

PTE 75-1

Final Exemption

40 Fed. Reg. 50845 (Oct. 31, 1975)

DEPARTMENT OF LABOR

Labor-Management Services Administration

DEPARTMENT OF THE TREASURY

Internal Revenue Service

[Prohibited Transaction Exemption 75-1]

EMPLOYEE BENEFIT PLANS

Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks

On August 8, 1975, notice was published in the FEDERAL REGISTER (40 FR 33564) that the Department of Labor (the Department) and the Internal Revenue Service (the Service) had under consideration a proposal to exempt certain classes of transactions involving employee benefit plans and certain broker-dealers, reporting dealers and banks from the restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and 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, pursuant to section 408(a) of the Act and section 4975 (c) (2) of the Code. The exemptions were proposed in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-20 I.R.B. 14.

All interested persons were invited to submit written comments with respect to the proposed exemptions. In addition, pursuant to notice published in the FEDERAL REGISTER on August 8, 1975 (40 FR 33563), a public hearing was held on August 26, 1975 with regard to the proposed exemptions and with regard to proposed regulations (26 CFR 54.4975-9 and 29 CFR 2510.3-21) designed to clarify the applicability of the definition of the term "fiduciary" set forth in section 4975(e) (3) of the Code and section 3(21) (A) of the Act to persons who render investment advice to employee benefit plans and to persons who execute securities transactions on behalf of plans (40 FR 33560 and 33561).

The Department and the Service have considered all of the written comments received and the testimony given at the public hearing and have determined to grant the proposed exemptions, as modified, in the form set forth below. Further, by notices published in this issue of the FEDERAL REGISTER, the Department and the Service have also adopted the regulations referred to above clarifying the definition of the term "fiduciary." The exemptions granted herein are premised on the adoption of these regulations and should, therefore, be considered in conjunction therewith.

On February 4, 1975, notice was published in the FEDERAL REGISTER (40 FR 5201) of the granting of an interim exemption from the prohibited transaction provisions of section 406 of the Act and from the taxes imposed by section 4975 of the Code with respect to certain securities transactions between employee benefit plans and certain broker-dealers, reporting dealers and banks for the period from January 1, 1975, to April 30, 1975.

By notices published in the FEDERAL REGISTER on April 23, 1975 (40 FR 17861), June 9, 1975 (40 FR 24578), and September 23, 1975 (40 FR 43785), the interim exemption was extended until October 31, 1975.

As indicated in those notices, the interim exemption was granted in order (1) to prevent the harm to employee benefit plans and to the interests in plans of participants and beneficiaries which, in all likelihood, would have resulted from the immediate and full application of all of the prohibited transaction provisions set forth in Title I and Title II of the Act, and (2) to afford all interested persons an opportunity to submit proposals for permanent exemptions relating to transactions between plans and certain broker-

dealers, reporting dealers and banks, and to provide an opportunity for the Department and the Service to consider such proposals. The granting of the interim exemption was based upon a record which includes written comments submitted in response to notices of the proposal of the granting of the interim exemption and of the extension of the interim exemption published in the FEDERAL REGISTER on January 13, 1975 (40 FR 2483 and 2455), and April 23, 1975 (40 FR 17861), respectively, and the testimony at a public hearing held on January 21, 1975.

Proposals for the granting of permanent exemptions from the prohibited transaction provisions of section 406 of the Act and from the taxes imposed by section 4975 of the Code were submitted by the Securities Industry Association and others and were made available for public inspection by the Service. Proposals for the adoption of regulations concerning the relationship of plans and broker-dealers, reporting dealers and banks were also submitted and made available for public inspection.

The written proposals which were submitted stated that the services provided by broker-dealers, reporting dealers and banks for which exemptions were requested have been of great benefit to plans and their participants and beneficiaries, and that it is in their best interests to have such services available in the future. The proposals represented that the exemptions and regulations suggested are in the interests of plans and their participants and beneficiaries with respect to the dealings of such plans with broker-dealers, reporting dealers and banks in the management of securities portfolios of plans.

Based upon these written submissions and the extensive regulation of the securities industry by the Securities and Exchange Commission, the national securities exchanges and other industry self-regulatory bodies, the Department and the Service proposed the granting of the class exemptions, which, as modified, are described below, for certain services furnished to employee benefit plans and for certain securities transactions engaged in by plans.

*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 or other party in interest or disqualified person with respect to a plan to which the exemption is applicable 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, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion in accordance with subsection (a) (1) (B) of section 404 of the Act; nor does it affect the requirement of section 401 (a) of the Code that a plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries.

