



# Federal Register

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**Wednesday,  
February 27, 2002**

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**Part III**

## **Department of Labor**

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**Pension and Welfare Benefits  
Administration**

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**Proposed Exemptions; Deutsche Bank,  
AG, et al.; Notice**

**DEPARTMENT OF LABOR****Pension and Welfare Benefits Administration**

[Application No. D-10924, et al.]

**Proposed Exemptions; Deutsche Bank, AG, et al.****AGENCY:** Pension and Welfare Benefits Administration, Labor.**ACTION:** Notice of proposed exemptions.

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

**Written Comments and Hearing Requests**

All interested persons are invited to submit written comments or requests for a hearing on the pending exemptions, unless otherwise stated in the Notice of Proposed Exemption, within 45 days from the date of publication of this **Federal Register** Notice. Comments and requests for a hearing should state: (1) The name, address, and telephone number of the person making the comment or request, and (2) the nature of the person's interest in the exemption and the manner in which the person would be adversely affected by the exemption. A request for a hearing must also state the issues to be addressed and include a general description of the evidence to be presented at the hearing.

**ADDRESSES:** All written comments and requests for a hearing (at least three copies) should be sent to the Pension and Welfare Benefits Administration (PWBA), Office of Exemption Determinations, Room N-5649, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210. Attention: Application No. \_\_\_\_\_, stated in each Notice of Proposed Exemption. Interested persons are also invited to submit comments and/or hearing requests to PWBA via e-mail or FAX. Any such comments or requests should be sent either by e-mail to: [moffittb@pwba.dol.gov](mailto:moffittb@pwba.dol.gov), or by FAX to (202) 219-0204 by the end of the scheduled comment period. The applications for exemption 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-1513, 200 Constitution Avenue, NW, Washington, DC 20210.

**Notice to Interested Persons**

Notice of the proposed exemptions will be provided to all interested persons in the manner agreed upon by the applicant and the Department within 15 days of the date of publication in the **Federal Register**. Such notice shall include a copy of the notice of proposed exemption as published in the **Federal Register** and shall inform interested persons of their right to comment and to request a hearing (where appropriate).

**SUPPLEMENTARY INFORMATION:** The proposed exemptions were requested in applications filed pursuant to section 408(a) of the Act and/or section 4975(c)(2) of the Code, and in accordance with procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, 32847, August 10, 1990). Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), transferred the authority of the Secretary of the Treasury to issue exemptions of the type requested to the Secretary of Labor. Therefore, these notices of proposed exemption are issued solely by the Department.

The applications contain representations with regard to the proposed exemptions which are summarized below. Interested persons are referred to the applications on file with the Department for a complete statement of the facts and representations.

**Deutsche Bank AG (DB)**

*Located in Germany, with Affiliates in New York, New York and Other Locations*

[Exemption Application No. D-10924]

**Proposed Exemption**

The Department is considering granting an exemption under the authority of section 408(a) of the Act, section 8477(c)(3) of the Federal Employees' Retirement System Act of 1986 (FERSA) 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, 32847, August 10, 1990).<sup>1</sup>

**Section I—Transactions**

If the exemption is granted, the restrictions of section 406(a)(1)(A) through (D) and 406(b)(1) and (2) of the Act, section 8477(c)(2)(A) and (B) of FERSA, and the sanctions resulting from the application of section 4975 of the

<sup>1</sup>For purposes of this exemption, references to specific provisions of Title I of the Act, unless otherwise specified, refer to the corresponding provisions of FERSA and the Code.

Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply to:

- (a) the lending of securities to:
- (1) Deutsche Banc Alex. Brown, Inc., its successors or affiliates (DBAB);
  - (2) any current or future affiliate of DB,<sup>2</sup> that is a bank, as defined in section 202(a)(2) of the Investment Advisers Act of 1940, that is supervised by the U.S. or a state, any broker-dealer registered under the Securities Exchange Act of 1934 (the "1934 Act"), or any foreign affiliate that is a bank or broker-dealer that is supervised by (1) the Securities and Futures Authority ("SFA") in the United Kingdom; (2) the Deutsche Bundesbank and/or the Federal Banking Supervisory Authority, *i.e.*, das Bundesaufsichtsamt fuer das Kreditwesen (the "BAK") in Germany; (3) the Ministry of Finance ("MOF") and/or the Tokyo Stock Exchange in Japan; (4) the Ontario Securities Commission, the Investment Dealers Association and/or the Office of Superintendent of Financial Institutions in Canada; (5) the Swiss Federal Banking Commission in Switzerland; and (6) the Reserve Bank of Australia or the Australian Securities and Investments Commission and/or Australian Stock Exchange Limited in Australia (the branches and/or affiliates in the six enumerated foreign countries hereinafter referred to as the "Foreign Affiliates") and together with the U.S. branches or affiliates (individually, "Affiliated Borrower" and collectively, "Affiliated Borrowers"), by employee benefit plans, including commingled investment funds holding plan assets (the Client Plans or Plans),<sup>3</sup> for which DB or an affiliate acts as securities lending agent or subagent (the "DB Lending Agent")<sup>4</sup> and also may serve as

<sup>2</sup> Any reference to DB shall be deemed to include any successors thereto.

<sup>3</sup> The common and collective trust funds trustee, custodied, and/or managed by DB or an affiliate, and in which Client Plans invest, are referred to herein as "Commingled Funds." The Client Plan separate accounts trustee, custodied, and/or managed by DB or an affiliate are referred to herein as "Separate Accounts." Commingled Funds and Separate Accounts are collectively referred to herein as "Lender" or "Lenders."

<sup>4</sup> DB or an affiliate may be retained by primary securities lending agents to provide securities lending services in a sub-agent capacity with respect to portfolio securities of clients of such primary securities lending agents. As a securities lending sub-agent, DB's role parallels that under the lending transactions for which DB or an affiliate acts as a primary securities lending agent on behalf of its clients. References to DB's performance of services as securities lending agent should be deemed to include its parallel performance as a securities lending sub-agent and references to the Client Plans should be deemed to include those plans for which the DB Lending Agent is acting as a sub-agent with respect to securities lending.

trustee, custodian or investment manager of securities being lent; and

(b) the receipt of compensation by the DB Lending Agent in connection with these transactions.

#### Section II—Conditions

Section I of this exemption applies only if the conditions of Section II are satisfied. For purposes of this exemption, any requirement that the approving fiduciary be independent of the DB Lending Agent or the Affiliated Borrower shall not apply in the case of an employee benefit plan sponsored and maintained by the DB Lending Agent and/or an affiliate for its own employees (a DB Plan) invested in a Commingled Fund, provided that at all times the holdings of all DB Plans in the aggregate comprise less than 10% of the assets of the Commingled Fund.

(a) For each Client Plan, neither the DB Lending Agent nor any affiliate (except as expressly permitted herein) has or exercises discretionary authority or control with respect to the investment of the assets of Client Plans involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3–21(c)) with respect to such assets, including decisions concerning a Client Plan's acquisition or disposition of securities available for loan.

This paragraph (a) will be deemed satisfied notwithstanding that the DB Lending Agent exercises discretionary authority or control or renders investment advice in connection with an Index Fund or Model-Driven Fund managed by the DB Lending Agent in which Client Plans invest.

(b) Any arrangement for the DB Lending Agent to lend securities is approved in advance by a Plan fiduciary who is independent of the DB Lending Agent (the Independent Fiduciary).

(c) The specific terms of the securities loan agreement (the Loan Agreement) are negotiated by the DB Lending Agent which acts as a liaison between the Lender and the Affiliated Borrower to facilitate the securities lending transaction. In the case of a Separate Account, the Independent Fiduciary of a Client Plan approves the general terms of the Loan Agreement between the Client Plan and the Affiliated Borrower as well as any material change in such Loan Agreement. In the case of a Commingled Fund, approval is pursuant to the procedure described in paragraph (i), below.

(d) The terms of each loan of securities by a Lender to an Affiliated

Borrower are at least as favorable to such Separate Account or Commingled Fund as those of a comparable arm's length transaction between unrelated parties.

(e) A Client Plan, in the case of a Separate Account, may terminate the lending agency or sub-agency arrangement at any time, without penalty, on five business days notice. A Client Plan in the case of a Commingled Fund may terminate its participation in the lending arrangement by terminating its investment in the Commingled Fund no later than 35 days after the notice of termination of participation is received, without penalty to the Plan, in accordance with the terms of the Commingled Fund. Upon termination, the Affiliated Borrowers will transfer securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the Separate Account or, if the Plan's withdrawal necessitates a return of securities, to the Commingled Fund, within:

(1) The customary delivery period for such securities;

(2) Five business days; or

(3) The time negotiated for such delivery by the Client Plan, in a Separate Account, or by the DB Lending Agent, as lending agent to a Commingled Fund, and the Affiliated Borrowers, whichever is least.

(f) The Separate Account, Commingled Fund or another custodian designated to act on behalf of the Client Plan, receives from each Affiliated Borrower (either by physical delivery, book entry in a securities depository located in the United States, wire transfer or similar means) by the close of business on or before the day the loaned securities are delivered to the Affiliated Borrower, collateral consisting of U.S. currency, securities issued or guaranteed by the United States Government or its agencies or instrumentalities, irrevocable bank letters of credit issued by a U.S. bank, other than DB (or any subsequent parent corporation of the DB Lending Agent) or an affiliate thereof, or any combination thereof, or other collateral permitted under Prohibited Transaction Exemption 81–6 (46 FR 7527, January 23, 1981) (PTE 81–6) (as it may be amended or superseded) (collectively, the Collateral). The Collateral will be held on behalf of a Client Plan in a depository account separate from the Affiliated Borrower.

(g) The market value (or in the case of a letter of credit, a stated amount) of the Collateral on the close of business

on the day preceding the day of the loan is initially at least 102 percent of the market value of the loaned securities. The applicable Loan Agreement gives the Separate Account or the Commingled Fund in which the Client Plan has invested a continuing security interest in, and a lien on or title to, the Collateral. The level of the Collateral is monitored daily by the DB Lending Agent. If the market value of the Collateral, on the close of trading on a business day, is less than 100 percent of the market value of the loaned securities at the close of business on that day, the Affiliated Borrower is required to deliver, by the close of business on the next day, sufficient additional Collateral such that the market value of the Collateral will again equal 102 percent.

(h)(1) For a Lender that is a Separate Account, prior to entering into a Loan Agreement, the applicable Affiliated Borrower furnishes its most recently available audited and unaudited statements to the DB Lending Agent which will, in turn, provide such statements to the Client Plan before the Client Plan approves the terms of the Loan Agreement. The Loan Agreement contains a requirement that the applicable Affiliated Borrower must give prompt notice at the time of a loan of any material adverse changes in its financial condition since the date of the most recently furnished financial statements. If any such changes have taken place, the DB Lending Agent will not make any further loans to the Affiliated Borrower unless an Independent Fiduciary of the Client Plan in a Separate Account is provided notice of any material change and approves the continuation of the lending arrangement in view of the changed financial condition.

(2) For a Lender that is a Commingled Fund, the DB Lending Agent will furnish upon reasonable request to an Independent Fiduciary of each Client Plan invested in the Commingled Fund the most recently available audited and unaudited financial statements of the applicable Affiliated Borrower prior to authorization of lending, and annually thereafter.

(i) In the case of Commingled Funds, the information described in paragraph (c) (including any information with respect to any material change in the arrangement) shall be furnished by the DB Lending Agent as lending fiduciary to the Independent Fiduciary of each Client Plan whose assets are invested in the Commingled Fund, not less than 30 days prior to implementation of the arrangement or material change to the lending arrangement as previously described to the Client Plan, and

thereafter, upon the reasonable request of the Client Plan's Independent Fiduciary. In the event of a material adverse change in the financial condition of an Affiliated Borrower, the DB Lending Agent will make a decision, using the same standards of credit analysis the DB Lending Agent would use in evaluating unrelated borrowers, whether to terminate existing loans and whether to continue making additional loans to the Affiliated Borrower.

In the event any such Independent Fiduciary submits a notice in writing within the 30 day period provided in the preceding paragraph to the DB Lending Agent, as lending fiduciary, objecting to the implementation of, material change in, or continuation of the arrangement, the Plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the Commingled Fund, without penalty to the Plan, no later than 35 days after the notice of withdrawal is received. In the case of a Plan that elects to withdraw pursuant to the foregoing, such withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a Plan electing to withdraw. In the case of a Plan whose assets are proposed to be invested in the Commingled Fund subsequent to the implementation of the arrangement, the Plan's investment in the Commingled Fund shall be authorized in the manner described in paragraph (c).

(j) In return for lending securities, the Lender either—

(1) Receives a reasonable fee, which is related to the value of the borrowed securities and the duration of the loan; or

(2) Has the opportunity to derive compensation through the investment of cash Collateral. (Under such circumstances, the Lender may pay a loan rebate or similar fee to the Affiliated Borrowers, if such fee is not greater than the fee the Lender would pay in a comparable arm's length transaction with an unrelated party.)

(k) Except as otherwise expressly provided herein, all procedures regarding the securities lending activities will, at a minimum, conform to the applicable provisions of PTE 81-6 and Prohibited Transaction Exemption 82-63 (46 FR 14804, April 6, 1982) (PTE 82-63), both as amended or superseded, as well as to applicable securities laws of the United States, the United Kingdom, Canada, Australia, Switzerland, Japan and Germany.

