SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 231

[Release No. 33-6188]

Employee Benefit Plans; Interpretations of Statute

AGENCY: Securities and Exchange Commission.

ACTION: Interpretations of statute.

SUMMARY: The Commission has authorized the issuance of a release setting forth the views of its staff on the application of the Securities Act of 1933 to employee benefit plans. The purpose of the release is to provide guidance to the public and thereby assist employers and plan participants in complying with the Act.

FOR FURTHER INFORMATION CONTACT: Peter J. Romeo, Division of Corporation Finance, Securities and Exchange Commission, Washington, D.C. 20549, (202) 272-2573.

SUPPLEMENTARY INFORMATION: On January 16, 1979, the Supreme Court issued a decision in which it addressed for the first time in its history the application of the Securities Act of 1933 ("1933 Act") [15 U.S.C. 77a et seq.] to participation interests in a private pension plan. The decision, which was rendered in the case of *International Brotherhood of Teamsters* v. *Daniel ("Daniel")*,[1] has generated considerable controversy and comment.[2] Moreover, it has raised questions about the application of the Act to many types of employee benefit plans[3] not covered by the decision. In an effort to resolve the uncertainty which has developed and thereby assist employers and plan participants in complying with the 1933 Act, the Commission has authorized the issuance of this release setting forth the views of its Division of Corporation Finance (hereinafter, the "staff")[4] on the application of the Act to such plans.

The release initially discusses the circumstances under which interests in plans and related entities may be subject to the requirements of the 1933 Act. In this connection, an analysis is provided of the criteria to be used in determining when an offer or sale of a security will occur. There is also a discussion of the various exemptions from the Act's registration provisions that may be available for such offers or sales. This is followed by a brief discourse on the application of the Act both to the various types of securities transactions in which plans may engage

[1] 99 S. Ct. 790, —— U.S. —— (1979). In *Daniel*, the Supreme Court held that neither the 1933 Act nor the Securities Exchange Act of 1934 ("1934 Act") [15 U.S.C. 78a et seq.] apply to a compulsory, noncontributory pension plan.

[2] *See*, e.g., L. J. Haas, *Supreme Court in Daniel leaves open possibility that some plans may be subject to securities laws* J. Tax., 263-267 (May 1979); J. D. Mamorsky and T. L. O'Brien, *Securities Law and the Daniel Case*, Pension World (May 1979); H. S. Bloomenthal, *The ABC's of Employee Benefit Plans—D for Daniel*, Sec. Fed. Corp. L. Rep. Vol. 1, No. 3 at 17 (March 1979); B. W. Nimkin, *Noncontributory Benefit Plans*, Rev. Sec. Reg., Vol. 12:4 (February 28, 1979); H. L. Pitt, *Daniel: A Seed for More Difficulties for the SEC*, Legal Times of Wash., January 29, 1979 at 27, Col. 1; M. Siegel, *Pension Outlook*, N.Y.L.J. Vol. 181, No. 48 at 1, Col. 1; P. M. Kelly, *Securities Regulation of Retirement Plans after Daniel*, Loyola Univ. L. J., 631-665 (Summer, 1979).

[3] As used in this release, the term "employee benefit plan" means a pension, profit-sharing, or similar plan. It does not include welfare and similar plans which provide for hospitalization or disability benefits, funeral expenses, or social or cultural activities. These latter plans historically have not been considered subject to the securities laws because they do not involve any expectation of financial return on the employee's part.

[4] While this release was prepared by the Division of Corporation Finance, in some instances the views described were originally expressed by the Commission's Division of Investment Management. All such instances are duly noted in the release.

and to resales by plan participants of securities acquired through the operation of plans. Finally, the release describes the methods of registration under the Act of securities issued by plans and related entities.

Although this release is intended to provide guidance to the public on the application of the 1933 Act to employee benefit plans, it should not be viewed as an exhaustive or all-inclusive treatment of the subject. The complexity and ever-increasing variety of such plans precludes the issuance of a release sufficiently comprehensive to cover all issues that might arise. Because this release is necessarily limited in its scope, the Commission's staff will continue its past practice of providing interpretive advice and assistance to the public regarding such plans upon request, except where otherwise indicated herein.

The staff recognizes that many of the issues discussed herein are controversial and that differences of opinion can exist with respect to them. Although it believes the positions described in the release are in accord with the general policies and purposes of the 1933 Act, the staff nevertheless invites interested members of the public who wish to express an opinion on such positions to submit their views in writing.[5] All comments received from the public will be given serious consideration by the staff and, to the extent they are persuasive, could result in a revision of some of the views expressed herein.

Because of the length of this release, the staff believes it would be helpful at the outset to summarize briefly the positions expressed herein. The summary, however, should not be read without also referring to the explanatory section of the release, where the various positions are discussed in detail.

Summary

The registration and antifraud provisions of the 1933 Act are applicable to the offer and sale of securities. Registration, however, would not be necessary if one of the exemptions specified in the Act is available.

1. The Term "Security".—There are two types of securities that may be issued in connection with employee benefit plans: (1) participation interests of employees in their respective plans,[6] and (2) participation interests of plans in the collective investment vehicles in which such plans invest their assets.

The interests of plans in collective investment vehicles are in all instances securities, generally in the form of investment contracts. They are therefore subject to both the registration and antifraud provisions of the 1933 Act. The interests of employees in a plan, however, are securities only when the employees voluntarily participate in the plan and individually contribute thereto. Thus, employee interests in plans which are not both voluntary and contributory are not securities and therefore are not subject to the Act.

2. The Term "Sale".—A sale of interests in voluntary, contributory plans occurs where there is both an investment decision and the furnishing of value by participating employees. Consistent with this view, the staff does not believe a sale occurs when an existing plan is converted into an ESOP [7] or other type of plan, except where employees are given a choice in the matter and therefore have the opportunity to make an investment decision. Similarly, there is no sale under noncontributory plans when employees make elections as to the manner of investing the employer's contributions.

The definition of "sale" in the 1933 Act also encompasses any "solicitation of an offer to buy" securities of the employer. Such solicitations sometimes will be attributed to employers in the context of certain employee stock purchase plans which acquire the employer's securities in the open market. If the employer's involvement in such a plan is limited to performing ministerial-type functions, no solicitation of an offer to buy is deemed to exist. But if the employer's involvement is so substantial that there are significant differences between acquiring stock under the plan and acquiring it in ordinary brokerage transactions, the employer will be deemed to be soliciting its employees to buy its securities, and registration generally will be necessary. An exception to this general rule, however, exists in the case of a TRASOP [8] where the employer's involvement is limited primarily to performing ministerial-type functions and paying half the price of stock purchased by employees under the plan.

3. Exemptions from Registration.—Registration of securities offered or sold pursuant to employee benefit plans is necessary unless an exemption is available. In most instances, an exemption is available and registration therefore is not required. Some of the exemptions that are frequently relied upon are those provided by the 1933 Act for nonpublic offerings, intrastate offerings, and certain small offerings. The only exemption, however, which is specifically designed for interests issued in connection with employee benefit plans is the one provided by section 3(a)(2) of the Act.

The section 3(a)(2) exemption applies both to the interests of plans in certain investment vehicles maintained by banks and insurance companies and to the interests of participants in the plans themselves. Interests issued in connection with Keogh plans, however, are specifically excluded from the exemption, although the Commission can exempt such interests from registration under certain conditions.

Although the language of section 3(a)(2) can be read to suggest otherwise, the staff does not believe that a single trust fund for a plan must be maintained by a bank in order for the exemption to be available. However, if the trust fund involves a single employer and invests employee monies in securities of the employer, the exemption cannot be utilized. For purposes of section 3(a)(2), the term "single employer" is deemed to include the employer and any entity controlling, controlled by, or under common control with, the employer. Thus, a parent and its subsidiaries are considered a single employer under this interpretation.

While the section 3(a)(2) exemption is not available by its terms for so-called "guaranteed investment contracts" issued to plans by insurance companies, the staff has taken a no-action position with respect to the offer and sale of such contracts if certain specified conditions are met. A similar position, again subject to certain conditions, also has been taken with respect to the offer and sale of interests in multiple-employer trusts established by insurance companies for the offering of various forms of annuity contracts to unrelated employers.

4. Securities Transactions by Plans. In addition to issuing participation interests to employees or fostering the purchase of employer stock by such persons, a plan may engage in various other transactions involving the purchase, sale or distribution of securities. It may, for instance, acquire stock of the employer from various sources, including the company. For a

[5] Letters pertaining to this release should be addressed to Peter J. Romeo, Division of Corporation Finance, Securities and Exchange Commission, Washington, D.C. 20549.

[6] In some plans, such as stock bonus and certain stock purchase plans, where stock is directly acquired by employee participants, there may not be separate employee interests, apart from the stock, that are deemed to be securities. The stock acquired by employees under such plans, however, is a security.

[7] "ESOP" is a shorthand designation for "Employee Stock Ownership Plan."

[8] "TRASOP" is a shorthand designation for "Tax Reduction Act Stock Ownership Plan."

variety of reasons, however, registration usually would not be necessary with respect to the acquisition transaction.

A plan also may offer or sell securities of the employer or other entities held in its portfolio. If the plan is considered to be an affiliate [9] of the employer, sales by it of the employer's securities would be subject to the registration provisions of the 1933 Act in the same manner as if the employer were engaging in the transaction. Sales by the plan of non-employer securities, however, usually would not have to be registered because of the availability of the exemption provided by section 4(1) of the Act for transactions not involving issuers, underwriters or dealers.

The distribution, or actual delivery, of employer stock by a plan to individual participants would not be subject to registration, although any offers or sales of such stock to participants prior to actual delivery would have to be registered, unless an exemption were available.

5. Resales by Plan Participants.—Employees who receive securities under a plan may freely resell such securities without restriction if the securities have been registered and they are not affiliates of the issuer. If the securities have not been registered, they generally must either be registered or sold in reliance upon some exemption, such as that provided by section 4(1) of the 1933 Act. An exception to this general rule occurs when non-affiliates receive unregistered securities under a plan which satisfies certain conditions.

6. Methods of Registration.—If the securities to be issued under a plan must be registered, Form S–8 [17 CFR 239.16b] would be the appropriate form for this purpose if the employer were able to satisfy the requirements for its use. If Form S–8 cannot be used, the issuer would then consider other forms, such as S–1 [17 CFR 239.11] or S–18 [17 CFR 239.28].

Affiliates who receive securities under a plan and wish to have them registered for resale may utilize a Form S–16 [17 CFR 239.27] reoffer prospectus for this purpose if the securities were originally issued pursuant to a Form S–8 filing. If the securities were not so issued, Form S–1 may be utilized, assuming the issuer is agreeable to a filing on that form, or the securities may be resold pursuant to Rule 144 [17 CFR 240.144] under the 1933 Act.

[9] An "affiliate" of an entity is defined in Rule 405 [17 CFR 230.405] under the 1933 Act as "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the [entity]."

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I. General Structure of the Act

According to its preamble, the 1933 Act is intended "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof * * *" Sections 5 and 17 of the Act are the principal provisions used to implement the Act's disclosure and antifraud purposes. Section 5 provides that every offer or sale of a security made through the use of the mails or interstate commerce must be accomplished through the use of a registration statement [10] meeting the Act's disclosure requirements,[11] unless one of the several exemptions from registration set out in sections 3 and 4 of the Act is available.[12] Section 17 of the Act prohibits the use of fraud or misrepresentation in the offer or sale of a security.[13]

To promote compliance with the registration and antifraud requirements, the Act provides for both civil liabilities and potential criminal penalties in the event violations occur. The civil liabilities are specified in sections 11 and 12 and basically give the buyer the right to rescind the sale and recover the net cost of the security. The criminal penalties are prescribed in section 24 and consist of a fine of up to $10,000 or imprisonment for up to five years, or both, if the Act is willfully violated. In addition, section 20(b) of the Act authorizes the Commission to bring injunctive actions whenever it appears a person is engaged, or is about to engage, in violations of the Act.

II. The Term "Security"

In order for the registration and antifraud provisions of the 1933 Act to be applicable, there must be an offer or sale of a security. The term "security" is defined in section 2(1) of the Act [14] and includes, among other things, stocks, bonds and investment contracts. The Commission believes that two types of securities, generally in the form of investment contracts, may be issued in connection with employee benefit plans: (1) interests of participants in their respective plans, and (2) interests of

[10] A registration statement generally consists of two parts: a prospectus which is delivered to investors before a sale becomes final and a separate section containing information which is on file with the Commission but which is not required to be furnished to investors. Sales of securities cannot be made until the registration statement becomes effective.

[11] The types of information required to be included in registration statements are specified in Schedules A and B of the 1933 Act and in the various registration forms under the Act adopted by the Commission.

[12] Part IV of this release will discuss some of the exemptions commonly relied upon for transactions involving employee benefit plans.

[13] It should be noted that Section 10(b) of the 1934 Act and rule 10b–5 [17 CFR 240.10b–5] thereunder prohibit the use of any manipulative device or contrivance in connection with the purchase or sale of any security.

[14] Section 2(1) states in its entirety that: The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

plans in collective investment media, such as bank collective trust funds and insurance company separate accounts, in which such plans invest their assets.[15] Each of these interests will be discussed in detail in the sections which follow.

A. Interests of Participants in Plans

An investment contract involves "an investment in a common venture premised on a reasonable expectation of profits to be derived from the entreprenurial or managerial efforts of others."[16] The Commission has traditionally applied this test, which is often called the "*Howey* test" because it was first articulated in the case of *S.E.C.* v. *W. J. Howey Co.*,[17] to the interests of employees in pension, profit-sharing and similar plans. In this regard, it has in the past determined that such interests are investment contracts because the plans are in essence investment vehicles designed to produce profits in the form of retirement or other benefits for the employees through the efforts of plan managers.[18]

Although the Commission has believed that employee interests in pension and profit-sharing plans generally are securities, it has required such interests to be registered only where a plan is both voluntary [19] and contributory [20] and invests in securities of the employer an amount greater than that paid into the plan by the employer.[21] The basis for this administrative practice, which was codified by Congress in 1970 in Section 3(a)(2) of the 1933 Act,[22] is as follows:

(1) Registration serves no purpose where a plan is involuntary, since a participant is not permitted to make an investment decision in such a circumstance; and

(2) The costs of registration are a significant burden to an employer and should be imposed only where the employer has a direct financial interest in soliciting voluntary employee contributions, as in the case where such contributions will be used to purchase the employer's securities.

