

**DEPARTMENT OF LABOR****Employee Benefits Security  
Administration**

[Application Nos. D-08295 and D-10365]

**Proposed Class Exemption To Permit  
Certain Loans of Securities by  
Employee Benefit Plans**

**AGENCY:** Department of Labor.

**ACTION:** Notice of proposed amendment to PTE 81-6 and proposed restatement and redesignation of PTE 82-63.

**SUMMARY:** This document contains a notice of pendency before the Department of Labor (the Department) of a proposed amendment to PTE 81-6 and a proposed restatement of PTE 82-63. If granted, the proposed exemption would amend and replace Prohibited Transaction Exemption (PTE) 81-6 (46 FR 7527, January 23, 1981) which exempts the lending of securities by employee benefit plans to certain banks and broker-dealers, and would replace PTE 82-63 (47 FR 14804, April 6, 1982), which exempts certain compensation arrangements for the provision of securities lending services by a plan fiduciary to an employee benefit plan. The class exemption proposed in this notice, if granted, would incorporate PTEs 81-6 and 82-63 and expand those class exemptions to additional parties, subject to modified conditions. If granted, the proposed exemption would affect participants and beneficiaries of employee benefit plans, persons who lend securities on behalf of such plans, and parties in interest who engage in securities lending transactions with such plans.

**DATES:** Written comments and requests for a public hearing must be received by the Department on or before December 8, 2003. The replacement exemption and the revocation of PTEs 81-6 and 82-63 would be effective 60 days following publication of the final grant.

**ADDRESSES:** All written comments and requests for a public hearing (preferable three copies) should be addressed to: U.S. Department of Labor, Office of Exemption Determinations, Employee Benefits Security Administration, Room N-5649, 200 Constitution Avenue, NW., Washington, DC 20210 (Attention: Application No. D-10365.) Interested

persons are also invited to submit comments and/or hearing requests to EBSA by email to: [moffitt.betty@dol.gov](mailto:moffitt.betty@dol.gov) or by fax at (202) 219-0204 by the end of the scheduled comment period. All comments received will be available for public inspection in the Public Disclosure Room, U.S. Department of Labor, Room N-1513, 200 Constitution Avenue, NW., Washington, DC 20210.

**FOR FURTHER INFORMATION CONTACT:**

Allison Padams Lavigne, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor, (202) 693-8540 (This is not a toll-free number.)

**SUPPLEMENTARY INFORMATION:** Notice is hereby given of the pendency before the Department of a proposed class exemption that would amend and incorporate PTEs 81-6 and 82-63 into a new class exemption and would expand the existing relief from the restrictions of sections 406(a)(1)(A) through (D) and 406(b)(1) of ERISA and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A) through (E) of the Code to additional parties under modified conditions.<sup>1</sup> Notice is also hereby given of the pendency before the Department of a proposed revocation of PTEs 81-6 and 82-63.

The proposed exemption was requested in two applications. One was submitted by the American Bankers Association (ABA) (D-08295)<sup>2</sup> and the second application was submitted by the Robert Morris Associates, now known as the Risk Management Association (RMA) (D-10365). The applications were filed pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Code and in accordance with the procedures set forth in 29 CFR 2570, subpart B (55 FR 32836, August 10, 1990.)

**Background**

PTE 81-6 provides relief from section 406(a)(1)(A) through (D) of ERISA and Code section 4975(c)(1)(A) through (D) for the lending of securities by employee benefit plans to banks and

broker-dealers registered under the Securities Exchange Act of 1934, who are parties in interest with respect to such plans. The exemption was amended in 1987 to include broker-dealers exempted from registration as dealers in exempted government securities, provided that all other conditions of the exemption are met.

Securities lending transactions generally operate in the following manner. An institutional investor, such as a plan, lends securities from its portfolio to a broker-dealer or bank in order to augment the return on those securities while continuing to enjoy the benefits of owning the securities (e.g., from the receipt of any interest, dividends, or other distributions made on the loaned securities and from any appreciation in the value of the securities). The lender generally requires that the securities loaned be fully collateralized, and the collateral usually is in the form of cash or high quality liquid securities, such as U.S. Government or Federal Agency obligations or irrevocable bank letters of credit. If the borrower deposits cash collateral, the lender invests the collateral, and the borrowing agreement may provide that the lender pays the borrower a previously-agreed upon rebate and keeps the earnings on the collateral. If the borrower deposits government securities, the borrower is entitled to the earnings on its deposited securities and pays the lender a lending fee. If the borrower deposits bank letters of credit as collateral, the borrower pays the lender a fee as compensation for the loan of its securities.

PTE 82-63 exempts certain compensation arrangements for the provision of securities lending services by a plan fiduciary to an employee benefit plan, provided that: the loan of securities is not prohibited by section 406(a); the lending fiduciary is authorized to engage in lending transactions on behalf of the plan; the compensation is reasonable and is paid in accordance with terms of a written instrument; the compensation arrangement is approved by an independent fiduciary; and the authorization is provided only after the independent fiduciary has received all information necessary to approve the arrangement with the lending fiduciary.

Currently, relief under PTE 81-6 is limited to securities lending transactions in which a plan loans securities to a U.S. broker-dealer or U.S. bank which is a party in interest to the plan. Moreover, only collateral consisting of cash, securities issued or guaranteed by the United States Government or its agencies or

instrumentalities, or irrevocable bank letters of credit may be accepted by the plan. As discussed more fully below, the applicant(s) have asked the Department to extend relief to foreign broker-dealers and banks and to allow plans to accept additional forms of collateral.

**Discussion of the Application**

The application contains facts and representations with regard to the requested exemption which are summarized below. Interested persons are referred to the application on file with the Department for the complete representations of the applicant.

*1. The Applicant*

The RMA is the primary association of securities lending professionals. RMA's membership is composed of approximately 2800 member institutions consisting of banks and regulatory agencies. RMA states that its purpose as an association is to foster standards and performance in the practice and management of lending and credit activities in its members and other institutions which comprise the financial service industry.

According to RMA, securities lending activities in the international business context have increased greatly. Securities commonly loaned now include U.S. and foreign corporate and government securities. Lenders are continuing to expand their global securities lending networks by becoming familiar with and lending securities located in new markets and by lending to borrowers located in new jurisdictions. The applicant represents that plans are effectively prevented from participating in securities lending transactions in foreign markets because of the limitations contained in PTE 81-6.

