INVESTMENT COMPANY INSTITUTE

MEMO# 13809

August 9, 2001

DOL PROPOSES INDIVIDUAL EXEMPTION FOR EXTENSIONS OF CREDIT IN CONNECTION WITH REDEMPTIONS FROM UNITIZED FUNDS

[13809] August 9, 2001 TO: PENSION COMMITTEE No. 54-01 RE: DOL PROPOSES INDIVIDUAL EXEMPTION FOR EXTENSIONS OF CREDIT IN CONNECTION WITH REDEMPTIONS FROM UNITIZED FUNDS The Department of Labor has published a proposed individual exemption for certain extensions of credit by Riggs Bank, N.A. (the "Bank") to participant-directed individual account plans in order to facilitate redemptions from certain unitized funds. The proposed exemption would provide relief from ERISA section 406(a) for (a) the extension of credit by the Bank to a plan; and (b) the plan's repayment of such extension of credit, plus accrued interest. Comments concerning the proposed exemption must be submitted by September 13, 2001. According to the summary of facts and representations supporting the proposed exemption, the Bank provides "unitization" services to employee benefit plans, which facilitate daily trading of plan investment options that would otherwise not be able to be traded or settled within one day. A Unitized Fund generally consists of an investment that is not traded on a daily basis (e.g., company stock, a guaranteed investment contract, or a plan account managed by an investment manager) and liquid investments (e.g., money market fund shares). Unitization services permit daily transactions by establishing "units" representing undivided interests in all of the assets of the Unitized Fund. When cash is required to settle transactions in units resulting from participant withdrawals and exchanges from a Unitized Fund, the cash requirements are satisfied first from the liquid investments, and then shares of the Unitized Fund investments may be sold to restore the liquidity. From time to time, the Bank may be required to reject all requests for unit redemptions for a particular business day and immediately proceed to sell assets to obtain the necessary liquidity. Once actual liquidity is increased sufficiently, the Bank may notify the plan recordkeeper to resubmit the redemption orders. The Bank proposes to avoid the administrative difficulties and expense of rejecting unit redemptions due to insufficient liquidity by offering plans the opportunity to receive short-term cash advances from the Bank if the cash portion of a Unitized Fund is insufficient to cover unit redemption requests on a particular business day. The notice of proposed exemption notes that the Bank would not have any discretionary authority or control or provide any investment advice with respect to the selection of the assets of a Unitized Fund, or provide any asset 2allocation or other services that may affect or influence participant transactions involving a Unitized Fund. The summary of facts and representations states that such extensions of credit and the payment of interest by the plans could raise issues under section 406(a) of ERISA, because the Bank is a service provider to the plans. According to

the Department of Labor’s notice of proposed exemption, a copy of which is attached, the exemption would be subject to certain conditions, including the following: • Each advance must be made in accordance with the terms of a written agreement (the Agreement) that describes terms and procedures for the advances and is approved in writing by a fiduciary of the plan that is independent of the Bank; • Interest payable by the plan on each advance must be determined in accordance with any objective formula or method described in the Agreement; • The plan must repay each advance and accrued interest in accordance with the terms of the Agreement within 10 business days after the initiation of the advance; • The aggregate amount advanced must not exceed 25 percent of the total market value of the Unitized Fund; • The Agreement may be terminated at any time by the independent plan fiduciary, subject to the plan’s repayment of any outstanding advances; • The advances must be made on terms at least as favorable to the plan as those the plan could obtain in an arm’s-length transaction with an unrelated party; • Neither the Bank nor any affiliate has or exercises any discretionary authority or control with respect to the initiation of an advance, the amount of an advance, the interest payable on an advance, or the repayment of the advance; and • Neither the Bank nor any affiliate is (1) a trustee of the plan (other than a nondiscretionary trustee who does not render investment advice with respect to the assets of the Unitized Fund), (2) a plan administrator, (3) a fiduciary who is expressly authorized in writing to manage, acquire or dispose of on a discretionary basis any assets of the Unitized Fund, or (4) an employer any of whose employees are covered by the plan. Kathy D. Ireland Associate Counsel Attachment 3Attachment (in .pdf format)
