed amendments to Prohibited Transaction Exemption 77-9 (PTE 77-9). The exemption relates to certain transactions involving employee benefit plans and insurance agents and brokers, pension consultants, insurance companies, investment companies, and investment company principal underwriters. The proposed amendments are in response to requests by the applicants that the Department permit certain transactions similar to those currently addressed in PTE 77-9. If they are adopted, the amendments will affect the participants and beneficiaries of employee benefit plans, fiduciaries of such plans, and persons engaging in transactions to which the exemption applies.

EFFECTIVE DATE: If adopted, this proposed exemption would be effective for transactions occurring after October 31, 1977.

DATE: Written comments and requests for a public hearing must be received by June 7, 1982.

ADDRESS: Written comments and requests for a public hearing (preferably at least three copies) should be sent to: Office of Fiduciary Standards, Pension and Welfare Benefit Programs, Room C-4526, U.S. Department of Labor, Washington, D.C. 20210. Attention: Amendments to Prohibited Transaction Exemption 77-9.

The above-referenced applications and all comments and requests for a public hearing will be available for public inspection in the Public Documents Room, Pension and Welfare Benefit Programs, U.S. Department of Labor, Room N-4677, 200 Constitution Avenue, N.W., Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Mary O. Lin, Esq., Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, D.C. 20216; telephone 202-523-8658. This is not a toll-free number.

SUPPLEMENTARY INFORMATION: Notice is hereby given of the pendency before the Department of proposed amendments to Prohibited Transaction Exemption 77-9 (PTE 77-9). PTE 77-9 provides an

exemption from the prohibited transaction restrictions of section 408 of ERISA, and from the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1) of the Code.¹

I. Background

PTE 77-9 was initially granted on June 24, 1977 (42 FR 32395). On that same date, additional conditions were proposed to be added to the exemption (42 FR 32399). The proposed additional conditions, together with other proposed amendments (see 43 FR 18354, April 28, 1978), were the subject of a public hearing on July 20, 1978. The exemption, as amended, was published in the Federal Register on January 5, 1979 (44 FR 1479). Subsequently, a change in the effective date of one of the conditions of PTE 77-9 was proposed (see 4 FR 32310, June 5, 1979) and adopted (see 44 FR 52365, September 7, 1979).

PTE 77-9 provides that insurance agents and brokers, pension consultants, insurance companies, investment companies, and investment company principal underwriters who either are, or are affiliated with, fiduciaries or other service providers with respect to employee benefit plans may, under conditions set forth in the exemption, engage in specified transactions with such employee benefit plans. Those transactions would otherwise be prohibited by section 408 of the Act, which, generally, prohibits a plan fiduciary from engaging in transactions on behalf of the plan with persons who are "parties in interest" with respect to the plan. The term "party in interest" includes persons who provide services to the plan.

Section III of PTE 77-9 describes the transactions covered by the exemption. Generally, they involve purchases, with plan assets, of securities issued by investment companies, or of insurance or annuity contracts issued by insurance companies, and the payment of sales commissions with respect thereto. Sections IV and V of PTE 77-9 contain the conditions that are applicable with respect to the transactions described in Section III.

II. The Applications

A. Application No. D-447. Application No. D-447 was submitted by the Investment Company Institute (ICI).² In

¹ Section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1005, January 3, 1979), transferred the authority of the Secretary of the Treasury to issue exemptions of the type proposed herein to the Secretary of Labor.

² The Investment Company Institute is a trade association for the mutual fund industry of the

that application, ICI requested an exemption from the prohibited transaction provisions of the Act for certain transactions between an employee benefit plan and entities within an investment company complex when an entity within the complex serves as a non-discretionary trustee or custodian with respect to the plan. Generally, the subject transactions pertained to the purchase, redemption, or exchange of investment company securities, the sale of insurance or annuity contracts, and the provision of various services.

In a letter dated May 10, 1979, ICI made a new submission with respect to the requested exemption, in which it requested an exemption for (1) the provision to a plan of "nondiscretionary trust or custodial services" by an investment company, and the receipt of fees therefor, and (2) any other transaction which would be permissible under the Act or the Code but for the provision of the non-discretionary trust or custodial services to a plan. In support of its request, ICI states that investment company complexes customarily internalize trustee or custodian functions by means of a bank or non-bank subsidiary. ICI further suggests that requiring a plan holding shares of an investment company to retain a custodian unaffiliated with such investment company increases the expenses of the plan and reduces the efficiency of the plan's transactions with respect to securities issued by that investment company. ICI has further supplemented its application with a letter, dated April 21, 1980, which listed typical nondiscretionary trust or custodial services.³

United States. Its membership comprises numerous investment companies, their investment advisers, and their principal underwriters.

