

**MEMO# 13197**

February 23, 2001

## **DOL PUBLISHES FINAL INDIVIDUAL EXEMPTION FOR PLAN'S IN-KIND TRANSFER OF SECURITIES IN EXCHANGE FOR MUTUAL FUND SHARES**

[13197] February 23, 2001 TO: PENSION COMMITTEE No. 15-01 AD HOC COMMITTEE ON CROSS-TRADES AD HOC COMMITTEE ON INVESTMENT ADVICE RE: DOL PUBLISHES FINAL INDIVIDUAL EXEMPTION FOR PLAN'S IN-KIND TRANSFER OF SECURITIES IN EXCHANGE FOR MUTUAL FUND SHARES The Department of Labor has published a final individual exemption, which provides relief from ERISA sections 406(a) and (b) for an employee benefit plan's in-kind transfer of securities to mutual funds advised by SEI Investments or its affiliates ("SEI"), in exchange for shares of such mutual funds. In addition, the exemption treats a plan's purchase of fund shares pursuant to the arrangement as a "purchase or sale" of shares of an open-end investment company for purposes of prohibited transaction exemption (PTE) 77-4.1 The final exemption is substantially similar to the proposed exemption published last year.<sup>2</sup> SEI serves as investment adviser to a number of mutual funds, and also as investment manager or trustee to qualified plans. Under SEI's program, an independent fiduciary of a plan may retain SEI as the plan's investment manager, or SEI may serve in a more limited capacity, such as developing the "asset allocation strategy" for the plan. SEI requested the individual exemption to address the transfer of assets of a plan to an account maintained by SEI, for example, in cases where an independent plan fiduciary terminates an agreement with a prior investment manager and retains SEI to serve as the investment manager or directed trustee. Specifically, if a plan's existing portfolio includes securities that are suitable for investment in a fund advised by SEI, the final exemption allows the transfer of such securities in-kind to the relevant fund, rather than requiring the liquidation of the securities prior to the transfer. In 1 PTE 77-4 generally permits the purchase and sale by an employee benefit plan of mutual fund shares when a fiduciary of the plan is also the investment adviser for the mutual fund. See 42 Fed. Reg. 18732 (Apr. 3, 1977). <sup>2</sup> See Institute Memorandum to Pension Committee No. 85-00, Ad Hoc Committee on Cross-Trades, and Ad Hoc Committee on Investment Advice, dated November 3, 2000. SEI submitted the only written comment in response to the proposed exemption. Notable modifications reflected in the final exemption, which are based on SEI's comments, are discussed below. <sup>2</sup>exchange, the plan would receive shares in the fund that are equal in value to the transferred securities.<sup>3</sup> The final exemption's requirements are, for the most part, identical to those in the proposed exemption. The final exemption, however, clarifies certain representations made by SEI regarding the nature of its program and the transactions involved. Modifications reflected in the final exemption (all of which were requested by SEI) include the following: • The proposed exemption had contemplated SEI's

use of unaffiliated sub-advisers, although SEI had represented that it may consider retaining affiliated sub-advisers in the future. The final exemption notes that since the time the original representation was made to the Department, SEI has retained a sub-adviser in which SEI has an ownership interest. • The final exemption clarifies SEI's position regarding the type of fiduciary it may become as a result of its activities. In the final exemption, SEI represents that it does not become a "discretionary investment management fiduciary until after the [independent fiduciary] has specified which portion of the Plan's assets" will be allocated to SEI's account. Furthermore, SEI represents that it "may become a nondiscretionary investment advisory fiduciary with respect to a particular pool of assets (e.g., helping the Plan develop its [asset allocation strategy]) before those assets are 'converted' into Fund shares." • In the final exemption, SEI represents that its client agreements are structured to avoid undertaking fiduciary responsibility until after the completion of the "purchase transaction," and that therefore, it believes no exemptive relief is necessary. However, because of uncertainty about "whether its services prior to the completion of a purchase transaction might involve the provision of investment advice, SEI maintains its request that the exemption be made retroactive to June 19, 1996" to cover transactions that have occurred since that time. • The final exemption reflects SEI's requested clarification that where SEI's "plan-level" investment management fees include a performance fee, the performance fee factors are not actively negotiated with each client plan. Rather, "the use of a performance fee and its terms are always open to negotiation at the request of the client plan." • The proposed exemption had stated that SEI's practice was to credit back fees for "secondary services" (e.g., custodial, accounting, administrative or brokerage services) to plans in the same manner as it credits back its "fund-level" advisory fees, but that SEI reserved the right to retain such fees in the future in accordance with Advisory Opinions 93-12A and 93-13A. In the final exemption, SEI represents that it has exercised its right to retain some fees for secondary services in accordance with the referenced advisory opinions. 3 Whether a portfolio of securities is suitable for an in-kind transfer would be determined by sub-advisers retained by SEI to manage its funds. The transfer also must be consistent with pre-established, objective procedures that are approved by the fund's board of trustees. 3 • The final exemption modifies the disclosure requirements for situations where SEI or an affiliate executes brokerage transactions for affiliated mutual funds. Unlike the disclosure requirements in the proposed exemption, the final exemption does not require disclosures beyond that required by PTE 77-4 in connection with the provision of such brokerage services. The final exemption, however, notes that in providing these services, "SEI is relying on the provisions of PTE 77-4 which contain separate disclosure requirements as they pertain to fees and that no relief is provided under this exemption for SEI's receipt of fees" from the mutual funds. The final exemption is effective June 19, 1996, the effective date provided in the proposed exemption. A copy of the final individual exemption is attached. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format)