(2) The exemptions granted herein are supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory and other exemptions and transitional rules. Furthermore, the fact that a transaction is the subject of an exemption is not dispositive of whether the transaction would have been a prohibited transaction in the absence of such exemption, or, though it would have been a prohibited transaction, is exempt by operation of a statutory exemption or a transitional rule.

(3) Each class exemption set forth herein is applicable to a particular transaction only if the transaction satisfies the conditions specified for the class in which it falls.

(4) Under the regulations adopted in conjunction with these exemptions relating to the definition of the term "fiduciary" (26 CFR 54.4975-9 (c) through (e) and 29 CFR 2510.3-21 (c) through (e) ), a person who is a plan fiduciary is deemed to be a fiduciary only with respect to those plan assets with respect to which he exercises or has responsibility to exercise those functions which make him a fiduciary. Thus, a fiduciary will be treated as a party in interest or disqualified person other than a fiduciary (e.g., a person providing services to the plan) when he engages in a transaction with the plan which does not involve any plan assets with respect to which he is a fiduciary.

(5) For purposes of section 406 of the Act and section 4975(c) (1) of the Code, if a fiduciary with respect to one plan engages in a transaction with a second plan pursuant to an agreement, arrangement or understanding whereby it is expected that a fiduciary with respect to the second plan will engage in a similar transaction with the first plan, each transaction will be treated as an indirect transaction between the plan and the fiduciary with respect to such plan.

In accordance with section 408(a) of the Act and section 4975(c) (2) of the Code, and based upon the entire record, including not only the written comments submitted in response to the notice of August 8, 1975, the testimony at the public hearing held on August 26, 1975, and the proposals submitted for the granting of permanent exemptions, but also the written comments submitted in response to the notices of January 13, 1975, and April 23, 1975, relating to the interim exemption and the testimony at the public hearing held on January 21, 1975, the Department and the Service make the following findings and determinations:

- i. The class exemptions set forth herein are administratively feasible;
- ii. They are in the interests of plans and of their participants and beneficiaries; and
- iii. They are protective of the rights of participants and beneficiaries of plans.

*I. Agency transactions and services.* Section 414(c) (4) and section 2003(c) (2) (D) of the Act presently provide an exemption until June 30, 1977, from the prohibited transaction provisions of the Act and the Code, respectively, for the provision of services between a plan and a party in interest or disqualified person if such services are either provided under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such contract), or if the party in interest or disqualified person ordinarily and customarily furnished such services on June 30, 1974, if such provision of services remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if the provision of services was not, at the time of such provision, a prohibited transaction within the meaning of section 503 (b) of the Code or the corresponding provisions of prior law. In ERISA IB 75-1 and TIR-1329, issued on December 31, 1974, the Department and the Service indicated that the exemption provided by section 414(c) (4) and section 2003(c) (2) (D) of the Act applies to the execution of brokerage transactions on behalf of a plan if the conditions of those sections are met.

Based on the proposals which were submitted relating to this class exemption, the letters of comment, and the testimony given at the public hearings, the Department and the Service have made the following determinations. Broker-dealers regularly provide research, information and advice concerning securities and execute transactions for the purchase or sale of securities in the ordinary course of their business as broker-dealers and the provision of such services might constitute prohibited transactions. Although exemptions are provided in sections 414(c) (4) and 2003(c) (2) (D) of the Act, these exemptions terminate on June 30, 1977, and moreover, are not available at the present time for persons who first provided such services after June 30, 1974. Therefore, the granting of exemptions is necessary with respect to such services to permit the unimpeded flow of information, research and brokerage services, either alone or in combination, to employee benefit plans.

Accordingly, the Department and the Service have granted the exemption set forth below to permit persons who are parties in interest or disqualified persons with respect to employee benefit plans to effect securities transactions on behalf of such plans, to perform certain functions incidental to effecting such transactions, and to provide certain limited advisory and research services to plans.

The exemption is of limited duration, however, when the person effecting such securities transactions on behalf of an employee benefit plan is a fiduciary with respect to such plan, as that term is defined in section 3(21) (A) of the Act and section 4975(e) (3) of the Code and in the regulations interpreting that term adopted in conjunction with the granting of these exemptions. Such transactions, when effected by a plan fiduciary, present opportunities for abuse in the management of plan assets. Moreover, section 11(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(a)), as amended by the Securities Acts Amendments of 1975 (Pub. L. 94-29, 88 Stat. 110), prohibits any member of a national securities exchange from effecting any transaction on such exchange for an account with respect to which it or an associated person thereof exercises investment discretion.