The Commission's belief that the registration provisions of the 1933 Act should be applicable to voluntary, contributory plans which involve the purchase by employees of employer stock is supported by the legislative history of the Act. In 1934 Congress considered and rejected a proposed amendment to the Act that would have exempted employee stock investment and stock option plans from the Act's registration provisions. The amendment, which had been passed by the Senate but was eliminated in conference, was not adopted "on the ground that the participants in employees' stock investment plans may be in as great need of the protections afforded by the availability of information concerning the issuer for which they work as are most members of the public."[23]

The decision by the Supreme Court in the *Daniel* case, in which the Court held that the interests of employees in involuntary, noncontributory pension plans are not securities, has raised questions concerning the applicability of the 1933 Act to other types of employee benefit plans not covered by the decision.[24] In the interest of providing guidance to the public and because of uncertainty with respect to the implications of *Daniel*,[25] the staff believes it is appropriate at this time to set forth its own views regarding the application of the 1933 Act to employee benefit plans. Those views are expressed according to the major categories into which pension and profit-sharing plans may fall (i.e., defined benefit and defined contribution, corporate, Keogh, IRA, and miscellaneous plans).

1. *Defined Benefit and Defined Contribution Plans.*—Employee benefit plans are of an infinite variety. All such plans, however, can be reduced to two broad categories: defined benefit plans and defined contribution plans.

A defined benefit plan[26] pays fixed or determinable benefits.[27] The benefits ordinarily are described in a formula which specifies the amount payable in monthly or annual installments to participants who retire at a certain age.[28] As long as the plan and the employer(s) contributing to the plan remain solvent, and the plan continues to be operated, vested participants will receive the benefits specified. In the event the investment results of the plan do not meet expectations, the employer(s) usually will be required, on the basis of actuarial computations, to make additional contributions to fund the promised benefits.[29] Conversely, if plan earnings are better than anticipated, the employer(s) may be permitted to make contributions that are less than the projected amounts.

A defined contribution plan[30] does not pay any fixed or determinable benefits. Instead, benefits will vary, depending on the amount of plan contributions, the investment success of the plan, and allocations made of benefits forfeited by nonvested participants who terminate employment. Thus, the amount of benefits is based, in part, on the earnings generated by the plan.

Both defined benefit and defined contribution plans can provide for employee contributions. In addition, defined contribution plans maintain individual accounts for all participating employees.[31] These accounts reflect each participant's share in the underlying trust assets and are adjusted annually to take into account plan contributions, earnings and forfeitures. In contrast, defined benefit plans ordinarily do not maintain individual accounts, except to the extent necessary under the Internal Revenue Code to record benefits attributable to voluntary contributions by employees.[32]

The *Daniel* decision dealt with an involuntary, noncontributory plan which

[15] A plan could, of course, invest its assets directly in stocks, bonds and similar instruments, rather than in collective investment vehicles. Such instruments clearly are securities, for they are expressly referred to in Section 2(1) and otherwise possess the characteristics of securities.

[16] *United Housing Foundation, Inc.* v. *Forman*, 411 U.S. 837, 852 (1975).

[17] 328 U.S. 293 (1946).

[18] Opinion of the Assistant General Counsel of the Commission—first opinion (1941), (hereinafter, "Opinion of Assistant General Counsel") CCH Fed. Sec. L. Rep., 1941–1944 Transfer Binder, ¶ 75,195.

[19] A "voluntary" plan is one in which employees may elect whether or not to participate.

[20] For purposes of this release, a "contributory" plan is one in which employees make direct payments, usually in the form of cash or payroll deductions, to the plan.

[21] Letter to *Commerce Clearing House* dated May 12, 1953.

[22] Pub. L. 91–547 (December 14, 1970) and Pub. L. 91–567 (December 22, 1970). Section 3(a)(2) exempts from registration interests or participations issued in connection with certain corporate plans, unless the plan is held in a single trust or separate account for a single employer and "an amount in excess of the employer's contribution is allocated to the purchase of securities * * * issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer."

[23] H.R. Report No. 1838, 73rd Cong., 2d Sess. (1934), 41.

[24] Some courts have applied the *Daniel* decision to other types of pension plans. See *Black* v. *Payne*, 591 F. 2d 83 (9th Cir. 1979); *Tanuggi* v. *Grolier, Inc.*, 471 F. Supp. 1209 (S.D.N.Y., 1979); and *Newkirk* v. *General Electric Company*, CCH ¶ 97,216 (N.D. Cal., 1979).

[25] See Note 2, *supra*.

[26] All defined benefit plans are considered to be pension plans. *See* Internal Revenue Code ("IRC") [26 U.S.C. 1 et seq.] § 414(j).

[27] IRC Reg. § 1.401–1(b)(1) (1956).

[28] If retirement occurs at a different age or in a different form, participants will receive an adjusted monthly or annual amount. See IRC § 415(b)(2)(B).

[29] An exception to this general rule arises in the case of multi-employer collectively bargained defined benefit plans (such as the one at issue in *Daniel*) where the contribution obligations of participating employers are limited to contractually fixed amounts for each hour, day or week employment.

[30] Some examples of defined contribution plans are profit-sharing plans, stock bonus plans, ESOPs, and so-called money purchase pension plans.

[31] In fact, defined contribution plans are sometimes characterized as "Individual Account Plans."

[32] IRC § 411(b)(2)(A). The benefits must not be less than the employee's contribution with statutory interest. IRC § 411(a)(1) and § 411(c)(2)(B).

was also a defined benefit plan. The Supreme Court's opinion in that case, however, did not rest on the fact that the plan was a defined benefit one. Instead, the Court based its decision on the involuntary nature of the plan (unlike all prior cases of the Court involving securities, the employees did not have a choice whether to participate)[33] and the fact that the plan did not provide for direct, identifiable contributions by employees (the employees' labor could be considered a contribution "only in the most abstract sense").[34] This view is supported both by the Court's statement of the issue presented by the case ("whether a noncontributory, compulsory pension plan constitutes a 'security' ")[35] and by its later statement that "We hold the Securities Acts do not apply to a noncontributory, compulsory pension plan."[36] In neither instance did the Court refer to the defined benefit nature of the plan.

In light of the foregoing, the staff is of the view that the defined benefit or defined contribution nature of a plan is not dispositive in determining whether a security is present. Other factors, such as whether the plan is voluntary or involuntary, and contributory or noncontributory, must be taken into consideration, as indicated in the analysis of the major types of plans which follows.[37]

2. Corporate Plans.—Perhaps the largest single category of plans in terms of the number of participants are so-called "corporate" plans. Such plans may be defined benefit or defined contribution in nature, but all share the common characteristic of being established by corporations. Common types of corporate plans are pension, profit-sharing, bonus, thrift, savings and similar plans. Almost all such plans are established pursuant to Section 401 of the Internal Revenue Code.[38]

To determine whether or not a participant's interest in a corporate plan is a security, the Court in *Daniel* indicated that it is necessary to demonstrate that a participant "chose" to give up "specific" consideration in return for a "separable financial interest" that had "substantially the characteristics of a security."[39] A participation interest possesses the essential characteristics of a security when the elements of an investment contract are present.[40]

The foregoing suggests that some of the key factors to be considered in connection with the "security" question are whether a plan is voluntary or involuntary, and whether it is contributory or noncontributory. There are four possible combinations in which these elements can appear, each of which is separately discussed in the sections which follow.

a. Involuntary, Noncontributory Plans. The Court in *Daniel* held that "* * * the Securities Acts do not apply to a noncontributory, compulsory pension plan."[41] This holding clearly precludes the finding that interests in such plans are securities. Accordingly, the 1933 Act is not applicable to such interests.

b. Involuntary, Contributory Plans. Where a plan requires direct contributions by employees, it would be possible to take the position that there is an "investment" (in the form of employee contributions) "in a common enterprise" (the plan) "with an expectation of profits" (the excess of benefits over contributions) "from the efforts of others" (the plan managers). In the *Daniel* decision, however, the Supreme Court based its decision that no investment contract was present at least in part on the involuntary nature of the plan involved in that case. The Court noted in this regard that in its other decisions involving investment contracts the person found to have been an investor "*chose* to give up a specific consideration in return for a separable financial interest with the characteristics of a security."[42]

After consideration of the foregoing, the staff believes it is appropriate from an administrative standpoint for it to take the position that the interests of employees in involuntary, contributory plans are not securities[43] and that the registration and antifraud provisions of the 1933 Act do not apply to them.

C. *Voluntary, Noncontributory Plans*

Plans in which employees may voluntarily participate without making any personal contributions generally arise in rather limited circumstances.[44] The staff traditionally has not required participation interests in such plans to be registered.[45] In its view, no practical purpose is served by requiring registration of such interests, since in almost all instances employees would chose to participate, due to the fact that they would receive benefits without incurring any out-of-pocket expenses.[46]

Whether interests in voluntary, noncontributory plans are securities is a matter that has not been addressed by a court. As previously indicated, the "security" question depends to some extent on whether a plan is voluntary. But the mere presence of a voluntary feature in a plan would not, by itself, necessarily indicate the presence of a security, since the other elements of an investment contract also must be present.

In most instances, the fact that a plan is noncontributory would mean that the

[33] 99 S. Ct. 796.

[34] 99 S. Ct. 796–797.

[35] 99 S. Ct. 793.

[36] 99 S. Ct. 802.

[37] See, in particular, the section herein entitled "Voluntary, Contributory Plans."

[38] Plans which are qualified under Section 401 become entitled to certain tax benefits.

[39] 99 S. Ct. 796–797. The Court also stated that the consideration should be "tangible and definable." 99 S. Ct. 797.

[40] As indicated in Note 6, *Supra*, some plans, such as stock bonus and certain stock purchase plans, which are in essence mechanisms for the acquisition of stock, may not involve separate securities in the form of participation interests that are investment contracts. The stock acquired by employees under such plans, however, is a security.

[41] 99 S. Ct. 802.

[42] 99 S. Ct. 796.

[43] At least one court subsequent to *Daniel* has addressed the issue of whether such interests are securities in the context of a plan sponsored by a public (i.e., governmental) employer. In *Black* v. *Payne*, 591 F. 2d 83 (9th Cir. 1979), the question raised was whether participation in a state sponsored involuntary, contributory pension plan (which appeared to share the characteristics of a defined benefit plan) constituted an investment contract. The District Court held that such participation failed to satisfy the definition of a security enunciated by the Supreme Court in *Daniel*. The Court of Appeals for the Ninth Circuit agreed, noting that even though the plan was contributory, participation therein did not involve a reasonable expectation of profit nor the element of volition sufficient to bring the transaction within the scope of the securities laws. Pointing to the Supreme Court's discussion of the impact of the Employee Retirement Income Security Act of 1974 ("ERISA") [29 U.S.C. 1001 et seq.] in the *Daniel* situation, the Court also expressed the view that the existence of extensive state regulation and control over the plan constituted a formidable factor militating against extending the federal securities laws to cover this type of plan. *Id.* at 87, n. 3.

[44] The circumstances usually are that the plan contains a number of alternatives for the investment of the employer's contribution, and participating employees are allowed to determine: (1) whether they will participate in the plan (the response almost always being in the affirmative), and (2) the investment alternative they prefer to have an interest in.

[45] *See*, e.g., letter re *Four Phase Systems, Inc.* dated October 5, 1978.

[46] Perhaps the only circumstance in which any employee might choose not to participate would arise where it is more advantageous for tax reasons not to do so. In this regard, one commentator [Nimkin, note 2, *supra*, at 971] has stated that: "[Under a noncontributory plan], the employee's choice is not between giving or not giving consideration (his labor) in exchange for the plan interests, but between two retirement plans that under the tax law are mutually exclusive: a personally-financed IRA and an employer-financed plan. It is the Internal Revenue Code that requires the employee to make this choice, not the employer. [However], it can be argued that once the employee has an alternative, he needs to be adequately informed about the employer's plan, and that this need is best protected by the registration and antifraud provisions of the federal securities laws. This suggests that "opt-out" provisions should not be included in noncontributory plans without awareness of their possible securities law implications."

"investment of money" aspect of the *Howey* test is not met.[47] Even where a noncontributory plan meets the "investment" requirement, it may not satisfy the "profit" element of the *Howey* test. The Court in *Daniel* seemed to dismiss the earnings generated by the plan managers as being too insignificant in relation to employer contributions to qualify as "profits" in the investment contract sense.[48] Moreover, the Court seemed to believe that any participation by employees in the earnings of the plan at issue in that case depended primarily on the personal efforts of the employees to meet the vesting requirements, rather than on the plan actually generating such earnings.

Although a commentator has suggested that a security may be present in some voluntary, noncontributory plans,[49] the staff, as a matter of administrative practice, will assume that such plans do not involve securities. Accordingly, the registration and antifraud provisions of the 1933 Act are not considered by the staff to be applicable to such plans.

d. *Voluntary, Contributory Plans.* Since 1941, the Commission and its staff have adhered to the position that interests in voluntary, contributory pension and profit-sharing plans are securities.[50] The articulated basis for this view is that such interests constitute investment contracts, although it also has been suggested that they may be "certificates of interest or participation in a profit-sharing agreement" as well.[51]

The Commission recently confirmed its view in the testimony of its Chairman before the Senate Committee on Human Resources on the antifraud provisions of the proposed ERISA Improvements Act of 1979 (S. 209),[52] wherein it was noted that

> * * * An employee who is given a choice whether to participate in a voluntary pension plan, and decides to contribute a portion of his earnings or savings to such plan, has clearly made an investment decision, particularly when his contribution is invested in securities issued by his employer. Employees making such decisions should continue to be afforded the protections of the antifraud provisions of the federal securities laws.

The Commission's view that the interests of employees in voluntary, contributory plans are investment contracts appears to be supported by the reasoning used in the *Daniel* decision. Certainly, where a plan is voluntary, the requirement that employees be able to choose whether or not to invest has been met. And the other elements of an investment contract would also appear to be present where a plan is contributory, regardless of whether the plan is defined contribution or defined benefit in nature, as the following analysis indicates.

