

under the exemption be expanded to include foreign currency, securities issued or guaranteed by the government of an "exempted country" or one of its instrumentalities, or irrevocable letters of credit issued by a bank which is organized and regulated under the laws of an exempted country and which is a person other than the borrower or an affiliate thereof.

The Department requested additional information relating to the operation and regulatory environment of these foreign countries. The Department notes that the relief provided in PTE 81-6 was based, in part, on the regulatory oversight of banks and broker-dealers located in the United States. This regulatory framework and the conditions contained in PTE 81-6 were integral to the Department's determination that the exemption was administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of the participants and beneficiaries of such plan.

In response to the Department's questions, RMA amended its request to narrow the definition of exempted foreign bank or broker-dealer to include those entities regulated under the laws of the United Kingdom (the UK). Banks and broker-dealers in the UK which engage in securities lending activities of the type contemplated by the proposed exemption are subject to extensive regulation under the Financial Services and Markets Act 2000 (FSMA) which governs "the conduct of investment business"³ in the UK. The Financial Services Authority (FSA) is an independent non-government body which exercises statutory powers under the FSMA. The FSA is accountable to the Treasury⁴ of the UK, and, through them, to Parliament. The FSA must report annually on the achievement of its statutory objectives to the Treasury which presents this report to the Parliament.

The duties of the FSA fall into the following categories: (1) Authorization of firms; (2) establishing standards for firms; (3) oversight of firms; (4) enforcement of [investment] laws and rules in the UK; (5) reducing financial crime; and (6) providing consumer service. Before a firm may conduct

investment business, it must be authorized by the FSA. Only those firms which demonstrate to the FSA that they satisfy threshold criteria (which relate to the firms' honesty, competence and financial soundness) are authorized to engage in investment. The FSA ensures that financial business is not being carried out by unauthorized firms. In addition, the FSA collects and maintains information about the authorized firms. Any investment agreement entered into without such authorization is unenforceable, and the counterparty to such agreement is entitled to restitution and compensation for any loss incurred.

The FSA also establishes "prudence" standards for the firms it regulates. These standards include capital requirements which are designed to ensure that firms are able to meet financial obligations. Firms are also required to meet FSA standards relating to management, accounting and auditing practices. Further, the FSA sets the conduct of business standards relating to the firms' relationships with consumers. This involves overseeing a firm's dealings with investors to ensure, for example, that information is understandable, fair and not misleading.

The FSA has responsibility for overseeing the integrity of the UK investment markets. Specifically, it oversees the exchanges, clearing and settlement houses, and conducts market surveillance and transaction monitoring. The FSA also supervises the soundness of banks. In so doing, the aim is, among other things, to protect depositors.

In its enforcement capacity, the FSA investigates and, if appropriate, disciplines and prosecutes those responsible for conducting financial business outside of the rules. Under the FSMA, the FSA has the statutory authority to revoke a firm's authorization, discipline firms and individuals by public statements and financial penalties, seek injunctions, prosecute for offenses and require money to be returned as compensation for consumers.

According to RMA, the FSA's oversight of the securities markets in the UK provides a sufficient level of safeguards to protect the interests of the plans that would be lending securities to UK banks and broker-dealers under this exemption, if granted.

Collateral Offered to the Plan

The RMA requested that the Department expand the types of collateral permitted to be used in securities lending arrangements to include currency denominated in UK pounds or Euros, securities issued or

guaranteed by the government of the UK or one of its agencies or instrumentalities, the sovereign debt of the member countries of the European Monetary Union denominated in UK pounds or in Euros, or irrevocable letters of credit denominated in UK pounds or Euros and issued by a bank which is regulated under the laws of the UK.

With respect to the Euro, RMA represents that, although it is a relatively new form of currency, it is closely monitored and regulated in connection with the implementation of the European Monetary Union (EMU). The EMU⁵ consists of the following nations: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and Sweden. In order to be admitted as members, these nations were required to meet five criteria: (1) Exchange rates must not fluctuate beyond certain predetermined fluctuation limits for a period of two years; (2) a government deficit must not exceed 3% of gross domestic product (GDP); (3) a government debt to GDP ratio is 60% or less; (4) an inflation rate must not be more than 1.5% above that of the average rate of the three best performing participating nations; and (5) an average long-term interest rate is no more than 2% above that of the three best performing participating nations. The primary goal of the introduction of the Euro is to establish and maintain price stability throughout the EMU region. The European Central Bank (ECB) and the European System of Central Banks (ESCB) provide a comprehensive management and regulatory infrastructure designed to support this objective. The responsibility of the ESCB is to maintain price stability and to define and implement the monetary policy of the EMU nations and promote the smooth operation of payment systems.

The RMA proposed that, if letters of credit are used as collateral, they must be issued by a bank whose long-term deposit rating is investment grade or higher, as determined by a nationally recognized independent statistical rating organization. Upon further consideration of this issue, RMA suggested that the "counterparty credit rating" of a bank is a more appropriate measure with respect to these transactions. Counterparty credit ratings take into account factors that focus on the bank's capacity to meet its financial

³ The conduct of investment business in the UK includes: (1) Buying, selling, subscribing for or underwriting investments; (2) arranging transactions in the field of investment and (3) giving investment advice.

⁴ The Treasury is the department of the government in the UK responsible for formulating and putting into effect the UK's financial and economic policy.

⁵ Although the UK did not initially participate in the EMU, it is anticipated that a significant amount of business in the financial sector of the UK will be transacted in Euros.