However, section 11(a) of that Act also provides an exception from the prohibition set forth therein until May 1, 1978, for members of a national securities exchange who were members on May 1, 1975. The Conference Report relating to the Securities Acts Amendments of 1975 (H.R. Rep. No. 94-229, 94<sup>th</sup> Cong. 1<sup>st</sup> Sess. (1975)) also indicates, at page 107, that it was the view of the conferees that the Department and the Service should grant an exemption from the prohibited transaction provisions of the Act and the Code to permit broker-dealers to continue to provide brokerage services to plans with respect to which they exercise investment discretion until May 1, 1978, in order to conform the pertinent provisions of the Act and the Code to section 11(a) of the Securities Exchange Act of 1934 and thereby permit broker-dealers to phase out in an orderly fashion the businesses of both serving as investment advisers to plans and providing brokerage services to such plans.

Therefore, with respect to a person who is a plan fiduciary, the exemption for effecting securities transactions on behalf of employee benefit plans, and for functions performed incidental to the effecting of such transactions, whether or not such transaction is effected on a national securities exchange, is available only if such person was ordinarily and customarily effecting securities transactions on May 1, 1975, and such exemption will terminate on May 1, 1978.

Regardless of whether the transaction is effected by a person who is a fiduciary, the availability of the exemption set forth below is also subject to the condition that the transaction be effected on behalf of the plan, or the advisory services be furnished to the plan, on terms at least as favorable to the plan as an arm's-length transaction with an unrelated party would be. In response to questions raised in the written comments, it is the view of the Department and the Service that this condition requires that the transaction be effected on behalf of the plan, or the advisory services be furnished to the plan, on terms at least as favorable to the plan as those which would have existed between the plan and such party in interest or disqualified person if they were not related.

Minor changes designed to clarify the exemption have been made in the provisions of the exemption in response to suggestions made in the letters of comment.

*Exemption.* Accordingly, the following exemption is granted 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 ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1875-20 I.R.B. 14:

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and 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, shall not apply-

(a) Until May 1, 1978, to the effecting of any securities transaction on behalf of an employee benefit plan by a person who is a fiduciary with respect to the plan, acting in such transaction as agent for the plan, and to the performance by such person of clearance, settlement, or custodial functions incidental to effecting such transaction, if such person ordinarily and customarily effected such securities transactions and performed such functions on May 1, 1975;

(b) To the effecting of any securities transaction on behalf of an employee benefit plan by a person who is a party in interest or a disqualified person with respect to such plan (other than a person who is a fiduciary with respect to the plan), acting in such transaction as agent for the plan, and to the performance by such person of clearance, settlement, or custodial functions incidental to effecting such transaction; or

(c) To the furnishing to an employee benefit plan by a person who is a party in interest or disqualified person with respect to such plan of any advice, either directly or through publications or writings, as to the value of securities or other property, the advisability of investing in, purchasing, or selling securities or other property, or the availability of securities or other property or of purchasers or sellers of securities or other property, or of any analyses or reports concerning issuers, industries, securities or other property, economic factors or trends, portfolio strategy, or the performance of accounts, under circumstances which do not make such party in interest or disqualified person a fiduciary with respect to such plan; Provided that, in each instance, such transactions are effected on behalf of the plan,

or such advice, analyses or reports are furnished to the plan, on terms at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and were not, at the time such transactions were effected or at the time such advice, analyses or reports were furnished, prohibited transactions within the meaning of section 503(b) of the Code. For purposes of this exemption, the term "person" shall include such person and any affiliates of such person, and the term "affiliate" shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21(e) and 26 CFR 54.4975-9(e).

*II. Principal transactions.* The interim exemption in effect until November 1, 1975, for certain securities transactions provided an exemption from the prohibited transaction provisions for the purchase or sale of securities between a plan and a broker-dealer, reporting dealer or bank if certain conditions designed to safeguard the interests of plans and their participants and beneficiaries were met. As indicated in the notice of initial granting of the interim exemption (40 FR 5201, February 4, 1974), the record developed with respect to the granting of that exemption from the testimony received at the public hearing held on January 21, 1975, and from the written comments submitted in response to the notice of proposed granting of the interim exemption (40 FR 2455 and 2483, January 13, 1975), established that an exemption for such transactions is administratively feasible, in the interest of plans and of their participants and beneficiaries, and protective of the rights of plan participants and beneficiaries.

The Department and the Service have, therefore, granted an exemption for this class of principal transactions, modified to take into account the long-term nature of the exemption and the regulations under section 3(21) (A) of the Act and section 4975(e) (3) of the Code (relating to the definition of the term "fiduciary") adopted in conjunction with the exemptions set forth herein.

