

DEPARTMENT OF LABOR**Pension and Welfare Benefits
Administration**

[Prohibited Transaction Exemption 98-23;
Exemption Application No. D-10213, et al.]

**Grant of Individual Exemptions;
Bankers Trust Company**

AGENCY: Pension and Welfare Benefits
Administration, Labor.

ACTION: Grant of individual exemptions.

SUMMARY: This document contains exemptions issued by the Department of Labor (the Department) from certain of the prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (the Act) and/or the Internal Revenue Code of 1986 (the Code).

Notices were published in the **Federal Register** of the pendency before the Department of proposals to grant such exemptions. The notices set forth a summary of facts and representations contained in each application for exemption and referred interested persons to the respective applications for a complete statement of the facts and representations. The applications have been available for public inspection at the Department in Washington, DC. The notices also invited interested persons to submit comments on the requested exemptions to the Department. In addition the notices stated that any interested person might submit a written request that a public hearing be held (where appropriate). The applicants have represented that they have complied with the requirements of the notification to interested persons. No public comments and no requests for a hearing, unless otherwise stated, were received by the Department.

The notices of proposed exemption were issued and the exemptions are being granted solely by the Department because, effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) transferred the authority of the Secretary of the Treasury to issue exemptions of the type proposed to the Secretary of Labor.

Statutory Findings

In accordance with section 408(a) of the Act and/or section 4975(c)(2) of the Code and the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, 32847, August 10, 1990) and based upon the entire record, the Department makes the following findings:

(a) The exemptions are administratively feasible;

(b) They are in the interests of the plans and their participants and beneficiaries; and

(c) They are protective of the rights of the participants and beneficiaries of the plans.

Bankers Trust Company (Bankers Trust) Located in New York, New York

[Prohibited Transaction Exemption 98-23;
Exemption Application No. D-10213]

Exemption

The restrictions of sections 406(a), 406 (b)(1) and (b)(2) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply, effective February 16, 1996, to the: (1) lending of certain securities to BT Alex. Brown Incorporated, Bankers Trust International PLC, and Bankers Trust (Australia) Limited (and their corporate successors), which are affiliates of Bankers Trust, (collectively; the Affiliated Borrowers), by certain employee benefit plans (including commingled investment funds holding plan assets) (the Client Plans), for which Bankers Trust and certain other affiliates (the BT Group) act as the directed trustee or custodian or securities lending agent or sub-agent;¹ and (2) receipt of compensation by the BT Group in connection with these transactions; provided that the following conditions are satisfied:

1. Neither the Affiliated Borrowers nor the BT Group has or exercises discretionary authority or control with respect to the investment of the assets of the Client Plans involved in the transaction (other than with respect to the investment of cash collateral after securities have been loaned and collateral received), or renders investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to those assets, including decisions concerning a Client Plan's acquisition and disposition of securities available for loan.

2. Before a Client Plan participates in a securities lending program and before any loan of securities to the Affiliated Borrowers is affected, a Client Plan fiduciary who is independent of the BT Group and the Affiliated Borrowers must have:

(a) Authorized and approved a securities lending authorization

¹ The applicant represents that because Bankers Trust may add new affiliates, the entities comprising the BT Group may change. However, the Affiliated Borrowers will always be BT Alex. Brown Incorporated, Bankers Trust International PLC and Bankers Trust (Australia) Limited (and their corporate successors) for purposes of this exemption.

agreement with the BT Group, where the BT Group is acting as the securities lending agent;

(b) Authorized and approved the primary securities lending authorization agreement with the primary lending agent, where BT Group is lending securities under a sub-agency arrangement with the primary lending agent;² and

(c) Approved the general terms of the securities loan agreement (the Loan Agreement) between such Client Plan and the Affiliated Borrowers, the specific terms of which are negotiated and entered into by BT Group.

3. The Client Plan may terminate the agency or sub-agency agreement at any time without penalty to such plan on five (5) business days notice, whereupon the Affiliated Borrowers shall deliver securities identical to the borrowed securities (or the equivalent in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the plan within (a) the customary delivery period for such securities, (b) five (5) business days, or (c) the time negotiated for such delivery by the Client Plan and the Affiliated Borrowers, whichever is less.

4. The Client Plan will receive from the Affiliated Borrowers (either by physical delivery or by book entry in a securities depository located in the United States, wire transfer or similar means) by the close of business on or before the day on which the loaned securities are delivered to the Affiliated Borrowers, collateral consisting of U.S. currency, securities issued or guaranteed by the U.S. Government or its agencies or instrumentalities, or an irrevocable bank letter of credit issued by a U.S. bank, which is a person other than the Affiliated Borrowers or an affiliate thereof, or any combination thereof, or other collateral permitted under Prohibited Transaction Exemption (PTE) 81-6 (as amended from time to time or, alternatively, any additional or superceding class exemption that may be issued to cover securities lending by employee benefit plans), having, as of the close of business on the preceding business day, a market value (or, in the case of a letter of credit, a stated amount) initially equal to at least 102 percent of the market value of the loaned securities.