(1) *Investment of money.* The payment of cash or its equivalent by an employee to a contributory plan clearly satisfies the "investment" requirement in that the consideration paid is "specific, tangible and definable."[53]

(2) *In a common enterprise.* The opinion in *Daniel* suggests that a plan will satisfy the common enterprise requirement where the interests of employees therein are "separable" and possess "substantially the characteristics of a security."

With regard to the separability aspect, it appears the Court believed that where there is an investment contract, it is possible to segregate the non-investment (or employment) portion of a person's total compensation package from the investment (or pension) portion. In contributory plans, the amount set aside for investment purposes can be readily identified by examining the contributions made by each individual participant. A record of such contributions is always available in defined contribution plans because such plans maintain individual accounts for participants. And it also should be present in defined benefit plans, by virtue of the requirement that, in order to qualify for favorable tax treatment,[54] such plans must return to nonvested employees who cease being participants accrued benefits based upon the employee's contributions. Thus, in both defined contribution and defined benefit plans, there is, in effect, a separate account maintained for each participant to the extent of such person's contributions to the plan. Accordingly, the investment aspects of an employee's compensation package are segregated under both types of plans.

(3) *With an expectation of profits.* An employee who voluntarily contributes his own funds to a pension or profit-sharing plan can expect that in return for his contributions the plan will generate earnings through the efforts of the plan managers that will result in his receiving pension or similar benefits that will exceed his total contributions. In terms of economic realities, the excess of benefits over contributions, to the extent they are dependent on earnings by the plan, may be deemed a profit which the employee fully expects to receive as a result of his payments to the plan. By deciding to participate in the plan voluntarily, the employee implicitly has made an investment decision to the effect that his contributions will achieve investment results that will be equal to or superior to those he could obtain from investing his funds elsewhere. Accordingly, from the employee's standpoint, there would appear to be an "expectation of profits" in the investment contract sense.

The foregoing analysis clearly appears to be valid when applied to a defined contribution plan, for the level of benefits under such a plan is directly related to the plan's investment success. Further analysis, however, is necessary for defined benefit plans.[55]

In *Daniel,* the Court indicated there was no "expectation of profits" with respect to the defined benefit plan at issue in that case because (1) the plan did not depend substantially on earnings

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[47] 99 S. Ct. 797.

[48] 99 S. Ct. 797–798.

[49] One commentator [Nimkin, note 2, *supra,* at 970] has suggested that where some or all of the following characteristics are present in a noncontributory plan, a security may exist:

(a) the interests are close to the commonly understood notion of a security, such as interests in an ESOP that are invested solely in employer stock, and they either satisfy the other elements of the *Howey* test or do not call for a *Howey* investment contract analysis at all;

(b) the value of the interests is measurable and is not insignificant in dollars or in percentage of total compensation;

(c) the amount of employer contributions attributable to each of the interests can be identified, as in a case where such contributions are a percentage of employee compensation; and

(d) there is a fixed relationship between employer contributions and employee benefits as there normally would be in a profit-sharing or other individual account plan.

[50] Opinion of Assistant General Counsel, Note 18, *supra.*

[51] Opinion of the Assistant General Counsel of the Commission—second opinion (1941), CCH, 1941–1944 Transfer Binder, ¶75,195.

[52] The ERISA Improvements Act of 1979 would, among other things, remove the interests of employees in employee benefit plans from the definitional scope of the term "security" for purposes of the antifraud provisions of the 1933 and 1934 Acts. The proposed legislation, however, would not limit the application of the registration provisions of the 1933 Act to such interests. The Commission's views on the bill are set forth in the Statement of Harold M. Williams, Chairman, Securities and Exchange Commission, Before the Senate Committee on Human Resources, on S. 209, 96th Cong., 1st Sess. (February 8, 1979).

[53] This is not to say that a person's "investment," in order to meet the definition of an investment contract, must always take the form of cash. Goods and services may also be sufficient in some instances. 99 S. Ct. 797, n. 12.

[54] IRC §§ 411(a)(1) and 411(c)(2)(B).

[55] *See,* e.g., the recent case of *Tanuggi* v. *Grolier Inc.,* 471 F. Supp. 1209 (S.D.N.Y. 1979). The question presented in that case was whether the securities laws applied to interests in a voluntary, shared contribution, defined benefit plan. The particular plan featured a mandatory contribution component and a voluntary contribution component. The Court found no security present with respect to the mandatory contribution component. It did not, however, reach the question of whether interests in the voluntary component constituted a security, inasmuch as the plaintiff's contributions did not exceed the mandatory level.

to meet its benefit obligations, since it could rely on increased employer contributions to cover any shortfalls in earnings, and (2) the vesting requirements for the plan were so substantial that an employee's participation in the plan's earnings depended more on his own efforts to meet the vesting requirements than it did on the plan actually generating the earnings.[56] The Court's statements can be interpreted to suggest that unless a defined benefit plan has a substantial dependency on earnings, as well as vesting requirements that are not excessively difficult to satisfy, there may be no expectation of profits in the investment contract sense.

Several points should be kept in mind with respect to the Court's statements. First, they were made in the context of an involuntary, noncontributory defined benefit plan, in which employees neither invested any funds of their own nor had any investment choice to make. The situation is materially different in voluntary, contributory plans, where employees clearly make investment decisions by deciding to invest their funds in such plans rather than in other investment media. An employee who participates in such a plan implicitly does so because he expects the plan to generate earnings that will be sufficient to provide him with a return on his investment, in the form of certain promised benefits, that will be equal to or superior to other investment alternatives available to him.

Second, many, if not most, defined benefit plans substantially depend on earnings to pay the benefits promised by them.[57] Quite often, in the case of multi-employer plans, a shortfall in earnings (and thus a shortfall in assets to pay benefits) results not in increased employer contributions, as the Court suggested is usually the case,[58] but in a revision downward of the level of benefits to be paid.[59] Or, in some instances, the plan itself may be terminated and benefits may be paid only to the extent that the Pension Benefit Guaranty Corporation[60] is able to do so within its prescribed limitations. The fact that a plan may reduce its level of benefits or terminate altogether in the event earnings are insufficient to pay benefits underscores the dependency which many plans have on such earnings.

Third, vesting requirements under ERISA (which was not applicable to Daniel) are much less strict than the requirement of 20 years continuous service with which Daniel had to comply.[61] Because the ERISA requirements are substantially less difficult to satisfy than the vesting provision in *Daniel*, the staff takes the position that the ERISA requirements would not be a barrier to finding an investment contract present.

On the basis of all of the foregoing, the staff is of the view that where a plan is both voluntary and contributory, regardless of whether it is defined contribution or defined benefit in nature, a participant generally would have an expectation of profits from it in the investment contract sense.

(4) *From the efforts of others.* Any earnings generated by a plan would, of course, result from the efforts of the plan managers. Thus, the requirement of an investment contract that there be reliance on the efforts of others to produce profits would seem to be satisfied in the context of a voluntary, contributory plan.

* * * * *

As a result of the foregoing anlysis, the staff believes that the interests of employees in voluntary, contributory, corporate pension and profit-sharing plans are securities within the meaning of section 2(1) of the 1933 Act. Moreover, as indicated in Part III of this release, such securities are deemed to be offered and sold to employees within the meaning of section 2(3) of the Act. Accordingly, they are subject to both the registration and antifraud requirements of the Act. But, as indicated in the discussion of section 3(a)(2) in Part IV of the release, such securities generally would be required to be registered only where the plan invests in employer securities an amount greater than that contributed to the plan by the employer.

3. Keogh Plans

Keogh plans (also known as "H.R. 10 plans") are tax-deferred retirement plans established by self-employed individuals[62] for the benefit of themselves and their employees. They were authorized by Congress in 1962[63] to permit such individuals to share some of the favorable tax benefits[64] which prior therto were available only in conection with certain corporate plans.

There are two types of securities that may be issued in connection with Keogh plans: (1) interests in collective funding vehicles arising from investments made by the plans, and (2) interests of employee participants in the plan themselves.

With respect to the interests of Keogh plans in collective funding vehicles, these clearly are securities, often in the form of investment contracts. There is an investment of money by the plan in a common enterprise (the funding vehicle) with the expectation that the managers of the funding vehicle will generate earnings on that investment.

Congress gave implicit recognition to the fact that interests in collective funding vehicles maintained for Keogh plans are securities when it amended section 3(a)(2) of the 1933 Act in 1970. In both the Senate and House reports relating to the 1970 Amendments, it was indicated that such interests were not being exempted under section 3(a)(2) "because of their fairly complex nature as an equity investment and because of the likelihood that they could be sold to self-employed persons, unsophisticated in the securities field."[65] Clearly, the reference to such interests in the reports (and in section 3(a)(2) as well) was based on the belief that they are securities. As explained in Part IV of this release, however, the Commission possesses authority under section 3(a)(2) to exempt interests or participations

[56] 99 S. Ct. 797–798.

[57] The Supreme Court appeared to believe otherwise, as indicated by its statement that "a plan usually can count on increased employer contributions, over which the plan itself has no control, to cover shortfalls in earnings." 99 S. Ct. 798.

[58] *Id.*

[59] Of course, benefits accrued by participants up to the date the level of benefits is revised would be payable on the basis of the schedule of benefits in effect until then.

[60] The Pension Benefit Guaranty Corporation ("PBGC") was created by ERISA to provide some assurance that the benefits promised to vested participants in employee benefit plans would, in fact, be paid. Pursuant to ERISA, every single-employer defined benefit plan must meet certain minimum funding standards and pay annual premiums to the insurance fund maintained by the PBGC. The PBGC guarantees a portion of the defined benefit in the event the employer terminates the plan. The extent of PBGC coverage is set forth in 29 U.S.C. 1301–1381.

[61] Daniel was denied his pension because, although he had over 22 years of service as a teamster, he had suffered an involuntary break-in-service of approximately four months midway through his career. Thus, the years prior to the break-in-service could not be used to satisfy the requirement of 20 years of "continuous" service.

[62] An individual who is an "employee" within the meaning of Section 401(c)(1) of the Internal Revenue Code of 1954 may establish a Keogh plan.

[63] The Self-Employed Individuals Tax Retirement Act of 1962, Pub. L. 87–792 (1962).

[64] The tax advantages to a self-employed person in establishing a Keogh Plan are essentially twofold: A deduction can be taken for at least a part of his contributions to the plan and the income earned on his contributions is not taxed until it is distributed.

[65] Senate Report No. 91–184 (1969), at 27–28, and House Report No. 91–1382 (1970), at 44. Although Section 3(a)(2) may not be available, the intrastate offering exemption (see Part IV) often can be relied upon for the offer and sale of interests in collective funding vehicles maintained for Keogh plans. However, if the funds in that vehicle are commingled with those from exempt qualified plans sold to non-residents, the two offerings would be integrated, and the intrastate exemption would not be available.

issued in connection with Keogh plans from the registration requirements of the 1933 Act.

The interests of covered employees in Keogh plans also appear to be securities. Although many such plans involve only one individual, a significant number cover more than one person (as would occur, for example, where a law partnership institutes a plan in which all employees can participate). Using the analysis already described with respect to corporate plans, the staff is of the view that voluntary contributions by participants to such plans would create securities in the form of investment contracts.

Although the interests of participants in voluntary, contributory Keogh plans are deemed to be securities, the staff has not required the separate registration of such interests. Most plans can rely on an exemption from registration for the offer and sale of employee interests.[66] For those relatively few plans that do not have a readily available exemption, the staff, as a matter of administrative discretion, will not require such interests to be registered. The antifraud provisions of the 1933 Act, however, would continue to apply to the offer and sale of such interests to employees.

4. IRAs and Simplified Employee Pension Plans

IRAs (or "Individual Retirement Accounts") are a relatively new form of tax deductible retirement savings created by ERISA in 1974. They are intended to allow employees who are not covered under a corporate or Keogh plan to obtain tax benefits similar to those provided under such plans.[67]

Although IRAs commonly are established by individuals, they also may be sponsored by employers and unions for their employees and members, respectively. In an effort to encourage the establishment of employer-sponsored IRAs, the Revenue Act of 1978[68] introduced the concept of "Simplified Employee Pensions".[69] Simplified pensions have been characterized as plans with a minimum of paper work and red tape,[70] and, in this context, the Revenue Act provides for simplified employer reports to the IRS and to employees.[71] For the purposes of this discussion, IRAs and Simplified Employee Pensions will be considered the same.

The applicability of the federal securities laws to IRAs was specifically considered by Congress at the time ERISA was pending congressional approval. In that regard, the conference report on ERISA stated:

> The conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the federal securities laws to individual retirement accounts or the application to them of the laws relating to common trusts or investment funds maintained by any institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation.[72]

The status of IRAs under the securities laws was further commented upon by the Senate Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs in a study conducted in 1975. The Subcommittee expressed the belief that "IRAs and collective investment funds for IRAs clearly are not exempt from registration under . . . the Securities Act of 1933."[73] While the question of whether or not an exemption would be available would depend on the facts and circumstances of each case, it is clear that IRAs which involve the placement of an individual's funds in the hands of another person with reliance on that person to produce profits are securities which are subject to the registration and antifraud requirements of the 1933 Act.

Many IRAs involve a direct investment by an individual in an exempt security (such as one issued by a bank)[74] or in a medium that is not considered to be a security (such as a traditional fixed annuity). In neither instance would registration be necessary, and only in the former would the antifraud provisions be applicable.

Beyond the foregoing are two other situations in which the registration of IRAs is considered unnecessary. The first of these involves IRAs which are funded solely by specific mutual fund shares that are registered under the 1933 Act. The staff has stated that, so long as these shares are offered pursuant to current prospectuses which contain appropriate disclosure of the IRAs to which they may be offered, no separate registration of the IRAs is necessary.[75]

The second situation involves so-called master trust or prototype plan arrangements[76] which are used to market IRAs and Keogh plans. Where these types of trusts or arrangements exist, the sponsoring organization usually limits its own involvement to establishing the plan and/or setting up a separate account for each individual participant. The commingling of account assets is generally prohibited and, for the most part, complete investment discretion is vested in each account holder. Participants usually are afforded several investment alternatives, such as savings accounts or other bank instruments, insurance products or the like. The sponsor generally limits its role to that of a custodian and does not render any investment advice.

