would allow the assets of certain employee benefit plans to be invested in synthetic guaranteed investment contracts (the Buy & Hold Synthetic GICs) that would be offered by Deutsche Bank. Due to a printing error, appearing on page 4846 of the proposed exemption in Representation 7, the formula for computing the Crediting Rate for each Buy & Hold Synthetic GIC, was stated as follows:

$$BV = \sum_{k=\ n.}^{N} ((\text{net cashflow}_k)/((1\ IRR^k))$$

The Department notes that the correct formula for calculating the Crediting Rate is

$$BV = \sum_{k=\ n}^{N} ((\text{net cashflow}_k)/((1{+}IRR^{k-n}))$$

and it hereby amends the proposal.

FOR FURTHER INFORMATION CONTACT: Ms. Jan D. Broady of the Department at (202) 219–8881. (This is not a toll-free number.)

Signed at Washington, DC this 3rd day of February, 2000.

Ivan L. Strasfeld,

Director of Exemption Determinations, Pension and Welfare Benefits Administration, Department of Labor.

[FR Doc. 00–2857 Filed 2–7–00; 8:45 am]

BILLING CODE 4510–29–P

DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

[Application Nos. D–10119 and D–10120, et al.]

Morgan Guaranty Trust Company of New York, et al.

AGENCY: Pension and Welfare Benefits Administration, Department of Labor.

ACTION: Notice of proposed exemptions.[1]

SUMMARY: This document contains notices of pendency before the Department of Labor (the Department) of proposed exemptions from the prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (the Act) and from the taxes imposed by the Internal Revenue Code of 1986 (the Code).

The exemptions, if granted, would permit purchases of securities by the applicants' asset management affiliate on behalf of employee benefit plans for which such asset management affiliate is a fiduciary, from underwriting or selling syndicates where the applicants' broker-dealer affiliate participates as a manager or syndicate member. The exemptions, if granted, would affect participants and beneficiaries of the plans investing in such securities.

EFFECTIVE DATE: The exemptions, if granted, would be effective as of the date of publication of this notice in the **Federal Register**.

DATES: Written comments and/or requests for a public hearing must be received by the Department by March 24, 2000.

ADDRESSES: All written comments and/or requests for a public hearing (preferably, three copies) should be sent to the Office of Exemption Determinations, Pension and Welfare Benefits Administration, Room N–5649, U.S. Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210, Attention: Application Nos. D–10119 and D–10120, *et al.* The applications pertaining to the proposed exemptions and the comments received will be available for public inspection in the Public Documents Room of the Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N–5638, 200 Constitution Avenue, N.W., Washington, D.C. 20210.

FOR FURTHER INFORMATION CONTACT: Andrea W. Selvaggio, Janet L. Schmidt, or Karin Weng of the Department, telephone (202) 219–8194. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: Notice is hereby given of the pendency before the Department of five applications for exemption from the restrictions of section 406 of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1) of the Code. The exemptions were requested in separate applications filed pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, August 10, 1990), by the following entities: Morgan Guaranty Trust Company of New York and J.P. Morgan Investment Management Inc., Goldman, Sachs & Co., The Chase Manhattan Bank, Citigroup Inc., and Morgan Stanley Dean Witter & Co. Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), generally transferred the authority of the Secretary of the Treasury to issue exemptions of the type requested to the Secretary of Labor. Accordingly, this notice of pendency is being issued solely by the Department.[2]

Summary of Facts and Representations

The facts and representations contained in the applications are summarized below. Interested persons are referred to the applications on file with the Department for the complete representations of the applicants.

The Applicants

The five applicants, diversified financial services firms, have requested similar exemptive relief. It is represented that the applicants and their various affiliates are all regulated by other federal government agencies such as the Securities and Exchange Commission (the SEC), as well as state government agencies, and securities regulatory organizations. For convenience, following the initial description of each of the applicants, below, the applicants and their affiliates shall be referred to in the remainder of the notice in generic terms that denote certain roles, namely, ''the Applicant,'' ''the Asset Manager,''[3] or ''the Affiliated Broker-Dealer.''[4]

1. Morgan Guaranty Trust Company of New York (MGT) is a New York Trust Company. J.P. Morgan Investment Management Inc. (JPMIM), is a registered investment adviser. Both MGT and JPMIM are wholly owned subsidiaries of J.P. Morgan & Co. (JPM), a Delaware corporation. MGT and JPMIM (together, the Applicant) provide investment management and investment advisory services. Hereinafter, the Applicant shall be referred to as ''the Asset Manager'' when discussing the Applicant's activities relating to investment management or investment advisory services. J.P. Morgan Securities Inc., a wholly owned indirect subsidiary of JPM, is a registered broker-dealer (hereinafter, the Affiliated Broker-Dealer). It is represented that, as of December 31, 1998, the last day of the

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[1] The term ''Proposed Exemptions'' refers to the following individual exemption applications: Application Nos. D–10119 and D–10120, Morgan Guaranty Trust Company of New York and J.P. Morgan Investment Management Inc.; Application No. D–10587, Goldman, Sachs & Co.; Application No. D–10779, The Chase Manhattan Bank; Application No. D–10820, Citigroup Inc; and Application No. D–10832, Morgan Stanley Dean Witter & Co.

[2] All references in the remainder of the preamble to specific provisions of Title I of the Act shall refer also to the corresponding provisions of the Code (if any).

[3] To the extent that the Applicant has more than one asset management affiliate, all references to the Asset Manager herein shall refer also to the other asset management entity or entities.

[4] To the extent that the Applicant has more than one registered broker-dealer affiliate that participates in underwriting or selling syndicates, all references to the Affiliated Broker-Dealer herein shall refer also to the other broker-dealer entity or entities.

most recent fiscal year for which information is available, JPMIM and MGT had $316 billion in total client assets under management. As of that date, approximately 40 percent of client assets under management were attributable to employee benefit plans (Client Plans) subject to the fiduciary responsibility provisions of the Act, including Client Plans investing in a pooled fund (Pooled Fund).

2. Goldman, Sachs & Co. (Goldman), a New York limited partnership, is a wholly owned subsidiary and the principal operating subsidiary of The Goldman Sachs Group, Inc. Goldman is a registered broker-dealer and investment adviser. Hereinafter, Goldman shall be referred to, generally, as ''the Applicant'' and, specifically, as ''the Affiliated Broker-Dealer'' when discussing Goldman's activities as an underwriter. Goldman, Sachs Asset Management (hereinafter, the Asset Manager) is a separate operating division of the Applicant and is engaged in the investment management and investment advisory business. It is represented that, as of November 26, 1999, the last day of the Applicant's most recent fiscal year, the Asset Manager had total client assets under management of $241.4 billion. As of that date, approximately 12.7 percent of client assets under management were attributable to Client Plans, including those investing in a Pooled Fund.

3. The Chase Manhattan Bank (CMB), a New York State bank, is a subsidiary of The Chase Manhattan Corporation (CMC). Chase Asset Management (CAM), a registered investment adviser, is a subsidiary of CMB. CMB and CAM (together, the Applicant) provide investment management and investment advisory services. Hereinafter, the Applicant shall be referred to as ''the Asset Manager'' when discussing the Applicant's activities relating to investment management or investment advisory services. Chase Securities Inc., a subsidiary of CMC, is a registered broker-dealer (hereinafter, the Affiliated Broker-Dealer). It is represented that, as of December 31, 1998, the last day of its most recent fiscal year for which information is available, CMB had total client assets under management of approximately $31 billion. As of that date, CAM had total client assets under management of approximately $48 billion. As of December 31, 1998, approximately 1.0 percent of client assets of CMB, and approximately 9.6 percent of client assets of CAM, were attributable to Client Plans, including those investing in a Pooled Fund.

4. Citigroup, Inc. (Citigroup or the Applicant) is a Delaware corporation and a diversified holding company. Salomon Smith Barney Inc. (SSB or the Applicant), a New York corporation, is an indirect subsidiary of Citigroup. SSB is a registered broker-dealer and investment adviser. Hereinafter, SSB shall be referred to, generally, as the ''the Applicant'' and, specifically, as ''the Affiliated Broker-Dealer'' when discussing SSB's activities as an underwriter. Salomon Smith Barney Asset Management (hereinafter, the Asset Manager) is a separate operating division of SSB and is engaged in the investment management and investment advisory business. It is represented that, as of September 30, 1999, the last day of its most recent fiscal year, all of Citigroup's asset management affiliates had, in the aggregate, client assets under management of approximately $351 billion. As of that date, approximately 3.7 percent of client asset under management were attributable to Client Plans, including those investing in a Pooled Fund.

5. Morgan Stanley Dean Witter & Co. (hereinafter, the Applicant) is a publicly traded Delaware corporation. The Applicant is a registered investment adviser. Morgan Stanley Dean Witter Investment Management Inc. (hereinafter, the Asset Manager) is a wholly owned subsidiary of the Applicant. The Asset Manager is a registered investment adviser. Morgan Stanley & Co. Incorporated (hereinafter, the Affiliated Broker-Dealer) is another wholly owned subsidiary of the Applicant. The Affiliated Broker-Dealer is a registered investment adviser and broker-dealer. It is represented that all of the Applicant's asset management affiliates had, in the aggregate, client assets under management of approximately $425 billion, as of November 30, 1999, the last day of their most recent fiscal year. As of that date, approximately 20 percent of client assets under management were attributable to Client Plans, including those investing in a Pooled Fund.