(l) DB agrees to indemnify and hold harmless the Client Plans in the United

States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with an Affiliated Borrower so that the Client Plans do not have to litigate (e.g., in the case of Deutsche Bank AG, London Branch) in a foreign jurisdiction nor sue to realize on the indemnification. Such indemnification is against any and all reasonably foreseeable damages, losses, liabilities, costs and expenses (including attorney's fees) which the Client Plans may incur or suffer, arising from any impermissible use by an Affiliated Borrower of the loaned securities, from an event of default arising from the failure of an Affiliated Borrower to deliver loaned securities in accordance with the applicable Loan Agreement or from an Affiliated Borrower's other failure to comply with the terms of such agreement, except to the extent that such losses are caused by the Client Plan's own negligence.

If any event of default occurs, to the extent that (i) liquidation of the pledged Collateral or (ii) additional cash received from the Affiliated Borrower does not provide sufficient funds on a timely basis, the DB Lending Agent, as securities lending agent, promptly and at its own expense (subject to rights of subrogation in the Collateral and against such Affiliated Borrower) will purchase or cause to be purchased, for the account of the Client Plan, securities identical to the borrowed securities (or their equivalent as discussed above). If the Collateral and any such additional cash is insufficient to accomplish such purchase, DB, pursuant to the indemnification, indemnifies the Client Plan invested in a Separate Account or Commingled Fund for any shortfall in the Collateral plus interest on such amount and any transaction costs incurred (including attorney's fees). Alternatively, if such replacement securities cannot be obtained in the open market, DB pays the Lender the difference in U.S. dollars between the market value of the loaned securities and the market value of the related Collateral as determined on the date of the Affiliated Borrower's breach of the obligation to return the securities pursuant to the applicable Loan Agreement.

(m) The Lender receives the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including but not limited to all interest and dividends on the loaned securities, shares of stock as a result of stock splits and rights to purchase additional securities, or other distributions.

(n) Prior to any Client Plan's approval of the lending of its securities to any Affiliated Borrower, a copy of the final exemption (if granted) and this notice of proposed exemption is provided to the Client Plan.

(o) The Independent Fiduciary of each Client Plan that is invested in a Separate Account is provided with (including by electronic means) quarterly reports with respect to the securities lending transactions, including, but not limited to, the information described in Representation 24 of the Summary of Facts and Representations, and the certification of an auditor selected by the DB Lending Agent who is independent of the DB Lending Agent (but may or may not be independent of the Client Plan) that the loans appear no less favorable to the Lender than the pricing established in the schedule described in Representation 16, so that the Independent Fiduciary may monitor such transactions with the Affiliated Borrower. The Independent Fiduciary of a Client Plan invested in a Commingled Fund will receive the auditor's certification and, upon request, will also receive the quarterly report.

(p) Only Client Plans with total assets having an aggregate market value of at least \$50 million are permitted to lend securities to the Affiliated Borrowers; provided, however, that—

(1) In the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangement with the DB Lending Agent, the foregoing \$50 million requirement shall be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(2) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan

Asset Regulation, which entity is engaged in securities lending arrangements with the DB Lending Agent, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Client Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity—

(A) Has full investment responsibility with respect to plan assets invested therein; and

(B) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

In addition, none of the entities described above are formed for the sole purpose of making loans of securities.

(q) With respect to any calendar quarter, at least 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of Lenders will be to borrowers unrelated to the DB Lending Agent.

(r) In addition to the above, all loans involving foreign Affiliated Borrowers have the following requirements:

(1) The foreign Affiliated Borrower is a bank, supervised either by a state or the United States, a broker-dealer registered under the Securities Exchange Act of 1934 or a bank or broker-dealer that is supervised by (1) the SFA in the United Kingdom; (2) the BAK in Germany; (3) the MOF and/or the Tokyo Stock Exchange in Japan; (4) the Ontario Securities Commission, the Investment Dealers Association and/or the Office of Superintendent of Financial Institutions in Canada; (5) the Swiss Federal Banking Commission in Switzerland; and (6) the Reserve Bank of Australia or the Australian Securities and Investments Commission and/or Australian Stock Exchange Limited in Australia;

(2) The foreign Affiliated Borrower is in compliance with all applicable provisions of Rule 15a-6 under the Securities Exchange Act of 1934 (17 CFR 240.15a-6)(Rule 15a-6) which provides foreign broker-dealers a limited exemption from United States registration requirements;

(3) All Collateral is maintained in United States dollars or U.S. dollar-denominated securities or letters of credit (unless an applicable exemption provides otherwise);

(4) All Collateral is held in the United States and the situs of the securities lending agreements is maintained in the United States under an arrangement that complies with the indicia of ownership requirements under section 404(b) of the Act and the regulations promulgated under 29 CFR 2550.404(b)-1 related to the lending of securities; and

(5) Prior to a transaction involving a foreign Affiliated Borrower, the foreign Affiliated Borrower—

(A) Agrees to submit to the jurisdiction of the United States;

(B) Agrees to appoint an agent for service of process in the United States, which may be an affiliate (the Process Agent);

(C) Consents to service of process on the Process Agent; and

(D) Agrees that enforcement by a Client Plan of the indemnity provided by DB may occur in the United States courts.

(s) The DB Lending Agent maintains, or causes to be maintained, within the United States for a period of six years from the date of such transaction, in a manner that is convenient and accessible for audit and examination, such records as are necessary to enable the persons described in paragraph (t)(1) to determine whether the conditions of the exemption have been met, except that—

(1) A prohibited transaction will not be considered to have occurred if, due to circumstances beyond the control of the DB Lending Agent and/or its affiliates, the records are lost or destroyed prior to the end of the six-year period; and

(2) No party in interest other than the DB Lending Agent or its affiliates shall be subject to the civil penalty that may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if the records are not maintained, or are not available for examination as required below by paragraph (t)(1).

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

(A) Any duly authorized employee or representative of the Department, the Internal Revenue Service or the Securities and Exchange Commission;

(B) Any fiduciary of a participating Client Plan or any duly authorized representative of such fiduciary;

(C) Any contributing employer to any participating Client Plan or any duly authorized employee or representative of such employer; and

(D) Any participant or beneficiary of any participating Client Plan, or any duly authorized representative of such participant or beneficiary.

(t)(2) None of the persons described above in paragraphs (t)(1)(B)–(t)(1)(D) are authorized to examine the trade secrets of the DB Lending Agent or its affiliates or commercial or financial information which is privileged or confidential.

### Section III—Definitions

(a) *DB Plan*: An ERISA covered employee benefit plan sponsored and maintained by the DB Lending Agent and/or an affiliate for its own employees.

(b) *Index Fund*: Any investment fund, account or portfolio sponsored, maintained, trusted or managed by the DB Lending Agent or an affiliate, in which one or more investors invest, and—

(1) which is designed to track the rate of return, risk profile and other characteristics of an Index by either (i) replicating the same combination of securities which compose such Index or (ii) sampling the securities which compose such Index based on objective criteria and data;

(2) for which the DB Lending Agent or its affiliate does not use its discretion, or data within its control, to affect the identity or amount of securities to be purchased or sold;

(3) that contains “plan assets” subject to the Act, pursuant to the Department’s Plan Asset Regulation; and,

(4) that involves no agreement, arrangement, or understanding regarding the design or operation of the Fund which is intended to benefit the DB Lending Agent or its affiliate or any party in which the DB Lending Agent or its affiliate may have an interest.

(c) *Model-Driven Fund*: Any investment fund, account or portfolio sponsored, maintained, trusted or managed by the DB Lending Agent or an affiliate, in which one or more investors invest, and—

(1) which is composed of securities the identity of which and the amount of which are selected by a computer model that is based on prescribed objective criteria using independent third-party data, not within the control of the DB Lending Agent or an affiliate, to transform an Index;

(2) which contains "plan assets" subject to the Act, pursuant to the Department's Plan Asset Regulation; and

(3) that involves no agreement, arrangement or understanding regarding the design or operation of the Fund or the utilization of any specific objective criteria which is intended to benefit the DB Lending Agent, any affiliate of the DB Lending Agent, or any party in which the DB Lending Agent or any affiliate may have an interest.

(d) *Index*: a securities index that represents the investment performance of a specific segment of the public market for equity or debt securities in the United States and/or foreign countries, but only if—

(1) The organization creating and maintaining the index is—

(A) engaged in the business of providing financial information, evaluation, advice or securities brokerage services to institutional clients,

(B) a publisher of financial news or information, or

(C) a public stock exchange or association of securities dealers;

(2) the index is created and maintained by an organization independent of DB; and

(3) the index is a generally accepted standardized index of securities which is not specifically tailored for the use of the DB Lending Agent or an affiliate.

### Summary of Facts and Representations

1. Deutsche Bank AG (hereafter referred to as either "DB" or "the Applicant") is a German banking corporation. DB is a leading commercial bank which provides a wide range of banking, fiduciary, record-keeping, custodial, brokerage and investment services to corporations, institutions, governments, employee benefit plans, governmental retirement plans and private investors worldwide. DB is one of the largest financial institutions in the world in terms of assets. As of calendar year 2001, total assets of DB were 928,994 million Euros. Shareholders equity equaled 43,683 million Euros. DB manages over \$585 billion in assets either through collective trusts, separately managed accounts or mutual funds.

Outside the United States, DB, as a whole, is not supervised by a state or by the United States. However, DB is regulated and supervised globally by the BAK in cooperation with the Deutsche Bundesbank (the "Bundesbank").<sup>5</sup> The

<sup>5</sup>In addition, Deutsche Bank AG, New York Branch, is regulated and supervised by the New York State Banking Department. Certain activities of

BAK is a federal institution with ultimate responsibility to the German Ministry of Finance. The Bundesbank is the central bank of the Federal Republic of Germany and an integral part of the European Central Banks. The BAK supervises the operations of banks, banking groups, financial holding groups and foreign bank branches in Germany, and has the authority to (a) issue and withdraw banking licenses, (b) issue regulations on capital and liquidity requirements of banks, (c) request information and conduct investigations, and (d) intervene in cases of inadequate capital or liquidity endangered deposits, or bankruptcy by temporarily prohibiting certain banking transactions. The BAK ensures that DB has procedures for monitoring and controlling its worldwide activities through various statutory and regulatory standards. Among these standards are requirements for adequate internal controls, oversight, administration, and financial resources. The BAK reviews compliance with these operational and internal control standards through an annual audit performed by the year-end auditor and through special audits ordered by the BAK. The supervisory authorities require information on the condition of DB and its branches through periodic, consolidated financial reports and through a mandatory annual report prepared by the auditor. The supervisory authorities also require information from DB regarding capital adequacy, country risk exposure, and foreign exchange (FX) exposures. German banking law mandates penalties to ensure correct reporting to the supervisory authorities, and auditors face penalties for gross violations of their duties.

Additionally, the BAK in cooperation with the Bundesbank supervises all branches of DB, wherever located, subjecting them to announced and unannounced on-site audits, and all other supervisory controls applicable to German banks. With respect to branches located in the European Economic Area ("EEA") member states,<sup>6</sup> such audits are

Deutsche Bank's New York branch are also regulated and supervised by the Federal Reserve Bank of New York. Bankers Trust Company, an indirect wholly-owned subsidiary of DB, is a New York State bank and a member of the Federal Reserve System.

<sup>6</sup>DB's branches domiciled outside the EEA are also subject to local regulation and supervision by the host country's supervisory authority, e.g., the MOF in Japan, the Swiss Federal Banking Commission in Switzerland, the Australian Prudential Regulation Authority in Australia, and the Office of the Superintendent of Financial Institutions in Canada. For DB's branches domiciled in EEA member states, the BAK is the lead supervisory authority pursuant to the rules on the "European passport," and only some aspects are

carried out consistent with the applicable European Directives, and with respect to branches outside the EEA, consistent with applicable international agreements, memoranda of understanding, or other arrangements with the relevant foreign supervisory authorities.<sup>7</sup>

DB's subsidiaries that pursue banking and other financial activities (other than insurance) or activities that are closely related thereto are consolidated with DB and form a "banking group" for purposes of the capital ratios and the large exposure limits that the bank is required to meet also on a group-wide basis. In conformity the European Directives,<sup>8</sup> the BAK supervises such banking groups (where their parent institution is domiciled in Germany) on a consolidated basis. While oversight is less individualized for subsidiaries than for branches, the supervision extends to adequacy of equity capital of banking and financial holding groups and compliance with the regulations regarding large loans granted by such groups. Thus, DB is subject to comprehensive supervision and regulation on a consolidated basis by its home country supervisor.<sup>9</sup>

Bankers Trust Company, a wholly-owned subsidiary of DB, is a New York banking corporation and a leading commercial bank, providing a wide range of banking and related services to various entities, including employee benefit plans and other institutional investors. Bankers Trust Company, and other affiliates or branches of the Applicant, advise various portfolios subject to ERISA that are invested in

subject to complementary supervision by the host country's supervisory authority (e.g., the Securities and Futures Authority in the United Kingdom supervises the conduct of the investment business of DB in the United Kingdom).

<sup>7</sup>As a result of meetings between the U.S. and German Regulators in October 1993, the U.S. Department of Treasury has accorded national treatment to German bank branches, and the German Ministry of Finance has granted relief to branches of U.S. banks in Germany, in particular with respect to "dotation" or endowment capital requirements and capital adequacy standards. Since the German Banking Act (s. 53c) allows such exemptions only insofar as branches of German companies are afforded equal exemptions in the foreign state, this confirms indirectly the recognition of the German banking supervisory standards by the U.S. regulators. Thus, with respect to capital adequacy, each government has agreed to accept the capital adequacy requirements of the other for foreign banks doing business in the other's jurisdiction.