² When the BT Group acts as sub-agent, rather than the primary lending agent, the primary lending agent is receiving no section 406(b) of the Act relief herein. In such situations, the primary lending agent may be provided relief by Prohibited Transaction Class Exemption (PTE) 81-6 and PTE 82-63. PTE 81-6 was published at 46 FR 7527, January 23, 1981, as amended at 52 FR 18754, May 19, 1987, and PTE 82-63 was published at 47 FR 14804, April 6, 1982.

If the market value of the collateral on the close of trading on a business day is less than 100 percent of the market value of the borrowed securities at the close of business on that day, the Affiliated Borrowers will deliver additional collateral on the following day such that the market value of the collateral in the aggregate will again equal 102 percent. The Loan Agreement will give the Client Plan a continuing security interest in, title to, or the rights of a secured creditor with respect to the collateral and a lien on the collateral. The BT Group will monitor the level of the collateral daily.

5. When the BT Group lends securities to the Affiliated Borrowers, the following conditions must be met: (a) the collateral will be maintained in U.S. dollars, U.S. dollar-denominated securities or letters of credit of U.S. Banks, or any combination thereof, or other collateral permitted under PTE 81-6 (as amended from time to time or, alternatively, any additional or superceding class exemption that may be issued to cover securities lending by employee benefit plans);³ (b) all collateral will be held in the United States; (c) the situs of the loan agreement will be maintained in the United States; (d) the lending Client Plans will be indemnified by Bankers Trust in the United States for any transactions covered by this exemption with the foreign Affiliated Borrowers so that the Client Plans will not have to litigate in a foreign jurisdiction nor sue the foreign Affiliated Borrowers to realize on the indemnification; (e) prior to the transaction, the foreign Affiliated Borrowers will enter into a written agreement with the Client Plan whereby the Affiliated Borrowers consent to the service of process in the United States and to the jurisdiction of the courts of the United States with respect to the transactions described herein; and (f) (1) Bankers Trust International PLC is a deposit taking institution supervised by the Bank of England; and (2) Bankers Trust (Australia) Limited is a merchant bank which is under the jurisdiction of the Federal Reserve Bank of Australia.

6. Before entering into the Loan Agreement and before a Client Plan lends any securities to the Affiliated Borrowers, the Affiliated Borrowers shall have furnished the following items to the Client Plan fiduciary: (a) the most recent available audited and unaudited statement of the Affiliated Borrowers' financial condition; (b) at the time of the loan, the Affiliated Borrowers must give prompt notice to the Client Plan

fiduciary of any material adverse changes in the Affiliated Borrowers' financial condition since the date of the most recently financial statement furnished to the Client Plan; and (c) in the event of any such changes, the BT Group will request approval of the Client Plan to continue lending to the Affiliated Borrowers before making any such additional loans. No such new loans will be made until approval is received. Each loan shall constitute a representation by the Affiliated Borrower that there has been no such material adverse change.

7. The Client Plan: (a) receives a reasonable fee that is related to the value of the borrowed securities and the duration of the loan, or (b) has the opportunity to derive compensation through the investment of cash collateral. In the case of cash collateral, the Client Plan may pay a loan rebate or similar fee to the Affiliated Borrower, if such fee is not greater than the fee Client Plan would pay an unrelated party in an arm's length transaction.

8. All procedures regarding the securities lending activities will at a minimum conform to the applicable provisions of PTEs 81-6 and 82-63 (as amended from time to time or, alternatively, any additional or superceding class exemption that may be issued to cover securities lending by employee benefit plans).

9. In the event Bankers Trust International PLC and/or Bankers Trust (Australia) Limited default on a loan, Bankers Trust will liquidate the loan collateral to purchase identical securities for the Client Plan. If the collateral is insufficient to accomplish such purchase, Bankers Trust will indemnify the Client Plan for any shortfall in the collateral plus interest on such amount and any transaction costs incurred (including attorney's fees of the Client Plan for legal actions arising out of the default on the loans or failure to properly indemnify under this provision). Alternatively, if such identical securities are not available on the market, Bankers Trust will pay the Client Plan cash equal to the market value of the borrowed securities as of the date they should have been returned to the Client Plan plus all the accrued financial benefits derived from the beneficial ownership of such loaned securities. The lending Client Plans will be indemnified by Bankers Trust in the United States for any loans to the foreign Affiliated Borrowers.

10. In the event BT Alex. Brown Incorporated, a U.S. registered broker-dealer, defaults on a loan, Bankers Trust will liquidate the loan collateral to purchase identical securities for the

Client Plan. If the collateral is insufficient to accomplish such purchase, BT Alex. Brown Incorporated will indemnify the Client Plan for any shortfall in the collateral plus interest on such amount and any transaction costs incurred (including attorney's fees of the Client Plan for legal actions arising out of the default on the loans or failure to properly indemnify under this provision).

11. If the Affiliated Borrowers' default on the securities loan or enter bankruptcy, the collateral will not be available to the Affiliated Borrowers or their creditors, but is used to make the Client Plan whole.

12. The Client Plans will be entitled to the equivalent of all distributions made to holders of the borrowed securities, including all interest, dividends and distributions on the loaned securities during the loan period.