An argument often made is that interests in these types of plans do not constitute securities within the meaning of Section 2(1). The theory underlying

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[66] See Part IV of this release for a discussion of some exemptions available to plans.

[67] For example, an employee can claim a tax deduction for contributions to an IRA of the lesser of 15% of earned income or $1,500, and he will generally not be taxed on the amounts held in the IRA until they are distributed. In addition to the tax benefits, the ERISA requirements for certain employer-sponsored IRAs relating to reporting obligations, fiduciary standards, and prohibitions against self-dealing are generally less burdensome than those which apply to corporate plans.

[68] Pub. L. 95-600 (November 6, 1978).

[69] Under a simplified pension plan, the deduction limit for employee contributions to IRAs is increased to $7,500 or 15% of compensation, whichever is less. And, to the extent that an employer's contributions to IRAs for its employees are less than the usual limits on deductible IRA contributions, the employees are permitted to make up the difference through deductible contributions to the IRA, provided such persons are not active participants in a qualified plan for that year.

[70] Hearings before the Subcommittee on Private Pension Plans and Employee Fringe benefits on S. 3140, S. 3193 95th Cong., 2d Sess. (1978), at 11.

[71] Staff of Joint Committee on Taxation, 96th Cong., 1st Sess. General Explanation of the Revenue Act of 1978, H.R. 13511, Pub. L. 95-600, at 97.

[72] Joint Explanatory Statement of the Committee of Conference, H.R. 93-1280 (1974), 338.

[73] The Securities Activities of Commercial Banks, Study Outline of The Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. (1975), at 204. In this regard, it should be noted that the exemption provided by Section 3(a)(2) of the Act, clearly does not apply to IRAs because they are authorized by Section 408 of the Internal Revenue Code, not Sections 401 or 404, as is necessary under 3(a)(2).

[74] Section 3(a)(2) exempts, among other things, "any security issued or guaranteed by any bank."

[75] Letter re *Investment Company Institute* available October 21, 1974, where the Commission's Division of Corporation Finance also took the same position with respect to accounts and plans created under Section 403(b) of the Internal Revenue Code as deferred compensation arrangements for employees of public school systems and charitable organizations. In addition, it was indicated in the same letter that the Division of Investment Management would not recommend any enforcement action to the Commission with respect to the creation of such plans without registration under the Investment Company Act of 1940 ("1940 Act") [15 U.S.C. 80a, et seq.], provided no custodian or trustee could exercise investment discretion with respect to the plans.

[76] The term "master plan" refers to a standardized form of plan with related form of trust or custodial agreement, administered by the sponsoring organization for the purpose of providing plan benefits on a standardized basis.

The term "prototype plan" refers to a standardized form of plan with or without a related form of trust or custodial agreement, which is made available by the sponsoring organization for use without change by emloyers who wish to adopt such plan and which will not be administered by the sponsoring organization which makes such form available. *CCH Pension Plan Guide* ¶32,000.

this view is that each individual relies on his own efforts to earn a profit in his account, rather than on the efforts of others, and therefore one of the key elements of an investment contract is missing.[77] Although in practice this theory does not apply where an IRA or Keogh plan is funded through the use of a pooled investment medium, it has more validity where the sponsor acts as a mere custodian for a participant's separate account (the assets of which are not commingled) and the participant retains complete investment power or control over his account. Recognizing that the existence of an investment contract in such circumstances may be open to question, the staff generally has taken a no-action position regarding the registration of such interests.[78]

5. Miscellaneous Plans

In addition to the plans already mentioned, there are four types of employee benefit plans that merit a separate discussion, either because they involve issues of special interest or because they are somewhat unique.

a. Stock purchase plans. Stock purchase plans permit employees to purchase stock of their employer through payroll deductions or otherwise.[79] The stock may be acquired either directly from the employer or in open market purchases effected by the plan. Clearly, the stock is a security, and where it is supplied by the employer or an affiliate for purchase by employees under the plan registration is necessary absent an exemption. Where the stock is obtained through open market purchases, registration may not be required, as indicated in Part III of this release.

The only significant question presented by stock purchase plans under section 2(1) of the 1933 Act is whether the interests of participants therein are securities. In Release No. 33-4790 (July 13, 1965) [30 FR 9059], the Commission indicated that employee interests in stock purchase plans which acquire the employer's stock in the open market might be securities where there are substantial differences between the manner of acquiring stock under the plan and the manner of acquiring it in ordinary brokerage transactions. Some of the variations which might be considered substantial, according to the release, are (1) limitations on the rights of employees to withdraw from the plan or to withdraw securities held in custody, (2) the granting of management discretion to someone other than the individual participants, (3) the accumulation of sums by the plan manager for material periods of time before investment, (4) the payment of special fees or charges, such as a front-end load, and (5) the diminution of the employee's rights or privileges as a shareholder.

The staff continues to believe that the presence of some or all of the foregoing factors in a stock purchase plan may create a separate security in the form of a participation interest. The reason is that such factors tend to place the employee in a position where he is relying on the plan managers to maintain or protect his investment. Accordingly, where such participation interests are deemed to be securities, they would be subject to the registration and antifraud provisions of the 1933 Act upon their offer or sale.

b. Bond purchase plans. Bond purchase plans are authorized under section 405 of the Internal Revenue Code. They permit employers to purchase a special series of United States bonds for the benefit of employees or their beneficiaries. Although the bonds are securities, they are exempt from the registration requirements of the 1933 Act by virtue of section 3(a)(2) thereof.[80] Similarly, the interests of employees in such plans are not required by the staff to be registered, because of the nature of the bonds underlying them and the congressional policy to encourage the establishment of these plans.

c. Annuity Plans. Section 403(b) of the Internal Revenue Code permits public school systems and charitable organizations to enter into deferred compensation arrangements with their employees that are funded through the purchase of annuity contracts[81] or mutual fund shares for the covered employees. Variable annuity contracts are securities[82] as are mutual fund shares, and both are therefore subject to the registration and antifraud provisions of the 1933 Act. Whether the interests of employees in these plans also are securities in all instances is problematical.

Participation interests in section 403(b) plans that are both voluntary and contributory on the part of participating employees would appear to be securities, for the reasons already discussed under the section entitled "Voluntary, Contributory Plans." As a matter of administrative practice, however, the staff does not require such interests to be registered. The antifraud provisions, however, would be applicable to the offer and sale of such interests.

d. Stock bonus plans. Stock bonus plans are plans under which an employer awards shares of its stock to covered employees at no direct cost to the employees. These plans can take various forms, such as Employee Stock Ownership Plans ("ESOPs"), Tax Reduction Act Stock Ownership Plans ("TRASOPs"),[83] stock appreciation right plans ("SARs"), and other variations as well.

While the stock awarded to employees under the above types of plans is a security, the staff generally has not required it to be registered. The basis for this position generally has been that there is no "sale" in the 1933 Act sense to employees, since such persons do not individually bargain to contribute cash or other tangible or definable consideration to such plans.[84] It also is justified by the fact that registration would serve little purpose in the context of a bonus plan, since employees in almost all instances would decide to participate if given the opportunity. Similarly, the interests of employees in bonus plans have not been subjected to registration.

B. Interests of Plans in Collective Investment Media

The contributions made to employee benefit plans frequently are invested in pools of assets managed by other entities. These pools of assets may take the form, for example, of bank collective

[77] *See*, e.g., letter re *Security National Bank* dated November 26, 1975.

[78] The staff's no-action position involving master trust or prototype plan arrangements extends to both IRA and Keogh plans having substantially the same characteristics as those described in the text. See, e.g., letters re *A. G. Edwards & Sons, Inc.* dated June 15, 1978 and *The National Bank of Georgia* dated November 4, 1976.

[79] Plans which possess the essential characteristics of a stock purchase plan will be treated as such under the 1933 Act, even though they may not be labeled as "stock purchase plans." The substance of a plan, rather than the name assigned to it, is the determining factor with respect to the application of the 1933 Act.

[80] Section 3(a)(2) exempts, among other things, any security "issued * * * by the United States * * *"

[81] An annuity contract is one which provides an income for a specified period of time, such as a number of years or for life.

[82] *S.E.C.* v. *Variable Annuity Life Insurance Co.*, 359 U.S. 65, 79 S. Ct. 618 (1959), and *S.E.C.* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 87 S. Ct. 1557 (1967).

[83] Many TRASOPs permit employees to purchase stock of the employer at a price equal to half its market value. See Part III of this release for a discussion of the application of the 1933 Act to such purchases.

[84] The staff's position generally is applicable only in the context of bonus plans which are made available to a relatively broad class of employees. With respect to stock awarded to, or acquired by, employees pursuant to individual employment arrangements, the staff generally has concluded that such arrangements involve separately bargained consideration, and that a sale of the stock has occurred.

trust funds or insurance company separate accounts. In the staff's view, the participation interests of plans in these collective investment vehicles are securities, generally in the form of investment contracts.[85] That is, they involve an investment of money (the assets of the investing plan) in a common enterprise (the fund) with an expectation of profits (the earnings generated by the fund) from the efforts of others (the fund managers). In effect, plans which invest in such funds choose "to give up a specific consideration in return for a separable financial interest with the characteristics of a security."[86] Support for the fact that these interests are securities can be found in section 3(a)(2) of the 1933 Act, which provides a specific exemption from registration for them if certain specified conditions are met. Clearly, there would be no need to provide such an exemption unless the interests were securities.

The real issue, then, with respect to interests in collective investment media is not whether they are securities, but whether they are exempt from registration by virtue of section 3(a)(2) or some other exemption. The general exemptions that might be available are discussed separately in Part IV of this release.

III. The Term "Sale" and Other Factors Affecting Registration

It already has been stated that the application of the registration and antifraud provisions of the 1933 Act depends on there being a "sale" or an "offer" of a security. Section 2(3) of the 1933 Act defines these terms as follows:

> The term "sale" or "sell" shall include every contract of sale or disposition of a securities or interest in a security, for value. The term "offer to sell," "offer for sale," or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value
> * * *

The key elements in the foregoing definition from the standpoint of employee benefit plans are the words "value" and "solicitation of an offer to buy," for without one or both the 1933 Act is inapplicable. Each of these terms is discussed in the following sections.

A. What Constitutes "Value"

While the term "value" is not defined in the 1933 Act, the staff generally has taken the position that it includes all ordinary forms of consideration, such as cash, property, services, or the surrender of a legal right. There are two specific situations involving the term "value" that warrant a separate discussion. These are dealt with in the sections which follow.

1. Conversions of Existing Plans.—For various reasons, a company may decide to convert its pension or profit-sharing plan into an ESOP or other type of plan. When such a conversion occurs, all of the assets of the old plan are transferred to a trust established under the new plan.[87] In terms of the application of the 1933 Act, the question arises whether the exchange of interests in the former plan for interests in the new plan constitutes "value" within the meaning of section 2(3).

The staff's response to this question is that although "value" in the traditional sense may be present in the exchange, no useful purpose is served by applying the Act's registration provisions where employees have no investment decision to make with respect to the proposed conversion.[88] Accordingly, the staff has indicated that it will not recommend any enforcement action concerning registration if the conversion will occur without giving employees any choice in the matter [89] and, likewise, has declined to issue a no-action letter where the situation is otherwise.[90] Because the staff's position on the conversion of existing plans is clear-cut, it will decline to respond to any future requests on the subject.

2. Investment Elections Under Noncontributory Plans.—The application of Section 2(3) also becomes an issue in the context of noncontributory plans which provide employees with the opportunity to make various investment elections. For example, a plan may permit an employee to invest his share of the employer's contribution in various investment media (including company stock),[91] or to accept cash and defer a portion of the employer's award in the form of company stock,[92] or to elect cash or stock upon a distribution by the plan.[93] Because of the nature of these elections, which appear to involve investment decisions, the staff for some time declined to take a no-action position with respect to them.[94]

As a result of the *Daniel* decision, which dealt with a noncontributory plan, the staff has reconsidered its position. It now is of the view that registration should not be required with respect to investment elections in noncontributory plans.

3. The Bifurcated Sale Concept.—In its brief in the *Daniel* case, the Commission took the position that it was possible for some employee benefit plan transactions to involve a "sale" for purposes of the antifraud, but not the registration, provisions of the 1933 Act. The basis for this view was the belief that the phrase "unless the context otherwise requires," which precedes the definitional portion of the Act, allows in some cases a different construction of the term "sale" in the context of the Act's registration provisions than it does in the context of the antifraud provisions.[95]

The Supreme Court in *Daniel* did not specifically address the merits of the Commission's "bifurcated sale" concept.[96] The staff, however, has revisited this issue and concluded that, for purposes of analyzing the impact of the 1933 Act on various employee benefit plans, it serves no practical purpose to apply the term "sale" in a bifurcated manner. Accordingly, the term "sale," when applied to employee benefit plans in the future, will be considered to have the same meaning for purposes of both the registration and antifraud provisions of the Act.[97]

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[85] Collective investment vehicles also are generally considered to be "investment companies" subject to the requirements of the 1940 Act.

[86] 99 S. Ct. 796.

[87] *See*, e.g., letter re *Imaginetics, Inc.* dated June 22, 1978, and *G. F. Wacker Stores, Inc.* dated January 27, 1976.

[88] In this regard, whether or not an employee has a choice may depend on the nature of the plan being terminated. Many plans which provide for a choice do so as a result of requirements of the Pension Benefit Guaranty Corporation which, prior to the transfer of assets from a defined benefit plan, will require that such an election be offered. *See*, e.g., letter re *Guaranty Corporation* dated July 22, 1976.

[89] *See*, e.g., letters re *Decouper Industries Inc.* dated November 20, 1975; *CFW Construction Company Inc.* dated August 20, 1975; *Crowley Maritime Corporation* dated January 27, 1976; *G. F. Wacker Stores, Inc.* dated January 27, 1976; *Tracy-Locke Company Inc.* dated May 18, 1976; and *Mayer-Lang-Marquis, Inc.* dated October 25, 1977.