Modifications in the exemption for principal transactions as proposed on August 8, 1975 have been made in response to suggestions made in the written comments. In this regard, it has been urged that certain modifications be made to permit plans to purchase or sell securities issued by mutual funds from or to a broker-dealer who is a plan fiduciary under procedures which were in effect prior to the passage of the Act, which are protective of the rights and interests of plans and their participants and beneficiaries, and which are subject to regulation by the National Association of Securities Dealers, Inc., and the Securities and Exchange Commission. Paragraph (d) of the exemption has, therefore, been modified to provide an exception for the purchase or sale of mutual fund shares by plans from or to a plan fiduciary, provided that such fiduciary is not a principal underwriter for, or affiliated with, such mutual fund.

It was also asserted in the letters of comment that the records required by paragraph (e) of the exemption may be lost or destroyed during the six-year record maintenance period set forth in that paragraph, and that such loss or destruction under such circumstances should not result in loss of the exemption or in liability for plan fiduciaries if such loss or destruction occurred under circumstances beyond the control of such plan fiduciaries. In response to this comment, modifications have been made in paragraph (e) and in the comparable record-keeping provisions of the exemptions set forth below for underwriting and market-making transactions and extensions of credit.

In addition, other minor clarifying changes have been made in the exemption.

*Exemption.* Accordingly, the following exemption is granted 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 ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-20 I.R.B. 14:

The restrictions of section 406(a) of the Employee Retirement Income Security Act of 1974 (the Act) and the taxes imposed by section 4975 (a) and (b) of Internal Revenue Code of 1954 (the Code), by reason of section 4975(c) (1) (A) through (D) of the Code, shall not apply to any purchase or sale of a security between an employee benefit plan and a broker-dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), a reporting dealer who makes primary markets in securities of the United States Government or of any agency of the United States Government or of any agency of the United States Government ("Government securities") and reports daily to the Federal Reserve Bank of New York its positions with respect to Government securities and borrowings thereon, or a bank supervised by the United States or a State, if the following conditions are met:

(a) In the case of such broker-dealer, it customarily purchases and sells securities for its own account in the ordinary course of its business as a broker-dealer.

(b) In the case of such reporting dealer or bank, it customarily purchases and sells Government securities for its own account in the ordinary course of its business and such purchase or sale between the plan and such reporting dealer or bank is a purchase or sale of Government securities.

(c) Such transaction is at least as favorable to the plan as an arm's length transaction with an unrelated party would be, and it was not, at the time of such transaction, a prohibited transaction within the meaning of section 503(b) of the Code.

(d) Such broker-dealer, reporting dealer or bank is not a fiduciary with respect to the plan, and such broker-dealer, reporting dealer or bank is a party in interest or disqualified person with respect to the plan solely by reason of section 3(14) (B) of the Act or section 4975(e) (2) (B) of the Code or a relationship to a person described in such sections. For purposes of this paragraph, a broker-dealer, reporting dealer, or bank shall not be deemed to be a fiduciary with respect to a plan solely by reason of providing securities custodial services for a plan. Neither the restrictions of this paragraph nor (if the other conditions of this exemption are met) the restrictions of section 406(b) of the Act and the taxes imposed by section 4975 (a) and (b) of the Code, by reason of section 4975(c) (1) (E) and (F) of the Code, shall apply to the purchase or sale by the plan of securities issued by an open-end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), provided that a fiduciary with respect to the plan is not a principal underwriter for, or affiliated with, such investment company within the meaning of sections 2(a) (29) and 2(a) (3) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a) (29) and 80a-2(a) (3)).

(e) The plan maintains or causes to be maintained for a period of six years from the date of such transaction such records as are necessary to enable the persons described in paragraph (f) of this exemption to determine whether the conditions of this exemption have been met, except that-

(1) Such broker-dealer, reporting dealer, or bank shall not be subject to the civil penalty which may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975 (a) and (b) of the Code, if such records are not maintained, or are not available for examination as required by paragraph (f) below; and

(2) A prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the plan fiduciaries, such records are lost or destroyed prior to the end of such six-year period.

(f) Notwithstanding anything to the contrary in subsections (a) (2) and (b) of section 504 of the Act, the records referred to in paragraph (e) are unconditionally available for examination during normal business hours by duly authorized employees of (1) the Department of Labor, (2) the Internal Revenue Service, (3) plan participants and beneficiaries, (4) any employer of plan participants and beneficiaries, and (5) any employee organization any of whose members are covered by such plan. For purposes of this exemption, the terms "broker-dealer," "reporting dealer" and "bank" shall include such persons and any affiliates thereof, and the term "affiliate" shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21 (e) and 26 CFR 54.4975-9(e).

