

### Description of the Proposed Amendments

Although the Department is proposing this amendment on its own motion, its proposal is based, in part, on information received from a number of interested persons concerning the difficulties encountered in complying with several conditions contained in PTE 84-14. The Department has been informed that, due to the consolidation in the financial services industry and the large size of the resulting institutions, many financial institutions have found it more difficult to ensure that section I(a) (power of appointment) and section I(d) (parties "related" to the QPAM), are satisfied.

As understood by the Department, the difficulties encountered by large financial institutions under the current exemption may be illustrated by the following examples:

**EXAMPLE 1:** A registered investment adviser, QPAM I, manages Commingled Investment Fund F. Fund F has 75 plan investors, all of which utilize various service providers in the administration of their respective plans. Broker-Dealer B is a party in interest to several plan investors. Corporation C was the named fiduciary of Plan P until December 31, 2002, and invested part of the assets of Plan P in Fund F on December 15, 2002. Corporation C is also an affiliate of Broker-Dealer B. On March 1, 2003, QPAM I used Fund F assets to purchase securities from Broker-Dealer B. The exemption would not be available for this transaction because an affiliate of a party in interest involved in the transaction exercised, within the immediately preceding year, its authority to acquire an interest in Fund F.

**EXAMPLE 2:** Bank B, a QPAM, is a wholly-owned subsidiary of a large financial services institution, Corporation C, and has been retained to manage a fund established by Plan P. Corporation C has numerous subsidiaries, joint ventures and other business structures, including a 10 percent interest in Joint Venture J. Joint Venture J provides actuarial services to Plan P. Bank B uses Plan P assets to purchase, on several occasions, debt instruments issued by Joint Venture J. The general exemption set forth in Part I would not be available for this transaction because Corporation C controls the QPAM and has an interest in the party in interest which exceeds five percent.

**EXAMPLE 3:** Bank C is a QPAM that manages several investment funds. Bank C also serves as a custodian for employee benefit plan assets and, as a result, holds legal title to securities owned on behalf of the plans. Bank C owns a three percent interest in Corporation Y. Ten employee benefit plans (the Client Plans), for which Bank C acts as custodian and also exercises voting rights for securities holdings, own stock in Corporation Y in varying amounts up to one percent each. Bank C uses assets of one of its investment funds to purchase a parcel of unimproved real property from Corporation Y, a party in

interest with respect to a plan investor in the investment fund. The general exemption set forth in Part I may not be available for this transaction because Bank C owns three percent of Corporation Y and also is considered to own, for purposes of the exemption, the interests of the Client Plans in Corporation Y for which it holds legal title and exercises voting rights. Depending on the holdings of the Client Plans, from time to time, Bank C's aggregate ownership interest could exceed five percent of Corporation Y.

To address these concerns, the interested persons made a number of suggestions to modify several of the conditions of PTE 84-14 without sacrificing the protections embodied in the class exemption. First, with respect to section I(a) (power of appointment), several persons suggested that the Department delete the "one year look-back rule" under which the exemption would be unavailable to a party in interest if it had exercised the power of appointment within the one-year period preceding the transaction. Second, the interested persons suggested that the Department clarify that section I(a)'s power of appointment refers only to the power to appoint the QPAM as manager of the assets involved in the transaction, as opposed to any of the plan's assets.

The Department has determined to adopt these suggested modifications. The Department recognizes that the burdens of compliance in the current financial marketplace outweigh the benefits of the one year look-back rule. The Department believes that deletion of the rule would not significantly diminish the safeguards contained in the exemption. In addition, the Department believes that the focus of the "power of appointment" rule should be on the assets involved in the transaction, as opposed to all of the plan's assets. This proposed modification is consistent with the approach taken by the Department in more recent class exemptions.<sup>2</sup>

As amended, section I(a) would provide that at the time of the transaction, the party in interest or its affiliate does not have the authority to: (i) Appoint or terminate the QPAM as a manager of the plan assets involved in the transaction, or (ii) negotiate on behalf of the plan the terms of the management agreement with the QPAM (including renewals or modifications thereof) with respect to the plan assets involved in the transaction.

In addition, one of the interested persons suggested a modification to section I(a) in connection with commingled investment funds. In the

preamble to PTE 84-14, the Department explained that a party in interest who has the authority to redeem or acquire units of such a fund is considered, for purposes of the exemption, to have the authority to appoint or terminate the QPAM as a manager of plan assets. To further reduce administrative burdens, it was suggested that section I(a) be amended to make the class exemption available to a party in interest with respect to a plan investing in a commingled investment fund, notwithstanding that the party in interest has the authority to redeem or acquire units of such a fund on behalf of the plan, if the plan's interest in the fund represents less than 25 percent of the investment fund's total assets. According to the interested person, a party in interest to a plan with a relatively small interest in a commingled investment fund is less likely to be in a position to exercise undue influence over the QPAM's investment decisions. On the basis of this suggestion, the Department has proposed an amendment to section I(a) of the class exemption. However, contrary to the opinion of the interested person, the Department views 10 percent, and not 25 percent, as the meaningful measure for determining whether a QPAM may be susceptible to undue influence.

Therefore, the Department proposes to further amend the class exemption by adding the following paragraph at the end of section I(a):

Notwithstanding the foregoing, in the case of an investment fund in which two or more unrelated plans have an interest, a transaction with a party in interest with respect to an employee benefit plan will be deemed to satisfy the requirements of section I(a) if the assets of the plan managed by the QPAM in the investment fund, when combined with the assets of other plans established or maintained by the same employer (or affiliate thereof described in section V(c)(1) of the exemption) or by the same employee organization, and managed in the same investment fund, represent less than 10 percent of the assets of the investment fund.

Finally, the Department proposes to amend section V(c), the definition of affiliate as it applies to section I(a) and Part II. The definition currently provides that "an affiliate of a person means—

(1) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the person,

(2) Any corporation, partnership, trust or unincorporated enterprise of which such person is an officer, director, 5 percent or more partner, or employee (but only if the

<sup>2</sup> See e.g., PTE 94-20 (59 FR 8022, February 17, 1994) and PTE 98-54 (63 FR 63503, November 13, 1998).