[90] *See*, e.g., letters re *United Cotton Goods Company Inc.* dated September 29, 1976; *Guaranty Corporation* dated July 22, 1976; *Modern Merchandising, Inc.* dated August 30, 1976; and *Imaginetics Inc.* dated June 22, 1978.

[91] Letter re *Hycel, Inc.* dated December 2, 1977.

[92] Letter re *Aluminum Company of America* dated April 20, 1978.

[93] Letter re *U.S. Trust Corporation* dated December 11, 1978.

[94] *See*, e.g., letter re *First Union Inc.* available December 29, 1971 where, in a noncontributory incentive compensation program which featured an employee election to invest employer contributions in company stock, the staff declined to express a no-action position. *See* also, letters re *Piper Industries, Inc.* available March 6, 1972; and *Midlantic Banks, Inc.* available October 17, 1973.

[95] SEC Amicus Brief, 63–90.

[96] In a note to its decision, the Court indicated that "we express no opinion as to the correct resolution of the divergent views on this issue." 99 S. Ct. 801, n. 22.

[97] In each instance in this release where the staff has concluded that registration is not necessary, the reader should be careful to note the particular ground relied upon. In those instances where interests in an employee benefit plan need not be registered because there is no sale, the antifraud provisions also do not apply. On the other hand, in

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B. Solicitations of Offers To Buy

The registration and antifraud provisions of the 1933 Act apply not only where there has been a disposition of a security for value, but also where there has been an offer to sell a security or a solicitation of an offer to buy the same for value. Insofar as employee benefit plans are concerned, the issue of whether the employer has made a solicitation of an offer to buy its securities arises most frequently in connection with employee stock purchase plans.

1. *Stock Purchase Plans.*—As previously noted in Part II, a stock purchase plan allows an employee to purchase stock of the employer through payroll deductions or otherwise. The stock may be acquired directly from the employer, in which case registration would be necessary unless an exemption were available. Alternatively, the stock may be acquired in the open market through various types of arrangements involving payroll deductions.

The Commission's view as to whether registration by the employer will be necessary with respect to open market purchases depends on the employer's degree of participation in the plan.[98] If the employer's involvement is fairly substantial, it may be deemed to be soliciting its employees to buy its securities, and registration generally would be necessary in such circumstances. On the other hand, if the employer's participation is limited to ministerial-type functions so that purchases of stock under the plan are not significantly different than purchases outside the plan in ordinary brokerage transactions, registration would not be required.

In Release No. 33–4790, the commission specified the circumstances under which an employer's involvement in a stock purchase plan would be considered sufficiently limited so as not to raise a registration question. According to the release, the employer must not solicit employees to participate in the plan (only the broker or other agent of the employees may do so). It may, however, perform the following functions:

(1) Announce the existence of the plan;

(2) Make payroll deductions for the plan at the request of employees;

(3) Make available to the broker or other agent the names and addresses of employees in order to facilitate communications regarding the plan;

(4) Address communications to be sent to employees by the broker or other agent;

(5) Include the broker's communications with other announcements by the employer;

(6) Permit an initial meeting of employees regarding the plan to be held at the employer's premises; and

(7) Limit its expenditures to those involved in making payroll deductions and paying the reasonable fees and charges of the broker or other agent for commissions and bookkeeping and custodial expenses.

In addition to the general caveat in Release No. 33–4790 that any deviation from the foregoing standards could necessitate registration, the staff has stated that the following requirements should be complied with in order to avoid any registration difficulties:

(1) The plan should be limited solely to employees [99] or to persons, such as franchisees [100] and independent sales representatives,[101] who have essentially the same degree of access to information regarding the company as do its employees; and

(2) The employer must not make contributions to the plan to defray the cost of the stock [102] or lend money to employees for the purpose of facilitating its purchase.[103] This requirement, however, is not violated where an employee elects to supplement his personal contributions to the plan with his portion of profits distributable from the employer's profit-sharing plan.[104]

2. *TRASOPs.*—TRASOPs are a special form of Employee Stock Ownership Plan created by the Tax Reduction Act of 1975.[105] From the employee's standpoint, they are a combined stock bonus and stock purchase plan. That is, employees can receive shares of the employer at no cost to them under such a plan, and they also may be given the opportunity to purchase additional shares of the employer at half the prevailing market price.

Employers derive certain tax benefits by sponsoring TRASOPs. They can, for instance, receive up to an additional one percent investment tax credit for amounts contributed in cash or shares to the plan. In addition, they can become entitled to an extra one-half percent investment tax credit to the extent they match employee contributions for the purchase of company stock under the plan.

Generally, as pointed out in Release 33–4790, it has been the Commission's position that where an employer's involvement in a stock purchase plan (which a TRASOP partially can be) extends beyond the ministerial functions outlined in the preceding section, it is deemed to be soliciting an offer to buy the securities offered through the plan. In a contributory TRASOP, this customary analysis yields the result that the shares purchased by employees under such a plan must be registered. This is based on the theory that the employer's payment of half the price of stock purchased by the employees amounts to a subsidy that provides such a strong incentive to acquire the employer's stock that it is deemed to be a "solicitation of an offer to buy" within the meaning of section 2(3).

There are, however, persuasive reasons for taking the position that the registration of shares acquired in the open market under TRASOPs is neither necessary nor appropriate. First, no practical purpose appears to be served by requiring registration solely because the employer is paying half the purchase price. To hold otherwise creates the anomalous situation whereby a company is not required to provide a prospectus to employees who pay the full market price for stock under a plan which complies with the requirements of Release 33–4790, but must furnish a prospectus to employees who pay only half the market price under a TRASOP that is essentially identical to the 4790 plan.

Second, the party ultimately subsidizing half of the purchase price of shares acquired under a TRASOP is not the employer but the federal government. Through the device of an investment tax credit conditioned upon the employer's participation in a TRASOP, the employer's payment of half the cost of stock purchased by employees is in effect reimbursed by the U.S. Treasury. The congressional policy underlying this tax credit to encourage

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those instances where an employee plan involves the sale of a security, the antifraud provisions are, of course, applicable even though the staff may be taking the position that interests in the plan need not be registered.

[98] *See* in this regard Release No. 33–4790.

[99] *See* letter re *Buning the Florist, Inc.* dated May 10, 1976, in which the staff declined to take a no-action position with respect to an issuer's proposal that purchasers of its services be allowed to participate in its stock purchase plan without registration.

[100] Letter re *Servicemaster Industries, Inc.* dated January 10, 1979.

[101] Letter re *Baldor Electric Company* dated August 8, 1978.

[102] Letters re *Studebaker-Worthington, Inc.* dated June 13, 1975 and *Carlisle Corporation* dated April 15, 1975. An exception to this general principle involving TRASOPs is discussed later in this section.

[103] Letters re *Texas American Bancshares, Inc.* dated November 12, 1976 and *Atlantic American Corporation* dated August 1, 1977.

[104] Letter re *Manufacturers Hanover Corporation* dated March 17, 1978.

[105] Pub. L. 94–12 (1975), § 301(d). The Tax Reform Act of 1976 [Pub. L. 94–455 (1976), § 803] extended the TRASOP provisions through 1980.

the purchase of the employer's stock at half the market price is a further reason for not requiring registration.

On the basis of the foregoing reasons, the staff henceforth will take the position that shares acquired in the open market by employees under a TRASOP which otherwise satisfies the requirements of Release 33–4790 need not be registered. The purchase of such shares would, of course, continue to be subject to the antifraud provisions of the 1933 and 1934 Acts.

IV. Exemptions From Registration

If an issuer determines that an offer or sale of securities will occur in connection with an employee benefit plan, it must either register the securities or rely upon one of the several exemptions from registration contained in the 1933 Act.

A. Generally Available Exemptions

Sections 3 and 4 of the Act set forth the various exemptions from registration.[106] Those most likely to be available for securities transactions involving employee benefit plans are set forth below.

(1) *Section 3(a)(2).* This is the only exemption in the 1933 Act which specifically refers to employee benefit plans. Because of its significance, it will be discussed in detail later in this section.

(2) *Section 4(2).* This provision exempts transactions by an issuer not involving any public offering. Known as the "private offering" exemption, it generally is available if an offering is made to a limited number of persons who are sophisticated in business matters and have access to the types of information that could be obtained through the registration process. In connection with the exemption provided by section 4(2), the Commission has adopted Rule 146 [17 CFR 230.146], which provides certainty, in the form of a safe harbor, that the exemption is available if all of the conditions of the rule are met.

(3) *Section 3(a)(11).* This section, which is commonly referred to as the "intrastate offering" exemption, exempts offerings that are confined to residents of the state in which the issuer is organized and conducts the bulk of its business.[107] Rule 147 [17 CFR 230.147] under the Act provides a safe harbor for reliance upon the intrastate offering exemption if all of its conditions are satisfied.

(4) *Section 3(b).* Under this provision, the Commission has the authority to exempt certain offerings of securities if it finds that neither the public interest nor the protection of investors warrants registration "by reason of the small amount involved or the limited character of the public offering. Pursuant to the authority provided by section 3(b), the Commission has adopted Regulation A [17 CFR 230.251 to 230.264], Rule 240 [17 CFR 230.240], and Rule 242 [17 CFR 230.242], all of which may be utilized in connection with securities offered pursuant to employee benefit plans. Regulation A can be relied upon for offerings of up to $1.5 million during a 12 month period. Rule 240 is available for offerings of up to $100,000 during a similar period. Rule 242 may be used for offerings of up to $2 million of securities in a single issue if certain conditions are met.

B. Section 3(a)(2)

Congress amended section 3(a)(2) in 1970 [108] to exempt securities issued in connection with certain employee benefit plans. The relevant provisions of Section 3(a)(2) read as follows:

Section 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * * * *

(2) * * * any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian; * * * or any interest or participation in a single or collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of such Code, other than any plan described in clause (A) or (B) of this paragraph (i) the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code. The Commission, by rules and regulations or order, shall exempt from the provisions of section 5 of this title any interest or participation issued in connection with a stock bonus, pension, profit-sharing, or annuity plan which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954, if and to the extent that the Commission determines this to be necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title. For purposes of this paragraph, a security issued or guaranteed by a bank shall not include any interest or participation in any collective trust fund maintained by a bank; and the term "bank" means any national bank, or any banking institution organized under the laws of any State, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official; except that in the case of a common trust fund or similar fund, or a collective trust fund, the term "bank" has the same meaning as in the Investment Company Act of 1940.

1. Definitions.—The lengthy and complex provisions of section 3(a)(2) quoted above can best be analyzed by first defining the major terms used therein. The meaning of those terms is described below.

(a) *Interest or Participation.* The beneficial right or share which a participant has in a plan, or which a plan has in a single trust fund, collective trust fund, or separate account.

(b) *Common Trust Fund.* A trust fund maintained by a bank as an investment vehicle solely for trusts, estates or similar entities for which the bank acts in a bona fide fiduciary capacity, such as that of trustee, executor, administrator or guardian.[109] Such a fund may not be used as a vehicle for direct investment by members of the public.[110] The staff takes the position that the exemption in section 3(a)(2) of the 1933 Act (as well as its counterpart in section 3(c)(3) of the 1940 Act) for interests or participations in bank-maintained common trust funds was not meant to exempt investments by a bank as trustee for employee benefit plans,

[106] The exemptions in Sections 3 and 4 do not apply to the antifraud provisions of the Act. *See* in this regard the introductory phrase to Section 4, as well as Section 17(c) of the Act.

[107] The intrastate offering exemption requires that all plan participants and the plan trustee reside in the same state as the employer. See letters re *Queens County Medical Society* dated January 7, 1972 [plan participants], and *Continental Investors Life Insurance Company* dated March 4, 1971 [plan trustee]. Also, the exemption may not be relied upon if the securities of the employer held by the trustee are not eligible for the exemption. Letter re *Rochester Telephone Corp.* dated June 2, 1978.

[108] Note 22, *supra.* The amendments made to Section 3(a)(2) in 1970 hereinafter are cited as the "1970 Amendments".

[109] House Report No. 91–1382 (1970) (hereinafter "House Report"), at 43, and Senate Report No. 91–184 (1969) (hereinafter "Senate Report"), at 27.

[110] House Report at 43, and Senate Report at 27.

including Keogh plans.[111] Such investments were meant to be exempted by the later clause in section 3(a)(2) dealing with collective trust funds for employee benefit plans, provided the conditions of that clause are satisfied.

(c) *Collective Trust Fund.* A trust fund maintained by a bank as an investment vehicle solely for corporate stock bonus, pension, or profit-sharing plans (other than Keogh plans) which meet the requirements for qualification under section 401(a) of the Internal Revenue Code.[112] Like a common trust fund, a collective trust fund may not be used for direct investment by members of the public.[113] It should be noted that the section 3(a)(2) exemption for interests or participations in collective trust funds will not be available to a collective fund which commingles the assets of section 401 qualified plans with those of Keogh plans.[114]

(d) *Single Trust Fund.* A non-collective trust fund (i.e.), a fund which is not established at the instance of, or by, a financial intermediary for the use of separate employers).[115] Under this definition, each of the following would be considered a single trust fund: (1) a trust fund for employees of a single employer;[116] (2) a trust fund for employees of employers so closely related as to be regarded as a single employer (e.g., a parent and its subsidiaries);[117] and (3) a trust fund established and controlled by employers and/or a union representing the employees of such employers.

(e) *Bank.* This term includes the following entities only: (1) a banking institution organized under the laws of the United States, (2) a member bank of the Federal Reserve System, (3) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency and which is supervised and examined by a State or federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of the 1940 Act, and (4) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (1), (2) or (3).[118] In connection with the foregoing, neither a savings and loan association[119] nor a bank holding company will be considered a bank, but a foreign bank whose U.S. operations are subject to the regulations of domestic banking authorities will be so considered.[120]

(f) *Separate Account.* An account established and maintained by an insurance company pursuant to the laws of any State or territory of the United States, the District of Columbia, or of Canada or any province thereof, under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.[121]

(g) *Insurance Company.* A company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risk underwritten by insurance companies, and which is subject to supervision by the insurance commissioner, or a similar official or agency, of a State or territory or the District of Columbia; or any receiver or similar official, or any liquidating agent for such company, in his capacity as such.[122]

(h) *Plan.* The permanent[123] Program or arrangement under which participating employees will become entitled to benefits. The four types of plans which are specifically referred to in Section 3(a)(2) are described below. The first three must meet the requirements for qualification under section 401(a) of the Internal Revenue Code,[124] while the fourth must satisfy the requirements for the deduction of the employer's contribution under section 404(a)(2) of the Code.