<sup>8</sup>See, e.g., Council Directive 92/30/EEC of 6 April 1992 on the supervision of credit institutions on a consolidated basis, Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit.

<sup>9</sup>This is also the conclusion reached by the Board of Governors of the Federal Reserve System in its Order approving DB's application to become a bank holding company, effective May 20, 1999.

certain Index or Model-Driven Funds (collectively, Indexed Accounts) that are, respectively, designed to either track or transform an independently maintained securities index. Currently, securities in those portfolios may be lent to banks and broker-dealers that are not DB affiliates through the DB securities lending program.<sup>10</sup>

2. The Applicant seeks an exemption to permit it, through its branches and affiliates (including bank subsidiaries and affiliated broker-dealers) in the United States, Canada, Japan, Switzerland, Australia, Germany and the United Kingdom (i.e., Affiliated Borrowers) to borrow securities from Indexed Accounts under the conditions described herein. For purposes of this proposed exemption, an Affiliated Borrower will be any bank, as defined in section 202(a)(2) of the Investment Advisers Act of 1940, that is supervised by the U.S. or state, any broker-dealer registered under the Securities Exchange Act of 1934 (the "1934 Act"), or any foreign affiliate of Bankers Trust Company that is a bank or broker-dealer that is supervised by (1) the SFA in the United Kingdom; (2) the BAK in Germany; (3) the MOF and/or the Tokyo Stock Exchange in Japan; (4) the Ontario Securities Commission, the Investment Dealers Association and/or the Office of Superintendent of Financial Institutions in Canada; (5) the Swiss Federal Banking Commission in Switzerland; and (6) the Reserve Bank of Australia or the Australian Securities and Investments Commission and/or Australian Stock Exchange Limited in Australia (i.e., the Foreign Affiliates).

Branches and/or affiliates in the enumerated countries include: Deutsche Bank AG, London Branch; Deutsche Securities Limited, Tokyo Branch, Japan Bankers Trust, Ltd. and Deutsche Bank AG, Tokyo Branch; DB in Germany; Deutsche Bank AG, Sydney Branch; Deutsche Bank Canada and Deutsche Bank Securities Limited; and Deutsche Bank (Suisse) S.A. The Applicant and

its affiliates actively engage in the borrowing and lending of securities, with daily outstanding loan volume averaging billions of dollars. The Affiliated Borrowers utilize borrowed securities to satisfy their trading requirements or to re-lend to other broker-dealers and others who need a particular security for various periods of time.

The Applicant currently offers through various affiliates, including Bankers Trust Company, more than 20 collective investment funds that are invested according to the criteria of various third-party indexes or are model-driven based on such indexes (i.e., Index or Model-Driven Funds). For example, some funds track the Russell 2000 Index, while other funds track the Standard & Poor's 500 Composite Stock Price Index (the S&P 500 Index). The Index or Model-Driven Funds pertinent to this requested exemption track, among others, indices of foreign securities such as the MSCI EAFE, the DAX or the Kokosai Index.<sup>11</sup> Most of the Funds track stock indexes, although some Funds track indexes of debt securities, such as the Lehman Brothers Bond Indexes.<sup>12</sup>

In addition to Index or Model-Driven Funds that are collective investment funds, DB or an affiliate may have investment responsibility for individual investment funds which are separate portfolios for various client accounts, including employee benefit plans, where the portfolio is invested in accordance with a third-party index or a model based on that index. Such separately managed accounts and collective investment funds are also referred to herein as Indexed Accounts.

3. The securities lending transactions that would be covered by this proposed exemption will be initiated for an Indexed Account, as a Lender described herein, by a DB Lending Agent, following disclosure to the Client Plans of the borrower's affiliation with the DB Lending Agent.

The Applicant represents that the DB Plans will only use the exemption to the extent that the DB Plan is invested in a Commingled Fund with respect to which, at all times, the holdings of all DB Plans in the aggregate comprise less

than 10% of the assets of the Commingled Fund. No DB Plan Separate Accounts will participate.

The Applicant represents that at all times, the DB Lending Agent will effect loans in a prudent and diversified manner. While the DB Lending Agent will normally lend securities to requesting borrowers on a "first come, first served" basis, as a means of assuring uniformity of treatment among borrowers, the Applicant represents that in some cases it may not be possible to adhere to a "first come, first served" allocation. This can occur, for instance, where (a) the credit limit established for such borrower by the DB Lending Agent and/or the Client Plan has already been satisfied; (b) the "first in line" borrower is not approved as an Affiliated Borrower by the particular Lender whose securities are sought to be borrowed; (c) the borrower and the DB Lending Agent have negotiated rates more advantageous to the Lender than the rates other borrowers have offered; or (d) the "first in line" borrower cannot be ascertained, as an operational matter, because several borrowers spoke to different DB Lending Agent representatives at or about the same time with respect to the same security. In situations (a) and (b) above, loans would normally be effected with the "second in line." In situation (c) above, this may mean that the "first in line" borrower receives the next lending opportunity. In situation (d) above, securities would be allocated equitably among all eligible borrowers.

4. Except as described herein in connection with Index and Model-Driven Funds managed by the DB Lending Agent, the Applicant represents that neither the DB Lending Agent nor any affiliate will have discretionary authority or control with regard to the investment of the assets of Client Plans involved in the transaction or will render investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to such assets, including decisions regarding a Client Plan's acquisition or disposition of securities available for loan.

The plan assets for which the DB Lending Agent, to a limited extent, exercises discretionary authority or control or renders investment advice and which will be available for lending to the Affiliated Borrowers will be limited to those invested in Index and Model-Driven Funds. All procedures for lending securities will be designed to comply with the applicable conditions

<sup>10</sup> In this regard, the Department granted a class exemption known as Prohibited Transaction Exemption (PTE) 81-6 (46 FR 7527, January 23, 1981; as amended at 52 FR 18754, May 19, 1987) to provide relief from section 406(a) of the Act for loans of securities to borrowers who are not affiliated with the entity that is the investment manager of the affected plan or that provides investment advice for the plan with respect to the assets being loaned. PTE 81-6 does not provide relief for loans to any entities that are affiliates of the plans' lending agent. The Department also granted certain individual exemptions, known as PTE 98-23 (63 FR 29435, May 29, 1998) and PTE 99-50 (65 FR 534, January 5, 2000), to provide relief for loans to certain affiliates of DB, but not in connection with loans of securities over which DB or an affiliate has investment discretion (e.g., assets held in the Indexed Accounts).

<sup>11</sup> Morgan Stanley maintains the MSCI ("Morgan Stanley Composite Index") EAFE and Kokosai indexes. The DAX (Deutsche Aktienindex) is maintained by the Deutsche Boerse, a German stock exchange.

<sup>12</sup> The indexes of debt securities used for the Funds, such as the Lehman Brothers Bond Index, consist primarily of high-quality fixed-income securities representing the U.S. government, corporate, and mortgage-backed securities sectors of the bond market in the U.S. The Applicant currently has several debt Index Funds.

of PTE 81-6<sup>13</sup> and PTE 82-63,<sup>14</sup> as amended or superseded, except as described herein.

5. The Applicant represents that any arrangement for the DB Lending Agent to lend securities will be approved in advance by a Plan fiduciary who is independent of the DB Lending Agent. In addition, the Client Plan will acknowledge the relationship between the DB Lending Agent and the Affiliated Borrowers. However, all conditions described herein that require an independent Plan fiduciary will not, in the case of a DB Plan, require that the fiduciary be independent of the DB Lending Agent or the Affiliated Borrower.

6. When acting as a direct securities lending agent, the DB Lending Agent, pursuant to authorization from its client, will negotiate the terms of loans to Affiliated Borrowers and otherwise act as a liaison between the Lender (and its custodian) and the Affiliated Borrower. As lending agent, the DB Lending Agent will have the responsibility for monitoring receipt of all collateral required, marking such collateral to market daily to ensure adequate levels of collateral can be maintained, monitoring and evaluating the performance and creditworthiness of borrowers, and, if authorized by a client, holding and investing cash collateral pursuant to given investment guidelines. The DB Lending Agent may also act as trustee, custodian and/or investment manager for the Client Plan.

The DB Lending Agent, as securities lending agent for the Lenders, will negotiate a master securities borrowing agreement with a schedule of modifications attached thereto (Loan Agreement) with the Affiliated Borrowers, as is the case with all borrowers. The Loan Agreement will specify, among other things, the right of the Lender to terminate a loan at any time and the Lender's rights in the event of any default by the Affiliated

Borrowers. The Loan Agreement will set forth the basis for compensation to the Lender for lending securities to the Affiliated Borrowers under each category of collateral. The Loan Agreement will also contain a requirement that the Affiliated Borrowers must pay all transfer fees and transfer taxes related to the securities loans.

7. With respect to Lenders who are Separate Accounts, as direct lending agent, the DB Lending Agent will, prior to lending the Client Plan's securities, enter into an agreement (Client Agreement) with the Client Plan, signed by a fiduciary of the Client Plan who is independent of the DB Lending Agent and the Affiliated Borrowers. The Client Agreement will, among other things, describe the operation of the lending program, disclose the form of the securities loan agreement to be entered into on behalf of the Client Plan with borrowers, identify the securities which are available to be lent, and identify the required collateral and the required daily marking-to-market. The Client Agreement will also set forth the basis and rate of the DB Lending Agent's compensation for the performance of securities lending and cash collateral investment services. The Client Plan may terminate the Client Agreement at any time, without penalty, on no more than five business days notice.

The Client Agreement will contain provisions to the effect that if any Affiliated Borrower is designated by the Client Plan as an approved borrower, the Client Plan will acknowledge the relationship between the Affiliated Borrower and the DB Lending Agent. The DB Lending Agent will represent to the Client Plan that each and every loan made to the Affiliated Borrower on behalf of the Client Plan will be effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16.

8. When the DB Lending Agent is lending agent with respect to a Commingled Fund, the DB Lending Agent will, prior to the investment of a Client Plan's assets in such Commingled Fund, obtain from the Client Plan authorization to lend any securities held by the Commingled Fund to brokers and other approved borrowers, including the Affiliated Borrowers. Prior to obtaining such approval, the DB Lending Agent will provide a written description of the operation of the lending program (including the basis and rate of the DB Lending Agent's compensation for the performance of securities lending and cash collateral investment services),

disclose the form of the securities loan agreement to be entered into on behalf of the Commingled Fund with the borrowers, identify the securities which are available to be lent, and identify the required collateral and the required daily marking-to-market.<sup>15</sup> If the Client Plan objects to the arrangement, it will be permitted to withdraw from the Commingled Fund, without penalty, no later than 35 days after the notice of withdrawal is received.

In addition, the Client Plan will acknowledge the relationship between the DB Lending Agent and the Affiliated Borrowers, and the DB Lending Agent will represent that each and every loan made to the Affiliated Borrowers by the Commingled Fund will be effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16.

9. When the DB Lending Agent is lending securities under a sub-agency arrangement, before the Plan participates in the securities lending program, the primary lending agent will enter into a securities lending agency agreement (Primary Lending Agreement) with a fiduciary of the Client Plan who is independent of such primary lending agent, the DB Lending Agent, and the Affiliated Borrowers. The primary lending agent also will be unrelated to the DB Lending Agent and the Affiliated Borrowers. The Primary Lending Agreement will contain provisions substantially similar to those in the Client Agreement relating to: the description of the lending program, use of an approved form of securities loan agreement, specification of the securities to be lent, specification of the required collateral margin and the requirement of daily marking-to-market, and provision of a list of approved borrowers (which will include one or more of the Affiliated Borrowers). The Primary Lending Agreement will specifically authorize the primary lending agent to appoint sub-agents (including the DB Lending Agent) to facilitate performance of securities lending agency functions. The Primary Lending Agreement will expressly disclose that the DB Lending Agent is to

<sup>13</sup> As noted earlier, PTE 81-6 provides an exemption under certain conditions from section 406(a)(1)(A) through (D) of the Act and the corresponding provisions of section 4975(c)(1) of the Code for the lending of securities that are assets of an employee benefit plan to a U.S. broker-dealer registered under the 1934 Act (or exempted from registration under the 1934 Act as a dealer in exempt Government securities, as defined therein), or to a bank.

<sup>14</sup> PTE 82-63 provides an exemption under certain conditions from section 406(b)(1) of the Act and section 4975(c)(1)(E) of the Code for the payment of compensation to a plan fiduciary for services rendered in connection with loans of plan assets that are securities. PTE 82-63 permits the payment of compensation to a plan fiduciary for the provision of securities lending services only if the loan of securities itself is not prohibited under section 406(a) of the Act.

<sup>15</sup> The DB Lending Agent may make transmittals required by the exemption to Plan fiduciaries via authorized recordkeepers. The DB Lending Agent represents that all decisions reserved to fiduciaries under the terms of the exemption will be made by the fiduciaries and never by the recordkeeper on behalf of the fiduciary.



act in a sub-agency capacity. The Primary Lending Agreement will also set forth the basis and rate for the primary lending agent's compensation from the Client Plan for the performance of securities lending services and will authorize the primary lending agent to pay a portion of its fee, as the primary lending agent determines in its sole discretion, to any sub-agent(s) it retains (including the DB Lending Agent) pursuant to the authority granted under such agreement.