*III. Underwritings.* Based on the proposals submitted relating to this class exemption, the letters of comment, and the testimony given at the public hearings, the Department and the Service have made the following determinations. It is often in the interests of plans to purchase underwritten securities in a public offering because, more often than not, the public offering price for such securities will be more favorable to the plan than the net cost to the plan of the same securities in the secondary market immediately following the initial public offering. However, when a fiduciary of a plan, as defined in section 3(21) (A) of the Act and section 4975(e) (3) of the Code and the regulations adopted thereunder in conjunction with these proposed exemptions, or an affiliate of such fiduciary, is a member of the underwriting or selling syndicate for the public offering of a security, the purchase of such security by the plan during the existence of the syndicate from such fiduciary, or from an affiliate of such fiduciary, would constitute a prohibited transaction under section 406 of the Act and section 4975(c)(1) of the Code. Further, since it is generally in the interests of the members of an underwriting syndicate that all shares being offered by the syndicate are sold, the purchase of any such shares by the plan when a fiduciary with respect to the plan, or an affiliate of such a fiduciary, is a member of the syndicate might also be a prohibited use of plan assets for the benefit of such fiduciary under

section 406 of the Act and section 4975(c) (1) of the Code, even if the seller is not a fiduciary with respect to the plan, or an affiliate of such fiduciary. However, the purchase of securities during the existence of an underwriting or selling syndicate with respect to such securities, of which a fiduciary or an affiliate thereof is a member, from a person who is not such fiduciary or an affiliate thereof will not be deemed such a prohibited use where such fiduciary is not involved in any way in causing the plan to make the purchase, e.g., neither recommends the purchase to the plan nor participates in any other manner in the plan's decision to make the purchase.

It should be noted, moreover, that under the regulations adopted in conjunction with these exemptions relating to the definition of the term "fiduciary", a person who is a plan fiduciary is deemed to be a fiduciary only with respect to those plan assets with respect to which he exercises or has responsibility to exercise those functions which make him a fiduciary.

Further, it should be noted that the purchase by a plan of securities during the existence of an underwriting syndicate of which a plan fiduciary, or an affiliate thereof, is a member, from a broker-dealer, reporting dealer or bank which is neither a plan fiduciary nor an affiliate of such a fiduciary, but which is a party in interest or disqualified person with respect to the plan would not subject such broker-dealer, reporting-dealer or bank to civil penalties under section 502(i) of the Act or excise tax under section 4975 (a) and (b) of the Code notwithstanding that the conditions of the class exemption for such underwriting transactions set forth below are not met. However, such broker-dealer, reporting dealer or bank would be liable for such penalties or taxes if the conditions of the class exemption for principal transactions previously set forth are not met.

Based on the testimony given at the hearing and the written comments which have been submitted, certain modifications have been made in the exemption as set forth below. Although many of these modifications are intended merely to clarify the provisions of the exemption, certain major revisions have also been made. In this regard, the exemption has been modified so that it is available only with respect to purchases of underwritten securities by a plan from persons other than fiduciaries (or any affiliate thereof). Further, the effective date of the condition limiting the availability of the exemption where the fiduciary is a manager of the underwriting or selling syndicate has been extended from January 1, 1977, to July 1, 1977.

In addition, the condition in the proposed exemption relating to the amount of gross commissions, spread or profit which may be received by the seller in such transactions has been removed in order to provide necessary and appropriate flexibility in this area. Further, the exemption has been modified to make it feasible for plans to purchase securities during unregistered secondary offerings of such securities when a fiduciary is a member of the offering syndicate. This modification has been made based on a determination that certain reporting requirements in the Securities Exchange Act of 1934 ensure that sufficient information regarding these issues is publicly available so that the interests of plans and their participants and beneficiaries in the purchase of such securities may be protected.

In addition, the requirement of the proposed exemption that the underwritten securities be purchased on the first day of the offering has been revised to take into account the possibility that such securities may be purchased in a secondary offering, and to permit the purchase of debt securities after the first day in those circumstances when interest rates for comparable debt securities have fallen below the interest rate set for the debt securities being purchased.

A revision has also been made in the requirement that the issuer, of the securities be in existence for at least three years in order to permit plans to purchase underwritten securities of new issuers which are guaranteed by persons whose securities could have been purchased by the plan in an underwriting consistent with the conditions of this exemption.