Requested Exemption

6. Each Applicant requests exemptive relief permitting purchases of securities by the Asset Manager, for the Asset Manager's Client Plans, including Pooled Funds, from underwriting or selling syndicates in which the Affiliated Broker-Dealer participates as a manager or member. Each Applicant states that such purchases would be made from an underwriter or broker-dealer other than the Affiliated Broker-Dealer and that the Affiliated Broker-Dealer would not receive any selling concessions with respect to the securities sold to Client Plans.

7. Each Applicant represents that where the Affiliated Broker-Dealer is a member of an underwriting or selling syndicate, the Asset Manager makes purchases of securities for its Client Plans in compliance with Prohibited Transaction Exemption (PTE) 75–1 (40 FR 50845, October 31, 1975), Part III. PTE 75–1, Part III, provides a class exemption, under certain conditions, for a plan fiduciary to purchase securities from an underwriting or selling syndicate of which the fiduciary or an affiliate is a member. However, relief under PTE 75–1 is unavailable if the fiduciary or its affiliate is a manager of the underwriting or selling syndicate.

8. Regardless of whether the fiduciary or its affiliate is a manager or member of the underwriting or selling syndicate, PTE 75–1 is also unavailable for the purchase of unregistered securities, including securities that have been purchased by an underwriter for resale to ''qualified institutional buyers'' (QIBs), pursuant to SEC Rule 144A (17 CFR 230.144A) under the Securities Act of 1933 (the 1933 Act)(Rule 144A Securities). Rule 144A is frequently used for sales of securities of foreign issuers to U.S. investors who are QIBs. Each Applicant states that syndicates selling securities pursuant to Rule 144A are functionally equivalent to syndicates selling securities in registered offerings.

9. Each Applicant represents that the Affiliated Broker-Dealer is frequently involved in securities offerings as a manager of underwriting or selling syndicates, or as a manager or member of a syndicate selling Rule 144A Securities. Each Applicant further asserts that the inability of the Asset Manager to purchase securities for its Client Plans from such syndicates can be detrimental to those accounts because the accounts can lose important investment opportunities.

10. According to each Applicant, there has been considerable consolidation in the nation's financial services industry since 1975, resulting in more situations where a plan fiduciary may be affiliated with the manager of an underwriting syndicate.[5]

[5] For further background, see ''The Costs Imposed on Pension Plans by ERISA's Prohibited Transactions Provisions,'' December 1998, Anthony Saunders and Ingo Walter. This study, by Professors Saunders and Walter of the Stern School of Business of New York University, discusses the consolidation of the financial services industry. It was privately commissioned by J.P. Morgan (see Application Nos. D–10119 and D–10120). The study estimates the economic loss to plans resulting from their investment managers' inability to purchase securities from affiliated underwritings by examining the one-day, one-week, and one-month investment returns on various initial public offerings (IPOs) during the years 1991 through 1996. In response to the Department's request for

In addition, many plans have expanded their investment portfolios in recent years to include foreign securities. As a result, the exemption provided in PTE 75–1, Part III, is often unavailable for purchases of certain securities that may be appropriate plan investments.[6]

Investments in Offered Securities

11. Each Applicant represents that the Asset Manager makes investment decisions on behalf of, or renders investment advice to, its Client Plans in accordance with the governing document of the particular Client Plan or Pooled Fund and the guidelines and objectives established in the investment management or advisory agreement. Since the Client Plans are covered by Title I of the Act, such investment decisions are also subject to the fiduciary responsibility provisions of the Act.

12. Each Applicant states, therefore, that a decision to invest in particular securities is made on the basis of price, value, and a Client Plan's investment criteria, not on whether the securities are currently being sold through an underwriting or selling syndicate. Each Applicant further asserts that the Asset Manager has little incentive to make purchases from offerings for which the Affiliated Broker-Dealer is an underwriter that are not in the interests of the Client Plans because the Asset Manager's compensation for its services is generally based upon assets under management. If the assets under its management do not perform well, the Asset Manager will receive less compensation and could lose clients.

13. Each Applicant states that the Asset Manager generally purchases securities in large blocks because the same investments will be made across several of its accounts. If there is a new offering of an equity or fixed income security that the Asset Manager had otherwise intended to purchase, it may be able to purchase the security through the offering syndicate at a lower price than it would pay in the open market, without transaction costs and with a reduced market impact if it is buying a relatively large quantity. This is because a large purchase in the open market can cause an increase in the market price and, consequently, in the cost of the securities. Purchasing from an offering syndicate can thus reduce the costs to the Asset Manager's Client Plans.

14. However, absent an individual exemption, if the Affiliated Broker-Dealer is a manager of the syndicate underwriting the offering, the Asset Manager is currently foreclosed from purchasing any securities from that underwriting syndicate. If the Asset Manager then purchases the same securities in the secondary market, the Client Plans may incur greater costs because the market price is often higher than the offering price, and because of transaction and market impact costs. Alternatively, the Asset Manager may have foregone other investment opportunities because of its decision to purchase in the offering, and these opportunities, if still available, may have become more expensive.

Underwriting of Securities Offerings

15. Each Applicant represents that the Affiliated Broker-Dealer manages and participates in firm commitment underwriting syndicates for registered offerings of both equity and debt securities. While equity and debt underwritings may operate differently with regard to the actual sales process, the basic structures are the same. In a firm commitment underwriting, the underwriting syndicate acquires the securities from the issuer and then sells the securities to investors.

16. Each Applicant represents that while, as a legal matter, the syndicate assumes the risk that the securities might not be distributable, as a practical matter, this risk is reduced, in marketed deals, through ''building a book'' (*i.e.*, taking indications of interest) prior to pricing the securities. Each Applicant asserts that, consequently, there is little incentive for the underwriters to use their discretionary accounts (or the discretionary accounts of their affiliates) to buy up the securities as a way to avoid underwriting liabilities.

17. Each syndicate has a lead manager, who is the principal contact between the syndicate and the issuer and who is responsible for organizing and coordinating the syndicate. The syndicate may also have co-managers, who generally assist the lead manager in working with the issuer to prepare the registration statement to be filed with the SEC and in distributing the underwritten securities. While equity syndicates typically include additional members that are not managers, more recently, membership in many debt syndicates has been limited to lead and co-managers.

18. Where more than one underwriter is involved, the lead manager, who has been selected by the issuer, contacts other underwriters, and the underwriters enter into an Agreement Among Underwriters. Most lead managers have a form of agreement. This document is then supplemented for the particular deal by sending an ''invitation telex'' setting forth particular terms to the other underwriters.

19. The arrangement between the syndicate and the issuer is embodied in an underwriting agreement, which is signed on behalf of the underwriters by one or more of the managers. The underwriting agreement provides, subject to certain closing conditions, that the underwriters are obligated to purchase the underwritten securities from the issuer in accordance with their respective commitments. This obligation is met by using the proceeds received from the buyers of the securities in the offering, although there is a risk that the underwriters will have to pay for a portion of the securities, in the event that not all of the securities are sold.

20. However, each Applicant represents that, generally, the risk that the securities will not be sold is small because the underwriting agreement is not executed until after the underwriters have obtained indications of interest in purchasing the securities from a sufficient number of investors to acquire all the securities being offered. Once the underwriting agreement is executed, the underwriters immediately begin contacting the investors to confirm the sales, first orally and then by written confirmation, and sales are finalized within hours and sometimes minutes. The underwriters are anxious to complete the sales as soon as possible because until they ''break syndicate,'' they cannot enter the market. In many cases, the underwriters will act as market-markers for the security. A market-maker holds itself out as willing to buy or sell the security for its own account on a regular basis.

21. Each Applicant represents that the process of ''building a book'' or soliciting interest occurs as follows. In an equity offering, after a registration statement is filed with the SEC and while it is under review by the SEC

additional information, Professor Walter explained, in a letter dated August 20, 1999, why short periods were selected for calculating the hypothetical returns: ''The fact that IPOs do not have significant excess performance over the long run is well documented in finance and is known to all mutual and pension fund managers. Indeed, long-term relative performance of IPOs (*i.e.*, those held for a period over 3 years) is significantly below market performance as measured by standard indices such as the S&P 500 . . .''

[6] Under the Gramm-Leach-Bliley Act, signed into law by the President on November 12, 1999, certain provisions of the Glass-Steagall Act and the Bank Holding Company Act of 1956, as amended, are repealed. The Department notes that the effect of such law will likely be further consolidation of the financial services industry. The new law will facilitate cross-ownership and control among bank holding companies and securities firms through the creation of ''financial holding companies'' that will be permitted to engage in a broad range of financial and related activities, including underwriting and dealing activities.

staff, representatives of the issuer and the managers conduct meetings with potential investors, who learn about the company and the securities and receive a preliminary prospectus. The underwriters cannot make any firm sales until the registration statement is declared effective by the SEC. Prior to the effective date, while the investors thus cannot become legally obligated to make a purchase, they indicate whether they have an interest in buying, and the managers compile a ''book'' of investors who are willing to ''circle'' a particular portion of the issue. These indications of interest are sometimes referred to as a ''soft circle'' because investors cannot be legally bound to buy the securities until the registration statement is effective. However, each Applicant represents that investors generally follow through on their indications of interest, and would be expected to do so, barring any sudden adverse developments (in which case it is likely that the offering would be withdrawn), because if they do not follow through, the underwriters will be reluctant to sell to them in future offerings.

