

obligations as they come due. RMA states that rating agencies, such as Standard & Poor's, look to the credit of the bank when examining transactions that rely on lines of credit for credit enhancements.

RMA has also requested that plans be allowed to accept collateral that is denominated in a different currency than the securities lent. RMA notes that, because plans are currently not permitted under PTE 81-6 to accept foreign government debt as collateral for borrowed securities, plans are not able to fully participate in the overseas securities lending markets and are prevented from enjoying revenue opportunities that are available to other lenders. RMA further states that most broker-dealers who are active in the international securities lending area are active in several markets. Thus, a broker-dealer may have a relatively large position in the currency of one country (e.g., Euro), but may have a need to borrow securities denominated in the currency of another country (e.g., UK pounds). In these circumstances, the borrower would want to deliver Euros as collateral for a loan of UK pound denominated securities. RMA believes that plans would be at a competitive disadvantage if the proposed exemption did not permit plans to accept collateral that is denominated in a different currency than the securities that are lent.

Another request of RMA relates to the level of collateral that must be provided to a lender. RMA suggests that the market value of the collateral offered to the plan be not less than 100 percent of the then market value of the securities lent, if the collateral is denominated in the same currency as the securities, and 102 percent of the then market value of the securities lent if the collateral is denominated in a different currency. However, after consideration of the issue, the Department believes that it would be more protective of the plan to require that the market value of the collateral be 105 percent of the then market value of the securities lent where the collateral offered by a borrower is denominated in a different currency than that of the securities.

#### **Plan's Rights With Respect to the Collateral Under the Law of the UK Upon a Borrower's Default**

RMA states in its application that under standard securities lending practices in the UK, title to the collateral given to the lender in exchange for borrowed securities, passes to the lender. According to RMA, this practice is reflected in the standard lending agreements used in the UK RMA

represents that the securities lending transactions contemplated by the proposed exemption would be carried out in accordance with standard securities lending practices in the United Kingdom. Because the lending plan will have title to the collateral in these transactions, such plans will not be restricted in their ability to apply the collateral towards the cost of replacing the borrowed securities or to replace the collateral with cash in the event the borrower were to default.

To further protect the plan's interests in the event of a borrower's default, RMA proposes that, in the securities lending agreement, the borrower will agree to submit to the jurisdiction of the courts of the United States. Once a plan receives a judgment against a borrower in a U.S. court, the plan would then enforce the judgment in a UK court. RMA states that the enforcement of U.S. judgments in the UK courts is governed by common law. A basic principle of such common law is that any judgment of a court of a foreign country which is for a debt or a definite sum of money which is final and conclusive on the merits, and as to which the foreign court had jurisdiction over the defendant, is enforceable at common law in the absence of fraud. Under UK common law, a foreign court is considered to have jurisdiction over the defendant if the defendant agreed to submit to the jurisdiction of the foreign court prior to the commencement of the proceedings.

To enforce a U.S. judgment under common law, a claimant must commence an action in a UK court by writ. If a claimant obtains a favorable judgment in a U.S. court following a summary judgment action or a trial, the judgment is enforceable in the UK like any other UK judgment.

As an alternative to submission to the jurisdiction of the United States courts, if the lending agent is domiciled in the United States, the lending agent may agree to indemnify and hold harmless each plan against any shortfall in the value of the collateral as compared to the value of the loaned securities.

#### **Indicia of Collateral and Location of Collateral Offered to the Plan**

In dealing with the indicia of ownership of the collateral offered to the plan in return for the securities lent to Foreign Banks and Foreign Broker-Dealers, RMA has represented that the indicia of ownership of the collateral for the borrowed securities will be maintained within the jurisdiction of the district courts of the United States as required by section 404(b) of ERISA, or if held outside the U.S., in a central

clearing facility.<sup>6</sup> RMA represents that the requirements of section 404(b) and the Department's regulation thereunder will be satisfied.

Thus, if a Foreign Bank or Foreign Broker-Dealer offers Foreign Collateral to the plan, under regulation 29 CFR 2550.404b-1, the indicia of ownership of the collateral must be held within the jurisdiction of the district courts of the United States<sup>7</sup>, or the assets must be under the management and control of a fiduciary which is a corporation or partnership organized under the laws of the United States or a State which has its principal place of business within the United States and which is a bank, an insurance company or an investment advisor (as described in the regulations.) In the alternative, the regulations require that the indicia of ownership of the collateral be in the physical possession of a person which is organized under the laws of the United States which is a bank, as defined under section 202(a)(2) of the Investment Advisers Act of 1940, a broker-dealer registered under the Securities Exchange Act of 1934 with a net worth exceeding \$750,000, or has its obligations and liabilities guaranteed by individuals listed in the regulation; be maintained by a broker-dealer in the custody of an entity designated as a "satisfactory control location" under Rule 15c3-3 under the Securities Exchange Act of 1934; or be maintained by a bank, in the custody of an entity that is a foreign securities depository, foreign clearing agency acting as a securities depository or a foreign bank, which entity is supervised or regulated by a government agency or regulatory authority in the foreign jurisdiction having authority over such depositories, clearing agencies or banks.<sup>8</sup>

#### **Discussion of Proposed Exemption**

Section I of the proposal describes the transactions which are covered by the exemption. Section I(a) tracks the language of PTE 81-6 by permitting the lending of securities that are assets of an employee benefit plan to a U.S. Broker-Dealer or U.S. Bank, if the general conditions set forth in section II are met. However, the conditions contained in

<sup>6</sup>In this regard, RMA represents that in the UK, the indicia of ownership for the foreign collateral is typically held in a central clearing facility in accordance with customary procedures in the UK.

<sup>7</sup>The indicia of ownership of bank letters of credit (foreign or U.S.) must always be maintained within the jurisdiction of the district courts of the United States since they fall outside the exception provided in regulation 29 CFR 2550.404b-1.

<sup>8</sup>Regulation 29 CFR 2550.404b-1 has been summarized in part. Interested persons should consult the complete regulation to ensure compliance.