(1) *Pension Plan.* A plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to its employees over a period of years, usually for life, after retirement.[125]

(2) *Profit-Sharing Plan.* A plan established and maintained by an employer to provide for participation in its profits by its employees or their beneficiaries.[126]

(3) *Stock Bonus Plan.* A plan established and maintained by an employer to provide benefits similar to those of a profit-sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company.[127]

(4) *Annuity Plan.* A pension plan under which retirement benefits are provided under annuity or insurance contracts without a trust.[128]

(i) *Single Employer.* An employer and any entity controlling, controlled by, or under common control with, such employer. This definition represents a departure from prior staff interpretations and will be discussed in detail later in this section.

2. Scope of the Exemption.—The 1970 Amendments to section 3(a)(2) codified in part the Commission's longstanding administrative position[129] that interests or participations issued in connection

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[111] See letters re *National Boulevard Bank of Chicago* dated February 20, 1974 and September 18, 1974 (reconsideration request) issued by the Division of Investment Management.

[112] House Report at 43, and Senate Report at 27. *See* also letter re *Communications Workers of America* dated December 28, 1979 issued by the Division of Investment Management.

[113] House Report at 43, and Senate Report at 27.

[114] Letter re *Pueblo Bank and Trust Company* dated December 4, 1979. The same principle applies to the commingling of assets of Section 401 plans with assets of IRAs.

[115] Letter re *Communications Workers of America* cited in Note 112, *supra.*

[116] *See* the definition in this section of the term "single employer."

[117] Letter re *Gibson, Dunn & Crutcher* dated March 18, 1974 issued by the Division of Investment Management.

[118] The definition used for the term "bank" is the one found in Section 2(a)(5) of the 1940 Act. The 1940 Act definition is applicable because of the language used in the last clause of Section 3(a)(2), which states that ". . . in the case of a common trust fund or similar fund, or a collective trust fund, the term 'bank' has the same meaning as in the Investment Company Act of 1940."

[119] Letter re *First Western Savings Association* dated September 8, 1975.

[120] Letter re *Sumitomo Trust and Banking Company, Limited* dated November 27, 1978.

[121] Section 2(14) of the 1933 Act.

[122] Section 2(13) of the 1933 Act.

[123] IRC Regulation § 1.401–1(b)(2) states that for purposes of qualification under Section 401(a) of the IRC, "the term 'plan' implies a permanent as distinguished from a temporary program." The regulation goes on to indicate that "the abandonment of the plan for any reason other than business necessity within a few years after it has taken effect will be evidence that the plan from its inception was not a bona fide program for the exclusive benefit of employees in general."

[124] The availability of the Section 3(a)(2) exemption does not depend on the name given to a plan. What is important is that the plan meet the requirements for qualification under Section 401 of the Internal Revenue Code. Thus, plans with names such as "incentive compensation plan" [letter re *First Union, Inc.* dated November 29, 1971], "thrift and savings plans" [letter re *Finnigan Corporation* dated April 2, 1976], and "savings plan for salaried employees" [letter re *Bell System Savings Plan for Salaried Employees* dated March 18, 1971], have been considered within the scope of the exemption because they satisfied the requirements for qualification under Section 401.

If a pension, profit-sharing, stock bonus, or similar plan does not qualify under Section 401, then the exemption provided by Section 3(a)(2) would not be available. For example, a collective trust fund which included assets of Individual Retirement Accounts would not be able to rely upon the exemption because IRAs fall under Section 408 of the Internal Revenue Code, not Section 401. Letter re *Gary-Wheaton Bank* dated October 30, 1975.

[125] IRC Reg. § 1.401–1(b)(1)(i).

[126] IRC Reg. § 1.401–1(b)(1)(ii).

[127] IRC Reg. § 1.401–1(b)(1)(iii).

[128] IRC Reg. § 1.404(a)–3(a).

[129] Opinion of the Assistant General Counsel, Note 18 *supra.*

with employee benefit plans need not be registered unless employee funds are used to purchase employer securities. In the *Daniel* decision, however, the Supreme Court implied, in *dictum*, that the section 3(a)(2) exemption extends only to the interests or participations of plans in certain funding vehicles, rather than the interests of employees in the plans themselves.[130]

The legislative history of the 1970 Amendments indicates that their original purpose was to alleviate a concern expressed by banks and insurance companies that there was no clear exemption from registration in the 1933 Act for interests in the collective funding vehicles maintained by those entities for employee benefit plans.[131] While the amendments were under consideration, however, language was added that reflected the Commission's consistent administrative practice of not requiring interests in plans to be registered except where employee money is used to buy securities of the employer.[132]

The inclusion of the language referred to above, as well as a recent decision by a U.S. District Court,[133] would seem to support the staff's view that the implicit purpose of the 1970 Amendments was to exempt not only the interests of plans in certain investment vehicles, but also the interests of participants in the plans themselves.[134] This position is reasonable when one considers that, from the employee's standpoint, his interest in the plan is inseparable from his aliquot share of the plan's interest in the funding vehicle. Moreover, there is the practical consideration that if section 3(a)(2) were not broadly construed to cover employee interests in plans as well as plan interests in funding vehicles, many plans would have no exemption from registration upon which to rely for the offer and sale of interests to employees.[135] Accordingly, the staff believes it is appropriate to link both the plan's interest in a funding vehicle and the interests of participants in the plan itself for purposes of the exemption provided by section 3(a)(2).

The staff recognizes that the Supreme Court, in the *Daniel* decision, did not endorse the broad view of the 3(a)(2) exemption described above.[136] While the statements by the Court are entitled to serious consideration, they are *dicta* and therefore do not resolve the issue conclusively. This fact is reflected in Chief Justice Burger's concurring opinion, in which he stated that "There is no need to deal, in this case, with the scope of this exemption, since it is not an issue presented for decision."[137] The Chief Justice further noted that "the construction of the 1970 Amendment may be problematical" and "of real importance to someone in some future case" and that, as a result, he was "reserving any expression of views" on the scope of the exemption.[138] In light of all of the foregoing, particularly the negative effects on many plans which might flow from a narrow construction of Section 3(a)(2), the staff will continue to view the exemption as being applicable to both interests in funding vehicles and interests in plans.

3. Significant Interpretive Issues.— There are several significant interpretive issues under section 3(a)(2) that have arisen over the years. These are discussed in detail in the sections which follow.

a. *"Maintained by a Bank" Requirement.* Section 3(a)(2) states in part that it shall be available for interests or participations in any "common trust fund * * * maintained by a bank" or any "single or collective trust fund maintained by a bank," provided certain conditions are met. The word "maintained" has been interpreted by the staff to mean that the bank must exercise "substantial investment responsibility" over the trust fund administered by it.[139] Thus, a bank which functions in a mere custodial or similar capacity will not satisfy the "maintained" requirement.[140] In exercising its investment authority over a trust fund, however, a bank may hire an investment adviser to assist it, although the final decision whether or not to invest must be made by the bank.[141]

The principal question concerning the "maintained" requirement is whether it applies to single trust funds. The language of the statute, which is the starting point in statutory construction,[142] suggests that such funds must be so maintained. The staff, however, has taken the position that the "maintained" requirement applies only to common and collective trust funds.[143] Thus, interests or participations in a single trust fund which does not have a bank as trustee will be deemed exempt under Section 3(a)(2) if all of the other requirements of the provision are satisfied.

The staff's view that single trust funds need not be maintained by a bank is based on its perception of the intent of Congress at the time the reference to such funds was inserted in section 3(a)(2). The reference was included in 1970[144] at the request of Sperry-Rand Corporation,[145] with the Commission's full support.[146] Sperry-Rand had expressed concern that a failure to refer specifically to single trust funds in the then-pending amendments to section 3(a)(2) would create a negative inference

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[130] The Court stated in this regard that the 1970 Amendments to Section 3(a)(2) "recognized only that a pension plan has 'an interest or participation' in the fund in which its assets were held, not that prospective beneficiaries of a plan had any interest in either the plan's bank-maintained assets or the plan itself." 99 S. Ct. 799. *See* also, n. 19 at 99 S. Ct. 799.

[131] In the case of banks, the concern arose because the exemption for bank securities previously included in Section 3(a)(2) and thought to be applicable to interests in bank common and collective trust funds was determined not to be available for such interests. This position was codified to some extent in the 1970 Amendments to Section 3(a)(2), which added a provision to that section stating that a "security issued or guaranteed by a bank shall not include any interest or participation in any collective trust fund maintained by a bank." Subsequently, insurance companies also became concerned that the separate accounts maintained by them for investments by Section 401 corporate plans might involve the issuance of securities for which there was no available exemption from registration.

[132] See the portion of Section 3(a)(2) which states that the exemption does not extend to plans for a single employer "under which an amount in excess of the employer's contribution is allocated to the purchase of securities * * * issued by the employer or [an affiliate thereof] * * *"

[133] *Leonard* v. *Drug Fair* (D.C. of D.C., 1979), CCH ¶97,144.

[134] The exemption, however, certainly does not extend to stock or other securities that may be held by a plan. Such securities must find their own exemption from registration. *See* letter re *AMF, Inc.* dated September 29, 1978.

[135] This, of course, presumes that such interests are securities, a presumption that, as previously stated, may be applicable only to voluntary, contributory plans.

[136] Note 130, *supra.*

[137] 99 S. Ct. 802.

[138] *Id.*

[139] Letters re *Bank of America* dated December 8, 1971 and *Sterling National Bank and Trust Company of New York* dated February 10, 1976. A similar view has been adopted by the Division of Investment Management with respect to the "maintained" requirement of Section 3(c)(11) of the 1940 Act, a provision comparable to Section 3(a)(2) insofar as employee benefit plans are concerned. See letter re *Bank of Delaware* dated November 15, 1972.

[140] Letter re *Bank of America* dated December 8, 1971.

[141] Letters re *First Liberty Real Estate Fund* dated June 12, 1975 and *Sterling National Bank and Trust Company of New York* dated February 10, 1976.

[142] 99 S. Ct. 795.

[143] Letters re *Gilbert Associates* dated October 31, 1977 and *New England Electric System* dated April 5, 1979.

[144] Pub. L. No. 91-547 (December 14, 1970).

[145] *See* letter from the General Counsel of Sperry-Rand to the Honorable John E. Moss dated November 7, 1969. The letter is reproduced at pages 929-930 of the Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737 before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 91st Cong., 1st Sess., pt. 2 (1969). The letter to Congressman Moss was preceded by two letters from the Assistant Secretary of Sperry-Rand to staff members of the Commission dated April 30, 1969 and May 9, 1969, respectively.

[146] Commission minute dated June 18, 1969.

that interests in such funds were required to be registered. Such an inference, as previously indicated, would have been contrary to the Commission's consistent position over the years that interests in such funds were subject to registration only where employee funds were invested in securities of the employer.[147]

To eliminate the problem raised by Sperry-Rand, it was decided to insert the words "single or" in section 3(a)(2) immediately in front of the words "collective trust fund maintained by a bank." In retrospect, this method of resolving the issue was somewhat inartful, since it created the erroneous impression that single trust funds had to be maintaind by a bank in order for interests therein to be exempt under section 3(a)(2). Certainly, there was no intent by Congress to change the Commission's prior interpretive position that such funds did not have to be maintained by a bank in order to avoid registration. This is evident from the Conference Report on the subject, which stated that the amendment "codified a long established administrative practice of the Commission by making it clear that [the section 3(a)(2)] exemption applied not only to collective trust funds, but also to single trust funds."[148]

Further support for the validity of the staff's interpretation can be found in section 3(c)(11) of the 1940 Act. That section, together with its predecessor,[149] was the model upon which the provisions in section 3(a)(2) under discussion were based.[150] It excludes from the operation of the 1940 Act "any employees' stock bonus, pension or profit-sharing trust which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954," as well as "any collective trust fund maintained by a bank consisting solely of the assets of such trusts." Clearly, single trust funds are not required to be maintained by a bank under section 3(c)(11). A different view of such funds under section 3(a)(2) would result in an anomaly whereby virtually all single trust funds for section 401 plans would have to be maintained by a bank under the 1933 Act but not under the 1940 Act. Such a result would, in the staff's view, be contradictory and counter to the apparent intent of Congress.

[147] Opinion of Assistant General Counsel, note 18, *supra*.

[148] House Report No. 91-1631 (1970), 31.

[149] The predecessor of section 3(c)(11) was section 3(c)(13), which had been in existence since the inception of the Act in 1940.

[150] See Hearing on Amendment No. 438 to S. 1659 (1967), 1338-1347.

b. *What Constitutes a "Single Employer".* The general exemption provided by section 3(a)(2) for interests or participations issued in connection with certain employee benefit plans contains two exclusions.[151] One relates to interests in Keogh plans and will be discussed in the next section. The other relates to interests in plans whose contributions are held in a single trust fund or separate account for a "single employer" and which permit amounts in excess of the employer's contribution[152] to be used to purchase securities of the employer or its affiliates.[153]

The purpose of the second exclusion described above is to deny the section 3(a)(2) exemption to interests in plans which invest employee contributions in securities of the employer or related entities. It appears, however, that this purpose has been frustrated somewhat by the staff's prior interpretation of the term "single employer." Until now, the staff has viewed the term in a literal sense and stated that a parent and its subsidiaries are not a single employer for purposes of section 3(a)(2).[154] The effect of this has been to permit some plans covering a parent and its subsidiaries to invest employee funds in securities of the parent (or one of the subsidiaries) without abrogating the 3(a)(2) exemption. This has occurred because the exclusion referred to above applies only where a plan both covers a single employer *and* invests employee money in employer securities.