*2. Summary of RMA's Application*

**Eligible Borrowers**

In its original submission, RMA requested an exemption to permit employee benefit plans to lend securities to U.S. banks and broker-dealers and "exempted foreign banks and broker-dealers." RMA proposed to define "exempted foreign banks and broker-dealers" as either those subject to the laws and regulations of a country which is a member of the Organization for Economic Cooperation and Development or those which are rated with respect to their long-term creditworthiness as at least "A" by Standard & Poors or "A3" by Moody's Investors Services, Inc. RMA also requested that the permissible collateral

<sup>1</sup> Section 102 of Reorganization Plan No. 4 of 1978 (5 U.S.C. App. 1 (1996)) generally transferred the authority of the Secretary of the Treasury to issue exemptions under section 4975(c)(2) to the Secretary of Labor.

<sup>2</sup> The ABA requested broad relief to permit employee benefit plans to lend securities to any foreign bank or broker-dealer. In this regard, the ABA did not continue to pursue their exemption request by responding to issues raised by the Department relating to the definition of eligible borrowers and providing information on how securities markets in other countries operate as compared to those in the United States. However, the ABA's request is being addressed, in part, by this Notice which is based on exemption application D-10365.

under the exemption be expanded to include foreign currency, securities issued or guaranteed by the government of an "exempted country" or one of its instrumentalities, or irrevocable letters of credit issued by a bank which is organized and regulated under the laws of an exempted country and which is a person other than the borrower or an affiliate thereof.

The Department requested additional information relating to the operation and regulatory environment of these foreign countries. The Department notes that the relief provided in PTE 81-6 was based, in part, on the regulatory oversight of banks and broker-dealers located in the United States. This regulatory framework and the conditions contained in PTE 81-6 were integral to the Department's determination that the exemption was administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of the participants and beneficiaries of such plan.

In response to the Department's questions, RMA amended its request to narrow the definition of exempted foreign bank or broker-dealer to include those entities regulated under the laws of the United Kingdom (the UK). Banks and broker-dealers in the UK which engage in securities lending activities of the type contemplated by the proposed exemption are subject to extensive regulation under the Financial Services and Markets Act 2000 (FSMA) which governs "the conduct of investment business"<sup>3</sup> in the UK. The Financial Services Authority (FSA) is an independent non-government body which exercises statutory powers under the FSMA. The FSA is accountable to the Treasury<sup>4</sup> of the UK, and, through them, to Parliament. The FSA must report annually on the achievement of its statutory objectives to the Treasury which presents this report to the Parliament.

The duties of the FSA fall into the following categories: (1) Authorization of firms; (2) establishing standards for firms; (3) oversight of firms; (4) enforcement of [investment] laws and rules in the UK; (5) reducing financial crime; and (6) providing consumer service. Before a firm may conduct

investment business, it must be authorized by the FSA. Only those firms which demonstrate to the FSA that they satisfy threshold criteria (which relate to the firms' honesty, competence and financial soundness) are authorized to engage in investment. The FSA ensures that financial business is not being carried out by unauthorized firms. In addition, the FSA collects and maintains information about the authorized firms. Any investment agreement entered into without such authorization is unenforceable, and the counterparty to such agreement is entitled to restitution and compensation for any loss incurred.

The FSA also establishes "prudence" standards for the firms it regulates. These standards include capital requirements which are designed to ensure that firms are able to meet financial obligations. Firms are also required to meet FSA standards relating to management, accounting and auditing practices. Further, the FSA sets the conduct of business standards relating to the firms' relationships with consumers. This involves overseeing a firm's dealings with investors to ensure, for example, that information is understandable, fair and not misleading.

The FSA has responsibility for overseeing the integrity of the UK investment markets. Specifically, it oversees the exchanges, clearing and settlement houses, and conducts market surveillance and transaction monitoring. The FSA also supervises the soundness of banks. In so doing, the aim is, among other things, to protect depositors.

In its enforcement capacity, the FSA investigates and, if appropriate, disciplines and prosecutes those responsible for conducting financial business outside of the rules. Under the FSMA, the FSA has the statutory authority to revoke a firm's authorization, discipline firms and individuals by public statements and financial penalties, seek injunctions, prosecute for offenses and require money to be returned as compensation for consumers.

According to RMA, the FSA's oversight of the securities markets in the UK provides a sufficient level of safeguards to protect the interests of the plans that would be lending securities to UK banks and broker-dealers under this exemption, if granted.

#### Collateral Offered to the Plan

The RMA requested that the Department expand the types of collateral permitted to be used in securities lending arrangements to include currency denominated in UK pounds or Euros, securities issued or

guaranteed by the government of the UK or one of its agencies or instrumentalities, the sovereign debt of the member countries of the European Monetary Union denominated in UK pounds or in Euros, or irrevocable letters of credit denominated in UK pounds or Euros and issued by a bank which is regulated under the laws of the UK.

With respect to the Euro, RMA represents that, although it is a relatively new form of currency, it is closely monitored and regulated in connection with the implementation of the European Monetary Union (EMU). The EMU<sup>5</sup> consists of the following nations: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and Sweden. In order to be admitted as members, these nations were required to meet five criteria: (1) Exchange rates must not fluctuate beyond certain predetermined fluctuation limits for a period of two years; (2) a government deficit must not exceed 3% of gross domestic product (GDP); (3) a government debt to GDP ratio is 60% or less; (4) an inflation rate must not be more than 1.5% above that of the average rate of the three best performing participating nations; and (5) an average long-term interest rate is no more than 2% above that of the three best performing participating nations. The primary goal of the introduction of the Euro is to establish and maintain price stability throughout the EMU region. The European Central Bank (ECB) and the European System of Central Banks (ESCB) provide a comprehensive management and regulatory infrastructure designed to support this objective. The responsibility of the ESCB is to maintain price stability and to define and implement the monetary policy of the EMU nations and promote the smooth operation of payment systems.

The RMA proposed that, if letters of credit are used as collateral, they must be issued by a bank whose long-term deposit rating is investment grade or higher, as determined by a nationally recognized independent statistical rating organization. Upon further consideration of this issue, RMA suggested that the "counterparty credit rating" of a bank is a more appropriate measure with respect to these transactions. Counterparty credit ratings take into account factors that focus on the bank's capacity to meet its financial

<sup>3</sup> The conduct of investment business in the UK includes: (1) Buying, selling, subscribing for or underwriting investments; (2) arranging transactions in the field of investment and (3) giving investment advice.

<sup>4</sup> The Treasury is the department of the government in the UK responsible for formulating and putting into effect the UK's financial and economic policy.