13. Only Client Plans with total assets having an aggregate market value of at least \$50 million are permitted to lend securities to the Affiliated Borrowers; provided however, that—

(a) In the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization (the Related Client Plans), whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangements with the Affiliated Borrowers, the foregoing \$50 million requirement shall be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(b) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization (the Unrelated Client Plans), whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with the Affiliated Borrowers, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50

³ See limitations discussed in Item I.5 of the Written Comments.

million (excluding the assets of any Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity—

(i) Has full investment responsibility with respect to plan assets invested therein; and

(ii) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million. (In addition, none of the entities described above are formed for the sole purpose of making loans of securities.)

14. For purposes of this exemption, the Affiliated Borrowers will consist only of BT Alex. Brown Incorporated, Bankers Trust International PLC and Bankers Trust (Australia) Limited, and their corporate successors.

15. In any calendar quarter, on average 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of the Client Plans by the BT Group in the aggregate will be to borrowers who are not affiliated with the BT Group.

16. The terms of each loan of securities by the Client Plans to any of the Affiliated Borrowers will be at market rates and at terms as favorable to such plans as if made at the same time and under the same circumstances to an unaffiliated party.

17. Each Client Plan will receive a monthly transaction report, including but not limited to the information described in paragraph 24 of the notice of proposed exemption (the Notice), so that the independent fiduciary of such plan may monitor the securities lending transactions with the Affiliated Borrowers.

18. During the notification of interested persons period, all Client Plans (that were Client Plans during this period) received a copy of the notice of pendency of the proposed exemption. In addition, current Client Plans will receive a copy of the final exemption and Bankers Trust will provide a copy of the final exemption to any new Client Plans.

19. Bankers Trust or the Affiliated Borrowers maintain or cause to be maintained within the United States for a period of six years from the date of such transaction such records as are

necessary to enable the persons described in paragraph (20) below to determine whether the conditions of this exemption have been met; except that a party in interest with respect to an employee benefit plan, other than Bankers Trust or the Affiliated Borrowers, shall not be subject to a civil penalty under section 502(i) of the Act or the taxes imposed by section 4975(a) or (b) of the Code, if such records are not maintained, or are not available for examination as required by this section, and a prohibited transaction will not be deemed to have occurred if, due to circumstances beyond the control of Bankers Trust or the Affiliated Borrowers, such records are lost or destroyed prior to the end of such six year period.

(20)(i) Except as provided in subparagraph (ii) of this paragraph (20) and notwithstanding any provisions of subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (19) are unconditionally available at their customary location for examination during normal business hours by—

(a) Any duly authorized employee or representative of the Department, the Internal Revenue Service, or the Securities and Exchange Commission,

(b) Any fiduciary of a Client Plan or any duly authorized representative of such fiduciary,

(c) Any contributing employer to any Client Plan, or any duly authorized employee or representative of such employer, and

(d) Any participant or beneficiary of any Client Plan, or any duly authorized representative of such participant or beneficiary.

(ii) None of the persons described in subparagraphs (b)–(d) of this paragraph (20) shall be authorized to examine trade secrets of Bankers Trust or the Affiliated Borrowers, or commercial or financial information which is privileged or confidential.

Effective Date: This exemption is effective as of February 16, 1996.

For a more complete statement of the facts and representations supporting the Department's decision to grant this exemption, refer to the Notice published on February 19, 1998 at 63 FR 8482.

Written Comments

The Department received one written comment (the Comment) with respect to the Notice and no requests for a public hearing. The Comment was filed by Bankers Trust and generally requests clarifications and modifications to the Notice. Set forth below in section I is a discussion of those aspects of the Comment which relate to the language

of the final exemption (the Exemption). In addition, section II below discusses the aspects of the Comment which relate to the Summary of Facts and Representations (the Summary) contained in the Notice.

I. Discussion of the Comment Regarding the Exemption

1. The introductory paragraph of the Notice proposes to exempt, in relevant part, the lending of securities to certain affiliates of Bankers Trust. Bankers Trust states that BT Securities Corporation has merged with Alex. Brown and Sons, Incorporated. Accordingly, Bankers Trust requests that the term "BT Alex. Brown Incorporated" be substituted for "BT Securities Corporation" in the relevant sections of the Notice.

The Department acknowledges the applicant's request and has modified the Exemption to reflect this substitution.

2. Bankers Trust states that it would like to avoid the need to request a clarification of the Exemption from the Department in the future should another change occur in the names of the entities that comprise the BT Group. Thus, the applicant suggests that the term "Affiliated Borrowers" be defined in the Exemption as BT Alex. Brown Incorporated, Bankers Trust International PLC, and Bankers Trust (Australia) Limited and their corporate successors [emphasis added]. Bankers Trust requests that this modification be made in the introductory paragraph of the operative language of the Exemption, in the last sentence of footnote 1, and elsewhere in the Exemption, as relevant.

The Department concurs with the applicant's suggestion and has modified the Exemption accordingly. However, with respect to corporate successors, the Department notes that the Exemption would not be effective for any new entities created by the sale of the underlying assets of an Affiliated Borrower to an unrelated third party.