22. Assuming that the meetings have produced sufficient indications of interest, each Applicant represents that the issuer and the managers together will set the price of the securities and ask the SEC to declare the registration effective. After the registration statement becomes effective and the underwriting agreement is executed, the underwriters contact those investors who have indicated an interest in purchasing securities in the offering to execute the sales. Each Applicant represents that offerings are often oversubscribed, and many have an over-allotment option that the underwriters can exercise to acquire additional shares from the issuer. Where an offering is oversubscribed, the underwriters decide how to allocate the securities among the potential purchasers. However, if an issue is a ''hot issue,'' i.e., it is selling in the market at a premium above its offering price, the underwriters may not hold this hot issue in their own accounts, nor sell it to their officers and directors. A hot issue may also not be sold to the personal accounts of those responsible for investing for others, such as officers of banks, insurance companies, mutual funds, and investment advisers. (NASD Manual & Notices to Members, IM–2110–1)

23. Each Applicant represents that debt offerings may be ''negotiated'' offerings, ''competitive bid'' offerings, or ''bought deals.'' ''Negotiated'' offerings, which often involve non-investment grade securities, are conducted in the same manner as an equity offering with regard to when the underwriting agreement is executed and how the securities are offered. ''Competitive bid'' offerings, in which the issuer determines the price for the securities through competitive bidding rather than negotiating the price with the underwriting syndicate, are performed under ''shelf'' registration statements pursuant to SEC Rule 415 under the 1933 Act (17 CFR 230.415).[7]

24. In a competitive bid offering, prospective lead underwriters will bid against one another to purchase debt securities, based upon their determinations of the degree of investor interest in the securities. Depending on the level of investor interest and the size of the offering, a bidding lead underwriter may bring in co-managers to assist in the sales process. Most of the securities are frequently sold within hours, or sometimes even less than an hour, after the securities are made available for purchase.

25. Because of market forces and the requirements of Rule 415, the competitive bid process is generally available only to issuers of investment-grade securities who have been subject to the reporting requirements of the Securities Exchange Act of 1934 (the 1934 Act) for at least one year.

26. Occasionally, in highly-rated debt issues, underwriters ''buy'' the entire deal off of a ''shelf registration'' before obtaining indications of interest. These ''bought'' deals involve issuers whose securities enjoy a deep and liquid secondary market, such that an underwriter has confidence without pre-marketing that it can identify purchasers for the bonds.

Structure of Diversified Financial Services Firms

27. Each Applicant represents that there are internal policies in place that restrict contact and the flow of information between investment management personnel and non-investment management personnel. These policies are designed to protect against ''insider trading,'' i.e., trading on information not available to the general public that may affect the market price of the securities. Diversified financial services firms must be concerned about insider trading problems because one part of the firm—e.g., the mergers and acquisitions group—could come into possession of non-public information regarding an upcoming transaction involving a particular issuer, while another part of the firm—e.g., the investment management group—could be trading in the securities of that issuer for its clients.[8]

28. Each Applicant states that its business separation policies and procedures are also designed to restrict the flow of any information to or from the Asset Manager that could limit its flexibility in managing client assets, and of information obtained or developed by the Asset Manager that could be used by other parts of the organization, to the detriment of the Asset Manager's clients.

29. Each Applicant states that major clients of the Affiliated Broker-Dealer include investment management firms that are competitors of the Asset Manager. Similarly, the Asset Manager deals on a regular basis with broker-dealers that compete with the Affiliated Broker-Dealer. If special consideration were shown to an affiliate, such conduct would likely adversely affect the relationships of the Affiliated Broker-Dealer and of the Asset Manager with firms that compete with that affiliate. Therefore, a goal of each Applicant's business separation policy is to avoid any possible perception of improper flows of information between the Affiliated Broker-Dealer and the Asset Manager, in order to prevent any adverse impact on client and business relationships.

Underwriting Compensation

30. Each Applicant represents that the underwriters are compensated through the ''spread,'' or difference, between the price at which the underwriters buy the securities from the issuer and the price at which the securities are sold to the public. The spread is divided into three components.

31. The first component includes the management fee, which generally represents an agreed upon percentage of the overall spread and is allocated among the lead manager and co-managers. Where there is more than one managing underwriter, the way the management fee will be allocated among the managers is generally agreed upon prior to soliciting indications of interest (the process of ''building a book''). Thus, according to each Applicant, such management fee allocations are not

[7] Rule 415 permits an issuer to sell debt as well as equity securities under an effective registration statement previously filed with the SEC by filing a post-effective amendment or supplemental prospectus.

[8] The Insider Trading and Securities Fraud Enforcement Act of 1988 required brokers and dealers to maintain and enforce written policies and procedures that are ''reasonably designed . . . to prevent the misuse in violation of [the federal securities laws] . . . of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.'' (Section 15(f) of the 1934 Act (15 U.S.C. 78o(f)); see also Rules 342 and 351 of the NYSE and SEC Regulation M (17 CFR 242.100(a)(3)).

reflective of the amount of securities that particular managers sell in an offering.

32. The second component is the underwriting fee, which represents compensation to the underwriters (including the non-managers, if any) for the risks they assume in connection with the offering and for the use of their capital. This component of the spread is also used to cover the expenses of the underwriting that are not otherwise reimbursed by the issuer.

33. The first and second components are received without regard to how the underwritten securities are allocated for sales purposes or to whom the securities are sold. The third component of the spread is the selling concession, which generally constitutes 60 percent or more of the spread. The selling concession compensates the underwriters for their actual selling efforts. The allocation of selling concessions among the underwriters follows the allocation of the securities for sales purposes, except to the extent that buyers designate other broker-dealers (who may be other underwriters as well as broker-dealers outside the syndicate) to receive the selling concessions from the securities they purchase.

34. Securities are allocated for sales purposes into two categories. The first and larger category is the ''institutional pot,'' which is the pool of securities from which sales are made to institutional investors. Selling concessions for securities sold from the institutional pot are generally designated by the purchaser to go to particular underwriters or broker-dealers. When securities are sold from the institutional pot, the managers sometimes receive a portion of the selling concessions, referred to as a ''fixed designation,'' [9] attributable to securities sold in this category, without regard to who sold the securities or to whom they were sold. For securities covered by this proposed exemption, however, the Affiliated Broker-Dealer may not receive, either directly or indirectly, any compensation that is attributable to the fixed designation generated by purchases of securities by the Asset Manager on behalf of its Client Plans.

35. The second category of allocated securities is ''retail,'' which are the securities retained by the underwriters for sale to their retail customers. The underwriters receive the selling concessions from their respective retail retention allocations. Securities may be shifted between the two categories based upon whether either category is oversold or undersold during the course of the offering.

36. Each Applicant asserts that the Affiliated Broker-Dealer's inability to receive any selling concessions, or any compensation attributable to the fixed designations generated by purchases of securities by the Asset Manager's Client Plans, removes the primary economic incentive for the Asset Manager to make purchases that are not in the interests of its Client Plans from offerings for which the Affiliated Broker-Dealer is an underwriter. The reason is that the Affiliated Broker-Dealer will not receive any additional fees as a result of such purchases by the Asset Manager.

Rule 144A Securities

37. Each Applicant represents that a number of the offerings of Rule 144A Securities in which the Affiliated Broker-Dealer participates represent good investment opportunities for the Asset Manager's Client Plans. Particularly with respect to foreign securities, a Rule 144A offering may provide the least expensive and most accessible means for obtaining the securities. However, PTE 75–1, Part III, does not include a category for Rule 144A Securities, regardless of whether the Affiliated Broker-Dealer is a manager or member of the underwriting or selling syndicate. Therefore, absent an individual exemption, the Asset Manager is foreclosed from purchasing such securities for its Client Plans in offerings in which the Affiliated Broker-Dealer participates.

38. Each Applicant states that Rule 144A, which was adopted in 1990, acts as a ''safe harbor'' exemption from the registration provisions of the 1933 Act for sales of certain types of securities to QIBs. QIBs include several types of institutional entities, such as employee benefit plans and commingled trust funds holding assets of such plans, which own and invest on a discretionary basis at least $100 million in securities of unaffiliated issuers.

39. Any securities may be sold pursuant to Rule 144A except for those of the same class or similar to a class that is publicly traded in the United States, or certain types of investment company securities. This limitation is designed to prevent side-by-side public and private markets developing for the same class of securities.