*Exemption.* Accordingly, the following exemption is granted 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 ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-20 I.R.B. 14:

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and 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, shall not apply to the purchase or other acquisition of any securities by an employee benefit plan during the existence of an underwriting or selling

syndicate with respect to such securities, from any person other than a fiduciary with respect to the plan, when such a fiduciary is a member of such syndicate, provided that the following conditions are met:

(a) No fiduciary who is involved in any way in causing the plan to make the purchase is a manager of such underwriting or selling syndicate, except that this paragraph shall not apply until July 1, 1977. For purpose of this exemption, the term "manager" means any member of an underwriting or selling syndicate, who, either alone or together with other members of the syndicate, is authorized to act on behalf of the members of the syndicate in connection with the sale and distribution of the securities being offered or who receives compensation from the members of the syndicate for its services as a manager of the syndicate.

(b) The securities to be purchased or otherwise acquired are-

(1) Part of an issue registered under the Securities Act of 1933 or, if exempt from such registration requirement, are (i) issued or guaranteed by the United States or by any person controlled or supervised by and acting as an instrumentality of the United States pursuant to authority granted by the Congress of the United States, (ii) issued by a bank, (iii) issued by a common or contract carrier, if such issuance is subject to the provisions of section 20a of the Interstate Commerce Act, as amended, (iv) exempt from such registration requirement pursuant to a Federal statute other than the Securities Act of 1933, or (v) are the subject of a distribution and are of a class which is required to be registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 781), and the issuer of which has been subject to the reporting requirements of section 13 of that Act (15 U.S.C. 78m) for a period of at least 90 days immediately preceding the sale of securities and has filed all reports required to be filed thereunder with the Securities and Exchange Commission during the preceding 12 months.

(2) Purchased at not more than the public offering price prior to the end of the first full business day after the final terms of the securities have been fixed and announced to the public, except that-

(i) If such securities are offered for subscription upon exercise of rights they are purchased on or before the fourth day preceding the day on which the rights offering terminates; or

(ii) If such securities are debt securities, they may be purchased at a public offering price on a day subsequent to the end of such first full business day, provided that the interest rates on comparable debt securities offered to the public subsequent to such first full business day and prior to the purchase are less than the interest rate of the debt securities being purchased.

(3) Offered pursuant to an underwriting agreement under which the members of the syndicate are committed to purchase all of the securities being offered, except if-

(i) Such securities are purchased by others pursuant to a rights offering; or

(ii) Such securities are offered pursuant to an over-allotment option.

(c) The issuer of such securities has been in continuous operation for not less than three years, including the operations of any predecessors, unless-

(1) Such securities are non-convertible debt securities rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization;

(2) Such securities are issued or fully guaranteed by a person described in paragraph (b) (1) (i) of this exemption; or

(3) Such securities are fully guaranteed by a person who has issued securities described in in paragraph (b) (1) (ii), (iii), (iv) or (v) and this paragraph (c).

(d) The amount of such securities to be purchased or otherwise acquired by the plan does not exceed three percent of the total amount of such securities being offered.



(e) The consideration to be paid by the plan in purchasing or otherwise acquiring such securities does not exceed three percent of the fair market value of the total assets of the plan as of the last day of the most recent fiscal quarter of the plan prior to such transaction, provided that if such consideration exceeds \$1 million, it does not exceed one percent of such fair market value of the total assets of the plan.

(f) The plan maintains or causes to be maintained for a period of six years from the date of such transaction such records as are necessary to enable the persons described in paragraph (g) of this exemption to determine whether the conditions of this exemption have been met, except that a prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the plan fiduciaries, such records are lost or destroyed prior to the end of such six-year period.

(g) Notwithstanding anything to the contrary in subsections (a) (2) and (b) of section 504 of the Act, the records referred to in paragraph (f) are unconditionally available for examination during normal business hours by duly authorized employees of (1) the Department of Labor, (2) the Internal Revenue Service, (3) plan participants and beneficiaries, (4) any employer of plan participants and beneficiaries, and (5) any employee organization any of whose members are covered by such plan.

If such securities are purchased by the plan from a party in interest or disqualified person with respect to the plan, such party in interest or disqualified person shall not be subject to the civil penalty which may be assessed under section 502 (i) of the Act, or to the taxes imposed by section 4975 (a) and (b) of the Code, if the conditions of this exemption are not met. However, if such securities are purchased from a party in interest or disqualified person with respect to the plan, the restrictions of section 406(a) of the Act shall apply to any fiduciary with respect to the plan 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 apply to such party in interest or disqualified person, unless the conditions for exemption of Part II of this notice (relating to certain principal transactions) are met.

For purposes of this exemption, the term “fiduciary” shall include such fiduciary and any affiliates of such fiduciary, and the term “affiliate” shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21(e) and 26 CFR 54.4975-9(e).