Pursuant to its authority to appoint sub-agents, the primary lending agent will enter into a securities lending sub-agency agreement (Sub-Agency Agreement) with the DB Lending Agent under which the primary lending agent will retain and authorize the DB Lending Agent, as sub-agent, to lend securities of the primary lending agent's Client Plans, subject to the same terms and conditions specified in the Primary Lending Agreement. The DB Lending Agent represents that the Sub-Agency Agreement will contain provisions that are in substance comparable to those described above in connection with a Client Agreement in situations where the DB Lending Agent is the primary lending agent. The DB Lending Agent will make in the Sub-Agency Agreement the same representations described above in paragraph 7 with respect to arm's length dealing with the Affiliated Borrowers. The Sub-Agency Agreement will also set forth the basis and rate for the DB Lending Agent's compensation to be paid by the primary lending agent.

10. In all cases, the DB Lending Agent will maintain transactional and market records sufficient to assure compliance with its representation that all loans to the Affiliated Borrowers are effected at arm's length terms, and in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16. Such records will be made available upon reasonable request and without charge to the Client Plan fiduciary, who (other than in the case of a DB Plan) is independent of the DB Lending Agent and the Affiliated Borrowers, in the manner and format agreed to by the Client Plan fiduciary and the DB Lending Agent.

11. A Lender, in the case of a Separate Account, will be permitted to terminate the lending agency or sub-agency arrangement at any time without penalty, on five business days notice. A Client Plan in the case of a Commingled Fund will be permitted to terminate its participation in the lending arrangement by terminating its investment in the Commingled Fund no later than 35 days after the notice of termination of

participation is received, without penalty to the Plan, in accordance with the terms of the Commingled Fund. Upon a termination, the Affiliated Borrower will be contractually obligated to return securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the Lender within one of the following time periods, whichever is least: the customary delivery period for such securities, five business days of written notification of termination, or the time negotiated for such delivery by the Client Plan, in a Separate Account, or by the DB Lending Agent, as lending agent to a Commingled Fund, and the Affiliated Borrowers.

Because the securities must be returned before the end of the customary delivery period for sale of those securities, the DB Lending Agent need not wait to sell the securities as long as it has the contractual assurance that they will be returned before settlement. Consequently, the lending has no impact on the investment decision to sell or its implementation and, therefore, no effect on tracking error vis-a-vis the relevant index.

12. The Lender, or another custodian designated to act on its behalf, will receive collateral from each Affiliated Borrower by physical delivery, book entry in a U.S. securities depository, wire transfer or similar means by the close of business on or before the day the loaned securities are delivered to the Affiliated Borrower. All collateral will be received by the Lender or other custodian in the United States. The collateral will consist of U.S. currency, securities issued or guaranteed by the U.S. Government or its agencies or instrumentalities, or irrevocable bank letters of credit issued by a U.S. bank other than DB (or any subsequent parent corporation of the DB Lending Agent) or an affiliate thereof, or any combination thereof, or other collateral permitted under PTE 81-6 (as amended or superseded). The collateral will be held on behalf of a Client Plan in a depository account separate from the Affiliated Borrower.

The market value (or, in the case of a letter of credit, a stated amount) of the collateral on the close of business on the day preceding the day of the loan will be at least 102 percent of the market value of the loaned securities. The Loan Agreement will give the Lender a continuing security interest in and a lien on or title to the collateral. The DB Lending Agent will monitor the level of the collateral daily. If the market value of the collateral, on the close of trading

on a business day, is less than 100 percent (or such greater percentage as agreed to by the parties) of the market value of the loaned securities at the close of business on that day, the DB Lending Agent will require the Affiliated Borrowers to deliver by the close of business on the next day sufficient additional collateral to bring the level back to at least 102 percent.

13. Prior to making any loans under the Loan Agreement from Separate Accounts, the Affiliated Borrowers will furnish their most recent available audited and unaudited financial statements to the DB Lending Agent, which will provide such statements to the Client Plan invested in such Separate Account before the authorizing fiduciary of the Client Plan is asked to approve the proposed lending to the Affiliated Borrowers. The terms of the Loan Agreement will contain a requirement that the Affiliated Borrowers must give prompt notice to the DB Lending Agent at the time of any loan of any material adverse change in their financial condition since the date of the most recently furnished financial statements. If any such material adverse change has taken place, the DB Lending Agent will request that the independent fiduciary of the Client Plan, if invested in a Separate Account, approve continuation of the lending arrangement in view of the changed financial conditions.

In addition, upon request, the DB Lending Agent will provide the audited financial statements of the applicable Affiliated Borrowers to Client Plans invested in Commingled Funds on an annual basis.

14. In the case of Client Plans currently invested in Commingled Funds, approval of lending to the Affiliated Borrowers will be accomplished by the following special procedure for Commingled Funds. The information described in paragraph 8 will be furnished by the DB Lending Agent as lending fiduciary to an independent fiduciary of each Client Plan invested in Commingled Funds not less than 30 days prior to implementation of the lending arrangement, and thereafter, upon the reasonable request of the authorizing fiduciary. In the event any such authorizing fiduciary submits a notice in writing within the 30-day period to the DB Lending Agent, in its capacity as the lending fiduciary, objecting to the implementation of or continuation of the lending arrangement with the Affiliated Borrowers, the Plan on whose behalf the objection was tendered will be given the opportunity to terminate its investment in the Commingled Fund,

without penalty to the Plan, no later than 35 days after the notice of withdrawal is received. In the case of a Plan that elects to withdraw pursuant to the foregoing, such withdrawal shall be effected prior to the implementation of the arrangement; but an existing arrangement need not be discontinued by reason of a Plan electing to withdraw. In the case of a Plan whose assets are proposed to be invested in a Commingled Fund subsequent to the implementation of the arrangement, the Plan's investment in the Commingled Fund shall be authorized in the manner described in paragraph 8.

In the case of loans made by Commingled Funds, upon notice by the Affiliated Borrower to the DB Lending Agent of a material adverse change in its financial conditions, the DB Lending Agent will make a decision whether to terminate existing loans and whether to continue making additional loans to the Affiliated Borrower, using the same standards of credit analysis the DB Lending Agent would use in evaluating unrelated borrowers. In the event the Plan invested in a Commingled Fund has any objection to the continuation of lending to an Affiliated Borrower, it may withdraw from the fund as described above.

15. With respect to material changes in the lending arrangement with the Affiliated Borrowers after approval by Client Plans, the DB Lending Agent will obtain approval from Client Plans (whether in Separate Accounts or Commingled Funds) prior to implementation of any such change. For those Client Plans invested in Commingled Funds, approval of the proposed material change will be by the procedure described in paragraph 14.

16. In return for lending securities, the Lender either will receive a reasonable fee which is related to the value of the borrowed securities and the duration of the loan, or will have the opportunity to derive compensation through the investment of cash collateral. Under such circumstances, the Lender may pay a loan rebate or similar fee to the Affiliated Borrowers, if such fee is not greater than the fee the Lender would pay in a comparable arm's length transaction with an unrelated party.

In this regard, each time a Lender loans securities to an Affiliated Borrower pursuant to the Loan Agreement, the DB Lending Agent will reflect in its records the material terms of the loan, including the securities to be loaned, the required level of collateral, and the fee or rebate payable. The fee or rebate payable for each loan will be effected at arm's-length terms,

and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described below. The rebate rates, which are established for cash collateralized loans made by the Lender, will take into account the potential demand for the loaned securities, the applicable benchmark cost of funds (typically the U.S. Federal Funds rate established by the Federal Reserve System), the overnight "repo" rate, or the like and the anticipated investment returns on the investment of cash collateral. Further, the lending fees with respect to loans collateralized by other than cash will be set daily to reflect conditions as influenced by potential market demand. The Applicant represents that the securities lending agent fee paid to the DB Lending Agent will comply with the requirements of PTE 82-63.

The DB Lending Agent will establish each day a written schedule of lending fees<sup>16</sup> and rebate rates<sup>17</sup> with respect to new loans of designated classes of securities, such as U.S. Government securities, U.S. equities and corporate bonds, international fixed income securities and non-U.S. equities, in order to assure uniformity of treatment among borrowers and to limit the discretion the DB Lending Agent would have in negotiating securities loans to Affiliated Borrowers. Loans to all borrowers of a given security on that day will be made at rates or lending fees on the relevant daily schedules or at rates or lending fees which are more

<sup>16</sup> The DB Lending Agent will adopt minimum daily lending fees for non-cash collateral payable by Affiliated Borrowers to the DB Lending Agent on behalf of a Lender. Separate minimum daily lending fees will be established with respect to loans of designated classes of securities. With respect to each designated class of securities, the minimum lending fee will be stated as a percentage of the principal value of the loaned securities. The DB Lending Agent will submit the method for determining such minimum daily lending fees to an authorizing fiduciary of the Client Plan, in the case of a Separate Account, for approval before initially lending any securities to Affiliated Borrowers on behalf of such Client Plan. The DB Lending Agent will submit the method for determining such minimum daily lending fees to an authorizing fiduciary of each Client Plan involved in or planning to invest in a Commingled Fund pursuant to the procedure described in paragraph 14, above.

<sup>17</sup> Separate maximum daily rebate rates will be established with respect to loans of securities within the designated classes identified above. Such rebate rates will be based upon an objective methodology which takes into account several factors, including potential demand for loaned securities, the applicable benchmark cost of fund indices, and anticipated investment return on overnight investments permitted by the Client Plan's independent fiduciary. The DB Lending Agent will submit the method for determining such maximum daily rebate rates to such fiduciary before initially lending any securities to an Affiliated Borrower on behalf of the Client Plan.

advantageous to the Lenders. The Applicant represents that in no case will loans be made to Affiliated Borrowers at rates or lending fees that are less advantageous to the Lenders than those on the relevant schedules. In addition, it is represented that the method of determining the daily securities lending rates (fees and rebates) will be disclosed to each Client Plan, whether in Separate Accounts or Commingled Funds. For those Client Plans invested in Commingled Funds, disclosure will be by the special procedure described in paragraph 14.

17. When a loan of securities by a Lender is collateralized with cash, the DB Lending Agent will transfer such cash to the trust or other investment vehicle for investment that the Client Plan has authorized, and will rebate a portion of the earnings on such collateral to the appropriate Affiliated Borrower as agreed to in the securities lending agreement between Lender and the Borrower. The DB Lending Agent will share with the Client Plan the income earned on the investment of cash collateral for the DB Lending Agent's provision of lending services, which will reduce the income earned by the Client Plans (whether in a Commingled Fund or Separate Account) from the lending of securities. The DB Lending Agent may receive a separate management fee for providing cash collateral investment services. Where collateral other than cash is used, the Affiliated Borrower will pay a fee to the Lender based on the value of the loaned securities. These fees will also be shared between the Client Plans (whether in a Commingled Fund or Separate Account) and the DB Lending Agent. Any income or fees shared will be net of cash collateral management fees and borrower rebate fees. The sharing of income and fees will be in accordance with the arrangements authorized by the Client Plan in advance of commencement of the lending program.

An authorizing fiduciary of the Client Plan also may authorize the DB Lending Agent to act as investment manager, custodian, and/or directed trustee of the Client Plan's Index or Model-Driven portfolio of securities available for lending whether in a Separate Account or Commingled Fund, and to receive a reasonable fee for such services.

18. The DB Lending Agent will negotiate rebate rates for cash collateral payable to each borrower, including Affiliated Borrowers, on behalf of a Lender. The fees or rebate rates negotiated will be effected at arm's length terms, and in no case will be less favorable to the Client Plan than the

pricing established according to the schedule described in paragraph 16.

With respect to any loan to an Affiliated Borrower, the DB Lending Agent, at the inception of such loan, will not negotiate and agree to a rebate rate with respect to such loan which it expects would produce a zero or negative return to the Lender over the life of the loan (assuming no default on the investments made by the DB Lending Agent where it has investment discretion over the cash collateral or on investments expected to be made by the Client Plan's designee, where the DB Lending Agent does not have investment discretion over cash collateral).

19. The DB Lending Agent may, depending on market conditions, reduce the lending fee or increase the rebate rate on any outstanding loan to an Affiliated Borrower, or any other borrower. Except in the case of a change resulting from a change in the value of any third party independent index with respect to which the fee or rebate is calculated, such reduction in lending fee or increase in rebate shall not establish a lending fee below the minimum or a rebate above the maximum set in the schedule of fees and rebates described in paragraph 16. If the DB Lending Agent reduces the lending fee or increases the rebate rate on any outstanding loan from a Separate Account to an Affiliated Borrower (except in the case of a change resulting from a change in the value of any third party independent index with respect to which the fee or rebate is calculated), the DB Lending Agent, by the close of business on the date of such adjustment, will provide the independent fiduciary of the Client Plan invested in the Separate Account with notice (including by electronic means) that it has reduced such fee or increased the rebate rate to such Affiliated Borrower and that the Client Plan may terminate such loan at any time.

20. Except as otherwise expressly provided in the exemption, the Applicant represents that all procedures regarding the securities lending activities will, at a minimum, conform to the applicable provisions of PTE 81-6 and PTE 82-63, both as amended or superseded, as well as to applicable securities laws of the United States and the United Kingdom.