³ In the April 21, 1980, letter, ICI states that nondiscretionary trustees and custodians:

(a) Open and maintain plan accounts and, in the case of defined contribution plans, individual participant accounts, pursuant to the employer's instructions;

(b) Receive contributions from the employer and credit them to individual participant accounts in accordance with the employer's instructions;

(c) Invest contributions and other plan assets in shares of a mutual fund or funds or other products such as insurance or annuity contracts designated by the employer, plan trustee, or participants, and reinvest dividends and other distributions in such investments;

(d) Redeem, transfer, or exchange mutual fund shares or surrender insurance or annuity contracts as instructed by the employer, plan trustee, or participant;

(e) Provide or maintain "designation of beneficiary" forms and make distributions from the trust or custodial account to participants or beneficiaries in accordance with the instructions of the employer, plan trustee, participants, or beneficiaries;

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All of the transactions specifically described in ICI's application (except for the provision of certain services to a plan, discussed below) would be exempt from the prohibited transaction rules by PTE 77-9, but for the provision of nondiscretionary trust or custodial services to the plan participating in the transaction by an entity within the investment company complex. With respect to the transactions described in paragraphs III(a) through III(d) of PTE 77-9,* paragraph V(a) limits the exemption to situations where, among other things, "(t)he insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter is not . . . a trustee of the plan."

Limited relief for transactions between an investment company complex and a plan that utilizes the custodial services provided by the complex is provided by paragraph III(f) of PTE 77-9, which exempts

(t)he purchase, with plan assets, of securities issued by an investment company from, or the sale of such securities to, and investment company or an investment company principal underwriter, when such investment company, principal underwriter, or the investment company investment adviser is a fiduciary or a service provider (or both) with respect to the plan solely by reason of the sponsorship of a master or prototype plan including the provision in

(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;

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

(j) Reply to and prepare correspondence, either directly or through the mutual fund distributor or adviser, regarding the investment account and the operation and interpretation of a master or prototype plan sponsored by the complex to which the nondiscretionary trustee or custodian belongs.

In some situations the trustee or custodian is empowered to amend the master or prototype plan; in others, this power resides in the sponsor of the master or prototype plan.

ICI further describes the duties of the nondiscretionary trustees as "ministerial" and indicates that such trustees possess no decisional authority with respect to a plan's funding medium or subsequent purchases or sales.

*The transactions described in those paragraphs are the purchase, with plan assets, of an insurance or annuity contract; the effecting by an insurance agent or broker, pension consultant, or investment company principal underwriter of a transaction for the purchase, with plan assets, of an insurance or annuity contract or of securities issued by an investment company; and the receipt of a sales commission by an insurance agent or broker, pension consultant, or investment company principal underwriter in connection with the transactions described above.

connection therewith of non-discretionary trust or custodial services, if any, with respect to the plan.

However, since paragraph III(f) is limited to transactions involving plans that adopt a complex's master or prototype plan and where, moreover, the investment company complex provides no services to the plan other than non-discretionary trust or custodial services in connection with sponsorship of the plan, it is not available to a large segment of the investment company industry.

B. Application No. D-1903. Investors Diversified Services Inc. (IDS) has also requested a class exemption from the prohibited transaction provisions of the Act. This application was made with respect to a broad range of transactions involving employee benefit plans and investment company complexes which provide (1) nondiscretionary trust or custodial services, and (2) actuarial and other consulting services, to such plans.

As is the case with the ICI application, exemptive relief for the transactions described in the IDS application (except for the provision of certain services to plans, discussed below) would, to the extent such relief is necessary, be available under PTE 77-9 but for the provision of nondiscretionary trust or custodial services to plans.* Because the requested relief parallels, in large part, that requested by ICI, the Department has decided that it is appropriate to consider the IDS application in conjunction with the ICI application, and to propose one class exemption designed to dispose of both applications.

*IDS' application requests relief for transactions involving the exchange of securities issued by one investment company for the securities issued by another investment company, and for the surrender of insurance or annuity contracts for their cash surrender value.

It appears to the Department that the exchange of investment company securities referred to constitutes a redemption of such securities held by a plan, coupled with a purchase of other securities issued by another investment company. The Department has taken the position that such a redemption is a transaction described in section III(c) of PTE 77-9 (relating to the purchase, with plan assets, of securities issued by an investment company). See letter from the Department and the Internal Revenue Service to John A. Cardon, Esq., et al., October 31, 1977. Therefore, it does not appear that additional relief is necessary in connection with such exchanges.

The Department is of the view that the surrender by a plan, for its cash value, of an insurance or annuity contract pursuant to the terms of the contract, where the issuer of the contract is a party in interest (including a fiduciary) with respect to the plan, is not a prohibited transaction by reason of the surrender, provided that the surrender of the contract at that time is not less advantageous to the plan or its participants than the retention of the contract.

III. Description of the Proposed Amendments

Upon consideration of the above mentioned applications, the Department proposes to amend PTE 77-9 to permit the transactions described in paragraphs III(a) through (d) and III(f) in situations where the plan engaging in the transaction utilizes nondiscretionary trust or custodial services provided by a person affiliated with the other party to the transaction. The Department proposes to effect these amendments by modifying paragraphs III(f) and V(a), and by adding new paragraph VI(g).