<sup>5</sup> Although the UK did not initially participate in the EMU, it is anticipated that a significant amount of business in the financial sector of the UK will be transacted in Euros.

obligations as they come due. RMA states that rating agencies, such as Standard & Poor's, look to the credit of the bank when examining transactions that rely on lines of credit for credit enhancements.

RMA has also requested that plans be allowed to accept collateral that is denominated in a different currency than the securities lent. RMA notes that, because plans are currently not permitted under PTE 81-6 to accept foreign government debt as collateral for borrowed securities, plans are not able to fully participate in the overseas securities lending markets and are prevented from enjoying revenue opportunities that are available to other lenders. RMA further states that most broker-dealers who are active in the international securities lending area are active in several markets. Thus, a broker-dealer may have a relatively large position in the currency of one country (e.g., Euro), but may have a need to borrow securities denominated in the currency of another country (e.g., UK pounds). In these circumstances, the borrower would want to deliver Euros as collateral for a loan of UK pound denominated securities. RMA believes that plans would be at a competitive disadvantage if the proposed exemption did not permit plans to accept collateral that is denominated in a different currency than the securities that are lent.

Another request of RMA relates to the level of collateral that must be provided to a lender. RMA suggests that the market value of the collateral offered to the plan be not less than 100 percent of the then market value of the securities lent, if the collateral is denominated in the same currency as the securities, and 102 percent of the then market value of the securities lent if the collateral is denominated in a different currency. However, after consideration of the issue, the Department believes that it would be more protective of the plan to require that the market value of the collateral be 105 percent of the then market value of the securities lent where the collateral offered by a borrower is denominated in a different currency than that of the securities.

#### **Plan's Rights With Respect to the Collateral Under the Law of the UK Upon a Borrower's Default**

RMA states in its application that under standard securities lending practices in the UK, title to the collateral given to the lender in exchange for borrowed securities, passes to the lender. According to RMA, this practice is reflected in the standard lending agreements used in the UK RMA

represents that the securities lending transactions contemplated by the proposed exemption would be carried out in accordance with standard securities lending practices in the United Kingdom. Because the lending plan will have title to the collateral in these transactions, such plans will not be restricted in their ability to apply the collateral towards the cost of replacing the borrowed securities or to replace the collateral with cash in the event the borrower were to default.

To further protect the plan's interests in the event of a borrower's default, RMA proposes that, in the securities lending agreement, the borrower will agree to submit to the jurisdiction of the courts of the United States. Once a plan receives a judgment against a borrower in a U.S. court, the plan would then enforce the judgment in a UK court. RMA states that the enforcement of U.S. judgments in the UK courts is governed by common law. A basic principle of such common law is that any judgment of a court of a foreign country which is for a debt or a definite sum of money which is final and conclusive on the merits, and as to which the foreign court had jurisdiction over the defendant, is enforceable at common law in the absence of fraud. Under UK common law, a foreign court is considered to have jurisdiction over the defendant if the defendant agreed to submit to the jurisdiction of the foreign court prior to the commencement of the proceedings.

To enforce a U.S. judgment under common law, a claimant must commence an action in a UK court by writ. If a claimant obtains a favorable judgment in a U.S. court following a summary judgment action or a trial, the judgment is enforceable in the UK like any other UK judgment.

As an alternative to submission to the jurisdiction of the United States courts, if the lending agent is domiciled in the United States, the lending agent may agree to indemnify and hold harmless each plan against any shortfall in the value of the collateral as compared to the value of the loaned securities.

#### **Indicia of Collateral and Location of Collateral Offered to the Plan**

In dealing with the indicia of ownership of the collateral offered to the plan in return for the securities lent to Foreign Banks and Foreign Broker-Dealers, RMA has represented that the indicia of ownership of the collateral for the borrowed securities will be maintained within the jurisdiction of the district courts of the United States as required by section 404(b) of ERISA, or if held outside the U.S., in a central

clearing facility.<sup>6</sup> RMA represents that the requirements of section 404(b) and the Department's regulation thereunder will be satisfied.

Thus, if a Foreign Bank or Foreign Broker-Dealer offers Foreign Collateral to the plan, under regulation 29 CFR 2550.404b-1, the indicia of ownership of the collateral must be held within the jurisdiction of the district courts of the United States<sup>7</sup>, or the assets must be under the management and control of a fiduciary which is a corporation or partnership organized under the laws of the United States or a State which has its principal place of business within the United States and which is a bank, an insurance company or an investment advisor (as described in the regulations.) In the alternative, the regulations require that the indicia of ownership of the collateral be in the physical possession of a person which is organized under the laws of the United States which is a bank, as defined under section 202(a)(2) of the Investment Advisers Act of 1940, a broker-dealer registered under the Securities Exchange Act of 1934 with a net worth exceeding \$750,000, or has its obligations and liabilities guaranteed by individuals listed in the regulation; be maintained by a broker-dealer in the custody of an entity designated as a "satisfactory control location" under Rule 15c3-3 under the Securities Exchange Act of 1934; or be maintained by a bank, in the custody of an entity that is a foreign securities depository, foreign clearing agency acting as a securities depository or a foreign bank, which entity is supervised or regulated by a government agency or regulatory authority in the foreign jurisdiction having authority over such depositories, clearing agencies or banks.<sup>8</sup>

#### **Discussion of Proposed Exemption**

Section I of the proposal describes the transactions which are covered by the exemption. Section I(a) tracks the language of PTE 81-6 by permitting the lending of securities that are assets of an employee benefit plan to a U.S. Broker-Dealer or U.S. Bank, if the general conditions set forth in section II are met. However, the conditions contained in

<sup>6</sup> In this regard, RMA represents that in the UK, the indicia of ownership for the foreign collateral is typically held in a central clearing facility in accordance with customary procedures in the UK.

<sup>7</sup> The indicia of ownership of bank letters of credit (foreign or U.S.) must always be maintained within the jurisdiction of the district courts of the United States since they fall outside the exception provided in regulation 29 CFR 2550.404b-1.

<sup>8</sup> Regulation 29 CFR 2550.404b-1 has been summarized in part. Interested persons should consult the complete regulation to ensure compliance.

PTE 81-6 have been amended to permit additional types of collateral to be used for the loan.<sup>9</sup> Section I(b) of the proposal expands PTE 81-6 by permitting the lending of securities that are assets of an employee benefit plan to a Foreign Broker-Dealer or a Foreign Bank. A Foreign Broker-Dealer or a Foreign Bank must meet both the general conditions set forth in section II of the proposed exemption, as well as the specific conditions described in section III. Section I(c) permits the payment to a lending fiduciary of compensation for services rendered in connection with loans of plan assets that are securities, provided that the conditions set forth in section IV are met. The conditions found in section IV mirror the conditions currently found in PTE 82-63. Although the relief provided by section I(c) would apply to a broader range of lending activities, no changes are being proposed with respect to any of the conditions that are contained in PTE 82-63.