21. DB agrees to indemnify and hold harmless the Client Plans in the United States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with the Affiliated Borrower so that the Lender does not have to litigate, in the case of a foreign Affiliated Borrower, in

a foreign jurisdiction, nor sue to realize on the indemnification. Such indemnification will be against any and all reasonably foreseeable losses, costs and expenses (including attorneys fees) which the Lender may incur or suffer arising from any impermissible use by an Affiliated Borrower of the loaned securities, from an event of default arising from the failure of an Affiliated Borrower to deliver loaned securities when due in accordance with the provisions of the Loan Agreement or from an Affiliated Borrower's other failure to comply with the terms of the Loan Agreement, except to the extent that such losses are caused by the Client Plan's own negligence. The applicable Affiliated Borrower will also be liable to the Lender for breach of contract for any failure by such Borrower to deliver loaned securities when due or to otherwise comply with the terms of the Loan Agreement.

If any event of default occurs to the extent that (i) liquidation of the pledged collateral or (ii) additional cash received from the Affiliated Borrower does not provide sufficient funds on a timely basis, the DB Lending Agent, as securities lending agent, promptly and at its own expense, shall purchase or cause to be purchased for the account of the Lender, securities identical to the borrowed securities (or their equivalent). If the collateral and any such additional cash is insufficient to accomplish such purchase, DB, pursuant to the indemnification, will indemnify the Lender for any shortfall in the collateral plus interest on such amount and any transaction costs incurred (including attorneys' fees). Alternatively, if such replacement securities cannot be obtained in the open market, DB will pay the Lender the difference in U.S. dollars between the market value of the loaned securities and the market value of the related collateral as determined on the date of the Affiliated Borrower's breach of the obligation to return the securities pursuant to the applicable Loan Agreement.

The "market value" of any securities listed on a national securities exchange in the United States will be the last sales price on such exchange on the preceding business day or, if there is no sale on that day, the last sale price on the next preceding business day on which there is a sale on such exchange, as quoted on the consolidated tape. If the principal market for securities to be valued is the over-the-counter market, the securities' market value will be the closing sale price as quoted on the National Association of Securities Dealers Automated Quotation System

(NASDAQ) on the preceding business day or the opening price on such business day if the securities are issues for which last sale prices are not quoted on NASDAQ. If the securities to be valued are not quoted on NASDAQ, their market value shall be the highest bid quotation appearing in The Wall Street Journal, National Quotation Bureau pink sheets, Salomon Brothers quotation sheets, quotation sheets of registered market makers and, if necessary, independent dealers' telephone quotations on the preceding business day. (In each case, if the relevant quotation does not exist on such day, then the relevant quotation on the next preceding business day in which there is such a quotation would be the market value.)

22. The Lender will be entitled to receive the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including but not limited to, interest and dividends, shares of stock as a result of a stock split and rights to purchase additional securities, or other distributions during the loan period.<sup>18</sup>

23. Further, prior to a Client Plan's authorization of a securities lending program, the DB Lending Agent will provide a Plan fiduciary with copies of the final exemption (if granted) and this notice of proposed exemption.

24. In order to provide the means for monitoring lending activity in Separate Accounts and Commingled Funds, a quarterly report will be provided to an auditor selected by the DB Lending Agent who is independent of the DB Lending Agent (but may or may not be independent of the Client Plan). This report will show the fees or rebates (as applicable) on loans to Affiliated Borrowers compared with loans to other borrowers, as well as the level of collateral on the loans. The Applicant represents that the quarterly report will show, on a daily basis, the market value of all outstanding security loans to Affiliated Borrowers and to other borrowers as compared to the total collateral held for both categories of loans. Further, the quarterly report will state the daily fees where collateral other than cash is utilized and will specify the details used to establish the daily rebate payable to all borrowers

<sup>18</sup>The Applicant represents that dividends and other distributions on foreign securities payable to a Lender may be subject to foreign tax withholdings. Under these circumstances, the applicable Affiliated Borrower, where necessary, will gross-up the in-lieu-of-payment (in respect of such dividend or distribution it makes) to the Lender so that the Lender will receive back what it otherwise would have received (by way of dividend or distribution) had it not loaned the securities.

where cash is used as collateral. The quarterly report also will state, on a daily basis, the rates at which securities are loaned to Affiliated Borrowers compared with those at which securities are loaned to other borrowers.

The independent auditor will review the lending data on a quarterly basis and certify whether the loans have satisfied the criteria of this exemption, in that they appear no less favorable to the Separate Account or Commingled Fund than the pricing established in the schedule described in paragraph 16. Client Plans invested in Separate Accounts will receive both the quarterly report and the auditor's certification as described above. Client Plans invested in Commingled Funds will receive the auditor's certification and, upon request, will receive the quarterly report.

In the event an authorizing fiduciary of a Plan invested in a Commingled Fund submits a notice in writing to the DB Lending Agent objecting to the continuation of the lending program to the Affiliated Borrowers, the Plan on whose behalf the objection was tendered will be given the opportunity to terminate its investment in the Commingled Fund, without penalty to the Plan, no later than 35 days after the notice of withdrawal is received.

25. To ensure that any lending of securities to an Affiliated Borrower will be monitored by an authorizing fiduciary of above average experience and sophistication in matters of this kind, only Client Plans with total assets having an aggregate market value of at least \$50 million will be permitted to lend securities to the Affiliated Borrowers. However, in the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangement with the DB Lending Agent, the foregoing \$50 million requirement will be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary must have total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess

of \$100 million. In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with the DB Lending Agent, the foregoing \$50 million requirement will be satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Client Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity must have full investment responsibility with respect to plan assets invested therein, and must have total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million. In addition, none of the entities described above may be formed for the sole purpose of making loans of securities.

26. With respect to any calendar quarter, at least 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of Lenders by the DB Lending Agent will be to borrowers unrelated to the DB Lending Agent. Thus, the competitiveness of the loan fee will be continuously tested in the marketplace. Accordingly, the Applicant believes that loans to Affiliated Borrowers should result in competitive fee income to the Lenders.

27. With respect to foreign Affiliated Borrowers, the Applicant represents that each such entity (e.g., Deutsche Bank AG, London Branch and other affiliates in the United Kingdom) is regulated by the host country's supervisory authority (e.g., the UK SFA) and is, therefore, authorized to conduct an investment banking business in and from the host country (e.g., the United Kingdom) as a broker-dealer. The proposed exemption will be applicable only to transactions effected by a DB Lending Agent with an Affiliated Borrower which is registered as a broker-dealer with the host country's supervisory authority (the Foreign Authority) and in compliance

with Rule 15a-6 under the Securities Exchange Act of 1934 (Rule 15a-6). The Applicant represents that the role of a broker-dealer in a principal transaction in each of the host countries (the United Kingdom, Germany, Japan, Canada, Switzerland and Australia) is substantially identical to that of a broker-dealer in a principal transaction in the United States. The Applicant further represents that registration of a broker-dealer with the Foreign Authority is equivalent to registration of a broker-dealer with the SEC under the 1934 Act. The Applicant maintains that the Foreign Authority has promulgated rules for broker-dealers which are equivalent to SEC rules relating to registration requirements, minimum capitalization, reporting requirements, periodic examinations, fund segregation, client protection, and enforcement. The Applicant represents that the rules and regulations set forth by the Foreign Authority and the SEC share a common objective: the protection of the investor by the regulation of securities markets. The Applicant explains that under each Foreign Authority's rules, a person who manages investments or gives advice with respect to investments must be registered as a "registered representative." If a person is not a registered representative and, as part of his duties, makes commitments in market dealings or transactions, that person must be registered as a "registered trader." The Applicant represents that the Foreign Authority's rules require each firm which employs registered representatives or registered traders to have positive tangible net worth and to be able to meet its obligations as they fall due, and that the Foreign Authority's rules set forth comprehensive financial resource and reporting/disclosure rules regarding capital adequacy. In addition to demonstration of capital adequacy, the Applicant states that the Foreign Authority's rules impose reporting/disclosure requirements on broker-dealers with respect to risk management, internal controls, and all records relating to a counterparty, and that all records must be produced at the request of the Foreign Authority at any time. The Applicant states that Foreign Authority's registration requirements for broker-dealers are backed up by potential fines and penalties and rules which establish a comprehensive disciplinary system.

28. In addition to the protections afforded by registration with the Foreign Authority, the Applicant represents that the Affiliated Borrower will comply

with the applicable provisions of Rule 15a-6 (described below). The Applicant represents that compliance by the Affiliated Borrower with the requirements of Rule 15a-6 will offer additional protections in lieu of registration with the SEC. The Applicant represents that Rule 15a-6 provides an exemption from U.S. broker-dealer registration for a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security (including over-the-counter equity and debt options) by a "U.S. institutional investor" or a "major U.S. institutional investor," provided that the foreign broker-dealer, among other things, enters into these transactions through a U.S. registered broker-dealer intermediary. The term "U.S. institutional investor", as defined in Rule 15a-6(b)(7), includes an employee benefit plan within the meaning of the Act if (a) the investment decision is made by a plan fiduciary, as defined in section 3 (21) of the Act, which is either a bank, savings and loan association, insurance company or registered investment advisor, (b) the employee benefit plan has total assets in excess of \$5,000,000, or (c) the employee benefit plan is a self-directed plan with investment decisions made solely by persons that are "accredited investors" as defined in Rule 501(a)(1) of Regulation D of the Securities Act of 1933, as amended. The term "major U.S. institutional investor" is defined as a person that is a U.S. institutional investor that has, or has under management, total assets in excess of \$100 million, or is an investment adviser registered under section 203 of the Investment Advisers Act of 1940 that has total assets under management in excess of \$100 million. The Applicant represents that the intermediation of the U.S. registered broker-dealer imposes upon the foreign broker-dealer the requirement that the securities transaction be effected in accordance with a number of U.S. securities laws and regulations applicable to U.S. registered broker-dealers.

The Applicant represents that, under Rule 15a-6, a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a U.S. institutional or major U.S. institutional investor in accordance with 15a-6 must, among other things:

a. Consent to service of process for any civil action brought by, or proceeding before, the SEC or any self-regulatory organization;

b. Provide the SEC with any information or documents within its possession, custody or control, any

testimony of any foreign associated persons,<sup>19</sup> and any assistance in taking the evidence of other persons, wherever located, that the SEC requests and that relates to transactions effected pursuant to Rule 15a-6; and

c. Rely on the U.S. registered broker-dealer through which the transactions with the U.S. institutional and major U.S. institutional investors are effected to (among other things):

1. Effect the transactions, other than negotiating their terms;

2. Issue all required confirmations and statements;

3. As between the foreign broker-dealer and the U.S. registered broker-dealer, extend or arrange for the extension of credit in connection with the transactions;

4. Maintain required books and records relating to the transactions, including those required by Rules 17a-3 (Records to be Made by Certain Exchange Members) and 17a-4 (Records to be Preserved by Certain Exchange Members, Brokers and Dealers) of the 1934 Act;

5. Receive, deliver and safeguard funds and securities in connection with the transactions on behalf of the U.S. institutional investor or major U.S. institutional investor in compliance with Rule 15c3-3 of the 1934 Act (Customer Protection-Reserves and Custody of Securities); and

6. Participate in all oral communications (e.g., telephone calls) between a foreign associated person and the U.S. institutional investor (other than a major U.S. institutional investor), and accompany the foreign associated person on all visits with both U.S. institutional and major U.S. institutional investors. By virtue of this participation, the U.S. registered broker-dealer would become responsible for the content of all these communications.

All collateral will be maintained in United States dollars or U.S. dollar-denominated securities or letters of credit. All collateral will be held in the United States and the DB Lending Agent will maintain the situs of the Loan Agreements (evidencing the Lender's right to return of the loaned securities and the continuing interest in and lien on or title to the collateral) in the United States under an arrangement that complies with the indicia of ownership requirements under section 404(b) of the

<sup>19</sup> A foreign associated person is defined in Rule 15a-6(b)(2) as any natural person domiciled outside the United States who is an associated person, as defined in section 3(a)(18) of the 1934 Act, of the foreign broker or dealer, and who participates in the solicitation of a U.S. institutional investor or a major U.S. institutional investor under Rule 15a-6(a)(3).

Act and the regulations promulgated under 29 CFR 2550.404(b)-1.

Prior to a transaction involving a foreign Affiliated Borrower, the foreign Affiliated Borrower will (a) agree to submit to the jurisdiction of the courts of the United States; (b) agree to appoint a Process Agent for service of process in the United States, which may be an affiliate; (c) consent to service of process on the Process Agent; and (d) agree that enforcement by a Client Plan of the indemnity provided by DB may occur in the United States Courts.