40. Buyers of Rule 144A Securities must be able to obtain, upon request, basic information concerning the business of the issuer and the issuer's financial statements, much of the same information as would be furnished if the offering were registered. This condition does not apply, however, to an issuer filing reports with the SEC under the 1934 Act, for which reports are publicly available. The condition also does not apply to a ''foreign private issuer'' for whom reports are furnished to the SEC under Rule 12g3–2(b) of the 1934 Act (17 CFR 240.12g3–2(b)), or to issuers who are foreign governments or political subdivisions thereof and are eligible to use Schedule B under the 1933 Act (which describes the information and documents required to be contained in a registration statement filed by such issuers).

41. Sales under Rule 144A, like sales in a registered offering, remain subject to the protections of the anti-fraud rules of federal and state securities laws. These rules include Section 10(b) of the 1934 Act and Rule 10b–5 thereunder (17 CFR 240.10b–5) and Section 17(a) of the 1933 Act (15 U.S.C. 77a). Through these and other provisions, the SEC may use its full range of enforcement powers to exercise its regulatory authority over the market for Rule 144A Securities, in the event that it detects improper practices.

42. Each Applicant asserts that this potential liability for fraud provides a considerable incentive to the issuer and offering syndicate to insure that the information contained in a Rule 144A offering memorandum is complete and accurate in all material respects. Among other things, the lead manager typically obtains an opinion from a law firm, commonly referred to as a ''10b–5'' opinion, stating that the law firm has no reason to believe that the offering memorandum contains any untrue statement of material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, are not misleading.

43. Each Applicant represents that Rule 144A offerings generally are structured in the same manner as underwritten registered offerings. The major difference is that a Rule 144A offering uses an offering memorandum rather than a prospectus that is filed with the SEC. The marketing process is the same in most respects, except that the selling efforts are generally limited to contacting QIBs and that there are no general solicitations for buyers (e.g., no general advertising). In addition, the Affiliated Broker-Dealer's role in these offerings has been as a lead or co-manager. While, generally, there are no non-manager members in the syndicate, each Applicant also requests relief for situations where the Affiliated Broker-Dealer acts only as a syndicate member, not as a manager.

44. According to each Applicant, one of the policy objectives of Rule 144A

[9] A fixed designation is sometimes referred to as an ''auto pot split.''

was to attract more foreign issuers to the United States, and Rule 144A has been achieving this objective—from April 1990 through December 1993, the first three years of Rule 144A, over $25.6 billion in foreign securities was sold under Rule 144A, representing more than one-fourth of Rule 144A placements. See SEC Staff Report on Rule 144A (August 18, 1994), [1994–95 Transfer Binder] Fed. Sec. L. Rep. ¶ 85,428 (Question 1). This figure continued to hold in 1998, at 30.4 percent, so that foreign issuer Rule 144A offerings have kept pace with the rapid growth of Rule 144A offerings overall. (Securities Data Company, Inc.)

Summary

In summary, the proposed transactions will satisfy the statutory criteria for an exemption under section 408(a) of the Act because: (a) The Client Plans will gain access to desirable investment opportunities; (b) in each offering, the Asset Manager will purchase the securities for its Client Plans from an underwriter or broker-dealer other than the Affiliated Broker-Dealer; (c) conditions similar to those of PTE 75–1, Part III, will restrict the types of securities that may be purchased, the types of underwriting or selling syndicates and issuers involved, and the price and timing of the purchases; (d) the amount of securities that the Asset Manager may purchase on behalf of Client Plans will be subject to percentage limitations; (e) the Affiliated Broker-Dealer will not be permitted to receive, either directly, indirectly, or through designation, any selling concessions with respect to the securities sold to the Asset Manager; (f) prior to any purchase of securities, the Asset Manager will make the required disclosures to an independent fiduciary (Independent Fiduciary) of each Client Plan and obtain written authorization; (g) the Asset Manager will provide regular reporting to an Independent Fiduciary of each Client Plan with respect to all securities purchased pursuant to the exemption, if granted; (h) each Client Plan will be subject to a minimum size requirement of at least $50 million ($100 million for ''Eligible Rule 144A Offerings''),[10] with certain exceptions for Pooled Funds; and (i) the Asset Manager must have total assets under management in excess of $5 billion and shareholders' or partners' equity in excess of $1 million.

Discussion of Proposed Exemption

1. The exemptive relief for underwritings proposed herein is similar to that provided in PTE 75–1, Part III. Under PTE 75–1, exemptive relief is subject to a number of conditions and limitations, including the following: (1) The plan fiduciary or its affiliate may not be a manager of the underwriting or selling syndicate; (2) the purchase must be from a person other than the plan fiduciary or its affiliate; (3) the types of securities that may be purchased and the price and timing of the purchases are circumscribed; (4) the amount of securities purchased on behalf of each plan may not exceed three percent of the offering; and (5) the consideration paid may not exceed three percent of the plan's total net assets (one percent, if the consideration involved exceeds $1 million).

2. The exemptive relief proposed herein differs from that provided by PTE 75–1 in the following respects: (1) The proposed exemption covers transactions where the plan fiduciary is affiliated with a manager, as well as a member, of the underwriting or selling syndicate;[11] (2) the proposed exemption covers purchases of Rule 144A Securities;[12] (3) percentage limitations on the amount of securities that may be purchased have been modified to provide an aggregate limitation on a fiduciary's purchases for all Client Plans from a particular offering; and (4) the proposed exemption provides additional conditions, including: (a) The transaction is not part of an agreement, arrangement, or understanding designed to benefit the plan fiduciary or its affiliate; (b) neither a manager nor a member of the underwriting or selling syndicate may receive any selling concessions with respect to the securities purchased for Client Plans by its affiliate; (c) prior to any purchase of securities on behalf of a Client Plan, certain disclosures are provided to an Independent Fiduciary of each such Client Plan and written authorization is obtained; (d) periodic reporting regarding the covered transactions is provided to an Independent Fiduciary of each Client Plan; and (e) investing plans and their investment managers must meet certain minimum size requirements.

Types of Securities and Offerings

3. Paragraphs (a) and (b) of the proposed exemption are derived from PTE 75–1, Part III, and provide the following: (1) The securities[13] are part of an issue registered under the 1933 Act, or if exempt from registration under such Act, fall within specified categories: issued or guaranteed by the United States; issued by a bank; exempt from registration under a federal statute other than the 1933 Act; registered under the 1934 Act; or are part of an Eligible Rule 144A Offering—a change from PTE 75–1, Part III, as noted

[10] SEC Rule 10f–3(a)(4) (17 CFR 270.10f–3(a)(4)) states that the term ''Eligible Rule 144A Offering'' means an offering of securities that meets the following conditions:

(i) The securities are offered or sold in transactions exempt from registration under section 4(2) of the Securities Act of 1933 [15 U.S.C. 77d(2)], rule 144A thereunder [Sec. 230.144A of this chapter], or rules 501–508 thereunder [Secs. 230.501–230.508 of this chapter];

(ii) The securities are sold to persons that the seller and any person acting on behalf of the seller reasonably believe to include qualified institutional buyers, as defined in Sec. 230.144A(a)(1) of this chapter; and

(iii) The seller and any person acting on behalf of the seller reasonably believe that the securities are eligible for resale to other qualified institutional buyers pursuant to Sec. 230.144A of this chapter.

[11] In restricting the scope of PTE 75–1, Part III, to exclude transactions where the plan fiduciary is affiliated with the syndicate manager, the Department was concerned that the syndicate manager, as distinguished from a mere member of a syndicate, has a greater interest in the success of the sale of the new securities. If an affiliate of the managing underwriter is an investment manager for plans, those plans could provide a potential market for the less attractive offerings of underwritten securities. This proposed exemption contains certain safeguards and conditions that are designed to address these potential conflict of interest situations.

[12] The Department notes that the provisions of the Act do not preclude plans from investing in any securities sold by an underwriting or offering syndicate, including those securities sold pursuant to Rule 144A. The exemptive relief provided by PTE 75–1, Part III, and the additional relief sought here are required because of the affiliation between the plan fiduciary and a member of the underwriting or selling syndicate.

[13] With respect to any purchase of asset-backed securities by a Client Plan, the Department notes that this proposed exemption provides relief only for the transactions described herein and does not cover any additional prohibited transactions that may occur as a result of a purchase of such securities. For example, additional prohibited transactions may occur by operation of the ''look-through rule'' contained in the Department's regulation defining ''plan assets'' for purposes of plan investments (see 29 CFR 2510.3–101). Such additional prohibited transactions may be covered by one of the Department's existing individual exemptions for asset-backed securities. A listing of such exemptions is provided in the text of the operative language of PTE 97–34 (62 FR 39021, July 21, 1997), which granted an amendment to these exemptions.

Further, the Department notes that, under the Department's plan asset regulation, if a plan invests in a publicly-offered security, the plan's assets will not include, solely by reason of such investment, any of the underlying assets of the entity issuing the security (*i.e.,* the ''look-through rule'' will not apply and the operations of the entity will not be subject to scrutiny under the prohibited transaction provisions of the Act). The regulation defines a ''publicly-offered'' security as one that is freely transferable, widely-held, and registered under the federal securities laws. For this purpose, a class of securities is considered ''widely held'' if it is owned by 100 or more investors who are independent of the issuer and of one another (see 29 CFR 2510.3–101(b)(3)).

above;[14] (2) the securities are purchased for not more than the offering price within a specific time period,[15] subject to certain specified exceptions for rights offerings and debt offerings;[16] (3) the securities are sold pursuant to a firm-commitment offering, in which the syndicate members are committed to purchasing all the securities being offered, subject to certain exceptions for rights offerings and over-allotment options; and (4) the issuer of the securities has been in continuous operation for not less than three years, with certain exceptions.