The staff announced some time ago that it was reconsidering its position concerning the single employer question.[155] It has now concluded that its past interpretation of the term was incorrect and contrary to the purpose of the exclusion. A parent and its subsidiaries are in fact under common control and to consider them as separate or unrelated employers ignores reality. Accordingly, in the future, a parent and its subsidiaries will be deemed a single employer for purposes of the 3(a)(2) exclusion being discussed, as will all entities which share a control relationship. It should be noted, however, that the staff's revised view of the single employer question will be applied on a prospective basis only. Therefore, it will not be cited with respect to past activities of employers made in reliance upon the staff's former interpretation.

c. Keogh Plans. As indicated in part II of this release, interests or participations issued in connection with Keogh plans generally are deemed to be securities which are subject to the registration and antifraud provisions of the 1933 Act. Although the intrastate exemption frequently is relied upon for the offer and sale of such interests, registration has been necessary in some instances.[156]

Section 3(a)(2) specifically excludes Keogh plan interests from the general exemption provided by the section[157] but does provide the Commission with the authority to exempt such interests from registration where it is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes [of the 1933 Act]" to do so. This power was granted to the Commission in 1970[158] but was not used until November 1976,[159] when an exemptive order under section

[151] The full text of the two exclusions states that the section 3(a)(2) exemption does not apply to any plan described in clause (A) or (B) of this paragraph (i) the contributions under which are held in a single trust fund maintained by a bank or in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or particpations in the trust or separate account itself) issued by the employer or by a company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees some or all of whom are employees within the meaning of Section 401(c)(1) of such Code.

[152] The reference in the second exclusion to amounts in excess of the employer's contributions simply means that employee funds may not be utilized to purchase securities of the employer or affiliated entities. No tracing of the employer's contributions is necessary to satisfy this requirement. It is enough simply to demonstrate that the amount invested by the plan in employer securities is the same or less than the amount contributed by the employer to the plan. Moreover, the staff has indicated in a letter concerning *Eastman Kodak Company* dated January 22, 1976 that an employee may allocate part or all of his share of the employer's plan contributions to the purchase of employer securities without destroying the 3(a)(2) exemption.

[153] The second exclusion originally applied to both single and collective trust funds maintained by banks for such plans. [Pub. L. 91-547 (December 14, 1970)]. Shortly after its enactment, however, it was amended to delete the reference to collective trust funds. [Pub. L. 91-567 (December 22, 1970)]. This was done in recognition of the fact that such funds might unwittingly lose the 3(a)(2) exemption simply because they invested some of the fund's assets in securities of one of the covered employers.

[154] *See*, e.g., letters re *Bell Systems* available April 16, 1971, *Aluminum Company of America* available March 14, 1974, *Western Gear Corporation* available July 11, 1975, and *Monsanto Co.* available November 19, 1976.

[155] Letter re *Public Service Co. of New Mexico* dated February 8, 1978.

[156] *See*, e.g., the following registration statements: National Bank of Detroit Trust for Retirement Plans (File No. 2-21954), American Security and Trust Company Self-Employed Retirement Trusts (2-51997), and Wells Fargo Keogh Plan Trusts (2-55249).

[157] Note 151, *supra*.

[158] The 1970 Amendments to Section 3(a)(2) granted such authority to the Commission. See Note 22, *supra*.

[159] See Release No. 33-5759 (November 11, 1976) relating to the Keogh plan of the firm of Cravath, Swaine & Moore.

3(a)(20 was issued for interests issued in connection with a Keogh plan for a law firm. Since that time, the Commission has issued over 50 exemptive orders [160] in response to applications submitted by various law firms, accounting firms, and a medical clinic.

Almost all applications for exemptive orders under section 3(a)(2) granted by the Commission have contained the following representations:

(1) The plan is comparable to corporate plans and would be exempt under section 3(a)(2) if the applicant were organized in corporate, rather than partnership, form;

(2) The plan is designed specifically for the applicant and therefore is not a uniform prototype designed for mass marketing by a financial institution to numerous unrelated self-employed persons;

(3) The plan is administered by the employer, who is subject to the fiduciary and disclosure requirements of ERISA, thereby assuring that the interests of participants are protected by the provisions of ERISA; and

(4) The applicant has the resources and the financial expertise to protect its interests and those of the plan participants adequately.

Because the applications for exemptive orders under section 3(a)(2) currently being received are essentially identical, the Commission's Division of Investment Management is drafting a proposed exemptive rule that may eliminate the need for granting exemptive orders in the future. It is anticipated that the proposed rule will be published for comment during 1980.

d. Plans Funded by Certain Insurance Contracts. A relatively new development in the pension and profit-sharing plan area is the funding of such plans through the issuance by insurance companies of so-called "guaranteed investment contracts." Generally, these fixed annuity contracts are sold to trustees of plans or corporate employers establishing plans, and they are written in the form of group annuity contracts for contract periods ranging from three years to beyond twenty years. The trustee or corporate employer makes contributions, in either a single sum or on a periodic basis, which contributions are held as part of the general assets or general account of the insurance company. These contracts generally provide for guaranteed interest and annuity purchase rates, both of which may be subject to change after a specified period, commonly three to five years. Some contracts provide for the payment of interest (or dividends in the case of mutual companies) in excess of the guaranteed amount based upon an investment year method of interest allocation. The contracts also provide for or permit the optional purchase of annuities generally at the time a retiree's annuity is desired.

Certain guaranteed investment contracts appear to be securities. They are not exempt from registration under Section 3(a)(2) of the 1933 Act because they are funded by insurance company general accounts, which are not referred to in that section. (Only separate accounts are mentioned.) They also are not exempt under Section 3(a)(8) of the Act in those instances where the issuing insurance company either fails to assume a meaningful mortality risk under the contract or allows the purchaser to bear a significant investment risk.[161]

Notwithstanding the above, the Division of Investment Management has indicated that it will not recommend any enforcement action if the offer and sale of guaranteed investment contracts to pension and profit-sharing plans is not registered, provided certain specified conditions are met.[162] The conditions are:

(1) Each contract must be issued in connection with a pension or profit-sharing plan which (a) covers not less than 15 persons, or (b) involves annual contributions in excess of $10,000, or (c) is established by a corporate employer with a net worth of at least $100,000 on the last day of its fiscal year preceding the day the contract becomes effective;

(2) Each prospective contractholder must be provided with an offer by the issuer (which also should be contained in any printed sales literature used) to provide upon request financial statements and other material information; and

(3) Advertising describing or offering such contracts must be directed solely to employers who may establish tax-qualified corporate plans or to trustees of such plans.

In addition to the foregoing, a more recent development has been the formation of multiple-employer trusts by insurance companies that are funded, respectively, by fixed or variable annuity contracts, or combination contracts providing both fixed and variable annuity alternatives. The formation of a trust for the offering of such contracts to unrelated employers appears to be necessary to satisfy state insurance requirements. Moreover, because of the economies of scale involved, it has the advantages of permitting reduced group annuity rates and limiting the expenditures for complying with ERISA recordkeeping and reporting requirements.

The Division of Investment Management has indicated that it will not recommend enforcement action to the Commission if multiple-employer trust arrangements of the type described above are marketed without registration of participations in the trusts under the Securities Act of 1933 or registration of the trusts under the Investment Company Act of 1940. A number of facts and representations were important in reaching the no-action position.[163] Specifically:

(1) Participants in the group annuity contract would tender consideration directly to the insurance company, and would receive annuity payments directly from the insurance company;

(2) The insurance company would perform all marketing, administrative and investment functions involved in funding the group annuity contracts, and any financial claim which the participants would have under the contracts would be against the insurance company itself;

(3) The insurance company would name the trustee of each trust, and reserve the right to remove them and name successor trustees;

(4) The sole responsibility of the trustee would be to serve as group annuity contract holder, and the trust would not have any financial interest in the group annuity contract.

In such circumstances, where the multiple-employer trust is passive, compliance with the federal securities laws would be unnecessary.

V. Securities Transactions by Plans

In addition to issuing participation interests and fostering stock purchases by employees, either of which may be subject to the registration and antifraud provisions of the 1933 Act depending on the circumstances, a plan may engage in various other transaction involving the purchase, sale or distribution of

[160] The Commission's Division of Investment Management has been delegated authority by the Commission to issue exemptive orders under Section 3(a)(2) where the applications for such orders do not involve any issues not previously settled by the Commission or raise questions of fact or policy indicating that a hearing should be held. *See* 17 CFR 200.30-5(b-1) (1) and (2).

[161] *See* in this regard, Release No. 33-6051 (April 5, 1979) (44 FR 21626).

[162] Letter to *American Council of Life Insurance* re Guaranteed Investment Contracts dated March 18, 1977. The letter specifically indicates that to the extent guaranteed investment contracts are securities they would be subject to the antifraud provisions of the 1933 Act.

[163] Letter re *Equitable Life Assurance Society of the United States* available July 9, 1979 issued by the Division of Investment Management.

securities. These are briefly discussed in the sections which follow.

A. Acquisitions of Employer Stock

Many plans invest part or all of their assets in stock or other securities of the employer. There are three primary sources that a plan can draw upon to acquire employer securities: the employer, affiliates of the employer, and persons selling their securities in the open market. Generally, no matter from whom the securities are obtained, registration will not be necessary with respect to the acquistion transaction by the plan. The reasons for this result will vary, depending on the manner of acquisition. For instance, there may be no sale involved (as in the case of a contribution of stock or cash to the plan by the employer),[164] or one of the several exemptions from registration provided by section 4 of the Act may be available.[165]

Although the transaction in which a plan acquires employer securities need not be registered, the same would not necessarily be true with respect to the offer, sale or distribution of those securities to plan participants. These latter transactions are separate and distinct from the acquisition transaction and therefore must either be registered or exempt from registration. Further, the plan trustee should take into consideration, when purchasing stock of the employer in the open market, the application of the antifraud provisions of the 1934 Act[166] to such purchases.

B. Sales of Employer Stock

A plan may from time-to-time offer or sell the securities of the employer held by it. If the plan is considered an affiliate[167] of the employer, any such offers or sales, whether to plan participants or to persons not associated with the company, would be subject to the registration and antifraud provisions of the 1933 Act[168] in the same manner as if the employer were engaging in the transaction. Thus, even if the securities to be sold were acquired on the open market, registration would be necessary under such circumstances, absent an available exemption.[169]

C. Distributions of Employer Stock to Plan Participants

The distribution, or actual delivery, of employer stock by a plan to individual participants is not deemed to be a registerable event. Of course, if the plan were to offer or sell such stock to participants prior to actual delivery, registration would be necessary unless an exemption were available.

D. Transactions in Non-Employer Securities

In conducting its operations, a plan may buy or sell securities of issuers other than the employer. Purchases of such securities by the plan ordinarily would not create any 1933 Act consequences,[170] since the compliance provisions of the Act are directed at sellers of securities, not at buyers. Sales of such securities would, of course, have to be made in reliance upon an exemption unless they were registered. The most common exemption relied upon for sales is that provided by section 4(1) of the Act for persons who are not issuers, underwriters [171] or dealers. Rule 144 (17 CFR 230.144)[172] under the 1933 Act provides a safe harbor from registration for persons who wish to rely upon the section 4(1) exemption for resales of restricted securities,[173] provided all of its conditions are met.

Plan trustees who intend to acquire significant amounts of the equity securities of an issuer (including the employer) should bear in mind the potential applicability of sections 13(d), 16(a), and 16(b) of the 1934 Act. Section 13(d) requires beneficial owners of more than five percent of a class of equity securities registered under section 12 of the 1934 Act [174] to report their ownership, as well as any further acquisitions, to the issuer, to any stock exchange on which the securities are traded, and to the Commission. Sections 16(a) and 16(b) apply to beneficial owners of more than 10% of a class of equity securities registered under section 12.[175] Section 16(a) requires an initial report of a person's holdings and subsequent reports of any changes in such holdings. Section 16(b) permits an issuer to recover any profits realized by persons subject to that section on purchases and sales of the issuer's securities that occur within a period of less than six months.

VI. Resales by Plan Participants

A matter of major concern to participants in a pension or profit-sharing plan is the tradeability of securities received by them under the plan. That is, can the securities be freely resold without restrictions or not? The next two sections will attempt to resolve the uncertainty that may exist regarding this issue.

A. Registered Plans

Many plans register the securities offered and sold by them on Form S–8 or some other appropriate registration form under the 1933 Act.[176] Generally, such securities are freely tradeable upon distribution to participants, unless the person acquiring the securities is an affiliate of the issuer. Thus, participants in a registered plan who do not have a control relationship with the issuer may resell the shares or other securities acquired by them under the plan without any restrictions.

Affiliates are in a somewhat different position because their control relationship with the issuer subjects them to the same disabilities regarding registration that would attach to the issuer if it tried to sell the securities. Such persons may resell their shares publicly either pursuant to an effective registration statement or pursuant to Rule 144 [177] under the 1933 Act. Affiliates also may resell the securities

[164] Letter re *Modern Merchandising, Inc.* dated March 24, 1977.

[165] Some of the available exemptions under Section 4 are those provided, respectively, by Section 4(1) for open market purchases from persons who are not underwriters, Section "4(1–1/2)" for purchases form affiliates in private transactions, and Section 4(2) for purchases from the employer in private transactions. For more information concerning the so-called Section "4(1–1/2)" exemption, *see* Note, *infra.*

[166] See Section 10(b) of the 1934 Act and Rule 10b–5 thereunder.

[167] See Note 9, *supra"* for a definition of the term "affiliate."

[168] The antifraud provisions of Section 10(b) of the 1934 Act and Rule 10b–5 thereunder also would apply to any such offers or sales.

[169] Letter re *General Motors Corp.* dated May 10, 1972.

[170] The antifraud provisions of the 1934 Act, however, would apply to all such purchases.

[171] The term "underwriter" is broadly defined in Section 2(11) of the 1933 Act and includes persons who acquire securities "with a view to * * * distribution."

[172] Rule 144 essentially states that a person shall not be deemed an underwriter of the securities he is selling if all of the conditions of the rule are satisfied. These conditions may be summarized as follows: (1) there must be current public information available about the issuer of the securities; (2) the securities must have been held by the seller for at least two years; (3) the amount of securities sold cannot exceed certain specified volume limitations; (4) the securities must be sold either in a broker's transaction or in a transaction with a marketmaker; and (5) a notice of sale on Form 144 must be filed with the Commission if certain specified amounts of securities are to be sold during a three-month period.

[173] See Note 180, *infra* for a description of the term "restricted securities."