3. Bankers Trust comments that the Affiliated Borrowers are sometimes only the securities lending agent and not the custodian or directed trustee of the Client Plan. Therefore, Bankers Trust requests that the word "or" should be substituted for the word "and" in the relevant places of the Exemption to clarify that an Affiliated Borrower may be only the securities agent for the Client Plan.

The Department acknowledges the applicant's clarification and has modified the Exemption accordingly.

4. Condition 3 of the Notice provides, among other things, that the Client Plan may terminate the agency or sub-agency

agreement on five (5) days notice whereupon the Affiliated Borrowers shall deliver certificates for securities identical to the borrowed securities to the Client Plan within a specified time period (as stated therein). Bankers Trust states that because the certificates of securities are not physically delivered to the Client Plan in every instance, the words “* * * certificates for” as used in this Condition should be deleted.

The Department acknowledges the applicant's clarification and has modified Condition 3 of the Exemption accordingly.

5. Condition 5(a) of the Notice requires that when the BT Group lends securities to the Affiliated Borrowers, the collateral will be maintained in U.S. dollars, U.S. dollar-denominated securities or letters of credit of U.S. Banks. The applicant states that when Bankers Trust lends securities to the Affiliated Borrowers under the Exemption, it should be able to use as collateral any property or other arrangement which may be permitted by the Department in a future class exemption for securities lending. Therefore, Bankers Trust suggests adding the following language as an insert at the end of the language contained in Condition 5(a):

* * * or any combination thereof, or other collateral permitted under Prohibited Transaction Exemption (PTE) 81-6 (as amended from time to time or, alternatively, any additional or superceding class exemption that may be issued to cover securities lending by employee benefit plans).

The Department concurs with the applicant's suggested modification and has added the above-referenced language to Condition 5(a) of the Exemption. However, the Department notes that the Exemption provides relief from the restrictions of section 406(a) as well as section 406(b)(1) and (b)(2) of the Act, whereas PTE 81-6 provides relief only for securities lending transactions which would violate section 406(a) of the Act. Thus, any amendments that may be made by the Department to PTE 81-6 which would permit different types of assets to be used as collateral for a securities loan would not allow the use of such assets as collateral under this Exemption to the extent that the transactions covered by this Exemption would require relief from section 406(b) of the Act.

6. Condition 8 of the Notice requires that all procedures regarding the securities lending activities will at a minimum conform to the applicable provisions of PTEs 81-6 and 82-63. Bankers Trust comments that the

following language should be added at the end of Condition 8 of the Notice.

* * * (as amended from time to time or, alternatively, any additional or superceding class exemption that may be issued to cover securities lending by employee benefit plans).

The Department concurs with the applicant's suggested modification and has added the above-referenced language to Condition 8 of the Exemption.

7. Condition 13 of the Notice requires that only Client Plans with total assets having an aggregate market value of at least \$50 million will be permitted to lend securities to the Affiliated Borrowers. Bankers Trust requests that the Client Plans be permitted to aggregate their assets for purposes of meeting the minimum Plan size requirement for lending securities to the Affiliated Borrowers under the Exemption. Therefore, Bankers Trust recommends that the following language be substituted for Condition 13 of the Notice:

“Only Client Plans with total assets having an aggregate market value of at least \$50 million are permitted to lend securities to the Affiliated Borrowers; provided however, that—

(a) In the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization (the Related Client Plans), whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are “plan assets” under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangements with the Affiliated Borrowers, the foregoing \$50 million requirement shall be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(b) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization (the Unrelated Client Plans), whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are “plan assets” under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with the Affiliated Borrowers, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Plan with respect to which the fiduciary responsible for making the

investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity—

(i) Has full investment responsibility with respect to plan assets invested therein; and
(ii) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(In addition, none of the entities described above are formed for the sole purpose of making loans of securities.)” [emphasis added]

The Department concurs with this change to the language of Condition 13 of the Notice and has modified the Exemption accordingly.

II. Discussion of the Comment Regarding the Summary

1. Paragraph 4 of the Summary in the Notice contains a discussion regarding Federal Reserve Board's Regulation T. Bankers Trust comments that the Regulation T provision that limited the situations for which securities may be borrowed or lent (the “purpose test”) has been amended to reflect recent legislation, and now may not apply to Bankers Trust securities lending activities in every instance. Thus, the representation previously made by Bankers Trust, as stated in the first sentence of Paragraph 4 of the Summary, should be modified to read as follows:

BT Alex. Brown Incorporated, a U.S. registered broker-dealer, will comply with the Federal Reserve Board's Regulation T in its securities lending activities to the extent that Regulation T applies.

The Department concurs with this modification.

2. Paragraph 17 of the Summary discusses the written schedule of lending fees and rebate rates established by the BT Group. In this regard, in order to clarify how these rates may relate to the rates for a particular securities lending transaction with a Client Plan, Bankers Trust requests that the third sentence in Paragraph 17 of the Summary be changed as follows:

In no case will loans be made to the Affiliated Borrowers at rates less favorable to the Client Plans than those on the schedule. [emphasis added]

The Department concurs with this modification.