Percentage Limitations on the Amount of Purchased Securities

4. Paragraphs (c) and (d) of the proposed exemption contain percentage limitations applicable to the amount of purchased securities. The first percentage test in paragraph (c) provides that the amount of securities to be purchased by the Asset Manager on behalf of a particular Client Plan or Pooled Fund may not exceed three percent of the total amount of securities being offered. Paragraph (c) further provides percentage limitations on the aggregate amount of securities that the Asset Manager may purchase for all its Client Plans, including Pooled Funds, from the total amount of securities being offered: 10 percent for equity securities; 35 percent for debt securities rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization, *i.e.,* Standard & Poor's Rating Services, Moody's Investors Service, Inc., Duff & Phelps Credit Rating Co., or Fitch IBCA, Inc., or their successors (collectively, the Rating Organizations); and 25 percent for debt securities rated in the fifth or sixth highest rating categories by at least one of the Rating Organizations.[17]

5. Paragraph (d) provides that the consideration to be paid by the Client Plan or Pooled Fund in purchasing the offered securities may not exceed three percent of the fair market value of such Client Plan's or Pooled Fund's total net assets. However, paragraph (d) eliminates the requirement contained in PTE 75–1, Part III, that, if the consideration involved exceeds $1 million, it may not exceed one percent of the fair market value of the plan's total assets. This modification by the Department parallels the amendment in 1997 of SEC Rule 10f–3.

Underwriting Compensation

6. The proposed exemption requires in paragraph (e) that any purchase of securities by the Asset Manager pursuant to the exemption may not be part of an agreement, arrangement, or understanding designed to benefit the Asset Manager or an affiliate.[18] Paragraph (f) further provides that the Affiliated Broker-Dealer may not receive, either directly, indirectly, or through designation, any selling concession, or other consideration that is based upon the amount of securities purchased by the Asset Manager's Client Plans pursuant to the exemption. Those selling concessions would be allocated to members of the syndicate who are not affiliated with the Asset Manager. The Affiliated Broker-Dealer may also not receive, either directly or indirectly, that portion of the fixed designation that is attributable to securities purchased pursuant to the exemption. The Affiliated Broker-Dealer is not precluded from receiving management fees, underwriting fees, or other consideration that is not based upon the amount of securities actually sold to the Asset Manager's Client Plans.

7. Paragraph (g) provides that the amount the Affiliated Broker-Dealer receives in management fees, underwriting fees, or other consideration may not be increased for the purpose of offsetting the reduction of the Affiliated Broker-Dealer's compensation from selling concessions. Further, the Affiliated Broker-Dealer must provide the Asset Manager with a written certification that the Affiliated Broker-Dealer complied with the underwriting compensation requirements found in paragraphs (e), (f), and (g) of the proposed exemption, in any offering where the Asset Manager purchased securities for its Client Plans. This certification will also be part of the quarterly report which the Asset Manager provides to the Independent Fiduciaries of the Client Plans.[19]

Disclosures

8. The proposed exemption requires in paragraphs (h) and (l) that the Asset Manager obtain written authorization from an Independent Fiduciary of each Client Plan, including each fiduciary of a plan that invests in a Pooled Fund, before engaging in the covered transactions.[20] Prior to, and subsequent

[14] Paragraph (a)(1)(ii) of the proposed exemption requires that if the securities are equity securities in an Eligible Rule 144A Offering, the offering syndicate shall obtain a legal opinion regarding the adequacy of the disclosure in the offering memorandum. This condition may be satisfied by the type of ''10b–5'' opinion customarily obtained in connection with such offerings. The Department believes that requiring such review by a law firm will help insure that the offering memorandum meets federal securities law standards. The Department notes that paragraph (c) of the proposed exemption requires debt securities to be rated by at least one independent nationally recognized statistical rating organization, thus insuring that sufficient information about those securities and their issuer will be available to investors.

[15] The language regarding the timing of the purchase differs slightly from PTE 75–1, Part III. This language is based upon Rule 10f–3, as amended in 1997 (17 CFR 270.10f–3; 62 FR 42401, August 7, 1997).

[16] Paragraph (a)(2)(ii) of the proposed exemption permits certain purchases of debt after the first day of the offering. Should the debt be downgraded after the offering commences and prior to being purchased for a Client Plan, the Department expects that the Asset Manager would consider whether, prior to purchase, the price was adjusted to reflect the downgrade.

[17] Paragraph (c)(4) of the proposed exemption requires that when calculating the percentages of securities purchased in an Eligible Rule 144A Offering, one must consider any concurrent public offering. The Department notes that any concurrent offering will necessarily be in a foreign securities market, since Rule 144A is unavailable where there is a concurrent domestic offering.

[18] The Department notes that the intent of the condition in paragraph (e) of the proposed exemption was not to deny direct benefits to other parties to a transaction but, rather, to exclude relief for transactions that are part of a broader overall agreement, arrangement, or understanding designed to benefit parties in interest.

[19] The certification required in paragraph (g)(2) of the proposed exemption is necessary because the Asset Manager and its Client Plans must monitor compliance with all the conditions of the exemption, if granted. However, the Asset Manager would not normally have access to the Affiliated Broker-Dealer's records detailing each underwriter's share of the compensation from a particular underwriting, as those records are considered confidential. Such records are required to be maintained pursuant to SEC and NASD rules and would, of course, be made available to the Department pursuant to the terms of the exemption, if granted.

[20] In this regard, the Department notes that the fiduciary responsibility provisions of the Act apply to the decision of an Independent Fiduciary to authorize the Asset Manager to invest in securities covered by this proposed exemption (Covered Securities) and to the decision to continue such authorization. Section 404(a)(1) of the Act requires, among other things, that a fiduciary of a plan must act prudently, solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. Accordingly, the Independent Fiduciary must act ''prudently'' with respect to the decision to authorize investment in these Covered Securities and the decision to continue such authorization.

The Department wishes to emphasize that it expects that the Independent Fiduciary, prior to authorizing investment in these Covered Securities, will fully understand the potential risks and rewards associated with investing in the initial offering of a security, following disclosure by the Asset Manager of all relevant information pertaining to the proposed transactions. Such consideration must necessarily include the fact that the Asset Manager's affiliate may be the managing underwriter. In addition, the Independent Fiduciary must be capable of periodically monitoring the actions taken by the Asset Manager in the performance of its duties. Thus, in considering whether to enter into transactions of the kind described herein, the Independent Fiduciary should take into account its ability to provide adequate oversight of the Asset Manager.

The Department further notes that, under section 405(a) of the Act, any plan fiduciary (including an investment manager) will have co-fiduciary liability

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to, execution of the written authorization, the Asset Manager must provide certain disclosures described in paragraphs (i), (j), (k), and (m) to an Independent Fiduciary of each Client Plan. In addition, the Asset Manager must provide a termination form, at least annually, that enables the Independent Fiduciary to terminate the authorization without penalty.

Periodic Reporting

9. Paragraph (n) of the proposed exemption requires that at least once every three months, the Asset Manager provide a report to an Independent Fiduciary of each Client Plan containing information about the Covered Securities purchased during the previous quarter. The Department modeled paragraph (n), in part, on the reporting provisions of Rule 10f–3 (17 CFR 270.10f–3).[21] The preamble to the 1997 amendments to Rule 10f–3 states that this rule ''permits an investment company that is related to certain participants in an underwriting to purchase securities during an offering, if certain conditions are met.'' [22] The SEC explained the origin of its rule as follows:

> Section 10(f) of the Investment Company Act was designed to address one of the major abuses noted in the period before enactment of the Investment Company Act—the use of funds by underwriters that controlled these funds as a ''dumping ground'' for unmarketable securities. [23]

Under Rule 10f–3, the Board of Directors of the investment company (including the directors who are not ''interested persons'' of the investment company) is responsible for monitoring compliance.[24]

10. Because the transactions covered by this proposed exemption are similar in nature to those covered by Rule 10f–3, the Department has determined that it is appropriate to adopt similar reporting requirements as in that rule. In addition to the items required to be reported by investment companies under Rule 10f–3, the proposed exemption requires that the Asset Manager report to the Independent Fiduciary the price at which any securities purchased during the reporting period were sold and the market value at the end of the reporting period of each security purchased during such period.[25]

11. The additional information should help the Independent Fiduciary monitor compliance with the exemption, if granted. The Independent Fiduciaries of the Client Plans would play a similar role to that of the Board of Directors of an investment company, *i.e.,* they have a fiduciary duty to monitor the activities of the Asset Manager.[26] In monitoring compliance, the Independent Fiduciary should bear in mind that the Asset Manager's subsequent decision to hold or sell a security purchased pursuant to the exemption, would not be covered by the exemption, if granted.[27]

12. Further, the Asset Manager must report any instance during the past quarter where the Asset Manager was precluded from trading in any security purchased under the exemption for any period of time because of its status as an affiliate of the Affiliated Broker-Dealer. For example, the security could be placed on a watch or restricted list due to activities of the Affiliated Broker-Dealer, and these restrictions could prevent the Asset Manager from trading the security. Such a situation could arise where a security was purchased by the Asset Manager pursuant to this proposed exemption on the first day of the offering and the rest of the offering was not selling well. In this situation, SEC Regulation M, [28] or the general anti-fraud or anti-manipulation provisions of the securities laws, [29] may limit the Asset Manager's ability to subsequently trade in that security, although these restrictions will generally not apply to the Asset Manager if the proper business separations are in place between the Affiliated Broker-Dealer and the Asset Manager (see, *e.g.,* Regulation M, 17 CFR 242.100(b)(3)). Should the Asset Manager's ability to trade a security purchased on behalf of a Client Plan be restricted, this information may be relevant to the decision whether or not to continue to permit purchases under the exemption.