[174] A class of equity securities is subject to registration under Section 12 if it is either listed on a national securities exchange (Section 12(b)) or if, at the end of the issuer's fiscal year, it is held of record by more than 500 persons and the issuer has assets exceeding $1,000,000 (Section 12(g)).

[175] Officers and directors of issuers whose securities are registered under Section 12 also are subject to the requirements of Sections 16(a) and 16(b).

[176] See Part VII for a discussion of the various forms that can be used under the 1933 Act for the registration of securities offered and sold by plans.

[177] See Note 172, *supra* for a brief description of Rule 144.

in a private transaction,[178] provided it is understood that the purchaser is acquiring restricted securities which are subject to the same limitations on resale that applied to the seller.

Registration of plan securities for resale by affiliates is relatively easy to accomplish in most cases, since a Form S–16 reoffer prospectus usually can be used for this purpose.[179] With respect to Rule 144, it should be noted that the two-year holding period requirement of the rule does not apply to securities acquired under a registered plan.[180] Thus, some or all of the securities ordinarily could be resold by affiliates under the rule immediately upon acquisition.

B. Unregistered Plans

Other than the one exception noted below, which is based upon an administrative position of the staff, unregistered securities distributed to participants under an employee benefit plan may not be freely resold. Thus, such securities, whether held by affiliates or non-affiliates, must either be registered or sold in reliance upon an exemption, such as that provided by Section 4(1) of the Act. Perhaps the most practical means for relying upon Section 4(1) is to resell the securities pursuant to Rule 144, which, as previously noted, requires that the securities be held a minimum of two years prior to resale.

The exception[181] to the general rule mentioned above applies to shares or other securities received by non-affiliates from a plan under the following conditions: (1) the issuer of the securities is subject to the periodic reporting requirements of Section 13 or 15(d) of the 1934 Act; (2) the stock being distributed is actively traded in the open market; and (3) the number of shares being distributed is relatively small in relation to the number of shares of that class issued and outstanding.

The above conditions are designed to provide some assurance that there is adequate information available to the public concerning the issuer of the distributed securities and that resales of such securities will not have a measurable impact on the trading market. Thus, where the conditions are satisfied, unregistered securities received by non-affiliates may be resold immediately without any restrictions. Affiliates, of course, would continue to be subject to registration, in the absence of an available exemption.

VII. Methods of Registration

Many plans are structured so that registration under the 1933 Act is not required. Where registration is necessary, an appropriate form for this purpose must be selected and all applicable requirements must be complied with. A brief discussion of the available forms and their requirements follows.

A. Form S–8

The principal form used to register securities issued in connection with employee benefit plans is Form S–8. The form is designed primarily to provide information to employees concerning the plan[182] and the securities[183] offered pursuant to it. Sone information concerning the employer,[184] including audited financial statements, also is required to be disclosed by the form. This information, however, is not as extensive as that required by many other registration forms, on the theory that employees are more familiar with their company than most other investors.

The form may be used by any issuer which has been subject, at the time of filing, to the periodic reporting requirements of Section 13 or 15(d) of the 1934 Act for a least the prior 90 days and has filed all reports required during the preceding 12 months or such shorter period that it was subject to those requirements.[185]

The availability of Form S–8 is conditioned on its being used to offer securities to "employees" of the issuer and its parents and subsidiaries pursuant to a "plan."[186] Independent contractors and other persons who do not have a formal employment relationship with the employer or its parent or subsidiaries[187] are not considered to be "employees" for purposes of the form.[188] In addition, a "plan" will not be deemed to exist where only one or a few persons are covered or the incidents of a plan (such as a formal plan document) are not present.[189]

In recent months, the staff has been exploring various possibilities for reducing the time and expense involved in registering securities on Form S–8. In this regard, the Commission recently invited public comment on various proposals concerning the form.[190] One of

[178] In making such private sales, the affiliates presumably would rely on the so-called "Section 4(1–1/2)" exemption. This is a hybrid exemption not specifically provided for in the 1933 Act but clearly within its intended purpose. The exemption basically would permit affiliates to make private sales of securities held by them so long as some of the established criteria for sales under both Section 4(1) and Section 4(2) of the Act are satisfied. For a detailed discussion of the "Section 4(1–1/2)" exemption, *see The Section "4(1–1/2)" Phenomenon: Private Resales of "Restricted Securities"*, a Report to the Committee on Federal Regulation of Securities of the ABA from the Study Group on Section "4(1–1/2)" of the Subcommittee on 1933 Act—General, dated April 30, 1979. The report is reproduced in The Business Lawyer (July 1979), at 1961.

[179] See Part VII for a discussion of the Form S–16 reoffer prospectus.

[180] See in this regard paragraph (d) of Rule 144, which states that the holding period requirement of the rule applies only to restricted securities. The term "restricted securities" is defined in paragraph (a)(3) of the rule and basically includes securities acquired in nonpublic offerings. Securities acquired in registered offerings clearly are not deemed to be restricted securities because such offerings are public in nature, not non-public.

[181] See in this regard Release No. 33–5750 (October 8, 1976) [41 FR 45632].

[182] The information concerning the plan would include: (1) eligibility requirements for employees; (2) contributions to be made by the employer and employees; (3) withdrawal provisions; (4) administration of the plan; (5) investments by the plan; and (6) brokerage placement practices. Also, if interests in the plan are registered, audited statements of the financial condition of the plan and the income and changes in equity of the plan for each of the latest two fiscal years, must be included.

[183] The information regarding the securities being registered would include the title of the class and the rights attendant to those securities. These rights would include: (1) dividend rights; (2) voting rights; (3) liquidation rights; (4) pre-emptive rights; (5) conversion rights; (6) redemption provisions; (7) sinking fund provisions; and (8) liability to further calls or to assessment by the issuer.

[184] The information concerning the employer would, in addition to audited financial statements of the type required to be set forth in its annual report to security holders, include: (1) a summary of operations for each of the preceding five fiscal years; (2) market prices of the employer's securities; (3) the employer's dividend policy; (4) certain significant developments in the last three years; (5) the employer's business and management; and (6) a list of the employer's parents. All of this information can be incorporated by reference from the employer's annual report, which must be furnished to employee participants.

[185] General Instruction A to Form S–8 also states that an issuer which is subject to Section 15(d) of the 1934 Act and wishes to use Form S–8 must furnish to its security holders, prior to the date of effectiveness of the A–8, an annual report for its last fiscal year containing substantially all of the information required by Rule 14a–3 [17 CFR 240.14a–3] under the 1934 Act.

[186] *See* General Instruction A to Form S–8.

[187] Employees of "sister" companies of an issuer (i.e., companies whose shares are paired for trading purposes with shares of the issuer) also may be offered securities pursuant to an S–8. *See* letter re the *L. E. Myers Co.* dated May 5, 1978.

[188] *See*, e.g., letter re *Piedmont Management Company, Inc.* dated March 22, 1977. The form cannot be used for sales to non-employees because such persons presumably do not possess the inherent knowledge of the issuer gained from employment that justifies the abbreviated disclosure requirements of the form.

[189] *See*, e.g., letter re *United States Surgical Corp.* dated August 16, 1976, in which the staff indicated that form S–8 was not available for the registration of securities to be issued to employees pursuant to certain options which did not relate to any specific employee benefit plan of the issuer.

[190] Release No. 33–6151 (November 19, 1979) [44 FR 67671]. In addition to the proposals described in this section, Release 33–6151 also invited comments on the following items: (1) amendments to Form S–8 that would conform plan disclosure and description requirements to similar requirements under ERISA; (2) amendments to Form S–8 to allow updating to be accomplished by means of filings or other documents or reports made pursuant to ERISA; and

Footnotes continued on next page

these proposals would permit new filings on S–8 to become effective automatically on the twentieth day after receipt, without review or other action by the Commission or its staff. In addition, the proposal would allow amendments to previously filed Form S–8 registration statements to become effective automatically on the date of filing, without any waiting period. It is believed that this proposal, if adopted, would permit issuers to make offerings on Form S–8 on a more timely basis than in the past and would allow the staff to reallocate the resources which it formerly devoted to reviewing filings on the form.

Another proposal of a more far-reaching nature would amend Form S–8 to resemble Form S–16 in both its disclosure and operational aspects. Form S–16 is an abbreviated registration form which provides a limited amount of information about the issuer and the offering. It does, however, incorporate by reference certain past and future reports required to be filed by the issuer under Section 13 or 15(d) under the 1934 Act. The assumption underlying Form S–16 is that the information in the 1934 Act reports is widely available and sufficiently detailed to satisfy the disclosure requirements of the 1933 Act.

The use of a Form S–16 registration format for employee benefit plans could result in significant cost savings to issuers. For instance, the expense of preparing such a filing would be minimized because of the limited disclosures involved. And, like all S–16 registration statements, there would be no need to amend the prospectus annually to update it, provided the accountant for the issuer filed an appropriate consent in the issuer's annual report on form 10–K [17 CFR 249.310].[191] Thus, in almost all cases, the initial filing on the revised Form S–8 would be the only one required for the plan, thereby eliminating the expense now involved in preparing and filing annual post-effective amendments to such forms.

It should be noted that final action on the foregoing proposals has yet to be taken by the Commission. It is anticipated, however, that they will be reviewed by the Commission during 1980 and that a decision as to their final status will be made at that time.

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(3) the adoption of one or more new forms that would be less difficult to comply with than Form S–8.

[191] The consent would permit the 10–K financial statements and the accountant's opinion concerning them to be used in connection with filings (such as those on Form S–8) under the 1933 Act.

B. Other Forms

For those issuers who are unable to satisfy the requirements for the use of Form S–8, there are several other forms [192] that may be available to register securities offered under a plan:

(1) *Form S–1.* This is the Commission's general registration form which is available to all issuers for which no other form is authorized or prescribed. It contains detailed disclosure requirements regarding the organization and business of the issuer, as well as extensive financial statement requirements.

(2) *Form S–18.* This form can be used for an offering of up to $5 million in securities for cash. Its availability is limited, however, to U.S. or Canadian corporations who are not subject to the periodic reporting requirements of the 1934 Act and who meet certain other standards.[193] The disclosure requirements of Form S–18 are considerably less difficult to comply with than those of Form S–1.

(3) *Form S–7.* The availability of this form is restricted to established companies who satisfy certain specified criteria.[194] The disclosure requirements of the form are somewhat abbreviated in comparison to those of Form S–1.

(4) *Form S–16.* This form is available only to issuers which qualify for the use of Form S–7 and meet certain other requirements[195] for its use in connection with primary offerings. As previously noted, the disclosure requirements of this form are minimal, with heavy reliance placed on the issuer's continuing disclosures under the 1934 Act.

[192] Specific descriptions of each of these other forms may be found in the Code of Federal Regulations, as follows: Form S–1 [17 CFR 239.11], Form S–7 [17 CFR 239.26], Form S–16 [17 CFR 239.27] and Form S–18 [17 CFR 239.28].

[193] The other requirements are: (1) the issuer must have, or propose to have its principal business operations in the country in which it is incorporated; and (2) the issuer must not be: (a) an investment company; (b) an insurance company exempt from Section 12 of the 1934 Act; (c) a majority owned subsidiary of an issuer which does not meet the requirements for the use of the form; (d) offering limited partnership interests; or (e) engaging or proposing to engage in significant mining operations or oil and gas related operations which exceed the criteria for exemption specified in Rule 3–18(k) [17 CFR 210.3–18(k)] of Regulation S–X.

[194] Among other things, the issuer must have had net income of at least $250,000 for three of the last four fiscal years (including the most recent fiscal year) and been subject to, and filed, all reports and materials required by, Sections 13, 14 and 15(d) of the 1934 Act for at least 36 months preceding the filing on the form. The other requirements for the use of the form can be found in General Instruction A to the form, which is reproduced in CCH ¶ 7,190.

[195] The issuer, among other things, must have stock held by non-affiliates with a market value of $50 million or more. All of the requirements for the use of the form are specified in General Instruction A thereof, which is reproduced in CCH ¶ 7,291.

Although any of the above forms are available to issuers who qualify for their use, the staff takes the position that when they are used in connection with primary offerings by employee benefit plans, they must contain all of the information regarding plans which Form S–8 would otherwise require. Thus, the disclosures regarding the plan would be the same, no matter which registration form was used.

C. Form S–16 Reoffer Prospectus

Affiliates who acquire securities under a plan may not, as previously indicated, freely resell such securities because of their control relationship to the issuer. As a practical matter, these persons must either register the securities for resale or rely upon Rule 144 [196] if they wish to sell the securities in a public transaction.

Affiliates who wish to register their securities for resale may do so on Form S–16, provided the issuer meets the qualifications for the use of the form and the affiliates have a present intention to sell their securities within the next 16 months.[197] S–16, as stated earlier, is a simplified registration form which consists of little more than the names of the selling security holders, the amount of securities being sold, and the terms of their distribution.

If the securities held by the affiliate are covered by a Form S–8 registration statement, the use of Form S–16 for resale is a relatively simple matter. A reoffer prospectus on that form can be filed as part of the S–8,[198] and no separate registration fee is required in such circumstances. The amount of securities that can be included in the S–16 reoffer prospectus, however, is limited to the quantities that can be sold under Rule 144, unless the issuer independently meets the qualifications for the use of the form. In the latter circumstance, there is no limitation on the amount of securities that can be included in the S–16 for resale.

[196] Rule 144 is not the exclusive means for resales without registration, as indicated in paragraph (j) of the rule. It appears, however, that insofar as affiliates are concerned, brokerage firms ordinarily would decline to execute an unregistered resale transaction of a public nature by such persons outside the rule.

[197] If Form S–16 cannot be used, Form S–1 would then become the proper form for resale purposes.

[198] *See* in this regard, General Instruction E to Form S–8. The staff has indicated that a limited number of securities issued by a plan prior to registration may be included in the S–8 filing solely for resale on the Form S–16 reoffer prospectus. Letter re *Colonial Bancorp, Inc.* dated October 17, 1977. The amount that can be so included is limited to 10 percent of the total number of shares issuable under all plans registered by the employer on Form S–8. Letter re *Microdyne Corp.* dated July 3, 1978.

For the Commission.
George A. Fitzsimmons,
Secretary.
February 1, 1980.
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