*IV. Market-making.* Based on the proposals submitted relating to this class exemption, the letters of comment and the testimony given at the public hearings, the Department and the Service have made the following determinations. Certain firms which provide investment advice to plans either directly or through their affiliates regularly maintain markets in securities, and as a result of this market-making activity, these firms in some instances can provide plans with the best available purchase or sales price with respect to particular securities.

The purchase or sale of securities by a plan from or to a fiduciary with respect to such plan, or an affiliate of such fiduciary, would be a prohibited transaction under section 406 of the Act and section 4975(c) (1) of the Code. Generally, the purchase or sale by a plan of securities for which a plan fiduciary or affiliate of such fiduciary is a market-maker, from or to a broker-dealer, reporting dealer or bank which is unrelated to such fiduciary (and is not otherwise a party in interest or disqualified person) will not be deemed a prohibited transaction under section 406 of the Act and section 4975(c) (1) of the Code, unless such transaction was engaged in for the purpose of benefiting such fiduciary or an affiliate of such fiduciary.

It should also be noted that under the regulations adopted in conjunction herewith relating to the definition of the term “fiduciary”, a person is a fiduciary only with respect to those plan assets with respect to which he exercises those functions which make him a fiduciary.

Certain revisions have been made in the exemption based on certain of the written comments which were submitted. The definition of the term “market-maker” has been revised so that it more closely conforms to the definition of that term set forth in section 3(a) (38) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a) (38)), as amended by the Securities Acts Amendments of 1975 (Pub. L. 94-29, 89 Stat. 103). In addition, the limitations on the size of plan holdings of securities referred to in the exemption have been modified so that they are based on the amount of assets under the management and control of the plan

fiduciary who is a market-maker, rather than on the total assets of the plan, since such fiduciary may not be a fiduciary with respect to all of the assets of the plan. An exception from these limitations has also been provided for the purchase or sale of government securities.

The condition with regard to the number of market-makers other than plan fiduciaries with respect to the securities being purchased or sold by the plan has been revised in response to suggestions made in the letters of comment in order to require that there be only one other market-maker. This revision is based on a determination that many securities which might be appropriate for plans to purchase, and particularly debt securities, frequently have only two market-makers. Further, the exemption now provides that the plan can only purchase or sell such securities from or to a fiduciary who is a market-maker on terms more favorable to the plan than those which the fiduciary, acting in good faith, reasonably believes to be available from all other market-makers. Other modifications have also been made to clarify other provisions of the exemption in response to the written comments.

The Department and the Service note that certain broker-dealers who are fiduciaries with respect to plans may purchase securities from or sell securities to such plans as so-called "block positioners" with respect to such securities. Such transactions would constitute prohibited transactions under section 406 of the Act and section 4975 (c) (1) of the Code. Although it has been suggested that an exemption be granted for such transactions, the Department and the Service lack sufficient supportive data on which to consider the proposal of such an exemption.

*Exemption.* Accordingly, the following exemption is granted 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 ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-20 I.R.B. 14:

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and 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, shall not apply to any purchase or sale of any securities by an employee benefit plan from or to a market-maker with respect to such securities who is also a fiduciary with respect to such plan, provided that the following conditions are met:

(a) The issuer of such securities has been in continuous operation for not less than three years, including the operations of any predecessors, unless-

(1) Such securities are non-convertible debt securities rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization;

(2) Such securities are issued or guaranteed by the United States or by any person controlled or supervised by and acting as an instrumentality of the United States pursuant to authority granted by the Congress of the United States, or

(3) Such securities are fully guaranteed by a person described in this paragraph (a)

(b) As a result of purchasing such securities-

(1) The fair market value of the aggregate amount of such securities owned, directly or indirectly, by the plan and with respect to which such fiduciary is a fiduciary, does not exceed three percent of the fair market value of the assets of the plan with respect to which such fiduciary is a fiduciary, as of the last day of the most recent fiscal quarter of the plan prior to such transaction, provided that if the fair market value of such securities exceeds \$1 million, it does not exceed one percent of such fair market value of such assets of the plan, except that this paragraph shall not apply to securities described in paragraph (a)(2) of this exemption; and

(2) The fair market value of the aggregate amount of all securities for which such fiduciary is a market-maker, which are owned, directly or indirectly, by the plan and with respect to which such fiduciary is a fiduciary, does not exceed 10 percent of the fair market value of the assets of the plan with respect to which such fiduciary is a fiduciary, as of the last day of the most recent fiscal quarter of the plan prior to such transaction, except that this paragraph shall not apply to securities described in paragraph (a) (2) of this exemption.

(c) At least one person other than such fiduciary is a market-maker with respect to such securities.

(d) The transaction is executed at a net price to the plan for the number of shares or other units to be purchased or sold in the transaction which is more favorable to the plan than that which such fiduciary, acting in good faith, reasonably believes to be available at the time of such transaction from all other market-makers with respect to such securities.