Under the proposal, U.S. Banks and U.S. Broker-Dealers would now be permitted to give plans Foreign Collateral for securities loans. Section V(f) defines Foreign Collateral as the currency of the United Kingdom or Euros, securities issued or guaranteed by the government of the United Kingdom or one of its agencies or instrumentalities, sovereign debt of the member countries of the EMU denominated in Euros or irrevocable letters of credit issued by a Foreign Bank, other than the borrower, which has a counter-party rating of investment grade or better as determined by a nationally recognized statistical rating organization. Further, section II(b) requires that the plan receive from the borrower: (a) U.S. Collateral having, as of the close of business on the preceding business day, a market value or, in the case of letters of credit, a stated amount, equal to not less than 100 percent of the then market value of the securities lent, or (b) Foreign Collateral having, as of the close of the preceding business day, a market value or, in the case of letters of credit, a stated amount, equal to not less than: (1) 102 percent of the then market value of the securities lent on a recognized securities exchange (as defined in section V(j)) or an automated trading system (as defined in section V(k)) on which the securities are primarily traded if the collateral posted is denominated in the same currency as the securities lent; or (2) 105 percent of

the then market value of the securities lent on a recognized securities exchange or an automated trading system on which the securities are primarily traded if the collateral posted is denominated in a different currency than the securities lent. The Department notes that, after consideration of the applicant's suggestion for an appropriate level of Foreign Collateral, it was determined that the plan's interests will be better protected if the amount of collateral is increased when Foreign Collateral is offered to the plan.

The securities lending agreement also must describe any fees to be received by a plan in connection with the lending of securities, whether the payment will be made in the same currency as the collateral, in the currency of the securities lent or in U.S. dollars. Lastly, the securities lending agreement must give the plan a continuing security interest in, title to, or the rights of a secured creditor with respect to the collateral received by the plan.

As an additional safeguard, the Department is requiring that when the plan receives Foreign Collateral or U.S. Collateral from a foreign bank or broker-dealer, the collateral itself must be maintained on behalf of the plan at an "Eligible Securities Depository" as defined in Rule 17f-7 of the Investment Company Act of 1940 [15 U.S.C. 80a]. Rule 17f-7 governs the custody of assets of registered management investment companies with custodians outside the United States. Rule 17f-7 permits a fund to maintain assets with a foreign securities depository if, among other things, the depository is an eligible securities depository. The term "Eligible Securities Depository" is defined in section [17 CFR Part 270] 2710.17f-7(b)(1) as a system for the central handling of securities that:

(i) Acts as or operates a system for the central handling of securities or equivalent book-entries in the country where it is incorporated, or a transnational system for the central handling of securities or equivalent book-entries;

(ii) Is regulated by a foreign financial regulatory authority as defined under section 2(a)(50) of the Act (15 U.S.C. 80a-2(a)(50))<sup>10</sup>;

<sup>10</sup> 15 U.S.C. 80a-2(a)(50) states that "foreign financial regulatory authority" means any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts or sale of a commodity for future delivery, or other instrument traded on or subject to the rules of a contract market, board of trade or foreign equivalent or other financial activities, or (C) membership organization,

(iii) Holds assets for the custodian that participates in the system on behalf of the Fund under safekeeping conditions no less favorable than the conditions that apply to other participants;

(iv) Maintains records that identify the assets of each participant and segregates the system's own assets from the assets of participants;

(v) Provides periodic reports to its participants with respect to its safekeeping of assets, including notices of transfers to or from any participant's account; and

(vi) Is subject to periodic examination by regulatory authorities or independent accountants.

The Department notes that the proposed exemption also permits collateral to be physically delivered to the Plan. In addition, where the borrower is a U.S. Bank or Broker-Dealer, the current requirements (with respect to where the collateral must be held on behalf of the plan) of PTE 81-6 have been incorporated into the proposal.

The Department also notes that section II(c) requires that, in the case of a Foreign Broker-Dealer or Foreign Bank, the borrower shall have furnished the Lending Fiduciary with its most recent available audited statement of its financial condition as audited by a firm which is eligible for appointment as a company auditor under the laws of the United Kingdom.

For purposes of this proposed class exemption, section V(c) defines the term "Foreign Broker-Dealer" as a broker-dealer registered and regulated under the laws of the Financial Services Authority in the United Kingdom that has as of the last day of its most recent fiscal year, equity capital which is equivalent of no less than \$200 million. Section V(d) defines the term "Foreign Bank" as an institution having substantially similar powers to a bank which is described in section 202(a)(2) of the Investment Advisers Act, is subject to authorization by the Financial Services Authority in the United Kingdom and has as of the last day of its most recent fiscal year, equity capital which is equivalent of no less than \$200 million.

The Department notes that, the proposed relief for Foreign Broker-Dealers and Foreign Banks is limited to UK Broker-Dealers and UK Banks as RMA has requested. Nevertheless, this proposal does not foreclose consideration by the Department of extending relief to broker-dealers and

a function of which is to regulate the participation of its members in activities listed above.

<sup>9</sup> The following discussion of proposed conditions is limited to conditions which are new or have been modified from the conditions of PTE 81-6.

banks that are subject to regulation in other countries. In this regard, we note that a sufficient showing must be made that collateral offered to plans will be held in a manner that will ensure that the plan's interest in such collateral will be adequately protected. In addition, information is needed on whether broker-dealers and banks in countries other than the UK are subject to a scheme of regulatory oversight comparable to that found in the United States. The Department invites interested persons to comment on these issues. Specifically, we request comments on the following: (1) The regulatory oversight of broker-dealers and banks in countries other than the UK; (2) the entities that are used in these countries to hold collateral on behalf of the plan while the securities loan is outstanding, and (3) whether these entities' have practices and policies designed to protect the plan's interest in the collateral and are subject to government supervision and oversight.

Section III of the proposed exemption contains additional conditions that are applicable to securities lending transactions with Foreign Broker-Dealers and Foreign Banks. Section III(a) requires that the lending fiduciary maintain the situs of the loan agreement in accordance with the indicia of ownership requirements under section 404(b) of ERISA and the regulations promulgated under 29 CFR 2550.404(b)-1. Further, section III(b) requires that a foreign borrower agree to submit to the jurisdiction of the district courts or the United States, and agree that the plan may in its sole discretion enforce the agreement in a U.S. court. It is the Department's understanding, that in the event the borrower were to default, the plan generally would be able to secure a judgment in the United States which would be enforceable in a UK court.

