

MEMO# 11662

February 22, 2000

DOL ISSUES PROPOSED PROHIBITED TRANSACTION EXEMPTIONS FOR UNDERWRITING

[11662] February 22, 2000 TO: PENSION COMMITTEE No. 15-00 RE: DOL ISSUES PROPOSED PROHIBITED TRANSACTION EXEMPTIONS FOR UNDERWRITING

The Department of Labor has issued a proposed individual exemption applicable to five financial services firms engaged in underwriting activity. Specifically, the exemption would permit purchases of securities by asset managers on behalf of employee benefit plans ("plans" or "client plans") for which the asset manager is a fiduciary, from underwriting syndicates in which a broker-dealer affiliate of the asset manager participates as a manager or syndicate member. This is a proposed exemption for which written comments may be submitted to the Department of Labor by March 24, 2000. Generally, the exemptive relief proposed is similar to that provided by the Department in PTE 75-1, Part III, but differs in the following respects: (1) the proposed exemption covers transactions where the plan fiduciary is affiliated with a manager, as well as a member, of the underwriting syndicate; (2) the proposed exemption covers purchases of Rule 144A securities; (3) percentage limitations on the amount of securities that may be purchased have been modified to provide an aggregate limitation on a fiduciary's purchases for its client plans from a particular offering; and (4) the proposed exemption sets forth additional conditions, including the following: (a) the transaction cannot be part of an agreement or understanding designed to benefit the plan fiduciary or its affiliate, (b) neither the manager nor a member of the underwriting syndicate may receive any selling concessions with respect to the securities purchased for client plans by its affiliate, (c) prior to any purchase of securities on behalf of a client plan, certain disclosures are provided to an independent fiduciary of each client plan and written authorization obtained, (d) periodic reports regarding the covered transactions is provided to an independent fiduciary for each client plan, and (e) investing plans and their managers must meet minimum size requirements. 1 The Department notes that the requirement contained in PTE 75-1, Part III, that, if the consideration exceeds \$1 million, it may not exceed one percent of the plan's total assets has been eliminated to parallel the amendment in 1997 of SEC Rule 10f-3. 2 The conditions set forth in the exemption are as follows: Types of securities and offerings to which exemption applies. The exemption applies to a broad class of securities including, but not limited to, securities that are (1) part of an issue registered under the Securities Act of 1933, or if exempt from registration fall within certain specified categories; (2) registered under the Securities Exchange Act of 1934; or (3) part of an Eligible Rule 144A Offering. Additionally, the securities must be purchased for not more than the offering price within a specific time period, sold pursuant to a firm-commitment offering in which the syndicate members are committed to

purchasing all the securities being offered (subject to certain exceptions); and (4) the issuer of the securities generally must have been in continuous operation for not less than three years. Percentage limitations on the amount of purchased securities. The amount of the securities to be purchased on behalf of a particular plan or pooled fund (as defined in the exemption) cannot exceed three percent of the total amount of the securities being offered in the underwriting. Furthermore, the asset manager in the aggregate may purchase for all of its client plans, including pooled funds, no more than 10 percent of the total amount of equity securities being offered. The aggregate limit placed on debt securities is 35 percent or 25 percent, depending on the security's rating. Also, the consideration paid for the securities by a client plan or pooled fund cannot exceed three percent of the fair market value of the client plan or pooled fund's total net assets.¹ Underwriting Compensation. Any purchase by the asset manager may not be part of an agreement or understanding designed to benefit the asset manager or an affiliate. The affiliated broker-dealer may not receive any selling concession or other consideration that is based upon the amount of securities purchased by the asset manager's client plans, nor receive the portion of the fixed designation that is attributable to securities purchased under the exemption. The broker-dealer is not precluded, however, from receiving management or underwriting fees or other consideration not based on the amount of securities actually sold to the client plans. (Such fees, however, may not be increased to offset the reduction in compensation from selling concessions.) The broker-dealer must provide the asset manager with written certification of compliance with these requirements. Authorization/Disclosures/Termination Opportunity. The asset manager must obtain written authorization from an independent fiduciary of each client plan, including a fiduciary of each plan that invests in a pooled fund engaging in the purchase. Prior to the authorization certain disclosures, as specified in the exemption, must be provided to the independent fiduciary for each plan. Also, the asset manager annually must provide a termination form to enable the independent fiduciary to terminate the authorization without penalty. Periodic Reporting. The proposed exemption requires the asset manager to provide to the independent fiduciary of each plan a quarterly report containing information about the securities purchased under the exemption during the previous quarter. The report is modeled, in part, on Rule 10f-3. In addition to reporting items that would be reported under Rule 10f-3, however, the asset manager also must report the price at which any securities purchased during the reporting period were sold and the market value at the end of the reporting period of each security purchased during the reporting period. The asset manager also must report any instance during the reporting period where the manager was precluded from trading in any security purchased under the exemption because of its status as an affiliate of the broker-dealer. Minimum Size Requirements. The proposed exemption applies only to client plans with total net assets of at least \$50 million. In the case of a pooled fund, the \$50 million requirement is satisfied if 50 percent or more of the units of beneficial interest in the fund are held by plans having total net assets of at least \$50 million. In the case of an Eligible Rule 144A Offering, however, the minimum size requirement increases to \$100 million, and a pooled fund must qualify as a "qualified institutional buyer" (QIB) under Rule 144A. Finally, the proposed exemption applies only if the asset manager is a "qualified professional asset manager" (QPAM) as defined in PTE 84-14, with some modification, as explained in the exemption.

Russell Galer Senior Counsel Attachment