

banks that are subject to regulation in other countries. In this regard, we note that a sufficient showing must be made that collateral offered to plans will be held in a manner that will ensure that the plan's interest in such collateral will be adequately protected. In addition, information is needed on whether broker-dealers and banks in countries other than the UK are subject to a scheme of regulatory oversight comparable to that found in the United States. The Department invites interested persons to comment on these issues. Specifically, we request comments on the following: (1) The regulatory oversight of broker-dealers and banks in countries other than the UK; (2) the entities that are used in these countries to hold collateral on behalf of the plan while the securities loan is outstanding, and (3) whether these entities' have practices and policies designed to protect the plan's interest in the collateral and are subject to government supervision and oversight.

Section III of the proposed exemption contains additional conditions that are applicable to securities lending transactions with Foreign Broker-Dealers and Foreign Banks. Section III(a) requires that the lending fiduciary maintain the situs of the loan agreement in accordance with the indicia of ownership requirements under section 404(b) of ERISA and the regulations promulgated under 29 CFR 2550.404(b)-1. Further, section III(b) requires that a foreign borrower agree to submit to the jurisdiction of the district courts or the United States, and agree that the plan may in its sole discretion enforce the agreement in a U.S. court. It is the Department's understanding, that in the event the borrower were to default, the plan generally would be able to secure a judgment in the United States which would be enforceable in a UK court.

As an alternative to the Foreign Broker-Dealer or Foreign Bank agreeing to submit to the jurisdiction of the United States courts, the lending fiduciary may, if domiciled in the United States, agree to indemnify and hold harmless each plan against any shortfall in the collateral or losses incurred by the plan arising from a borrower's default.

Miscellaneous Issues

The Department has received an inquiry regarding whether the relief provided by the proposed exemption would apply to securities loaned by plans pursuant to "exclusive securities lending arrangements." Under these exclusive arrangements, a lender (in this case, a plan) agrees to make a specific

portfolio of securities (that are owned by the plan) available exclusively to a specific borrower for a specific period of time. The borrower is given exclusive access to all of the securities in the portfolio and can borrow such securities as and when the borrower determines that it wishes to do so. The securities may not be lent to another person. However, the existence of an exclusive arrangement will not have any impact on the investment management decisions of the portfolio. Thus, the securities in the portfolio may continue to be purchased and sold without regard to the exclusive arrangement. Neither the borrower nor any of its affiliates has any discretionary authority or control with respect to the management of the portfolio, or with respect to the decision to cause the plan to enter into an exclusive arrangement or to negotiate the terms of such arrangement on behalf of the plan. The exclusive arrangement will be negotiated on behalf of the lending plan by a fiduciary who is independent of the borrower. However, under the terms of an exclusive arrangement, the borrower has a contractual right to borrow any of the securities included in the portfolio at any time during the agreed upon period. In exercising this right, the borrower is acting as a counterparty pursuant to the written loan agreement and not as a fiduciary.

Under these exclusive arrangements, compensation is paid by the borrower to the plan and may consist of one or more components. The first component generally is a fee paid by the borrower to the plan for the exclusive right to borrow the securities in the portfolio and may consist of either a flat fee (which may be equal to a percentage of the value of the total securities in the portfolio), or a periodic payment that is equal to a percentage of the value of the total balance of outstanding borrowed securities or a combination of both. A second component of the fees may include the plan's right to (a) retain a portion of the investment earnings generated by its investment of cash collateral received from the borrower and rebate the remaining earnings to the borrower, (b) retain all the investment earnings generated by its investment of the cash collateral and pay a rebate fee to the borrower; or (c) receive a lending fee paid by the borrower with respect to securities loans collateralized with non-cash collateral (based on the value of the borrowed securities and the duration of the particular loan.) The fees may be different for different securities or different groups of securities subject to the exclusive arrangement. These two

types of fees may be both paid to the plan, or offset against amounts due to the lender.

The Department is of the view that such exclusive securities lending arrangements would be covered by the relief provided in the proposed exemption, and, accordingly, has clarified section II(e)(1) of the proposal to more explicitly encompass a variety of compensation methods.¹¹

The Department notes that ERISA's general standards of fiduciary conduct also would apply to any proposed securities lending arrangements. Section 404 requires a fiduciary, among other things, to discharge his or her duties respecting a plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion. Accordingly, the plan's fiduciary, in deciding to approve the lending of securities to a Foreign Bank or Foreign Broker-Dealer, should fully understand the risks involved in this particular type of securities lending. The fiduciary should understand, for example, the additional risks involved in lending securities which are plan assets to a foreign financial institution, as well as, the risk associated with the receipt of collateral consisting of foreign currency or securities issued by a foreign country. In connection with the foregoing, the plan fiduciary should take into account any additional expenses and legal issues that may arise if a foreign borrower defaults and the plan fiduciary has to enforce and collect on a judgement in a foreign court.

Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department of Labor conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA 95) (44 U.S.C. 3506(c)(2)(A)). This helps to ensure that requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements on respondents can be properly assessed.

¹¹ In this regard, the Department notes that the proposed exemption does not provide relief from section 406(b) with respect to exclusive securities lending agreements. Accordingly, fees under an exclusive lending arrangement must be agreed to by the plan's independent fiduciary in advance of the implementation of the arrangement, or be determined pursuant to an objective formula.