As an alternative to the Foreign Broker-Dealer or Foreign Bank agreeing to submit to the jurisdiction of the United States courts, the lending fiduciary may, if domiciled in the United States, agree to indemnify and hold harmless each plan against any shortfall in the collateral or losses incurred by the plan arising from a borrower's default.

#### Miscellaneous Issues

The Department has received an inquiry regarding whether the relief provided by the proposed exemption would apply to securities loaned by plans pursuant to "exclusive securities lending arrangements." Under these exclusive arrangements, a lender (in this case, a plan) agrees to make a specific

portfolio of securities (that are owned by the plan) available exclusively to a specific borrower for a specific period of time. The borrower is given exclusive access to all of the securities in the portfolio and can borrow such securities as and when the borrower determines that it wishes to do so. The securities may not be lent to another person. However, the existence of an exclusive arrangement will not have any impact on the investment management decisions of the portfolio. Thus, the securities in the portfolio may continue to be purchased and sold without regard to the exclusive arrangement. Neither the borrower nor any of its affiliates has any discretionary authority or control with respect to the management of the portfolio, or with respect to the decision to cause the plan to enter into an exclusive arrangement or to negotiate the terms of such arrangement on behalf of the plan. The exclusive arrangement will be negotiated on behalf of the lending plan by a fiduciary who is independent of the borrower. However, under the terms of an exclusive arrangement, the borrower has a contractual right to borrow any of the securities included in the portfolio at any time during the agreed upon period. In exercising this right, the borrower is acting as a counterparty pursuant to the written loan agreement and not as a fiduciary.

Under these exclusive arrangements, compensation is paid by the borrower to the plan and may consist of one or more components. The first component generally is a fee paid by the borrower to the plan for the exclusive right to borrow the securities in the portfolio and may consist of either a flat fee (which may be equal to a percentage of the value of the total securities in the portfolio), or a periodic payment that is equal to a percentage of the value of the total balance of outstanding borrowed securities or a combination of both. A second component of the fees may include the plan's right to (a) retain a portion of the investment earnings generated by its investment of cash collateral received from the borrower and rebate the remaining earnings to the borrower, (b) retain all the investment earnings generated by its investment of the cash collateral and pay a rebate fee to the borrower; or (c) receive a lending fee paid by the borrower with respect to securities loans collateralized with non-cash collateral (based on the value of the borrowed securities and the duration of the particular loan.) The fees may be different for different securities or different groups of securities subject to the exclusive arrangement. These two

types of fees may be both paid to the plan, or offset against amounts due to the lender.

The Department is of the view that such exclusive securities lending arrangements would be covered by the relief provided in the proposed exemption, and, accordingly, has clarified section II(e)(1) of the proposal to more explicitly encompass a variety of compensation methods.<sup>11</sup>

The Department notes that ERISA's general standards of fiduciary conduct also would apply to any proposed securities lending arrangements. Section 404 requires a fiduciary, among other things, to discharge his or her duties respecting a plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion. Accordingly, the plan's fiduciary, in deciding to approve the lending of securities to a Foreign Bank or Foreign Broker-Dealer, should fully understand the risks involved in this particular type of securities lending. The fiduciary should understand, for example, the additional risks involved in lending securities which are plan assets to a foreign financial institution, as well as, the risk associated with the receipt of collateral consisting of foreign currency or securities issued by a foreign country. In connection with the foregoing, the plan fiduciary should take into account any additional expenses and legal issues that may arise if a foreign borrower defaults and the plan fiduciary has to enforce and collect on a judgment in a foreign court.

#### Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department of Labor conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA 95) (44 U.S.C. 3506(c)(2)(A)). This helps to ensure that requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements on respondents can be properly assessed.

<sup>11</sup> In this regard, the Department notes that the proposed exemption does not provide relief from section 406(b) with respect to exclusive securities lending agreements. Accordingly, fees under an exclusive lending arrangement must be agreed to by the plan's independent fiduciary in advance of the implementation of the arrangement, or be determined pursuant to an objective formula.

Currently, the Department is soliciting comments concerning the proposed revision of the information collection request (ICR) included in this Notice of Proposed Amendment to PTE 81-6 and Proposed Restatement and Redesignation of PTE 82-63. A copy of the ICR may be obtained by contacting Gerald B. Lindrew, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue, NW, Room N-5647, Washington, DC 20210. Telephone (202) 693-8410; Fax: (202) 219-4745. These are not toll-free numbers.

The Department has submitted a copy of the proposed information collection to OMB in accordance with 44 U.S.C. 3507(d) for review of its information collections. The Department and OMB are particularly interested in comments that:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Comments should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Employee Benefits Security Administration. Although comments may be submitted through December 22, 2003 OMB requests that comments be received within 30 days of publication of the Notice of Proposed Rulemaking to ensure their consideration.

The proposed amendment and restatement of existing exemptions was requested in two applications, one submitted by the ABA and a second submitted by RMA. The applicants requested that PTE 81-6, which currently provides exemptive relief from section 406(a)(1)(A) through (D) of ERISA and Code section 4975(c)(1)(A) through (D) for the lending of securities

by employee benefit plans to banks and broker-dealers registered under the Securities Exchange Act of 1934, or broker-dealers exempted from registration under section 15(a)(1) of the 1934 Act as a dealer in exempted government securities that are parties in interest with respect to such plans, be broadened to exempt certain foreign banks and broker-dealers and to permit additional forms of collateral. In response to the applications, and provided that certain conditions outlined in the proposed exemption are met, the Department proposes to amend PTE 81-6 to also exempt the lending of securities by employee benefit plans to foreign banks and broker dealers and to provide for the receipt of additional forms of collateral.

PTE 82-63, used in conjunction with PTE 81-6, exempts certain compensation arrangements for the provision of securities lending services by a plan fiduciary to an employee benefit plan provided that the lending fiduciary is authorized to engage in lending transactions on behalf of the plan and the other conditions of the exemption are met. The Department has amended PTE 81-6 and incorporated PTE 82-63 in this proposed exemption. The Department also gives notice of its revocation of PTE 81-6 and PTE 82-63. The ICR for the proposed exemption restates and combines existing ICRs previously approved<sup>12</sup> in PTE 81-6 (1210-0065) and PTE-82-63 (1210-0062) but with a program change to reflect both the addition of foreign broker-dealers and banks as potential borrowers and the related changes in conditions applicable to these borrowers, and an adjustment in the burden estimates of the number of respondents based on updated and corrected information. This ICR constitutes a revision of both PTE 81-6 and PTE 82-63, in that the two exemptions are combined and revised. Continued approval has been requested under control number 1210-0065; the control number 1210-0062 will be removed from OMB inventory when OMB approval of the information collection provision of this revised exemption is received.