29. In summary, the Applicant represents that the proposed transactions will satisfy the statutory criteria for an exemption under section 408(a) of the Act because:

a. For each Client Plan, neither the DB Lending Agent nor any affiliate (except as expressly permitted in the exemption) will have or exercise discretionary authority or control with respect to the investment of the assets of Client Plans involved in the transaction or will render investment advice with respect to such assets, including decisions concerning a Client Plan's acquisition or disposition of securities available for loan, except to the extent that the DB Lending Agent exercises discretionary authority or control or renders investment advice in connection with an Index Fund or Model-Driven Fund managed by the DB Lending Agent in which Client Plans invest.

b. Any arrangement for the DB Lending Agent to lend securities will be approved in advance by a Plan fiduciary who (except in the case of a DB Plan) is independent of the DB Lending Agent.

c. The terms of each loan of securities by a Lender to an Affiliated Borrower will be at least as favorable to such Separate Account or Commingled Fund as those of a comparable arm's length transaction between unrelated parties.

d. Upon termination of a loan, the Affiliated Borrowers will transfer securities identical to the borrowed securities (or the equivalent thereof) to the Lender within one of the following time periods, whichever is least: (1) The customary delivery period for such securities; (2) five business days; or (3) the time negotiated for such delivery by the Client Plan, in a Separate Account, or by the DB Lending Agent, as lending agent to a Commingled Fund, and the Affiliated Borrowers.

e. The Lender will receive from each Affiliated Borrower collateral consisting of U.S. currency, securities issued or guaranteed by the United States Government or its agencies or instrumentalities, irrevocable bank

letters of credit issued by a U.S. bank (other than DB or any subsequent parent corporation of the DB Lending Agent, or an affiliate thereof, or any combination thereof) or other collateral permitted under PTE 81-6 (as amended or superseded), which will be held in a depository account separate from the Affiliated Borrower.

f. In return for lending securities, the Lender either will receive a reasonable fee, which is related to the value of the borrowed securities and the duration of the loan, or will have the opportunity to derive compensation through the investment of cash collateral.

g. DB agrees to indemnify and hold harmless the Client Plans in the United States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with an Affiliated Borrower so that the Client Plans do not have to litigate, in the case of a foreign Affiliated Borrower, in a foreign jurisdiction nor sue to realize on the indemnification.

h. All loans involving foreign Affiliated Borrowers will involve Affiliated Borrowers that are registered as broker-dealers subject to regulation by the Foreign Authority and that are in compliance with all applicable provisions of Rule 15a-6.

i. Prior to a transaction involving a foreign Affiliated Borrower, the foreign Affiliated Borrower will: agree to submit to the jurisdiction of the United States; agree to appoint a Process Agent in the United States; consent to service of process on the Process Agent; and agree that enforcement by a Client Plan of the indemnity provided by DB may occur in the United States courts.

**FOR FURTHER INFORMATION CONTACT:** Gary Lefkowitz of the Department, telephone (202) 693-8546. (This is not a toll-free number).

### **Barclays Global Investors, N.A. (BGI)**

*Located in San Francisco, California*

[Exemption Application No. D-10925]

### **Proposed Exemption**

The Department is considering granting an exemption under the authority of section 408(a) of the Act, section 8477(c)(3) of the Federal Employees' Retirement System Act of 1986 (FERSA) 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, 32847, August 10, 1990).<sup>20</sup>

<sup>20</sup> For purposes of this exemption, references to specific provisions of Title I of the Act, unless otherwise specified, refer to the corresponding provisions of FERSA and the Code.

### *Section I—Transactions*

If the exemption is granted, the restrictions of section 406(a)(1)(A) through (D) and 406(b)(1) and (2) of the Act, section 8477(c)(2)(A) and (B) of FERSA, and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply to:

- (a) The lending of securities to:
  - (1) Barclays Capital Inc., its successors or affiliates (BC NY);
  - (2) Barclays Capital Securities Limited, its successors or affiliates (BC UK);
  - (3) Barclays Global Investor Services, its successors or affiliates (BGIS); and
  - (4) any future affiliate of BGI<sup>21</sup>, subject to the regulatory requirements applicable to BC NY, BC UK and/or BGIS (individually, "Borrower" and collectively, "Borrowers"), which are domestic or foreign broker-dealers, by employee benefit plans, including commingled investment funds holding plan assets (the Client Plans or Plans)<sup>22</sup>, for which BGI, an affiliate of the proposed Borrowers, acts as securities lending agent or subagent<sup>23</sup> and also may serve as trustee, custodian or investment manager of securities being lent; and
- (b) the receipt of compensation by BGI in connection with these transactions.

### *Section II—Conditions*

Section I of this exemption applies only if the conditions of Section II are satisfied. For purposes of this exemption, any requirement that the approving fiduciary be independent of BGI or the Borrower shall not apply in the case of a Barclays Plan invested in a Commingled Fund, provided that at

<sup>21</sup> Any reference to BGI shall be deemed to include any successors thereto.

<sup>22</sup> The common and collective trust funds trustee, custodied, and/or managed by BGI, and in which Client Plans invest, are referred to herein as "Commingled Funds." The Client Plan separate accounts trustee, custodied, and/or managed by BGI are referred to herein as "Separate Accounts." Commingled Funds and Separate Accounts are collectively referred to herein as "Lender" or "Lenders."

<sup>23</sup> BGI may be retained by primary securities lending agents to provide securities lending services in a sub-agent capacity with respect to portfolio securities of clients of such primary securities lending agents. As a securities lending sub-agent, BGI's role parallels that under the lending transactions for which BGI acts as a primary securities lending agent on behalf of its clients. References to BGI's performance of services as securities lending agent should be deemed to include its parallel performance as a securities lending sub-agent and references to the Client Plans should be deemed to include those plans for which BGI is acting as a sub-agent with respect to securities lending, unless otherwise specifically indicated or by the context of the reference.

all times, the holdings of all Barclays Plans in the aggregate comprise less than 10% of the assets of the Commingled Fund.

(a) For each Client Plan, neither BGI nor any affiliate (except as expressly permitted herein) has or exercises discretionary authority or control with respect to the investment of the assets of Client Plans involved in the transaction or renders investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to such assets, including decisions concerning a Client Plan's acquisition or disposition of securities available for loan.

This paragraph (a) will be deemed satisfied notwithstanding that BGI exercises discretionary authority or control or renders investment advice in connection with an Index Fund or Model-Driven Fund managed by BGI in which Client Plans invest.

(b) Any arrangement for BGI to lend securities is approved in advance by a Plan fiduciary who is independent of BGI (the Independent Fiduciary).

(c) The specific terms of the securities loan agreement (the Loan Agreement) are negotiated by BGI which acts as a liaison between the Lender and the Borrower to facilitate the securities lending transaction. In the case of a Separate Account, the Independent Fiduciary of a Client Plan approves the general terms of the Loan Agreement between the Client Plan and the Borrower as well as any material change in such Loan Agreement. In the case of a Commingled Fund, approval is pursuant to the procedure described in paragraph (i), below.

(d) The terms of each loan of securities by a Lender to a Borrower are at least as favorable to such Separate Account or Commingled Fund as those of a comparable arm's length transaction between unrelated parties.

(e) A Client Plan, in the case of a Separate Account, may terminate the lending agency or sub-agency arrangement at any time, without penalty, on five business days notice. A Client Plan in the case of a Commingled Fund may terminate its participation in the lending arrangement by terminating its investment in the Commingled Fund no later than 35 days after the notice of termination of participation is received, without penalty to the Plan, in accordance with the terms of the Commingled Fund. Upon termination, the Borrowers will transfer securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the Separate Account or, if the Plan's withdrawal necessitates a

return of securities, to the Commingled Fund, within:

(1) The customary delivery period for such securities;

(2) Five business days; or

(3) The time negotiated for such delivery by the Client Plan, in a Separate Account, or by BGI, as lending agent to a Commingled Fund, and the Borrowers, whichever is least.

(f) The Separate Account, Commingled Fund or another custodian designated to act on behalf of the Client Plan, receives from each Borrower (either by physical delivery, book entry in a securities depository located in the United States, wire transfer or similar means) by the close of business on or before the day the loaned securities are delivered to the Borrower, collateral consisting of U.S. currency, securities issued or guaranteed by the United States Government or its agencies or instrumentalities, irrevocable bank letters of credit issued by a U.S. bank, other than Barclays Bank PLC (Barclays) or any subsequent parent corporation of BGI, BC NY, BC UK and BGIS) or an affiliate thereof, or any combination thereof, or other collateral permitted under Prohibited Transaction Exemption 81-6 (46 FR 7527, January 23, 1981) (PTE 81-6) (as it may be amended or superseded) (collectively, the Collateral). The Collateral will be held on behalf of a Client Plan in a depository account separate from the Borrower.

(g) The market value (or in the case of a letter of credit, a stated amount) of the Collateral on the close of business on the day preceding the day of the loan is initially at least 102 percent of the market value of the loaned securities. The applicable Loan Agreement gives the Separate Account or the Commingled Fund in which the Client Plan has invested a continuing security interest in and a lien on or title to the Collateral. The level of the Collateral is monitored daily by BGI. If the market value of the Collateral, on the close of trading on a business day, is less than 100 percent of the market value of the loaned securities at the close of business on that day, the Borrower is required to deliver, by the close of business on the next day, sufficient additional Collateral such that the market value of the Collateral will again equal 102 percent.

(h) (1) For a Lender that is a Separate Account, prior to entering into a Loan Agreement, the applicable Borrower furnishes its most recently available audited and unaudited statements to BGI which will, in turn, provide such statements to the Client Plan before the Client Plan approves the terms of the Loan Agreement. The Loan Agreement

contains a requirement that the applicable Borrower must give prompt notice at the time of a loan of any material adverse changes in its financial condition since the date of the most recently furnished financial statements. If any such changes have taken place, BGI will not make any further loans to the Borrower unless an Independent Fiduciary of the Client Plan in a Separate Account is provided notice of any material change and approves the continuation of the lending arrangement in view of the changed financial condition.

(2) For a Lender that is a Commingled Fund, BGI will furnish upon reasonable request to an Independent Fiduciary of each Client Plan invested in the Commingled Fund the most recently available audited and unaudited financial statements of the applicable Borrower prior to authorization of lending, and annually thereafter.

(i) In the case of Commingled Funds, the information described in paragraph (c) (including any information with respect to any material change in the arrangement) shall be furnished by BGI as lending fiduciary to the Independent Fiduciary of each Client Plan whose assets are invested in the Commingled Fund, not less than 30 days prior to implementation of the arrangement or material change to the lending arrangement as previously described to the Client Plan, and thereafter, upon the reasonable request of the Client Plan's Independent Fiduciary. In the event of a material adverse change in the financial condition of a Borrower, BGI will make a decision, using the same standards of credit analysis BGI would use in evaluating unrelated borrowers, whether to terminate existing loans and whether to continue making additional loans to the Borrower.

In the event any such Independent Fiduciary submits a notice in writing within the 30 day period provided in the preceding paragraph to BGI, as lending fiduciary, objecting to the implementation of, material change in, or continuation of the arrangement, the Plan on whose behalf the objection was tendered is given the opportunity to terminate its investment in the Commingled Fund, without penalty to the Plan, no later than 35 days after the notice of withdrawal is received. In the case of a Plan that elects to withdraw pursuant to the foregoing, such withdrawal shall be effected prior to the implementation of, or material change in, the arrangement; but an existing arrangement need not be discontinued by reason of a Plan electing to withdraw. In the case of a Plan whose assets are proposed to be invested in the

Commingled Fund subsequent to the implementation of the arrangement, the Plan's investment in the Commingled Fund shall be authorized in the manner described in paragraph (c).

(j) In return for lending securities, the Lender either

(1) Receives a reasonable fee, which is related to the value of the borrowed securities and the duration of the loan; or

(2) Has the opportunity to derive compensation through the investment of cash Collateral. (Under such circumstances, the Lender may pay a loan rebate or similar fee to the Borrowers, if such fee is not greater than the fee the Lender would pay in a comparable arm's length transaction with an unrelated party.)

(k) Except as otherwise expressly provided herein, all procedures regarding the securities lending activities will, at a minimum, conform to the applicable provisions of PTE 81-6 and Prohibited Transaction Exemption 82-63 (46 FR 14804, April 6, 1982) (PTE 82-63), both as amended or superseded, as well as to applicable securities laws of the United States and the United Kingdom.

(l) Barclays agrees to indemnify and hold harmless the Client Plans in the United States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with a Borrower so that the Client Plans do not have to litigate, in the case of BC UK, in a foreign jurisdiction nor sue to realize on the indemnification. Such indemnification is against any and all reasonably foreseeable damages, losses, liabilities, costs and expenses (including attorney's fees) which the Client Plans may incur or suffer, arising from any impermissible use by a Borrower of the loaned securities, from an event of default arising from the failure of a Borrower to deliver loaned securities in accordance with the applicable Loan Agreement or from a Borrower's other failure to comply with the terms of such agreement, except to the extent that such losses are caused by the Client Plan's own negligence.

If any event of default occurs, to the extent that (i) liquidation of the pledged Collateral or (ii) additional cash received from the Borrower does not provide sufficient funds on a timely basis, BGI, as securities lending agent, promptly and at its own expense (subject to rights of subrogation in the Collateral and against such Borrower) will purchase or cause to be purchased, for the account of the Client Plan, securities identical to the borrowed securities (or their equivalent as

discussed above). If the Collateral and any such additional cash is insufficient to accomplish such purchase, Barclays, pursuant to the indemnification, indemnifies the Client Plan invested in a Separate Account or Commingled Fund for any shortfall in the Collateral plus interest on such amount and any transaction costs incurred (including attorney's fees). Alternatively, if such replacement securities cannot be obtained in the open market, Barclays pays the Lender the difference in U.S. dollars between the market value of the loaned securities and the market value of the related Collateral as determined on the date of the Borrower's breach of the obligation to return the securities pursuant to the applicable Loan Agreement.

(m) The Lender receives the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including but not limited to all interest and dividends on the loaned securities, shares of stock as a result of stock splits and rights to purchase additional securities, or other distributions.

(n) Prior to any Client Plan's approval of the lending of its securities to any Borrower, a copy of this notice of proposed exemption, and, if granted, the final exemption, is provided to the Client Plan.