Minimum Size Requirements

13. The proposed exemption applies only to Client Plans with total net assets of at least $50 million, as provided in paragraph (o). In the case of a Pooled Fund, however, the $50 million requirement will be met if 50 percent or more of the units of beneficial interest in such Pooled Fund are held by plans having total net assets of at least $50

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for any breach of fiduciary responsibility of another plan fiduciary: (1) if he knowingly participates in or conceals such breach; (2) if, by his failure to comply with section 404(a)(1) of the Act, he enables another fiduciary to commit such a breach; or (3) if he has knowledge of the breach of another fiduciary and he fails to make a reasonable effort, under the circumstances, to remedy the breach.

Finally, the granting of the exemption proposed herein should not be viewed as an endorsement by the Department of any plans' participation in the covered transactions.

[21] PTE 75–1, Part III, was based, in part, on a prior version of Rule 10f–3.

[22] 62 FR 42401, Aug. 7, 1997.

[23] *Id.*

[24] The information that the Board of Directors uses to monitor compliance must be included as an exhibit to the fund's semi-annual publicly available reports to the SEC, known as the Form N–SAR.

[25] See paragraph (n) of the proposed exemption.

[26] With respect to the directors' duty, the SEC stated in the preamble to Rule 10f–3:

> A fund's board should be vigilant in reviewing the procedures and transactions required by 10f–3 as well as in conducting any additional reviews that it determines are needed to protect the interests of investors, particularly if the fund purchases significant amounts of securities in reliance on 10f–3. For example, the board should consider monitoring how the performance of securities purchased in reliance on rule 10f–3 compares to securities not purchased in reliance on the rule, or to a benchmark such as a comparable market index. Such monitoring would enable the board to determine not only whether existing procedures are being followed, but whether the procedures are effective in fulfilling the policies underlying section 10(f). (62 FR at 42406) (See also footnote 52, 62 FR at 42406.)

[27] The Department notes that this proposed exemption would provide relief from the self-dealing and conflict of interest provisions of Part 4 of Title I of the Act for purchases of securities by the Asset Manager from an underwriting or selling syndicate in which an affiliate of the Asset Manager participates as a manager or member of such syndicate. It would not provide relief from any acts of self-dealing not directly arising from a purchase of the Covered Securities. Thus, no relief would be available for any violation of section 406(b) of the Act that may arise after the purchase. For example, because it is well-documented that securities purchased in IPOs may not perform well in the long term (see footnote 4), a violation of the Act could occur if the Asset Manager's decision regarding the holding or sale of the Covered Securities by the Client Plan was influenced by the interests of the Affiliated Broker-Dealer.

The Affiliated Broker-Dealer's interest in the security may extend beyond the sale of the security. As the SEC noted in its preamble to Regulation M, addressing Regulation M's protections against price manipulation: ''[I]mmediately following an offering * * * underwriters now engage in substantial syndicate-related market activity, and enforce penalty bids in order to reduce volatility in the market for the offering security.'' 62 FR 519, 521 (January 3, 1997). The SEC defines penalty bid as ''an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.'' SEC Regulation M (17 CFR 242.100(b)). For further background on the role of underwriters, see ''Corporate Finance and the Securities Laws, (2d ed. 1997),'' Charles J. Johnson, Jr. and Joseph McLaughlin, Aspen Publishers; ''Securities Industry Association: Capital Markets Handbook,'' edited by Bruce S. Foester, Aspen Publishers (1999). Recent Developments in Underwriting of IPO's: Spinning and Penalty Bids, Meredith B. Cross and Christine Sarudy Roberts, 1084 PLI/Corp 595 (Nov. 1998).

[28] A security might be put on a restricted list, for example, if the offering was not completely sold before the security began trading in the market. In this instance, the restricted period for purposes of Regulation M (17 CFR 242.101(a)) continues until all securities are sold. See, generally, ''Corporate Finance and the Securities Laws, (2d ed. 1997),'' Charles J. Johnson, Jr. and Joseph McLaughlin, Aspen Publishers; ''Securities Industry Association: Capital Markets Handbook,'' edited by Bruce S. Foester, Aspen Publishers (1999).

[29] These rules include Section 17(a) of the 1933 Act (15 U.S.C. 77q(a)) and Sections 9, 10(b), and 15(c) of the 1934 Act (15 U.S.C. 78i, 78j(b) and 78o(c)).

million. In the case of an Eligible Rule 144A Offering, each Client Plan must have at least $100 million in securities. For a Pooled Fund, the $100 million requirement will be met if 50 percent or more of the units of beneficial interest in such Pooled Fund are held by plans having at least $100 million in assets and the Pooled Fund itself qualifies as a QIB, as determined pursuant to Rule 144A (17 CFR 230.144A(a)(F)). The Department believes that these minimum size requirements will help insure that the Client Plans have the resources and investment sophistication needed in order to monitor the Asset Manager's investment performance with respect to the covered transactions.

14. Further, the proposed exemption applies only if the Asset Manager is a ''qualified professional asset manager'' (QPAM), as defined under Part V(a) of PTE 84–14, (49 FR 9494, 9506, March 13, 1984),[30] subject to the following modifications: The Asset Manager has as of the last day of its most recent fiscal year, total client assets under its management and control in excess of $5 billion and shareholders' or partners' equity in excess of $1 million.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which require, among other things, that a fiduciary discharge his or her duties respecting a plan solely in the interest of the participants and beneficiaries of such plan and in a prudent manner in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirements of section 401(a) of the Code that the plan operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) Before an exemption may be granted under section 408(a) of the Act and section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interests of the affected plans and their participants and beneficiaries, and protective of the rights of those participants and beneficiaries; and

(3) The proposed exemptions, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory or administrative exemptions. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is, in fact, a prohibited transaction.

(4) The proposed exemptions, if granted, will be subject to the express condition that the material facts and representations contained in the applications accurately describe all material terms of the transactions that are the subject of the exemptions.

Proposed Exemption

The Department is considering granting an exemption under the authority of section 408(a) of the Employee Retirement Income Security Act of 1974 (the Act) and section 4975(c)(2) of the Internal Revenue Code of 1986 (the Code) and in accordance with the procedures set forth in 29 CFR Part 2570, Subpart B (55 FR 32836, August 10, 1990).

Section I—Transactions

If the exemption is granted, the restrictions of section 406 of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1) of the Code, shall not apply to the purchase of any securities by the Asset Manager on behalf of employee benefit plans (Client Plans), including Client Plans investing in a pooled fund (Pooled Fund), for which the Asset Manager acts as a fiduciary, from any person other than the Asset Manager or an affiliate thereof, during the existence of an underwriting or selling syndicate with respect to such securities, where the Affiliated Broker-Dealer is a manager or member of such syndicate, provided that the following conditions are satisfied:

(a) The securities to be purchased are—

(1) either:

(i) part of an issue registered under the Securities Act of 1933 (the 1933 Act) (15 U.S.C. 77a et. seq.) or, if exempt from such registration requirement, are (A) issued or guaranteed by the United States or by any person controlled or supervised by and acting as an instrumentality of the United States pursuant to authority granted by the Congress of the United States, (B) issued by a bank, (C) exempt from such registration requirement pursuant to a federal statute other than the 1933 Act, or (D) are the subject of a distribution and are of a class which is required to be registered under section 12 of the Securities Exchange Act of 1934 (the 1934 Act) (15 U.S.C. 781), and the issuer of which has been subject to the reporting requirements of section 13 of that Act (15 U.S.C. 78m) for a period of at least 90 days immediately preceding the sale of securities and has filed all reports required to be filed thereunder with the Securities and Exchange Commission (SEC) during the preceding 12 months; or

(ii) part of an issue that is an ''Eligible Rule 144A Offering,'' as defined in SEC Rule 10f–3 (17 CFR 270.10f–3(a)(4)). Where the Eligible Rule 144A Offering is of equity securities, the offering syndicate shall obtain a legal opinion regarding the adequacy of the disclosure in the offering memorandum;

(2) purchased prior to the end of the first day on which any sales are made, at a price that is not more than the price paid by each other purchaser of securities in that offering or in any concurrent offering of the securities, except that—

(i) if such securities are offered for subscription upon exercise of rights, they may be purchased on or before the fourth day preceding the day on which the rights offering terminates; or

(ii) if such securities are debt securities, they may be purchased at a price that is not more than the price paid by each other purchaser of securities in that offering or in any concurrent offering of the securities and may be purchased on a day subsequent to the end of the first day on which any sales are made, provided that the interest rates on comparable debt securities offered to the public subsequent to the first day and prior to the purchase are less than the interest rate of the debt securities being purchased; and

(3) offered pursuant to an underwriting or selling agreement under which the members of the syndicate are committed to purchase all of the securities being offered, except if—

(i) such securities are purchased by others pursuant to a rights offering; or

(ii) such securities are offered pursuant to an over-allotment option.