3. Bankers Trust comments that the BT Group will provide notice of a change in the lending fee formula or

rebate rate formula, as discussed in paragraph 21 of the Summary. However, because the formula rates are designed to vary based on the operation of the formula, the BT Group will provide notice only of the formula change (unless such formula change would always be beneficial to the Client Plans), and not of a decrease or increase in the lending fee or rebate rate itself. Therefore, Bankers Trust states that its previous representations, which are contained in first and second sentences of Paragraph 21 of the Summary, should be clarified as follows:

Should the BT Group recognize prior to the end of a business day that, with respect to new and/or existing loans, it must change the rebate rate formula or lending fee formula in the best interest of Client Plans, it may do so with respect to the Affiliated Borrowers.

If the BT Group changes the lending fee formula or the rebate rate formula on any outstanding loan to the Affiliated Borrower (except for any change resulting from a change in the value of any third party independent index with respect to which the fee or rebate is calculated, or if the formula will always be beneficial to the Client Plan), the BT Group, by the close of business on the date of such adjustment, shall provide the independent fiduciary of the Client Plan with notice that it has changed such fee formula or rebate rate formula with respect to such Affiliated Borrower and that the Client Plan may terminate such loan at any time. [emphasis added]

The Department acknowledges Bankers Trust's request for clarification to the representations contained in Paragraph 21 of the Summary as well as the other clarifications to the current record provided by the applicant.

Therefore, after giving full consideration to the entire record, including the Comment, the Department has decided to grant the exemption, subject to the modifications and clarifications described above. The Comment has been included as part of the public record of the exemption application. The complete exemption file is available for public inspection in the Public Disclosure Room of the Pension and Benefits Administration, Room N-5638, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

For Further Information Contact: Ekaterina A. Uzlyan, U.S. Department of Labor, telephone (202) 219-8883. (This is not a toll-free number.)

Goldman Sachs & Co. (Goldman Sachs) and The Goldman Sachs Trust Company (GSTC) Located in New York, NY

[Prohibited Transaction Exemption 98-24; Exemption Application No. D-10306]

Exemption

The restrictions of sections 406(a)(1)(A) through (D) and 406(b)(1) and (2) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply, effective July 31, 1996, to the past and continued lending of securities to Goldman Sachs International or any other Goldman Sachs affiliate based in the United Kingdom (together, GSI), Goldman Sachs, affiliated U.S. registered broker-dealers of Goldman Sachs, or Goldman Sachs (Japan), Ltd., including any of its affiliates (together, Goldman Sachs (Japan)),⁴ by employee benefit plans (the Client Plans), including commingled investment funds holding Plan assets, for which Goldman Sachs Trust Company (GSTC), an affiliate of Goldman Sachs, acts as securities lending agent (or sub-agent) and to the receipt of compensation by GSTC in connection with these transactions, provided that the following conditions are met:

(a) For each Client Plan, neither GSTC, Goldman Sachs nor an affiliate of either has or exercises discretionary authority or control with respect to the investment of the Plan assets involved in the transaction, or renders investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to those assets.

(b) Any arrangement for GSTC to lend Plan securities to Goldman Sachs in either an agency or sub-agency capacity is approved in advance by a Plan fiduciary who is independent of Goldman Sachs and GSTC.⁵ In this regard, the independent Plan fiduciary also approves the general terms of the securities loan agreement (the Loan Agreement) between the Client Plan and Goldman Sachs, although the specific terms of the Loan Agreement are negotiated and entered into by GSTC

⁴Unless otherwise noted, for purposes of this exemption, Goldman Sachs, the affiliated U.S. registered broker-dealers of Goldman Sachs, GSI and Goldman Sachs (Japan) are collectively referred to herein as Goldman Sachs.

⁵The Department, herein, is not providing exemptive relief for securities lending transactions engaged in by primary lending agents, other than GSTC, beyond that provided pursuant to Prohibited Transaction Exemption (PTE) 81-6 (46 FR 7527, January 23, 1981, as amended at 52 FR 18754, May 19, 1987) and PTE 82-63 (47 FR 14804, April 6, 1982).

and GSTC acts as a liaison between the lender and the borrower to facilitate the lending transaction.

(c) The terms of each loan of securities by a Client Plan to Goldman Sachs is at least as favorable to such Plans as those of a comparable arm's length transaction between unrelated parties.

(d) A Client Plan may terminate the agency or sub-agency arrangement at any time without penalty to such Plan on five business days notice.

(e) The Client Plan receives from Goldman Sachs (either by physical delivery or by book entry in a securities depository located in the United States, wire transfer or similar means) by the close of business on or before the day the loaned securities are delivered to Goldman Sachs, collateral consisting of cash, securities issued or guaranteed by the United States Government or its agencies or instrumentalities, or irrevocable United States bank letters of credit issued by a person other than Goldman Sachs or an affiliate thereof, or any combination thereof, or other collateral permitted under PTE 81-6, as it may be amended or superseded.

(f) As of the close of business on the preceding business day, the fair market value of the collateral initially equals at least 102 percent of the market value of the loaned securities and, if the market value of the collateral falls below 100 percent, Goldman Sachs delivers additional collateral on the following day such that the market value of the collateral again equals 102 percent.