(o) The Independent Fiduciary of each Client Plan that is invested in a Separate Account is provided with (including by electronic means) quarterly reports with respect to the securities lending transactions, including, but not limited to, the information described in Representation 24 of the Summary of Facts and Representations, and the certification of an auditor selected by BGI who is independent of BGI (but may or may not be independent of the Client Plan) that the loans appear no less favorable to the Lender than the pricing established in the schedule described in Representation 16, so that the Independent Fiduciary may monitor such transactions with the Borrower. The Independent Fiduciary of a Client Plan invested in a Commingled Fund will receive the auditor's certification and, upon request, will also receive the quarterly report.

(p) Only Client Plans with total assets having an aggregate market value of at least \$50 million are permitted to lend securities to the Borrowers; provided, however, that —

(1) In the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a single master

trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangement with BGI, the foregoing \$50 million requirement shall be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

(2) In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with BGI, the foregoing \$50 million requirement is satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Client Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity.

(A) Has full investment responsibility with respect to plan assets invested therein; and

(B) Has total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million.

In addition, none of the entities described above are formed for the sole purpose of making loans of securities.

(q) With respect to any calendar quarter, at least 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of Lenders will be to borrowers unrelated to BGI.

(r) In addition to the above, all loans involving foreign Borrowers have the following requirements:

(1) The foreign Borrower is registered as a broker-dealer subject to regulation by the Securities and Futures Authority of the United Kingdom (the SFA);

(2) The foreign Borrower is in compliance with all applicable provisions of Rule 15a-6 under the Securities Exchange Act of 1934 (17 CFR 240.15a-6)(Rule 15a-6) which provides foreign broker-dealers a limited exemption from United States registration requirements;

(3) All Collateral is maintained in United States dollars or U.S. dollar-denominated securities or letters of credit (unless an applicable exemption provides otherwise);

(4) All Collateral is held in the United States and the situs of the securities lending agreements is maintained in the United States under an arrangement that complies with the indicia of ownership requirements under section 404(b) of the Act and the regulations promulgated under 29 CFR 2550.404(b)-1 related to the lending of securities; and

(5) Prior to a transaction involving a foreign Borrower, the foreign Borrower—

(A) Agrees to submit to the jurisdiction of the United States;

(B) Agrees to appoint an agent for service of process in the United States, which may be an affiliate (the Process Agent);

(C) Consents to service of process on the Process Agent; and

(D) Agrees that enforcement by a Client Plan of the indemnity provided by Barclays may occur in the United States courts.

(s) BGI maintains, or causes to be maintained, within the United States for a period of six years from the date of such transaction, in a manner that is convenient and accessible for audit and examination, such records as are necessary to enable the persons described in paragraph (t)(1) to determine whether the conditions of the exemption have been met, except that—

(1) A prohibited transaction will not be considered to have occurred if, due to circumstances beyond the control of BGI and/or its affiliates, the records are lost or destroyed prior to the end of the six-year period; and

(2) No party in interest other than BGI or its affiliates shall be subject to the civil penalty that may be assessed under section 502(i) of the Act, or to the taxes imposed by section 4975(a) and (b) of the Code, if the records are not maintained, or are not available for examination as required below by paragraph (t)(1).

(t)(1) Except as provided in subparagraph (t)(2) of this paragraph and notwithstanding any provisions of sections (a)(2) and (b) of section 504 of



the Act, the records referred to in paragraph (s) are unconditionally available at their customary location for examination during normal business hours by:

(A) Any duly authorized employee or representative of the Department, the Internal Revenue Service or the Securities and Exchange Commission;

(B) Any fiduciary of a participating Client Plan or any duly authorized representative of such fiduciary;

(C) Any contributing employer to any participating Client Plan or any duly authorized employee or representative of such employer; and

(D) Any participant or beneficiary of any participating Client Plan, or any duly authorized representative of such participant or beneficiary. (t)(2) None of the persons described above in paragraphs (t)(1)(B)–(t)(1)(D) are authorized to examine the trade secrets of BGI or its affiliates or commercial or financial information which is privileged or confidential.

### Section III—Definitions

(a) *Barclays Plan*: An ERISA covered employee benefit plan sponsored and maintained by BGI and/or an affiliate for its own employees.

(b) *Index Fund*: Any investment fund, account or portfolio sponsored, maintained, trustee or managed by BGI or an affiliate, in which one or more investors invest, and—

(1) which is designed to track the rate of return, risk profile and other characteristics of an Index by either (i) replicating the same combination of securities which compose such Index or (ii) sampling the securities which compose such Index based on objective criteria and data;

(2) for which BGI or its affiliate does not use its discretion, or data within its control, to affect the identity or amount of securities to be purchased or sold;

(3) that contains “plan assets” subject to the Act, pursuant to the Department’s Plan Asset Regulation; and, (4) that involves no agreement, arrangement, or understanding regarding the design or operation of the Fund which is intended to benefit BGI or its affiliate or any party in which BGI or its affiliate may have an interest.

(c) *Model-Driven Fund*: Any investment fund, account or portfolio sponsored, maintained, trustee or managed by BGI or an affiliate, in which one or more investors invest, and—(1) which is composed of securities the identity of which and the amount of which are selected by a computer model that is based on prescribed objective criteria using independent third-party

data, not within the control of BGI or an affiliate, to transform an Index;

(2) which contains “plan assets” subject to the Act, pursuant to the Department’s Plan Asset Regulation; and

(3) that involves no agreement, arrangement or understanding regarding the design or operation of the Fund or the utilization of any specific objective criteria which is intended to benefit BGI, any affiliate of BGI, or any party in which BGI or any affiliate may have an interest.

(d) *Index*: a securities index that represents the investment performance of a specific segment of the public market for equity or debt securities in the United States and/or foreign countries, but only if—

(1) The organization creating and maintaining the index is—

(A) engaged in the business of providing financial information, evaluation, advice or securities brokerage services to institutional clients,

(B) a publisher of financial news or information, or

(C) a public stock exchange or association of securities dealers;

(2) the index is created and maintained by an organization independent of Barclays; and

(3) the index is a generally accepted standardized index of securities which is not specifically tailored for the use of BGI.

### Summary of Facts and Representations

1. The applicants are Barclays Global Investors, N.A. (BGI) and its affiliated companies Barclays Capital Inc. (BC NY), Barclays Capital Securities Limited (BC UK), and Barclays Global Investors Services (BGIS), all of which are subsidiaries of Barclays Bank PLC (Barclays), a financial services group based in the United Kingdom. Barclays is a full-line investment services group which is an authorized institution under the Banking Act of 1987 of the United Kingdom and is regulated by the Bank of England. As of December 2000, Barclays had total assets in excess of \$472 billion.

BGI is a national bank headquartered in San Francisco, California. BGI serves as trustee, investment manager fiduciary and securities lending agent for employee benefit plans (Client Plans or Plans) invested in separate accounts or collective trust funds that hold plan assets on a commingled basis.<sup>24</sup> BGI also

manages certain assets for the Federal Thrift Savings Plan established pursuant to the provisions of FERSA. BGI is a leader in “passive” investment strategies; the majority of its assets under management are invested in Index or Model-Driven Funds (as described more fully below). As of June 2001, BGI and its affiliates had over \$771 billion in assets under management. Many of the Commingled Funds and Separate Accounts for which BGI acts as trustee and fiduciary engage in securities lending, with BGI acting as securities lending agent.

BC NY is a United Kingdom entity licensed in New York. It is an investment bank that customarily borrows securities in the ordinary course of its prime brokerage and equity finance businesses. BC NY is a registered broker-dealer under Section 15 of the Securities Exchange Act of 1934 (1934 Act).

BC UK is a broker-dealer located in London. BC UK also customarily borrows securities in the ordinary course of its business. BC UK is subject to regulation in the United Kingdom by the UK Securities and Futures Authority (SFA).

BGIS is located in San Francisco, California. BGIS is a registered broker-dealer under Section 15 of the 1934 Act. BGIS anticipates that in the future it will borrow securities in the ordinary course of its business.

2. The applicants represent that securities lending has become a common activity for institutional investors, including employee benefit plans, seeking to increase the return on their portfolios. Acting as principals, banks and broker-dealers borrow securities to satisfy their own needs or to re-lend to other entities wishing to borrow the securities. The lender generally requires that the loans of securities be fully collateralized by cash, U.S. Government securities, certain federal agency obligations or letters of credit. Where the collateral is cash, the lender or its agent generally invests the cash, and the lender retains a portion of the earnings on the cash collateral as its fee for lending the securities. Where non-cash collateral is used, the borrower pays a set fee directly to the lender.

Institutional investors often use the services of an agent in performing securities lending transactions. The lending agent is paid a fee for its services. Such fee may be a percentage of the income earned by the investor

<sup>24</sup> The common and collective trust funds trustee, custodied, and/or managed by BGI, and in which Client Plans invest, are referred to herein as “Commingled Funds.” The Client Plan separate

accounts trustee, custodied, and/or managed by BGI are referred to herein as “Separate Accounts.” Commingled Funds and Separate Accounts are collectively referred to herein as “Lender” or “Lenders.”

from lending its securities. The applicants represent that the essential functions of a securities lending agent are identifying appropriate borrowers of securities and negotiating the terms of loans to those borrowers. The agent also performs other services, such as monitoring the level of collateral and the value of loaned securities, and investing the cash collateral. The lending agent may receive a separate fee for the investment of cash collateral. The fee arrangement between BGI, as securities lending agent, and the Commingled Fund or the Client Plan in a Separate Account, is authorized by an independent Plan fiduciary.

BGI may provide services in several capacities for Client Plans, including trustee, custodian, securities lending agent, and/or investment manager. In connection with plan assets managed by BGI that are invested in Index and Model-Driven Funds, BGI exercises discretionary authority or control or renders investment advice with respect to such Funds, although BGI's discretion is effectively limited because of the nature of Index and Model-Driven Funds.<sup>25</sup> An Index Fund is one that is designed to track the rate of return, risk profile and other characteristics of an independently maintained securities index by either (i) replicating the same combination of securities which compose such index or (ii) sampling the securities which compose such index based on objective criteria and data. A Model-Driven Fund is one which is composed of securities the identity of which and the amount of which are selected by a computer model that is based on prescribed objective criteria using independent third-party data, not within the control of the investment manager, to transform an independently maintained securities index.

3. The applicants request an individual exemption for the lending of securities held in Commingled Funds or Separate Accounts to BC NY, BC UK, BGIS or any future affiliate of BGI subject to the regulatory requirements applicable to BC NY, BC UK and/or BGIS (individually, "Borrower" and collectively, "Borrowers"), by BGI as securities lending agent, following disclosure to the Client Plans of the Borrower's affiliation with BGI, and for the receipt of compensation by BGI in connection with such transactions.

The applicants represent that Plans sponsored and maintained by BGI and/or an affiliate for their own employees (Barclays Plans) will only use the

exemption to the extent that the Barclays Plan is invested in a Commingled Fund with respect to which, at all times, the holdings of all Barclays Plans in the aggregate comprise less than 10% of the assets of the Commingled Fund. No Barclays Plan Separate Accounts will participate.

The applicants represent that at all times, BGI will effect loans in a prudent and diversified manner. While BGI will normally lend securities to requesting borrowers on a "first come, first served" basis, as a means of assuring uniformity of treatment among borrowers, the applicants represent that in some cases it may not be possible to adhere to a "first come, first served" allocation. This can occur, for instance, where (a) the credit limit established for such borrower by BGI and/or the Client Plan has already been satisfied; (b) the "first in line" borrower is not approved as a borrower by the particular Lender whose securities are sought to be borrowed; (c) the borrower and BGI have negotiated rates more advantageous to the Lender than the rates other borrowers have offered; or (d) the "first in line" borrower cannot be ascertained, as an operational matter, because several borrowers spoke to different BGI representatives at or about the same time with respect to the same security. In situations (a) and (b), loans would normally be effected with the "second in line." In situation (c), this may mean that the "first in line" borrower receives the next lending opportunity. In situation (d), securities would be allocated equitably among all eligible borrowers.

4. Except as described herein in connection with Index and Model-Driven Funds managed by BGI, the applicants represent that neither BGI nor any affiliate will have discretionary authority or control with regard to the investment of the assets of Client Plans involved in the transaction or will render investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to such assets, including decisions regarding a Client Plan's acquisition or disposition of securities available for loan.

The plan assets for which BGI, to a limited extent, exercises discretionary authority or control or renders investment advice and which will be available for lending to the Borrowers will be limited to those invested in Index and Model-Driven Funds. All procedures for lending securities will be designed to comply with the applicable conditions of Prohibited Transaction Exemption 81-6 (PTE 81-6)(46 FR 7527,

January 23, 1981)<sup>26</sup> and Prohibited Transaction Exemption 82-63 (PTE 82-63)(46 FR 14804, April 6, 1982),<sup>27</sup> as amended or superseded, except as described herein.

5. The applicants represent that any arrangement for BGI to lend securities will be approved in advance by a Plan fiduciary who is independent of BGI. In addition, the Client Plan will acknowledge the relationship between BGI and the Borrowers. However, all conditions described herein that require an independent Plan fiduciary will not, in the case of a Barclays Plan, require that the fiduciary be independent of BGI or the Borrower.

6. When acting as a direct securities lending agent, BGI, pursuant to authorization from its client, will negotiate the terms of loans to Borrowers and otherwise act as a liaison between the Lender (and its custodian) and the Borrower. As lending agent, BGI will have the responsibility for monitoring receipt of all collateral required, marking such collateral to market daily to ensure adequate levels of collateral can be maintained, monitoring and evaluating the performance and creditworthiness of borrowers, and, if authorized by a client, holding and investing cash collateral pursuant to given investment guidelines. BGI may also act as trustee, custodian and/or investment manager for the Client Plan.