(b) The issuer of such securities has been in continuous operation for not less than three years, including the operation of any predecessors, unless—

(1) such securities are non-convertible debt securities rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization, *i.e.,* Standard & Poor's

[30] PTE 84–14 provides a class exemption, under certain conditions, for transactions between a party in interest with respect to an employee benefit plan and an investment fund (including a single customer or pooled separate account) in which the plan has an interest and which is managed by a QPAM.

Rating Services, Moody's Investors Service, Inc., Duff & Phelps Credit Rating Co., or Fitch IBCA, Inc., or their successors (collectively, the Rating Organizations); or

(2) such securities are issued or fully guaranteed by a person described in paragraph (a)(1)(i)(A) of this exemption; or

(3) such securities are fully guaranteed by a person who has issued securities described in (a)(1)(i)(B), (C), or (D) and this paragraph (b).

(c) The amount of such securities to be purchased by the Asset Manager on behalf of any single Client Plan or any Pooled Fund, does not exceed three percent of the total amount of the securities being offered. Notwithstanding the foregoing, the aggregate amount of any securities purchased with assets of all Client Plans (including Pooled Funds) managed by the Asset Manager (or with respect to which the Asset Manager renders investment advice within the meaning of 29 CFR 2510.3–21(c)) does not exceed:

(1) 10 percent of the total amount of any equity securities being offered;

(2) 35 percent of the total amount of any debt securities being offered that are rated in one of the four highest rating categories by at least one of the Rating Organizations; or

(3) 25 percent of the total amount of any debt securities being offered that are rated in the fifth or sixth highest rating categories by at least one of the Rating Organizations; and

(4) if purchased in an Eligible Rule 144A Offering, the total amount of the securities being offered for purposes of determining the percentages for (1)–(3) above is the total of:

(i) the principal amount of the offering of such class sold by underwriters or members of the selling syndicate to ''qualified institutional buyers'' (QIBs), as defined in SEC Rule 144A (17 CFR 230.144A(a)(1)); plus

(ii) the principal amount of the offering of such class in any concurrent public offering.

(d) The consideration to be paid by the Client Plan or Pooled Fund in purchasing such securities does not exceed three percent of the fair market value of the total net assets of the Client Plan or Pooled Fund, as of the last day of the most recent fiscal quarter of the Client Plan prior to such transaction.

(e) The transaction is not part of an agreement, arrangement, or understanding designed to benefit the Asset Manager or an affiliate.

(f) The Affiliated Broker-Dealer does not receive, either directly, indirectly, or through designation, any selling concession or other consideration that is based upon the amount of securities purchased by Client Plans pursuant to this exemption. In this regard, the Affiliated Broker-Dealer may not receive, either directly or indirectly, any compensation that is attributable to the fixed designations generated by purchases of securities by the Asset Manager on behalf of its Client Plans.

(g)(1) The amount the Affiliated Broker-Dealer receives in management, underwriting or other compensation is not increased through an agreement, arrangement, or understanding for the purpose of compensating the Affiliated Broker-Dealer for foregoing any selling concessions for those securities sold pursuant to this exemption. Except as described above, nothing in this paragraph shall be construed as precluding the Affiliated Broker-Dealer from receiving management fees for serving as manager of the underwriting or selling syndicate, underwriting fees for assuming the responsibilities of an underwriter in the underwriting or selling syndicate, or other consideration that is not based upon the amount of securities purchased by the Asset Manager on behalf of Client Plans pursuant to this exemption; and

(2) The Affiliated Broker-Dealer shall provide to the Asset Manager a written certification, signed by an officer of the Affiliated Broker-Dealer, stating the amount that the Affiliated Broker-Dealer received in compensation during the past quarter, in connection with any offerings covered by this exemption, was not adjusted in a manner inconsistent with Section I, paragraphs (e), (f), or (g), of this exemption.

(h) In the case of a single Client Plan, the covered transaction is performed under a written authorization executed in advance by an independent fiduciary (Independent Fiduciary) of the Client Plan.

(i) Prior to the execution of the written authorization described in paragraph (h) above, the following information and materials must be provided by the Asset Manager to the Independent Fiduciary of each single Client Plan:

(1) a copy of this notice of proposed exemption and of the final exemption, if granted, as published in the **Federal Register**;

(2) any other reasonably available information regarding the covered transactions that the Independent Fiduciary requests; and

(3) a termination form, with instructions specifying how to use the form, expressly providing that the authorization described in paragraph (h) may be terminated without penalty by the Independent Fiduciary on no more than five days' notice.

(j) Subsequent to an Independent Fiduciary's initial authorization permitting the Asset Manager to engage in the covered transactions on behalf of a single Client Plan, the Asset Manager will, at least annually, provide the Independent Fiduciary with another termination form and the information specified in subparagraph (i)(2) and (3) above.

(k) In the case of existing plan investors in a Pooled Fund, such Pooled Fund may not engage in any covered transactions pursuant to this exemption, unless the Asset Manager has provided the written information described below to the Independent Fiduciary of each plan participating in the Pooled Fund. The following information and materials shall be provided not less than 45 days prior to the Asset Manager's engaging in the covered transactions on behalf of the Pooled Fund pursuant to the exemption:

(1) a notice of the Pooled Fund's intent to purchase securities pursuant to this exemption and a copy of this notice of proposed exemption and of the final exemption, if granted, as published in the **Federal Register**;

(2) any other reasonably available information regarding the covered transactions that the Independent Fiduciary requests; and

(3) a termination form expressly providing an election for the Independent Fiduciary to terminate the plan's investment in the Pooled Fund without penalty to the plan. Such form shall include instructions specifying how to use the form. Specifically, the instructions will explain that the plan has an opportunity to withdraw its assets from the Pooled Fund for a period at least 30 days after the plan's receipt of the initial notice described in subparagraph (1) above and that the failure of the Independent Fiduciary to return the termination form by the specified date shall be deemed to be an approval by the plan of its continued participation in covered transactions as a Pooled Fund investor.

For purposes of this paragraph, the requirement that the authorizing fiduciary be independent of the Asset Manager shall not apply in the case of an in-house plan sponsored by the Applicant or an affiliate thereof.

(l) In the case of a plan whose assets are proposed to be invested in a Pooled Fund subsequent to implementation of the procedures to engage in the covered transactions, the plan's investment in the Pooled Fund is subject to the prior written authorization of an Independent Fiduciary, following the receipt by the Independent Fiduciary of the materials described in subsections (1), (2), and (3) of paragraph (k) and an explanation of the plan's ability to terminate its investment in the Pooled Fund. For purposes of this paragraph, the requirement that the authorizing fiduciary be independent of the Asset Manager shall not apply in the case of an in-house plan sponsored by the Applicant or an affiliate thereof.

(m) Subsequent to an Independent Fiduciary's initial authorization of a plan's investment in a Pooled Fund that engages in the covered transactions, the Asset Manager will, at least annually, provide the Independent Fiduciary with a termination form and the information specified in subparagraph (k)(3) above.

(n) At least once every three months, and not later than 45 days following the period to which such information relates, the Asset Manager shall:

(1) furnish the Independent Fiduciary of each single Client Plan, and of each plan investing in a Pooled Fund, with a report (which may be provided electronically) disclosing all securities purchased on behalf of that Client Plan or Pooled Fund pursuant to the exemption during the period to which such report relates, and the terms of the transactions, including:

(i) the type of security (including the rating of any debt security);

(ii) the price at which the securities were purchased;

(iii) the first day on which any sale was made during this offering;

(iv) the size of the issue;

(v) the number of securities purchased by the Asset Manager for the specific Client Plan or Pooled Fund;

(vi) the identity of the underwriter from whom the securities were purchased;

(vii) the spread on the underwriting;

(ix) the price at which any securities purchased during the period were sold; and

(x) the market value at the end of such period of each security purchased during the period and not sold;

(2) provide to the Independent Fiduciary written certifications signed by an officer of the Affiliated Broker-Dealer, as described in paragraph (g)(2), affirming that, as to each offering covered by this exemption during the past quarter, the Affiliated Broker-Dealer acted in compliance with Section I, paragraphs (e), (f), and (g) of this exemption;

(3) disclose to the Independent Fiduciary that, upon request, any other reasonably available information regarding the covered transactions that the Independent Fiduciary requests will be provided, including, but not limited to:

(i) the date on which the securities were purchased on behalf of the plan;

(ii) the percentage of the offering purchased on behalf of all Client Plans and Pooled Funds; and

(iii) the identity of all members of the underwriting syndicate; and

(4) disclose to the Independent Fiduciary in the next quarterly report, whether at any time during the preceding quarter, the Asset Manager was precluded from trading in a security purchased under this exemption for any period of time because of its status as an affiliate of the Affiliated Broker-Dealer and the reason for this restriction.

