

MEMO# 12835

November 3, 2000

DOL ISSUES PROPOSED INDIVIDUAL EXEMPTION FOR PLAN'S IN-KIND TRANSFER OF SECURITIES IN EXCHANGE FOR MUTUAL FUND SHARES

[12835] November 3, 2000 TO: PENSION COMMITTEE No. 85-00 AD HOC COMMITTEE ON CROSS-TRADES AD HOC COMMITTEE ON INVESTMENT ADVICE RE: DOL ISSUES PROPOSED INDIVIDUAL EXEMPTION FOR PLAN'S IN-KIND TRANSFER OF SECURITIES IN EXCHANGE FOR MUTUAL FUND SHARES The Department of Labor has published a proposed individual exemption, which would provide 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, a plan's purchase of fund shares pursuant to such an arrangement would be treated as a "purchase or sale" of shares of an open-end investment company for purposes of prohibited transaction exemption (PTE) 77-4.1 Comments on the proposed exemption must be submitted by November 24, 2000. SEI serves as investment adviser to a number of open-end funds registered under the Investment Company Act of 1940, and also serves as investment manager or trustee to qualified pension plans. Under the program described in the proposed exemption, an independent fiduciary of a plan may retain SEI as the plan's investment manager or it may serve in a more limited capacity, such as developing the asset allocation strategy for a plan.² The proposed exemption would address transactions arising from the transfer of assets of a plan to an account maintained by SEI, which may occur, for instance, where an independent plan fiduciary terminates an agreement with a prior investment manager and retains SEI to serve as 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 proposed exemption would allow the transfer of such securities in-kind to the relevant fund, rather than requiring the liquidation of the securities prior to the transfer. In exchange, the plan would receive shares in the fund that are equal in value to the transferred assets. Whether a 1 PTE 77-4 generally permits the purchase and sale by an employee benefit plan of shares of a registered open-end investment company when a fiduciary of the plan is also the investment adviser for the mutual fund. See 42 Fed. Reg. 18732 (Apr. 3, 1977). ² SEI would work with an independent plan fiduciary to develop an asset allocation strategy based upon criteria such as the plan's investment goals and risk tolerance. To conform to the plan's investment strategy, SEI may rebalance the account periodically among the funds in which it has invested. The nature of the asset allocation strategy is described in greater detail in the proposed exemption. ²portfolio 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. Additionally, under the proposed exemption, SEI would be required to accept the entire securities portfolio, including securities that are not suitable for investment by the funds. SEI would liquidate such securities as soon as reasonably practicable and use the cash proceeds to purchase fund shares on behalf of the plan. The proposed exemption provides that any purchase of fund shares that complies with the exemption's requirements would be treated as a "purchase or sale" of shares of an open-end investment company for purposes of PTE 77-4 and would be deemed to satisfy paragraphs (a), (d) and (e) of Section II of PTE 77-4.3 Consistent with PTE 77-4, each plan that retains SEI as an investment manager would pay a plan-level investment management fee covering all services provided. The plan-level investment management fee may include a performance fee that is calculated and payable in accordance with the Department's previously issued advisory opinions.⁴ With respect to plan assets invested in funds advised by SEI, the plan's pro rata share of investment advisory fees paid to SEI by the funds would be credited against the plan-level fees. SEI also may be separately retained by a plan as a non-discretionary trustee or custodian where it is directed to invest by SEI (if it is the investment manager), by an independent fiduciary, or by plan participants and beneficiaries under ERISA section 404(c). In this capacity, SEI may receive fees only for its administrative, custodial and similar services. SEI may also receive other fund-level fees for administrative, transfer, accounting, distribution and other secondary fund costs, in accordance with the Department's prior advisory opinions.⁵ In addition to the restrictions above, the proposed exemption conditions relief from sections 406(a) and (b) of ERISA on a number of other requirements, such as:

- an independent plan fiduciary must direct and approve in writing the transfer of the assets of the plan to the corresponding fund in exchange for fund shares;
- the independent fiduciary must receive numerous initial and continuing disclosures relating to the transaction, including all of the disclosures required under PTE 77-46; 3 Section II(a) of PTE 77-4 requires that a plan may not pay a sales commission in connection with such purchase or sale. Section II(d) requires certain disclosures to be made to an independent plan fiduciary. Section II(e) requires that the independent fiduciary approve in writing purchases or sales of mutual fund shares on the basis of the disclosures given. 4 The proposed exemption cites ERISA Advisory Opinions 86-20A (Aug. 29, 1986), 86-21A (Aug. 29, 1986) and 89-28A (Sept. 25, 1989). 5 The proposed exemption cites ERISA Advisory Opinions 93-12A (Apr. 27, 1993) and 93-13A (Apr. 27, 1993). 6 Such disclosures would include (1) a current prospectus of the relevant funds, (2) a description of the fees charged to the plan, including the nature and extent of any differential between the rates of the fees paid by the fund and the fees rates otherwise payable by the plan to SEI, (3) a statement of the reasons why a transfer may be appropriate for the plan, (4) a statement of whether there are any limitations on SEI with respect to which plan assets may be invested in the funds, (5) the identity of all securities that are deemed suitable for transfer to the funds, and (6) the identity of all such securities that would be valued in accordance with the procedures set forth in Rule 17a-7(b)(4) under the Investment Company Act of 1940. 3• no sales commissions or other fees may be paid by the plan in connection with the transaction;
- all transferred assets are securities for which market quotations are readily available, or cash;
- with respect to assets transferred in-kind, the plan must receive fund shares that have a total net asset value equal to the value of the plan assets exchanged for such shares, based on the current market value of the assets at the close of business day on which the transaction occurs⁷;
- the combined total of all fees received by SEI for the provision of services to the plan in connection with the in-kind transfer may not exceed "reasonable compensation " within the meaning of ERISA section 408(b)(2);
- all dealings in connection with the transaction between the plan and the funds must be on a basis no less favorable to the plan than dealings between the fund and other shareholders; and
- SEI

must comply with a six-year recordkeeping requirement and make available such records for examination. Thomas T. Kim Assistant Counsel Attachment (in .pdf format) 7 Valuations must be based on independent sources in accordance with the procedures set forth in Rule 17a-7(b) under the Investment Company Act of 1940 and the procedures established by the funds pursuant to Rule 17a-7. Such procedures must require that all securities for which a current market price cannot be obtained from the last sale price for transactions reported on a recognized securities exchange or NASDAQ be valued based on an average of the highest current independent bid and lowest current independent offer, as of the close of business on the last business day prior to the transaction at issue, determined on the basis of reasonable inquiry from at least three sources that are broker-dealers or pricing services independent of SEI.

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