(e) The plan maintains or causes to be maintained for a period of six years from the date of such transaction such records as are necessary to enable the persons described in paragraph (f) of this exemption to determine whether the conditions of this exemption have been met, except that a prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the plan fiduciaries, such records are lost or destroyed prior to the end of such six year period.

(f) Notwithstanding anything to the contrary in subsections (a) (2) and (b) of section 504 of the Act, the records referred to in paragraph (e) are unconditionally available for examination during normal business hours by duly authorized employees of (1) the Department of Labor, (2) the Internal Revenue Service, (3) plan participants and beneficiaries, (4) any employer of plan participants and beneficiaries, and (5) any employee organization any of whose members are covered by such plan.

For purposes of this exemption-

(1) The term “market-maker” shall mean any specialist permitted to act as a dealer, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.

(2) The term “fiduciary” shall include such fiduciary and any affiliates of such fiduciary, and the term “affiliate” shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21(e) and 26 CFR 54.4975-9(e).

*V. Extension of credit.* Based on the proposals submitted relating to this class exemption, the letters of comment, and the testimony given at the public hearings, the Department and the Service have made the following determinations. A normal part of the execution of securities transactions by broker-dealers on behalf of customers, including plans, is the extension of credit to customers so as to permit the settlement of transactions in the customary five-day settlement period. In addition, such extensions of credit are also customary in connection with certain kinds of securities transactions, such as short sales and the writing of option contracts.

Since such extensions of credit are normally made by broker-dealers in connection with the execution of transactions for customers, if the customer is a plan, the broker-dealer would be a party in interest or disqualified person with respect to the plan by reason of providing the service of executing a transaction for the plan. Section 406(a) (1) (B) of the Act and section 4975(c) (1) (B) of the Code prohibit extensions of credit between plans and parties in interest or disqualified persons.

However, the Department and the Service have determined to grant the exemption set forth below to permit extensions of credit by broker-dealers to plans under conditions designed to safeguard the interests of plans and their participants and beneficiaries.

*Exemption.* Accordingly, the following exemption is granted 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 ERISA Procedure 75-1 (40 FR 18471, April 28, 1975) and Rev. Proc. 75-26, 1975-20 I.R.B. 14:

The restrictions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and 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, shall not apply to any extension of credit to an employee benefit plan by a party in interest or a disqualified person with respect to the plan, provided that the following conditions are met:

(a) The party in interest or disqualified person-

(1) Is a broker or dealer registered under the Securities Exchange Act of 1934; and

(2) Is not a fiduciary with respect to any assets of such plan, unless no interest or other consideration is received by such fiduciary or any affiliate thereof in connection with such extension of credit.

(b) Such extension of credit-

(1) Is in connection with the purchase or sale of securities;

(2) Is lawful under the Securities Exchange Act of 1934 and any rules and regulations promulgated thereunder; and

(3) Is not a prohibited transaction within the meaning of section 503(b) of the Code.

(c) The plan maintains or causes to be maintained for a period of six years from the date of such transaction such records as are necessary to enable the persons described in paragraph (d) of this exemption to determine whether the conditions of this exemption have been met, except that-

(1) if such party in interest or disqualified person is not a fiduciary with respect to any assets of the plan, such party in interest or disqualified person shall not be subject to the civil penalty which may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975 (a) and (b) of the Code, if such records are not maintained, or are not available for examination as required by paragraph (d) below; and

(2) a prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of the plan fiduciaries, such records are lost or destroyed prior to the end of such six-year period.

(d) Notwithstanding anything to the contrary in subsections (a) (2) and (b) of section 504 of the Act, the records referred to in paragraph (c) are unconditionally available for examination during normal business hours by duly authorized employees of (1) the Department of Labor, (2) the Internal Revenue Service, (3) plan participants and beneficiaries, (4) any employer of plan participants and beneficiaries, and (5) any employee organization any of whose members are covered by such plan. For purposes of this exemption, the terms "party in interest" and "disqualified person" shall include such party in interest or disqualified person and any affiliates thereof, and the term "affiliate" shall be defined in the same manner as that term is defined in 29 CFR 2510.3-21(e) and 26 CFR 54.4975-9(e).

The effective date for exemptions I through V above is January 1, 1975.

Signed at Washington, D.C. this 24<sup>th</sup> day of October, 1975.

JAMES D. HUTCHINSON.

*Administrator of Pension and Welfare Benefit Programs,  
U.S. Department of Labor.*

DONALD C. ALEXANDER

*Commissioner of Internal Revenue.*

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