The Department estimates that there are approximately 13,913 borrowers that might take advantage of the class exemption. Generally, a plan is authorized to lend securities to two groups of broker dealers and banks as these are defined in the proposed amended and restated exemption—U.S.

Broker-Dealers and reporting dealers<sup>13</sup> and U.S. Banks, and Foreign Broker-Dealers and Foreign Banks regulated under the laws of the United Kingdom (UK). According to the Securities and Exchange Commission, 7,900 broker-dealers were registered as members at the close of FY 2001. Not all member broker-dealers perform services for employee benefit plans, and, among those broker-dealers that perform services for employee benefit plans, only those that borrow plans securities will make use of the exemption. Although fewer broker-dealers than are registered with the SEC may actually make use of the proposed exemption, the Department has conservatively based its burden analysis on the total number of broker-dealers that could borrow securities. There are also about 6,000 U.S. banks that might choose to take advantage of the restated exemption; the Department has conservatively assumed that all U.S. banks with trust powers will engage in borrowing securities. The applicants have indicated that 5 UK broker-dealers and 8 UK banks are also likely to borrow securities. Therefore, approximately 13,913 broker-dealers and banks might borrow securities under the proposed exemption.

The proposed exemption provides that before a plan can lend securities: the borrower must provide the plan with a financial statement; the transaction or series of transactions must be described in a written agreement; and, the compensation for the Lending Fiduciary must be described in a written agreement.

Furnishing a financial statement to the plan. The Department has not accounted for an hour or cost burden for preparing financial statements because borrowers of securities will have already prepared the statements required under the exemption in order to comply with SEC and FSA rules. It is assumed that borrowers will incur costs of \$1 per mailing and 2 minutes of administrative time to distribute financial statements quarterly in order to comply with the conditions of the proposed exemption. This provision is expected to require 1,855 hours and \$56,000 annually.

*Providing a written agreement covering the transaction or series of transactions.* The Department understands that it is customary business practice for agreements related to the lending of securities to be set

<sup>12</sup> Approval for the ICR included in PTE 81-6 expires on July 31, 2004; approval for the ICR included in PTE 82-63 expires on June 30, 2004.

<sup>13</sup> Reporting dealers covered by the exemption are not accounted for separately because they are bond and security brokerages that trade in U.S. Government Securities; thus, reporting dealers are already accounted for in the number of broker-dealer firms and banks.

forth in writing. The burden estimate allows for one half hour per year to review written lending agreements for compliance with this proposed exemption, and two minutes per agreement for distribution.<sup>14</sup>

**Compensation.** The proposed exemption provides that the compensation paid to a Lending Fiduciary must be reasonable and must be in accordance with the terms of a written agreement. As permitted under section IV(c) of the proposed exemption, the compensation agreement will most likely be written in the form of a master agreement covering a series of securities lending transactions at the time the Lending Fiduciary's services are engaged. Entering into such an agreement is also customary business practice; however, the Department has allowed in its estimates for one half hour per compensation agreement for review of compliance with this proposed exemption and two minutes per agreement for distribution.

For both the lending and compensation agreements, the hour burden for U.S. broker-dealers and U.S. banks, at 32 minutes per agreement, is 14,827 hours; for UK broker-dealers and UK banks, at 122 minutes per agreement, the hour burden is 53 hours. The total hour burden for the lending and compensation agreements is 14,880 hours.

**Type of Review:** Revision of a currently approved collection. Agency: Employee Benefits Security Administration, Department of Labor.

**Title:** Securities Lending Prohibited Transaction Exemption.

**OMB Number:** 1210-0065.

**Affected Public:** Business or other for-profit, Not-for-profit institutions, Individuals.

**Total Respondents:** 13,913.

**Frequency:** On occasion.

**Total Responses:** 83,478.

**Estimated Total Burden Hours:** 16,735.

**Estimated Burden Cost:** \$56,000.

### 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 ERISA and the Code. These provisions include any prohibited transaction provisions to which the exemption does

not apply and the general fiduciary responsibility provisions of section 404 of ERISA which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of ERISA; 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 any exemption may be granted under section 408(a) of ERISA 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 its participants and beneficiaries, and protective of the rights of the participants and beneficiaries of the plan;

(3) This proposed exemption, if granted, will be supplemental to, and not in derogation of, any other provisions of ERISA 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; and

(4) If granted, the pending class exemption will be applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

### Written Comments

All interested persons are invited to submit written comments or requests for a hearing on the proposed exemption to the address and within the time period set forth above. All comments and requests for a hearing will be made a part of the record. Comments and requests for a hearing should state the reasons for the writer's interest in the proposed exemption. Comments received will be available for public inspection with the application for exemption at the address set forth above.

### Proposed Exemption

On the basis of the facts and representations set forth in the application, the Department proposes to grant the following exemption under the authority of section 408(a) of ERISA and section 4975(c)(2) of the Code and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, August 10, 1990).

### I. Transactions

(a) Effective (60-days after the date of publication of the final class exemption in the **Federal Register**), the restrictions of section 406(a)(1)(A) through (D) of the Act 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 not apply to the lending of securities that are assets of an employee benefit plan to a "U.S. Broker-Dealer" or to a "U.S. Bank", provided that the conditions set forth in section II below are met.

(b) Effective (60-days after the date of publication of the final class exemption in the **Federal Register**), the restrictions of section 406(a)(1)(A) through (D) of the Act 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 not apply to the lending of securities that are assets of an employee benefit plan to a "Foreign Broker-Dealer" or "Foreign Bank", provided that the conditions set forth in sections II and III below are met.

(c) Effective (60-days after the date of publication of the final class exemption in the **Federal Register**), the restrictions of section 406(b)(1) of ERISA and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(E) of the Code shall not apply to the payment to a fiduciary (the Lending Fiduciary) of compensation for services rendered in connection with loans of plan assets that are securities, provided that the conditions set forth in section IV below are met.