(g) Prior to entering into the Loan Agreement, Goldman Sachs furnishes GSTC its most recently available audited and unaudited statements, which is, in turn, provided to a Client Plan, as well as a representation by Goldman Sachs, that as of each time it borrows securities, there has been no material adverse change in its financial condition since the date of the most recently-furnished statement that has not been disclosed to such Client Plan; provided, however, that in the event of a material adverse change, GSTC does not make any further loans to Goldman Sachs unless an independent fiduciary of the Client Plan is provided notice of any material adverse change and approves the loan in view of the changed financial condition.

(h) In return for lending securities, the Client Plan either—

(1) Receives a reasonable fee, which is related to the value of the borrowed securities and the duration of the loan; or

(2) Has the opportunity to derive compensation through the investment of cash collateral. (Under such

circumstances, the Client Plan may pay a loan rebate or similar fee to Goldman Sachs, if such fee is not greater than the fee the Client Plan would pay in a comparable arm's length transaction with an unrelated party.)

(i) All procedures regarding the securities lending activities conform to the applicable provisions of Prohibited Transaction Exemptions PTE 81-6 and PTE 82-63 as well as to applicable securities laws of the United States, the United Kingdom or Japan.

(j) Each Goldman Sachs entity indemnifies and holds harmless each lending Client Plan in the United States against any and all losses, damages, liabilities, costs and expenses (including attorney's fees) which the Client Plan may incur or suffer directly arising out of the lending of securities of such Client Plan to such Goldman Sachs entity. In the event that GSI or Goldman Sachs (Japan) defaults on a loan, GSTC will liquidate the loan collateral to purchase identical securities for the Client Plan. If the collateral is insufficient to accomplish such purchase, GSTC will indemnify the Client Plan for any shortfall in the collateral plus interest on such amount and any transaction costs incurred (including attorney's fees of the Client Plan for legal actions arising out of the default on the loans or failure to properly indemnify under such provisions). Alternatively, if such identical securities are not available on the market, GSTC will pay the Client Plan cash equal to (1) the market value of the borrowed securities as of the date they should have been returned to the Client Plan, plus (2) all the accrued financial benefits derived from the beneficial ownership of such loaned securities as of such date, plus (3) interest from such date to the date of payment.

(k) The Client Plan receives the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including, but not limited to, cash dividends, interest payments, shares of stock as a result of stock splits and rights to purchase additional securities, or other distributions.

(l) Except for Client Plans which have or had outstanding securities loans to Goldman Sachs before February 19, 1998, Goldman Sachs provides, prior to any Client Plan's approval of the lending of its securities to Goldman Sachs, copies of the notice of proposed exemption (the Notice) and the final exemption. With respect to Client Plans which have or had outstanding securities loans to Goldman Sachs through GSTC prior to February 19,

1998, GSTC provides such Plans with copies of the Notice.

(m) Each Client Plan receives monthly reports with respect to its securities lending transactions, including, but not limited to the information described in Representation 31 of the Notice, so that an independent fiduciary of the Client Plan may monitor such transactions with Goldman Sachs.

(n) Only Client Plans with total assets having an aggregate market value of at least \$50 million are permitted to lend securities to Goldman Sachs; provided, however, that—

(1) In the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization (the Related Client Plans), whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangements with Goldman Sachs, the foregoing \$50 million requirement shall be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(2) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization (the Unrelated Client Plans), whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with Goldman Sachs, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity—

(i) Has full investment responsibility with respect to plan assets invested therein; and

(ii) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(In addition, none of the entities described above are formed for the sole purpose of making loans of securities.)

(o) With respect to any calendar quarter, at least 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of Client Plans will be to unrelated borrowers.

(p) In addition to the above, all loans involving GSI and Goldman Sachs (Japan), have the following supplemental requirements:

(1) Such broker-dealer is registered as a broker-dealer with the Securities and Futures Authority of the United Kingdom or with the Ministry of Finance and the Tokyo Stock Exchange;

(2) Such broker-dealer is in compliance with all applicable provisions of Rule 15a-6 (17 CFR 240.15a-6) under the Securities Exchange Act of 1934 which provides for foreign broker-dealers a limited exemption from United States registration requirements;

(3) All collateral is maintained in United States dollars or dollar-denominated securities or letters of credit;

(4) All collateral is held in the United States and GSTC maintains the situs of the securities Loan Agreements in the United States under an arrangement that complies with the indicia of ownership requirements under section 404(b) of the Act and the regulations promulgated under 29 CFR 2550.404(b)-1; and

(5) GSI or Goldman Sachs (Japan) provides Goldman Sachs a written consent to service of process in the United States for any civil action or proceeding brought in respect of the securities lending transaction, which consent provides that process may be served on such borrower by service on Goldman Sachs.

(q) Goldman Sachs and its affiliates maintain, or cause to maintain within the United States for a period of six years from the date of such transaction, in a manner that is convenient and accessible for audit and examination, such records as are necessary to enable the persons described in paragraph (r)(1) to determine whether the conditions of the exemption have been met, except that—

(1) A prohibited transaction will not be considered to have occurred if, due

to circumstances beyond the control of Goldman Sachs and/or its affiliates, the records are lost or destroyed prior to the end of the six year period; and

(2) No party in interest other than Goldman Sachs shall be subject to the civil penalty that may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if the records are not maintained, or are not available for examination as required below by paragraph (r)(1).