Under existing paragraph III(f), as noted above a transaction described therein is exempt only if the member of the investment company complex engaging in the transaction is a fiduciary or a service provider (or both) with respect to the plan solely by reason of the sponsorship of a master or prototype plan, including the provision of related nondiscretionary trust or custodial services. The Department proposes to amend this paragraph so that the exemption described therein is not limited to plans adopting a master or prototype plan sponsored by the complex. Accordingly, if the Department's proposal is adopted, the exemption in paragraph III(f) will be available if the relationship to the plan of the investment company, its principal underwriter, or its investment adviser arises solely from the sponsorship of a master or prototype plan, or from the provision of nondiscretionary trust or custodial services, or from both. The Department tentatively believes that this modification will not adversely affect the protections afforded by the exemption to plan participants.

As is also noted above, the exemptive relief provided for transactions described in paragraphs III(a) through (d) is not available if the insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter is a trustee with respect to the plan engaged in the transaction. The Department proposes to amend that condition to permit the subject transactions in situations where a person seeking to avail itself of the relief provided by the exemption, or an affiliate thereof, is a nondiscretionary trustee with respect to the plan, provided that the nondiscretionary trustee does not render investment advice with respect to any assets of the plan.

In the preamble to the adoption of a previous amendment to PTE 77-9, the Department declined to amend paragraph V(a) in the manner now

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proposed. See 44 FR 1479, 1482 (January 5, 1979). At that time, the Department stated that it did not believe that an adequate showing had been made with respect to the burden of the condition contained in V(a), or the sufficiency of safeguards if the restriction were to be removed. Upon further consideration of this matter, including consideration of the submissions made by ICI and IDS in connection with these applications, the Department is persuaded of the merit of proposing these amendments for comment. As defined in the proposed amendments, the term

"nondiscretionary trustee" does not include a person who renders investment advice with respect to any assets of the plan. The Department tentatively believes that this constraint, which is designed to limit the influence such a trustee may have over other plan officials, together with the other safeguards contained in PTE 77-9, provides adequate protection for plan participants.

The Department also proposes to add new paragraph VI(g) to PTE 77-9. This paragraph defines the terms "nondiscretionary trust services" and "nondiscretionary trustee" as those terms are used in the proposed amendments to paragraph III(f) and V(a) respectively. The latter definition includes, for purposes of the proposed amendments, a person to whom authority has been delegated by the sponsor of a master or prototype plan to amend such plan. That authority, although discretionary by nature, has been identified by the Department as a function normally incident to the sponsorship of the master or prototype plan. See letter to John A. Cardon, Esq., *et al.*, cited in note 5, *supra*. The Department does not believe that any potential for overreaching is increased when that authority is delegated to the nondiscretionary trustee.

IV. Provision of Services

As noted above, the applicants request an exemption with respect to the provision of services to plans, including the provision of the trust or custodial services themselves, and actuarial or other consulting services. IDS has requested, in addition, relief for recommending the services to the plans.

In the Department's view, the relief provided by PTE 77-9 in connection with the transactions described in paragraphs III (a) through (d) includes relief for recommendations that lead to those transactions, but does not extend to cover other transactions, such as the provision of other services, or recommendations with respect thereto. However, the provision of such other

services is permitted by, although subject to the limitations contained in, section 408(b)(2) of the Act (relating to the provision of services between a plan and a party in interest) and the Department's regulations thereunder. See 29 CFR 2550.408b-2. Since exemptive relief for provision of such services is available under section 408(b)(2), under conditions that appear to the Department to be appropriate, the Department is not persuaded of the necessity for, and has not proposed herein, additional relief in connection with such services.

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, a fiduciary to discharge his duties respecting the plan solely in the interests of 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[s] and of the participants and beneficiaries of the plan[s]; and protective of the rights of the participants and beneficiaries or the plan[s]; and

(3) The proposed exemption, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and the Code, 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 Request for a Hearing

All interested persons are invited to submit written comments or requests for a hearing on the proposed amendments

to the address and within the time period set forth above. All comments will be made a part of the record. Comments are requests for a hearing should state the reasons for the writer's interest in the proposed amendments. Comments and requests for a hearing received will be available for inspection at the address set forth above.

Proposed Amendment

On the basis of the applications referred to and summarized above, the Department proposes to amend Prohibited Transaction Exemption 77-9 by revising paragraphs III(f) and V(a), and adding new paragraph VI(g), to read as set forth below, pursuant to the authority conferred under section 408(s) of the Act, and in accordance with ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

"Exemption

"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 section IV and V are met.

"Section II—Transactions."

"(f) The purchase, with plan assets, of securities issued by an investment company from, or the sale of such securities to, an investment company or an investment company principal underwriter, when such investment company, principal underwriter, or the investment company investment adviser is a fiduciary or a service provider (or both) with respect to the plan solely by reason of: (1) the sponsorship of a master or prototype plan; or (2) the provision of nondiscretionary trust services to the plan; or (3) both (1) and (2).

"Section V—Conditions for Transactions Described in Section III(a) through (d)."

(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(16)(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 section III(a) through (d) entered into after December 31, 1978, an employer any of whose employees are covered by the plan.

"Section VI—Definitions. For the purposes of this exemption:

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"[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 31st day of March, 1982.

Jeffrey N. Clayton,

*Administrator, Pension and Welfare Benefit
Programs, Labor-Management Services
Administration, U.S. Department of Labor.*

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