

employer securities as an investment or investment option under the individual account plans that they sponsor. The stock of a corporate REIT may constitute "qualifying employer securities" for purposes of section 407(d)(5) of the Act,<sup>5</sup> and, if so, the individual account plans sponsored by corporate REITs may invest in and hold such stock without engaging in a prohibited transaction.<sup>6</sup> The Applicant notes that statutory provisions under the Act specifically allow plan investments in qualifying employer securities, and Department regulations specifically reference the acquisition of qualifying employer securities with respect to participant-directed individual account plans.<sup>7</sup>

The Applicant believes that shares issued by a publicly traded Trust REIT constitute "securities" within the meaning of section 2(1) of the Securities Act of 1933. The Applicant argues that because shares of beneficial interest issued by a Trust REIT are securities, they also constitute "employer securities" in connection with Plans covering employees of such Trust REIT and its Employer Affiliates.<sup>8</sup> The Applicant asserts that, while it is clear that shares issued by Trust REITs do not constitute "marketable obligations" (as defined under section 407(e) of the Act) or interests in a "publicly traded partnership," as defined under the Code, it is unclear whether such shares would constitute "stock" and, thus, satisfy the definition of "qualifying employer security" in section 407(d)(5) of the Act. In this regard, section 407(a)(1) of the Act provides that a plan

may not acquire or hold any employer security, which is not a qualifying employer security. If the shares are not qualifying employer securities, the Plans sponsored by the Trust REITs and their Employer Affiliates cannot rely on sections 407<sup>9</sup> and 408(e)<sup>10</sup> of the Act to obtain relief from the prohibitions of sections 406 and 407 of the Act for the acquisition, holding or sale of Trust REIT shares.<sup>11</sup>

The Applicant believes that REITs structured as business trusts are virtually indistinguishable from REITs structured as corporations. The Applicant notes that under the Code, all tax-qualified REITs are treated as corporations for federal income tax purposes, notwithstanding their business structure.<sup>12</sup> According to the Applicant, Treasury Reg. section 1.856-1(d)(1) requires that a Trust REIT's trustees have the rights and powers "to meet the requirement of centralization of management," meaning that REIT trustees must have the "continued exclusive authority" to manage the affairs of the Trust REIT. The Applicant further notes that: the shareholders of Trust REITs possess the same limited liability protection as do stockholders of corporate REITs; Trust REITs are managed by trustees in much the same way as corporations are managed by directors; and shareholders of Trust REITs elect trustees just as stockholders of corporate REITs elect directors. According to the Applicant, in many states, Trust REITs may issue more than one class of shares, or may issue preferred or convertible classes of shares.<sup>13</sup> Further, in many states, the

rules that govern procedures for amending a Trust REIT's declaration of trust conform to the rules that govern amending a corporate charter, and the rules governing the amendment of a Trust REIT's bylaws conform to the rules governing the amendment of a corporation's bylaws.<sup>14</sup> The Applicant argues that the marketplace makes no distinction between publicly traded Trust REITs and publicly traded corporate REITs. In addition, Trust REIT shareholders and corporate REIT stockholders receive the same type of disclosure documents required by the Securities and Exchange Commission, and the trading rules of the stock exchanges apply in the same manner. The Applicant concludes that the ownership and legal operation of Trust REITs and corporate REITs are virtually the same and that the hallmark of corporate status, limited liability to equity investors, is provided under state law to shareholders of Trust REITs just as it is to stockholders of corporations.<sup>15</sup>

The Applicant represents that, despite these similarities and uniform treatment for federal income tax purposes, the distinction in REIT business form for state law purposes creates an anomaly for those Trust REITs that sponsor individual account plans. Thus, in the absence of an administrative exemption, the Applicant asserts that a Trust REIT which has roughly the same capitalization as a corporate REIT, whose shares bear the same indicia of ownership and offer the same investor protection against liability as shares issued by a corporate REIT, whose business is managed by shareholder-appointed trustees just as a corporate REIT's business is managed by shareholder-appointed directors, whose shares are traded on the same national exchange as a corporate REIT, and whose shares are traded at nearly the same daily volume as a corporate REIT, may be prohibited from allowing its employees to share in the growth of the business through the company's individual account plan, even though it may be permissible for the corporate REIT to do so.

The Applicant requests a class exemption to permit Trust REITs whose shares are publicly traded the same opportunity as corporate REITs by allowing their employees to share in the growth of the business through their

<sup>5</sup> Section 407(d)(5) provides, in part: "The term qualifying 'employer security' means an employer security which is:

(A) Stock,

(B) a marketable obligation (as defined in subsection (e) of this section), or

(C) an interest in a publicly traded partnership (as defined in section 7704(b) of title 26), but only if such partnership is an existing partnership as defined in section 10211(c)(2)(A) of the Revenue Act of 1987 (Pub. L. 100-203)."

<sup>6</sup> Section 407(b)(1) provides that the percentage limitations of "subsection (a) of this section shall not apply to any acquisition or holding of qualifying employer securities or qualifying employer real property by an eligible individual account plan." The Department notes that, for plan years beginning on or after 1/1/99, plans may not require that more than 10 percent of an elective deferral account be invested in qualifying employer securities, subject to certain exceptions. Section 407(b)(2), as amended by Pub. L. 105-34 section 1524(a) (August 8, 1997).

<sup>7</sup> 29 CFR 2550.404c-1(d)(2)(ii)(E)(4).

<sup>8</sup> Under ERISA section 3(20), the term "security" has the same meaning as such term has under section 2(1) of the Securities Act of 1933. ERISA section 407(d)(1) defines an employer security as "a security issued by an employer of employees covered by the plan, or by an affiliate of such employer."

<sup>9</sup> See note 5, *Supra*.

<sup>10</sup> Section 408(e) provides that: "sections 406 and 407 [29 U.S.C. 1106 and 1107] shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5) [29 U.S.C. 1107(d)(5)]) or acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 407(d)(4) [29 U.S.C. 1107(d)(4)])—

(1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 407(e)(1) [29 U.S.C. 1107(e)(1)]),

(2) if no commission is charged with respect thereto, and (3) if (A) the plan is an eligible individual account plan (as defined in section 407(d)(3) [29 U.S.C. 1107(d)(3)]), or (B) in the case of an acquisition or lease of qualifying employer real property by a plan which is not an eligible individual account plan, or of an acquisition of qualifying employer securities by such a plan, the lease or acquisition is not prohibited by section 407(a) [29 U.S.C. 1107(a)]."

<sup>11</sup> In proposing this exemption, the Department is providing no opinion herein as to whether shares of a Trust REIT constitute "stock" for purposes of section 407(d)(5).

<sup>12</sup> See Code section 856(a)(3).

<sup>13</sup> The Applicant provides the following citation in support of its assertion: Tex. Civ. Stat 3.1.

<sup>14</sup> The Applicant provides the following citations in support of its assertion: Md. Corps. & Assns. Ann. 8-501; Tex. Corps. & Assns. Ann. 9.1, 23.1.

<sup>15</sup> The Applicant provides the following citations in support of its assertion: Md. Corps. & Assns. Ann. 8-601; 3 Cal. Corp. Code 23001; Del. Code Ann. Tit. 12, 3803; Ill. Rev. Stat. Ch. 745, para. 60.2.; Tex. Corps. & Assns. Ann. 6138A-9.1, 6.138A-9.1.