(r)(1) Except as provided in subparagraph (r)(2) of this paragraph and notwithstanding any provisions of subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (q) are unconditionally available at their customary location during normal business hours by:

(i) Any duly authorized employee or representative of the Department, the Internal Revenue Service or the Securities and Exchange Commission (the SEC);

(ii) Any fiduciary of a participating Client Plan or any duly authorized representative of such fiduciary;

(iii) Any contributing employer to any participating Client Plan or any duly authorized employee representative of such employer; and

(iv) Any participant or beneficiary of any participating Client Plan, or any duly authorized representative of such participant or beneficiary.

(r)(2) None of the persons described above in paragraphs (r)(1)(ii)-(r)(1)(iv) of this paragraph (r)(1) are authorized to examine the trade secrets of Goldman Sachs or commercial or financial information which is privileged or confidential.

Effective date: This exemption is effective as of July 31, 1996.

For a more complete statement of the facts and representations supporting the Department's decision to grant this exemption, refer to the Notice published on February 19, 1998 at 63 FR 8489.

Written Comments

The Department received one written comment with respect to the Notice and no requests for a public hearing. The comment, which was submitted by Goldman Sachs, suggested modifications to the operative language of the Notice and recommended certain changes to the Summary of Facts and Representations (the Summary) of the Notice. Presented below are the modifications requested by Goldman Sachs and the Department's accompanying responses.

1. *Condition (l).* Condition (l) of the Notice requires that GSTC provide a copy of the proposed and final

exemption to Client Plans prior to such plans' approval of loans to Goldman Sachs. Given that the relief requested is retroactive, Goldman Sachs proposes to amend Condition (l) by inserting the following phrase at the beginning of this provision: "Except for Client Plans which have or had outstanding securities loans to Goldman through GSTC prior to February 19, 1998." In addition, Goldman Sachs suggests adding the following sentence to the end of Condition (l): "With respect to Client Plans which have or had outstanding securities loans to Goldman through GSTC prior to February 19, 1998, GSTC will provide such Plans with the notice of pendency as set forth in the Notice to Interested Persons section of the proposed exemption." In response, the Department has modified Condition (l) of the Notice to read as follows:

(1) Except for Client Plans which have or had outstanding securities loans to Goldman Sachs before February 19, 1998, Goldman Sachs provides, prior to any Client Plan's approval of the lending of its securities to Goldman Sachs, copies of the notice of proposed exemption (the Notice) and the final exemption. With respect to Client Plans which have or had outstanding securities loans to Goldman Sachs through GSTC prior to February 19, 1998, GSTC provides such Plans with copies of the Notice.

2. *Representations 7 and 8.* Representations 7 and 8 of the Summary discuss compliance provisions with Rule 15a-6 of the 1934 Act by Goldman Sachs, GSI and Goldman Sachs (Japan). As noted in the Summary, Rule 15a-6 provides foreign broker-dealers with a limited exemption from SEC registration requirements and offers additional protections. Goldman Sachs states that some of the provisions of Rule 15a-6 have been changed or modified as a result of an SEC No-Action Letter obtained by its counsel on behalf of it and a group of broker-dealers on April 9, 1997.⁶ Although Goldman Sachs represents that it intends to comply with any applicable provisions of Rule 15a-6 as it may change from time to time, for the sake of accuracy, it requests that Representations 7 and 8 be amended to reflect the rule and the no-action relief. Accordingly, Goldman Sachs suggests the following changes which have been made by the Department:

a. *Footnote 14.* Footnote 14 of the Summary states that GSI and Goldman Sachs (Japan) may rely on a U.S. bank or trust company, including GSTC,

⁶ See SEC No-Action Letter dated April 9, 1997 to Giovanni P. Prezioso, Esq. of Cleary, Gottlieb, Steen & Hamilton regarding Securities Activities of U.S.-Affiliated Foreign Dealers.

instead of relying on a U.S. broker-dealer. Goldman Sachs requests that Footnote 14 of the Summary be moved to the end of the third sentence of Representation 7.

b. *Addition of Footnote to Representation 7.* Goldman Sachs suggests that a new footnote be inserted at the end of Representation 7 which would read as follows:

"See also SEC No-Action Letter issued to Cleary, Gottlieb, Steen & Hamilton on April 9, 1997 (hereinafter, "the April 9 No-Action Letter"), expanding the definition of "Major U.S. Institutional Investor."

c. *Addition of Footnote to Representation 8(c)(5).* Representation 8(c)(5) of the Summary states that a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a U.S. institutional or major institutional investor must "receive, deliver and safeguard funds and securities in connection with transactions on behalf of the U.S. institutional investor or U.S. major institutional investor in compliance with Rule 15c3-3 of the 1934 Act (Customer Protection—Reserves and Custody of Securities)." To update this provision, Goldman Sachs requests that the following footnote be placed at the end of paragraph (c)(5) of Representation 8:

"Under certain circumstances described in the April 9, 1997 No-Action Letter (e.g., clearance and settlement transactions), there may be direct transfers of funds and securities between the Client Plan and GSI and Goldman Sachs (Japan). Goldman Sachs notes that in such situations, the U.S. registered broker-dealer will not be acting as a principal with respect to any duties it is required to undertake pursuant to Rule 15a-6."

d. *Modification of Representation 8(c)(6).* Representation 8(c)(6) of the Summary states that a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a U.S. institutional or major institutional investor must "participate in all oral communications (e.g., telephone calls) between the foreign associated person and the U.S. institutional investor (not the U.S. major institutional investor), and accompany the foreign associated person on all visits with both U.S. institutional and major institutional investors. By virtue of this participation, the U.S. registered broker-dealer would become responsible for the content of all these communications."