### II. General Conditions

(a) Neither the borrower nor any affiliate of the borrower has or exercises discretionary authority or control with respect to the investment of the plan assets involved in the transaction, or renders investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to those assets;

(b)(1) The plan receives from the borrower by the close of the Lending Fiduciary's business on the day in which the securities lent are delivered to the borrower:

(A) "U.S. Collateral" having, as of the close of business on the preceding business day, a market value or, in the case of bank letters of credit, a stated amount, equal to not less than 100 percent of the then market value of the securities lent, or

(B) "Foreign Collateral" having as of the close of business on the preceding business day, a market value or, in the case of bank letters of credit, a stated amount, equal to not less than:

(i) 102 percent of the then market value of the securities lent as valued on

<sup>14</sup> Estimates of 2 hours rather than 30 minutes are used for both lending and compensation agreements involving UK banks and UK broker-dealers.

a recognized securities exchange (as defined in section V(j)) or an automated trading system (as defined in V(k)) on which the securities are primarily traded if the collateral posted is denominated in the same currency as the securities lent; or

(ii) 105 percent of the then market value of the securities lent as valued on a recognized securities exchange (as defined in section V(j)) or an automated trading system (as defined in V(k)) on which the securities are primarily traded if the collateral posted is denominated in a different currency than the securities lent;

(2) If the borrower is a U.S. Bank or U.S. Broker-Dealer, the Plan receives such U.S. Collateral or Foreign Collateral from the borrower by the close of the Lending Fiduciary's business on the day in which the securities are delivered to the borrower. Such collateral is received by the plan either by physical delivery, wire transfer or by book entry in a securities depository located in the United States;

(3) If the borrower is a Foreign Bank or Foreign Broker-Dealer, the plan receives U.S. Collateral or Foreign Collateral from the borrower by the close of the Lending Fiduciary's business on the day in which the securities are delivered to the borrower. Such collateral is received by the plan either by physical delivery, wire transfer or by book entry in a securities depository located in the United States or held on behalf of the plan at an Eligible Securities Depository. The indicia of ownership of such collateral shall be maintained in accordance with ERISA section 404(b) and regulation 29 CFR 2550.404b-1.

(c) Prior to making of any such loan, the borrower shall have furnished the Lending Fiduciary with:

(1) The most recent available audited statement of the borrower's financial condition, as audited by a United States certified public accounting firm or in the case of a Foreign Broker-Dealer or Foreign Bank, a firm which is eligible for appointment as a company auditor under the laws of the United Kingdom;

(2) The most recent available unaudited statement of its financial condition (if the unaudited statement is more recent than such audited financial statement); and

(3) A representation that, at the time the loan is negotiated, there has been no material adverse change in its financial condition since the date of the most recent financial statement furnished to the plan that has not been disclosed to the Lending Fiduciary. Such representations may be made by the borrower's agreeing that each such loan

shall constitute a representation by the borrower that there has been no such material adverse change;

(d) The loan is made pursuant to a written loan agreement, the terms of which are at least as favorable to the plan as an arm's-length transaction with an unrelated party would be. Such loan agreement identifies the currency in which the payment of any fees described in section II(e) below, will be made to the plan, and states that the plan has a continuing security interest in, title to, or the rights of a secured creditor with respect to the collateral. Such agreement may be in the form of a master agreement covering a series of securities lending transactions;

(e) In return for lending securities, the plan:

(1) receives a reasonable fee (in connection with the securities lending transaction) and/or

(2) Has the opportunity to derive compensation through the investment of the currency collateral. Where the plan has that opportunity, the plan may pay a loan rebate or similar fee to the borrower, if such fee is not greater than the plan would pay in a comparable transaction with an unrelated party.

The combined total of all fees and other consideration received by the plan in connection with securities lending transactions is reasonable.

(f) The plan receives the equivalent of all distributions made to holders of the borrowed securities during the term of the loan including, but not limited to, dividends, interest payments, shares of stock as a result of stock splits and rights to purchase additional securities;

(g) If the market value of the collateral at the close of trading on a business day is less than the applicable percentage (described in section II b(1) of the exemption) of the market value of the borrowed securities at the close of trading on that day, the borrower shall deliver, by the close of business on the following business day, an additional amount of U.S. Collateral or Foreign Collateral the market value of which, together with the market value of all previously delivered collateral, equals at least the applicable percentage of the market value of all the borrowed securities as of such preceding day.

Notwithstanding the foregoing, part of the U.S. Collateral or Foreign Collateral may be returned to the borrower if the market value of the collateral exceeds the applicable percentage (described in section II(b)(1) of the exemption) of the market value of the borrowed securities, as long as the market value of the remaining U.S. Collateral or Foreign Collateral equals at least the applicable

percentage of the market value of the borrowed securities;

(h) The loan may be terminated by the plan at any time, whereupon the borrower shall deliver certificates for securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the plan within the lesser of:

(1) The customary delivery period for such securities,

(2) Five business days, or

(3) The time negotiated for such delivery by the plan and the borrower.

(i) In the event that the loan is terminated, and the borrower fails to return the borrowed securities or the equivalent thereof within the applicable time described in section II(h) above, the plan may, under the terms of the loan agreement:

(1) Purchase securities identical to the borrowed securities (or their equivalent as described above) and may apply the collateral to the payment of the purchase price, any other obligations of the borrower under the agreement, and any expenses associated with the sale and/or purchase, and

(2) The borrower is obligated, under the terms of the loan agreement, to pay, and does pay to the plan the amount of any remaining obligations and expenses not covered by the collateral, including reasonable attorney's fees incurred by the plan for legal action arising out of default on the loans, plus interest at a reasonable rate.

Notwithstanding the foregoing, the borrower may, in the event the borrower fails to return borrowed securities as described above, replace collateral, other than U.S. currency, with an amount of U.S. currency that is not less than the then current market value of the collateral, provided such replacement is approved by the Lending Fiduciary.

If the borrower fails to comply with any provision of a loan agreement which requires compliance with this exemption, the plan fiduciary who caused the plan to engage in such transaction shall not be deemed to have caused the plan to engage in a transaction prohibited by section 406(a)(1)(A) through (D) of the Act solely by reason of the borrower's failure to comply with the conditions of the exemption.

### III. Specific Conditions For Transactions Described in Section I(b)

(a) The Lending Fiduciary maintains the written documentation for the loan agreement at a site within the

jurisdiction of the courts of the United States.