(o) Each single Client Plan shall have total net assets with a value of at least \$50 million. In addition, in the case of a transaction involving an Eligible Rule 144A Offering on behalf of a single Client Plan, each such Client Plan shall have at least \$100 million in securities, as determined pursuant to SEC Rule 144A (17 CFR 230.144A). In the case of a Pooled Fund, the \$50 million requirement will be met if 50 percent or more of the units of beneficial interest in such Pooled Fund are held by plans having total net assets with a value of at least \$50 million. For purchases involving an Eligible Rule 144A Offering on behalf of a Pooled Fund, the \$100 million requirement will be met if 50 percent or more of the units of beneficial interest in such Pooled Fund are held by plans having at least \$100 million in assets and the Pooled Fund itself qualifies as a QIB, as determined pursuant to SEC Rule 144A (17 CFR 230.144A(a)(F)).

For purposes of the net asset tests described above, where a group of Client Plans is maintained by a single employer or controlled group of employers, as defined in section 407(d)(7) of the Act, the \$50 million net asset requirement or the \$100 million net asset requirement may be met by aggregating the assets of such Client Plans, if the assets are pooled for investment purposes in a single master trust.

(p) The Asset Manager qualifies as a ''qualified professional asset manager'' (QPAM), as that term is defined under Part V(a) of Prohibited Transaction Exemption 84–14 (49 FR 9494, 9506, March 13, 1984) and, in addition, has, as of the last day of its most recent fiscal year, total client assets under its management and control in excess of \$5 billion and shareholders' or partners' equity in excess of \$1 million.

(q) No more than 10 percent of the assets of a Pooled Fund, at the time of a covered transaction, are comprised of assets of employee benefit plans maintained by the Asset Manager, the Affiliated Broker-Dealer, or an affiliate for their own employees, for which the Asset Manager, the Affiliated Broker-Dealer, or an affiliate exercises investment discretion.

(r) The Asset Manager and the Affiliated Broker-Dealer maintain, or cause to be maintained, for a period of six years from the date of any covered transaction such records as are necessary to enable the persons described in paragraph (s) of this exemption to determine whether the conditions of this exemption have been met, except that—

(1) no party in interest with respect to a Client Plan, other than the Asset Manager and the Affiliated Broker-Dealer, shall be subject to a civil penalty under section 502(i) of the Act or the taxes imposed by section 4975(a) and (b) of the Code, if such records are not maintained, or not available for examination, as required by paragraph (s); and

(2) a prohibited transaction shall not be considered to have occurred if, due to circumstances beyond the control of the Asset Manager or the Affiliated Broker-Dealer, such records are lost or destroyed prior to the end of the six-year period.

(s)(1) Except as provided in subparagraph (2) of this paragraph (s) and notwithstanding any provisions of subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (r) are unconditionally available at their customary location for examination during normal business hours by—

(i) any duly authorized employee or representative of the Department, the Internal Revenue Service, or the SEC; or

(ii) any fiduciary of a Client Plan, or any duly authorized employee or representative of such fiduciary; or

(iii) any employer of participants and beneficiaries and any employee organization whose members are covered by a Client Plan, or any authorized employee or representative of these entities; or

(iv) any participant or beneficiary of a Client Plan, or duly authorized employee or representative of such participant or beneficiary;

(2) none of the persons described in paragraphs (s)(1)(ii)–(iv) shall be authorized to examine trade secrets of the Asset Manager or the Affiliated Broker-Dealer, or commercial or financial information which is privileged or confidential; and

(3) should the Asset Manager or the Affiliated Broker-Dealer refuse to disclose information on the basis that such information is exempt from disclosure pursuant to paragraph (s)(2)

above, the Asset Manager shall, by the close of the thirtieth (30th) day following the request, provide a written notice advising that person of the reasons for the refusal and that the Department may request such information.

Section II—Definitions

(a) The term ''the Affiliated Broker-Dealer'' means any broker-dealer affiliate of the Applicant (as ''affiliate'' is defined in paragraph (c)) that meets the requirements of this exemption.

(b) The term ''the Asset Manager'' means any asset management affiliate of the Applicant (as ''affiliate'' is defined in paragraph (c)) that meets the requirements of this exemption.

(c) The term ''affiliate'' of a person includes:

(1) any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with such person;

(2) any officer, director, partner, employee, or relative (as defined in section 3(15) of the Act) of such person; and

(3) any corporation or partnership of which such person is an officer, director, partner, or employee.

(d) The term ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual.

(e) The term ''Client Plan'' means an employee benefit plan that is subject to the fiduciary responsibility provisions of the Act and whose assets are under the management of the Asset Manager, including a plan investing in a Pooled Fund (as ''Pooled Fund'' is defined in paragraph (f) below).

(f) The term ''Pooled Fund'' means a common or collective trust fund or pooled investment fund maintained by the Asset Manager.

(g) The term ''Independent Fiduciary'' means a fiduciary of a Client Plan who is unrelated to, and independent of, the Asset Manager. For purposes of this exemption, a Client Plan fiduciary will not be deemed to be unrelated to, and independent of, the Asset Manager if:

(1) such fiduciary directly or indirectly controls, is controlled by, or is under common control with the Asset Manager;

(2) such fiduciary, or any officer, director, partner, employee, or relative of such fiduciary is an officer, director, partner, or employee of the Asset Manager (or is a relative of such persons); or

(3) such fiduciary directly or indirectly receives any compensation or other consideration from the Asset Manager for his or her own personal account in connection with any transaction described in this exemption.

If an officer, director, partner, or employee of the Asset Manager (or a relative of such persons), is a director of such Independent Fiduciary, and if he or she abstains from participation in (A) the choice of the Plan's investment manager/adviser and (B) the decision to authorize or terminate authorization for transactions described in Section I, then paragraph (g)(2) of this Section II, shall not apply.

(h) The term ''security'' shall have the same meaning as defined in section 2(36) of the Investment Company Act of 1940 (the 1940 Act), as amended (15 U.S.C. 80a–2(36)(1996)).

(i) The term ''Eligible Rule 144A Offering'' shall have the same meaning as defined in SEC Rule 10f–3(a)(4) (17 CFR 270. 10f–3(a)(4)) under the 1940 Act.

(j) The term ''qualified institutional buyer'' or ''QIB'' shall have the same meaning as defined in SEC Rule 144A (17 CFR 230.144A(a)(1)) under the 1933 Act.

(k) The term ''Rating Organizations'' means Standard & Poor's Rating Services, Moody's Investors Service, Inc., Duff & Phelps Credit Rating Co., or Fitch IBCA, Inc., or their successors.

Signed at Washington, D.C., this 3rd day of February, 2000.

Ivan L. Strasfeld,

Director of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor.

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EXECUTIVE OFFICE OF THE PRESIDENT

National Partnership for Reinventing Government

BEST Communities: Boosting Education, Skills and Training

AGENCY: National Partnership for Reinventing Government.

ACTION: Notice of performance partners with community-based coalitions.

AUTHORITY CITATION: Non-statutory.

BACKGROUND: The number one problem facing American business today is a shortage of highly skilled workers. America's competitiveness and the prosperity of the American people will depend increasingly upon high-skill, high-wage jobs. Realizing this potential will require investing in education and learning so all of our people can continue to learn throughout their lifetime and get the skills they need to succeed in the 21st century.

The BEST Communities initiative was recommended by the 21st Century Leadership Group—a forum of leaders from business, organized labor, education, and all levels of government—convened by the Vice President in January 1999. The Vice President asked the group to develop a set of recommendations to their peers that would help ensure a prepared and thriving workforce in the next century.

Their report, Skills for a New Century: A Blueprint for Lifelong Learning, presented to the Vice President in November 1999, outlined five broad recommendations to provide adults the skills they need and employers the skilled employees needed to remain competitive.

(1) Deliver education and training that is tied to high standards, leads to useful credentials and meets labor market needs.

(2) Improve access to financial resources for lifetime learning for all adult Americans, including those in low-wage jobs.

(3) Promote learning at a time, place, and manner that meets worker needs and interests, including through the use of learning technologies to enable learning at home, the workplace, or elsewhere.

(4) Encourage and motivate adults to pursue further education and training and inform them of resources available to help them do so.

(5) Form partnerships among a wide array of organizations and stakeholders to support workforce development and lifelong learning for adults.

Based on the Leadership Group's recommendation, the Vice President announced a new initiative to assist local communities interested in developing and implementing community-wide strategies to help adults get the skills they need to succeed. This effort would support community-based partnerships involving business, labor, education and government that develop plans focused on clear, objective, measurable goals for adult learning and skill development across a community. Existing web sites will be used to share key information and best practices across a broader network of communities.

Announcement: The National Partnership for Reinventing Government is seeking ten performance partners with community-based coalitions that want to work with Federal partners to enhance education, skills, training and lifelong learning for adults in their community. Community-based partnerships that are not selected as one