Given that the relief granted in the April 9, 1997 No-Action Letter significantly modified the "chaperoning" requirements of Rule 15a-6 to provide, under certain

circumstances, direct communications and contact between the foreign broker-dealer and the U.S. Institutional Investor, Goldman Sachs requests that the reference to "all communications" and "all visits" be amended to read "certain communications" and "certain visits." In addition, Goldman Sachs requests that the last sentence of Representation 8(c)(6) be deleted and the following footnote be added to the end of such section to read:

"Under certain circumstances, the foreign associated person may have direct communications and contact with the U.S. Institutional Investor. See April 9 SEC No-Action Letter."

3. *Representation 12.* The second sentence of Representation 12 states that "for each Plan, neither GSTC, Goldman Sachs nor any affiliate will have no discretionary authority or control or render investment advice over Client Plans' decisions concerning the acquisition or disposition of securities available for loan." Goldman Sachs requests that the word "no," which precedes the word "discretionary" be deleted from this sentence as it is in error. The Department concurs with this change and has made the required modification.

4. *Representation 15.* The third paragraph of Representation 15 states that the provisions of the Sub-Agency Agreement will be comparable to those of the Agency Agreement but it erroneously cross-references the Agency Agreement to Representation 9. Goldman Sachs wishes to point out that the correct cross-reference should be to Representation 14 rather than Representation 9. The Department concurs with this change and has made the required modification.

5. *Representation 24.* Goldman Sachs states that the fourth sentence of Representation 24 contains a typographical error in that the parenthetical should end after the phrase "from such loan" instead of at the end of the sentence. Therefore, the Department has revised this sentence to read as follows:

With respect to any loan to Goldman Sachs, GSTC will never negotiate a rebate rate with respect to such loan which would be expected to produce a zero or negative return to the Client Plan (assuming no default on the investments related to the cash collateral from such loan) where GSTC has investment discretion over the cash collateral.

6. *Representation 33 and Condition (n).* Representation 22 of the Summary and Condition (n) of the Notice exclude from the securities lending program commingled trust funds which contain

plan assets of more than one employer if the fiduciary responsible for making the investment decision is one of the Client Plan's employers. Goldman Sachs does not believe this restriction is necessary because it would preclude the State Street Collective Trust Funds from using GSTC as a securities lending agent and lending to Goldman Sachs under the exemption if one of State Street's employee benefit plans were invested in the fund, even though the fund would otherwise comply with the \$50 million in assets requirement and State Street as a fiduciary to the fund would otherwise satisfy the \$100 million under management requirement. Therefore, Goldman Sachs suggests that the Department revise paragraph (n)(2) of the Conditions and subclause (a) of the second paragraph of Representation 33 to read as follows:

(2) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization (the Unrelated Client Plans), whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with Goldman Sachs, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity—

- (i) Has full investment responsibility with respect to plan assets invested therein; and
- (ii) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

After considering this comment, the Department has made the changes suggested by Goldman Sachs.

For further information regarding Goldman Sachs's comments or other matters discussed herein, interested persons are encouraged to obtain copies of the exemption application file (Exemption Application No. D-10306) the Department is maintaining in this case. The complete application file, as well as all supplemental submissions received by the Department, are made available for public inspection in the Public Documents Room of the Pension and Welfare Benefits Administration, Room N-5638, U.S. Department of

Labor, 200 Constitution Avenue, NW, Washington, DC 20210.

Accordingly, after giving full consideration to the entire record, including the written comments provided by Goldman Sachs, the Department has made the aforementioned changes to the Notice. In addition, the Department has decided to grant the exemption subject to the modifications or clarifications described above.

For Further Information Contact: Ms. Jan D. Broady of the Department, telephone (202) 219-8881. (This is not a toll-free number.)

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and/or section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions to which the exemptions does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which among other things require a fiduciary to discharge his duties respecting the plan solely in the interest of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) These exemptions are supplemental to and not in derogation of, any other provisions of the Act and/or the Code, including statutory or administrative exemptions and transactional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction; and

(3) The availability of these exemptions is subject to the express condition that the material facts and representations contained in each application accurately describes all material terms of the transaction which is the subject of the exemption.

Signed at Washington, D.C., this 22nd day of May, 1998.

Ivan Strasfeld,

*Director of Exemption Determinations,
Pension and Welfare Benefits Administration,
U.S. Department of Labor.*

[FR Doc. 98-14197 Filed 5-28-98; 8:45 am]

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