(b) Prior to entering into a transaction involving a Foreign Broker-Dealer or Foreign Bank either:

(1) The Foreign Broker-Dealer or Foreign Bank agrees to submit to the jurisdiction of the United States; agrees to appoint an agent for service of process in the United States, which may be an affiliate (the Process Agent); consents to service of process on the Process Agent; and agrees that any enforcement by a plan of its rights under the securities lending agreement will, at the option of the plan, occur exclusively in the United States courts; or

(2) The Lending Fiduciary, if domiciled in the United States, agrees to indemnify and hold harmless each plan against any shortfall in the collateral, (as clearly set forth in the applicable lending agreement), plus interest and any transaction costs incurred (including attorney's fees of the plan arising out of the default on the loans or the failure to indemnify properly under this provision) which the plan may incur or suffer directly arising out of the lending of securities of such plan to a Foreign Broker-Dealer or Foreign Bank.

#### IV. Specific Conditions for Transactions Described in Section II(c)

(a) The loan of securities is not prohibited by section 406(a) of ERISA or otherwise satisfies the conditions of this exemption.

(b) The Lending Fiduciary is authorized to engage in securities lending transactions on behalf of the plan.

(c) The compensation is reasonable and is paid in accordance with the terms of a written instrument, which may be in the form of a master agreement covering a series of securities lending transactions.

(d) Except as otherwise provided in section IV(f), the arrangement under which the compensation is paid: (1) is subject to the prior written authorization of a plan fiduciary (the "authorizing fiduciary"), who is (other than in the case of a plan covering only employees of the Lending Fiduciary or any affiliates of such fiduciary) independent of the Lending Fiduciary and of any affiliate thereof, and (2) may be terminated by the authorizing fiduciary within (A) the time negotiated for such notice of termination by the plan and the Lending Fiduciary, or (B) five business days, whichever is less, in either case without penalty to the plan.

(e) No such authorization is made or renewed unless the Lending Fiduciary shall have furnished the authorizing fiduciary with any reasonably available

information which the Lending Fiduciary reasonably believes to be necessary to determine whether such authorization should be made or renewed, and any other reasonably available information regarding the matter that the authorizing fiduciary may reasonably request; and

(f) (Special Rule for Commingled Investment Funds) In the case of a pooled separate account maintained by an insurance company qualified to do business in a state or a common or collective trust fund maintained by a bank or trust company supervised by a state or federal agency, the requirements of section IV(d) of this exemption shall not apply, provided that:

(1) The information described in section IV(e) (including information with respect to any material change in the arrangement) shall be furnished by the Lending Fiduciary to the authorizing fiduciary described in section IV(d) with respect to each plan whose assets are invested in the account or fund, not less than 30 days prior to implementation of the arrangement or material change thereto, and, where requested, upon the reasonable request of the authorizing fiduciary;

(2) In the event any such authorizing fiduciary submits a notice in writing to the Lending Fiduciary objecting to the implementation of, material change in, or continuation of the arrangement, the plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the account or fund, without penalty to the plan, within such time as may be necessary to effect such withdrawal in an orderly manner that is equitable to all withdrawing plans and to the non-withdrawing plans. In the case of a plan that elects to withdraw pursuant to the foregoing, such withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a plan electing to withdraw; and

(3) In the case of a plan whose assets are proposed to be invested in the account or fund subsequent to the implementation of the compensation arrangement and which has not authorized the arrangement in the manner described in sections IV(f)(1) and IV(f)(2), the plan's investment in the account or fund shall be authorized in the manner described in section IV(d)(1).

#### V. Definitions

For purposes of this exemption:

(a) The term "U.S. Broker-Dealer" means a broker-dealer registered under the Securities Exchange Act of 1934 (the

1934 Act) or exempted from registration under section 15(a)(1) of the 1934 Act as a dealer in exempted government securities (as defined in section 3(a)(12) of the 1934 Act).

(b) The term "U.S. Bank" means a bank as defined in section 202(a)(2) of the Investment Advisers Act.

(c) The term "Foreign Broker-Dealer" means a broker-dealer registered and regulated under the laws of the Financial Services Authority in the United Kingdom that has as of the last day of its most recent fiscal year, equity capital which is equivalent of no less than \$200 million.

(d) The term "Foreign Bank" means an institution having substantially similar powers to a bank as defined in section 202(a)(2) of the Investment Advisers Act, is subject to regulation by the Financial Services Authority in the United Kingdom and has as of the last day of its most recent fiscal year, equity capital which is equivalent of no less than \$200 million.

(e) The term "U.S. Collateral" means U.S. currency, securities issued or guaranteed by the United States government or its agencies or instrumentalities, or irrevocable letters of credit issued by a U.S. Bank other than the borrower or an affiliate thereof, or any combination, thereof.

(f) The term "Foreign Collateral" means the currency of the United Kingdom, Euros, securities issued or guaranteed by the government of the United Kingdom or one of its agencies or instrumentalities, sovereign debt of a member country of the EMU that is denominated in Euros, or irrevocable letters of credit issued by a Foreign Bank, other than the borrower or an affiliate thereof, which has a counterparty rating of investment grade or better as determined by a nationally recognized statistical rating organization.

(g) The term "affiliate" of another person means: (1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person; (2) any officer, director, partner, employee, or relative (as defined in section 3(15) of ERISA) of such other person; and (3) any corporation or partnership of which such other person is an officer, director, partner or employee.

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

(i) The term "Eligible Securities Depository" means an eligible securities depository as that term is defined under

Rule 17f-7 of the Investment Company Act of 1940 [15 U.S.C. 80a], as such definition may be amended from time to time.

(j) The term “recognized securities exchange” means a U.S. securities exchange that is registered as a “national securities exchange” under section 6 of the Securities and Exchange Act of 1934 (15 U.S.C. 78f) or a designated offshore securities market as defined in Regulation S of the Securities Act of 1933 [17 CFR part 230.902(B)], as such definition may be amended from time to time, which performs with respect to securities, the functions commonly performed by a stock exchange within the meaning of the definitions under the applicable securities laws (e.g., 17 CFR part 240.3b-16).

(k) The term “automated trading system” means an electronic trading system that functions in a manner intended to simulate a securities exchange by electronically matching orders on an agency basis from multiple buyers and sellers such as an “alternative trading system” within the meaning of SEC’s Reg. ATS [17 CFR part 242.300] as such definition may be amended from time to time, or an “automated quotation system” as described in section 3(a)(51)(A)(ii) of the Securities and Exchange Act of 1934 [15 U.S.C. 78c(a)(51)(A)(ii)].

Signed at Washington, DC, this 17th day of October, 2003.

**Ivan L. Strasfeld,**

*Director, Office of Exemption Determinations,  
Employee Plan Benefits Administration, U.S.  
Department of Labor.*

[FR Doc. 03-26694 Filed 10-22-03; 8:45 am]

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