

the proposed exemption, in any offering where the Asset Manager purchased securities for its Client Plans.²⁴

Disclosures

8. The proposed exemption requires in paragraphs (h) and (l) of section I that the Asset Manager obtain written authorization from an Independent Fiduciary of each Client Plan, including each fiduciary of a plan that invests in a Pooled Fund, before engaging in the covered transactions.²⁵ Prior to, and subsequent to, execution of the written authorization, the Asset Manager must provide certain disclosures described in Section I (i), (j), (k), and (m) to an

²⁴ The certification required in paragraph (g)(2) of Section I of the proposed exemption is necessary because the Asset Manager and its Client Plans must monitor compliance with all the conditions of the exemption, if granted. However, the Asset Manager would not normally have access to the Affiliated Broker-Dealer's records detailing each underwriter's share of the compensation from a particular underwriting, as those records are considered confidential. Such records are required to be maintained pursuant to SEC and NASD rules and would, of course, be made available to the Department pursuant to the terms of the exemption, if granted.

²⁵ In this regard, the Department notes that the fiduciary responsibility provisions of the Act apply to the decision of an Independent Fiduciary to authorize the Asset Manager to invest in securities covered by this proposed exemption (the Covered Securities) and to the decision to continue such authorization. Section 404(a)(1) of the Act requires, among other things, that a fiduciary of a plan must act prudently, solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. Accordingly, the Independent Fiduciary must act "prudently" with respect to the decision to authorize investment in these Covered Securities and the decision to continue such authorization.

The Department wishes to emphasize that it expects that the Independent Fiduciary, prior to authorizing investment in these Covered Securities, will fully understand the potential risks and rewards associated with investing in the initial offering of a security, following disclosure by the Asset Manager of all relevant information pertaining to the proposed transactions. Such consideration must necessarily include the fact that the Asset Manager's affiliate may be the managing underwriter. In addition, the Independent Fiduciary must be capable of periodically monitoring the actions taken by the Asset Manager in the performance of its duties. Thus, in considering whether to enter into transactions of the kind described herein, the Independent Fiduciary should take into account its ability to provide adequate oversight of the Asset Manager.

The Department further notes that, under section 405(a) of the Act, any plan fiduciary (including an investment manager) will have co-fiduciary liability for any breach of fiduciary responsibility of another plan fiduciary: (1) if he knowingly participates in or conceals such breach; (2) if, by his failure to comply with section 404(a)(1) of the Act, he enables another fiduciary to commit such a breach; or (3) if he has knowledge of the breach of another fiduciary and he fails to make a reasonable effort, under the circumstances, to remedy the breach. Finally, the granting of the exemption proposed herein should not be viewed as an endorsement by the Department of any plans' participation in the covered transactions.

Independent Fiduciary of each Client Plan.

Periodic Reporting

9. In Section I, paragraph (n) of the proposed exemption requires that at least on a quarterly basis, the Asset Manager provide a report to an Independent Fiduciary of each Client Plan and of each plan investing in a Pooled Fund containing information about the Covered Securities purchased during the previous quarter. The Department modeled paragraph (n), in part, on the reporting provisions of Rule 10f-3 (17 CFR 270.10f-3).²⁶

10. Because the transactions covered by this proposed exemption are similar in nature to those covered by Rule 10f-3, the Department has determined that it is appropriate to adopt similar reporting requirements as in that rule. However, in addition to the items required to be reported by investment companies under Rule 10f-3, the proposed exemption requires that the Asset Manager report to the Independent Fiduciary the price at which any securities purchased during the reporting period were sold and the market value at the end of the reporting period of each security purchased during such period.²⁷

11. The additional information should help the Independent Fiduciary monitor compliance with the exemption, if granted. The Independent Fiduciaries of the Client Plans would play a similar role to that of the Board of Directors of an investment company, *i.e.*, they have a fiduciary duty to monitor the activities of the Asset Manager. In monitoring compliance, the Independent Fiduciary should bear in mind that the Asset Manager's subsequent decision to hold or sell a security purchased pursuant to the exemption, would not be covered by the exemption, if granted.²⁸

²⁶ PTE 75-1, Part III, was based, in part, on a prior version of Rule 10f-3.

²⁷ See Section I(n) of the proposed exemption, below.

²⁸ The Department notes that this proposed exemption would provide relief from the self-dealing and conflict of interest provisions of Part 4 of Title I of the Act for purchases of securities by the Asset Manager from an underwriting or selling syndicate in which an affiliate of the Asset Manager participates as a manager or member of such syndicate. It would not provide relief from any acts of self-dealing not directly arising from a purchase of the Covered Securities. Thus, no relief would be available for any violation of section 406(b) of the Act that may arise after the purchase. For example, because it is well-documented that securities purchased in IPOs may not perform well in the long term, a violation of the Act could occur if the Asset Manager's decision regarding the holding or sale of the Covered Securities by the Client Plan was influenced by the interests of the Affiliated Broker-Dealer.

The Affiliated Broker-Dealer's interest in the security may extend beyond the sale of the security.

12. Further, the Asset Manager must report any instance during the past quarter where the Asset Manager was precluded from selling any security purchased under the exemption for any period of time because of its status as an affiliate of the Affiliated Broker-Dealer. Such a situation could arise where a security was purchased by the Asset Manager pursuant to this proposed exemption on the first day of the offering and the rest of the offering was not selling well. In this situation, SEC Regulation M,²⁹ or the general anti-fraud or anti-manipulation provisions of the securities laws,³⁰ may limit the Asset Manager's ability to subsequently trade in that security, although these restrictions will generally not apply to the Asset Manager if the proper business separations are in place between the Affiliated Broker-Dealer and the Asset Manager. (see, *e.g.*, Regulation M, 17 CFR 242.100(b)(3)). Should the Asset Manager's ability to trade a security purchased on behalf of a Client Plan be restricted, this information may be relevant to the decision whether or not to continue to permit purchases under the exemption.

Minimum Size Requirements

13. The proposed exemption applies only to Client Plans with total net assets of at least \$50 million, as provided in paragraph (o) of Section I. In the case of a Pooled Fund, however, the \$50 million requirement will be met if 50 percent or more of the units of beneficial interest in such Pooled Fund are held by plans having total net assets of at least \$50 million. In the case of an Eligible Rule 144A Offering, each Client Plan must have at least \$100 million in securities. For a Pooled Fund, the \$100 million requirement will be met if 50 percent or more of the units of

As the SEC noted in its preamble to Regulation M, addressing Regulation M's protections against price manipulation: "[I]mmediately following an offering * * * underwriters now engage in substantial syndicate-related market activity, and enforce penalty bids in order to reduce volatility in the market for the offering security" (62 FR 519, 521, January 3, 1997). The SEC defines penalty bid as "an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions." SEC Regulation M (17 CFR 242.100(b)).

²⁹ A security might be put on a restricted list, for example, if the offering was not completely sold before the security begins trading in the market. In this instance, the restricted period for purposes of Regulation M (17 CFR 242.101(a)) continues until all of the securities are sold.

³⁰ These rules include section 17(a) of the 1933 Act (15 U.S.C. 77q(a)) and sections 9, 10(b), and 15(c) of the 1934 Act (15 U.S.C. 78i, 78j(b) and 78o(c)).