BGI, as securities lending agent for the Lenders, will negotiate a master securities borrowing agreement with a schedule of modifications attached thereto (Loan Agreement) with the Borrowers, as is the case with all borrowers. The Loan Agreement will specify, among other things, the right of the Lender to terminate a loan at any time and the Lender's rights in the event of any default by the Borrowers. The Loan Agreement will set forth the basis for compensation to the Lender for lending securities to the Borrowers under each category of collateral. The

<sup>26</sup> PTE 81-6 provides an exemption under certain conditions from section 406(a)(1)(A) through (D) of the Act and the corresponding provisions of section 4975(c)(1) of the Code for the lending of securities that are assets or an employee benefit plan to a U.S. broker-dealer registered under the 1934 Act (or exempted from registration under the 1934 Act as a dealer in exempt Government securities, as defined therein).

<sup>27</sup> PTE 82-63 provides an exemption under certain conditions from section 406(b)(1) of the Act and section 4975(c)(1)(E) of the Code for the payment of compensation to a plan fiduciary for services rendered in connection with loans of plan assets that are securities. PTE 82-63 permits the payment of compensation to a plan fiduciary for the provision of securities lending services only if the loan of securities itself is not prohibited under section 406(a) of the Act.

<sup>25</sup> See Proposed Class Exemption for Cross-Trades of Securities by Index and Model-Driven Funds as published at 64 FR 70057 (Dec. 15, 1999).

Loan Agreement will also contain a requirement that the Borrowers must pay all transfer fees and transfer taxes related to the securities loans.

7. With respect to Lenders who are Separate Accounts, as direct lending agent, BGI will, prior to lending the Client Plan's securities, enter into an agreement (Client Agreement) with the Client Plan, signed by a fiduciary of the Client Plan who is independent of BGI and the Borrowers. The Client Agreement will, among other things, describe the operation of the lending program, disclose the form of the securities loan agreement to be entered into on behalf of the Client Plan with borrowers, identify the securities which are available to be lent, and identify the required collateral and the required daily marking-to-market. The Client Agreement will also set forth the basis and rate of BGI's compensation for the performance of securities lending and cash collateral investment services. The Client Plan may terminate the Client Agreement at any time, without penalty, on no more than five business days notice.

The Client Agreement will contain provisions to the effect that if any Borrower is designated by the Client Plan as an approved borrower, the Client Plan will acknowledge the relationship between the Borrower and BGI and BGI will represent to the Client Plan that each and every loan made to the Borrower on behalf of the Client Plan will be effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16.

8. When BGI is lending agent with respect to a Commingled Fund, BGI will, prior to the investment of a Client Plan's assets in such Commingled Fund, obtain from the Client Plan authorization to lend any securities held by the Commingled Fund to brokers and other approved borrowers, including the Borrowers. Prior to obtaining such approval, BGI will provide a written description of the operation of the lending program (including the basis and rate of BGI's compensation for the performance of securities lending and cash collateral investment services), disclose the form of the securities loan agreement to be entered into on behalf of the Commingled Fund with the borrowers, identify the securities which are available to be lent, and identify the required collateral and the required daily marking-to-market.<sup>28</sup> If the Client

Plan objects to the arrangement, it will be permitted to withdraw from the Commingled Fund, without penalty, no later than 35 days after the notice of withdrawal is received.

In addition, the Client Plan will acknowledge the relationship between BGI and the Borrowers, and BGI will represent that each and every loan made to the Borrowers by the Commingled Fund will be effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16.

9. When BGI is lending securities under a sub-agency arrangement, before the Plan participates in the securities lending program, the primary lending agent will enter into a securities lending agency agreement (Primary Lending Agreement) with a fiduciary of the Client Plan who is independent of such primary lending agent, BGI, and the Borrowers. The primary lending agent also will be unrelated to BGI and the Borrowers. The Primary Lending Agreement will contain provisions substantially similar to those in the Client Agreement relating to: the description of the lending program, use of an approved form of securities loan agreement, specification of the securities to be lent, specification of the required collateral margin and the requirement of daily marking-to-market, and provision of a list of approved borrowers (which will include one or more of the Borrowers). The Primary Lending Agreement will specifically authorize the primary lending agent to appoint sub-agents (including BGI) to facilitate performance of securities lending agency functions. The Primary Lending Agreement will expressly disclose that BGI is to act in a sub-agency capacity. The Primary Lending Agreement will also set forth the basis and rate for the primary lending agent's compensation from the Client Plan for the performance of securities lending services and will authorize the primary lending agent to pay a portion of its fee, as the primary lending agent determines in its sole discretion, to any sub-agent(s) it retains (including BGI) pursuant to the authority granted under such agreement.

Pursuant to its authority to appoint sub-agents, the primary lending agent will enter into a securities lending sub-agency agreement (Sub-Agency Agreement) with BGI under which the primary lending agent will retain and

reserved to fiduciaries under the terms of the exemption will be made by the fiduciaries and never by the recordkeeper on behalf of the fiduciary.

authorize BGI, as sub-agent, to lend securities of the primary lending agent's Client Plans, subject to the same terms and conditions specified in the Primary Lending Agreement. BGI represents that the Sub-Agency Agreement will contain provisions that are in substance comparable to those described above in connection with a Client Agreement in situations where BGI is the primary lending agent. BGI will make in the Sub-Agency Agreement the same representations described above in paragraph 7 with respect to arm's length dealing with the Borrowers. The Sub-Agency Agreement will also set forth the basis and rate for BGI's compensation to be paid by the primary lending agent.

10. In all cases, BGI will maintain transactional and market records sufficient to assure compliance with its representation that all loans to the Borrowers are effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16. Such records will be made available upon reasonable request and without charge to the Client Plan fiduciary, who (other than in the case of a Barclays Plan) is independent of BGI and the Borrowers, in the manner and format agreed to by the Client Plan fiduciary and BGI.

11. A Lender, in the case of a Separate Account, will be permitted to terminate the lending agency or sub-agency arrangement at any time without penalty, on five business days notice. A Client Plan in the case of a Commingled Fund will be permitted to terminate its participation in the lending arrangement by terminating its investment in the Commingled Fund no later than 35 days after the notice of termination of participation is received, without penalty to the Plan, in accordance with the terms of the Commingled Fund. Upon a termination, the Borrower will be contractually obligated to return securities identical to the borrowed securities (or the equivalent thereof in the event of reorganization, recapitalization or merger of the issuer of the borrowed securities) to the Lender within one of the following time periods, whichever is least: The customary delivery period for such securities, five business days of written notification of termination, or the time negotiated for such delivery by the Client Plan, in a Separate Account, or by BGI, as lending agent to a Commingled Fund, and the Borrowers.

Because the securities must be returned before the end of the customary delivery period for sale of

<sup>28</sup> BGI may make transmittals required by the exemption to Plan fiduciaries via authorized recordkeepers. BGI represents that all decisions

those securities, BGI need not wait to sell the securities as long as it has the contractual assurance that they will be returned before settlement. Consequently, the lending has no impact on the investment decision to sell or its implementation and, therefore, no effect on tracking error.

12. The Lender, or another custodian designated to act on its behalf, will receive collateral from each Borrower by physical delivery, book entry in a U.S. securities depository, wire transfer or similar means by the close of business on or before the day the loaned securities are delivered to the Borrower. All collateral will be received by the Lender or other custodian, in the United States. The collateral will consist of U.S. currency, securities issued or guaranteed by the U.S. Government or its agencies or instrumentalities, or irrevocable bank letters of credit issued by a U.S. bank other than Barclays (or any subsequent parent corporation of BGI, BC NY, BC UK, and BGIS) or an affiliate thereof, or any combination thereof, or other collateral permitted under PTE 81-6 (as amended or superseded). The collateral will be held on behalf of a Client Plan in a depository account separate from the Borrower.

The market value (or, in the case of a letter of credit, a stated amount) of the collateral on the close of business on the day preceding the day of the loan will be at least 102 percent of the market value of the loaned securities. The Loan Agreement will give the Lender a continuing security interest in and a lien on or title to the collateral. BGI will monitor the level of the collateral daily. If the market value of the collateral, on the close of trading on a business day, is less than 100 percent (or such greater percentage as agreed to by the parties) of the market value of the loaned securities at the close of business on that day, BGI will require the Borrowers to deliver by the close of business on the next day sufficient additional collateral to bring the level back to at least 102 percent.

13. Prior to making any loans under the Loan Agreement from Separate Accounts, the Borrowers will furnish their most recent available audited and unaudited financial statements to BGI, which will provide such statements to the Client Plan invested in such Separate Account before the authorizing fiduciary of the Client Plan is asked to approve the proposed lending to the Borrowers. The terms of the Loan Agreement will contain a requirement that the Borrowers must give prompt notice to BGI at the time of any loan of any material adverse change in their

financial condition since the date of the most recently furnished financial statements. If any such material adverse change has taken place, BGI will request that the independent fiduciary of the Client Plan, if invested in a Separate Account, approve continuation of the lending arrangement in view of the changed financial conditions.

In addition, upon request, BGI will provide the audited financial statements of the applicable Borrowers to Client Plans invested in Commingled Funds on an annual basis.

14. In the case of Client Plans currently invested in Commingled Funds, approval of lending to the Borrowers will be accomplished by the following special procedure for Commingled Funds. The information described in paragraph 8 will be furnished by BGI as lending fiduciary to an independent fiduciary of each Client Plan invested in Commingled Funds not less than 30 days prior to implementation of the lending arrangement, and thereafter, upon the reasonable request of the authorizing fiduciary. In the event any such authorizing fiduciary submits a notice in writing within the 30-day period to BGI, in its capacity as the lending fiduciary, objecting to the implementation of or continuation of the lending arrangement with the Borrowers, the Plan on whose behalf the objection was tendered will be given the opportunity to terminate its investment in the Commingled Fund, without penalty to the Plan, no later than 35 days after the notice of withdrawal is received. In the case of a Plan that elects to withdraw pursuant to the foregoing, such withdrawal shall be effected prior to the implementation of the arrangement; but an existing arrangement need not be discontinued by reason of a Plan electing to withdraw. In the case of a Plan whose assets are proposed to be invested in a Commingled Fund subsequent to the implementation of the arrangement, the Plan's investment in the Commingled Fund shall be authorized in the manner described in paragraph 8.

In the case of loans made by Commingled Funds, upon notice by the Borrower to BGI of a material adverse change in its financial conditions, BGI will make a decision whether to terminate existing loans and whether to continue making additional loans to the Borrower, using the same standards of credit analysis BGI would use in evaluating unrelated borrowers. In the event the Client Plan invested in a Commingled Fund has any objection to the continuation of lending to a

Borrower, it may withdraw from the fund as described above.

15. With respect to material changes in the lending arrangement with the Borrowers after approval by Client Plans, BGI will obtain approval from Client Plans (whether in Separate Accounts or Commingled Funds) prior to implementation of any such change. For those Client Plans invested in Commingled Funds, approval of the proposed material change will be by the procedure described in paragraph 14.

16. In return for lending securities, the Lender either will receive a reasonable fee which is related to the value of the borrowed securities and the duration of the loan, or will have the opportunity to derive compensation through the investment of cash collateral. Under such circumstances, the Lender may pay a loan rebate or similar fee to the Borrowers, if such fee is not greater than the fee the Lender would pay in a comparable arm's length transaction with an unrelated party.

In this regard, each time a Lender loans securities to a Borrower pursuant to the Loan Agreement, BGI will reflect in its records the material terms of the loan, including the securities to be loaned, the required level of collateral, and the fee or rebate payable. The fee or rebate payable for each loan will be effected at arm's-length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described below. The rebate rates, which are established for cash collateralized loans made by the Lender, will take into account the potential demand for the loaned securities, the applicable benchmark cost of funds (typically the U.S. Federal Funds rate established by the Federal Reserve System), the overnight "repo" rate, or the like and the anticipated investment returns on the investment of cash collateral. Further, the lending fees with respect to loans collateralized by other than cash will be set daily to reflect conditions as influenced by potential market demand. The applicants represent that the securities lending agent fee paid to BGI will comply with the requirements of PTE 82-63.

BGI will establish each day a written schedule of lending fees<sup>29</sup> and rebate

<sup>29</sup> BGI will adopt minimum daily lending fees for non-cash collateral payable by Borrowers to BGI on behalf of a Lender. Separate minimum daily lending fees will be established with respect to loans of designated classes of securities. With respect to each designated class of securities, the minimum lending fee will be stated as a percentage of the principal value of the loaned securities. BGI will submit the method for determining such minimum daily lending fees to an authorizing fiduciary of the Client Plan, in the case of a Separate Account, for

rates<sup>30</sup> with respect to new loans of designated classes of securities, such as U.S. Government securities, U.S. equities and corporate bonds, international fixed income securities and non-U.S. equities, in order to assure uniformity of treatment among borrowers and to limit the discretion BGI would have in negotiating securities loans to Borrowers. Loans to all borrowers of a given security on that day will be made at rates or lending fees on the relevant daily schedules or at rates or lending fees which are more advantageous to the Lenders. The applicants represent that in no case will loans be made to Borrowers at rates or lending fees that are less advantageous to the Lenders than those on the relevant schedules. In addition, it is represented that the method of determining the daily securities lending rates (fees and rebates) will be disclosed to each Client Plan, whether in Separate Accounts or Commingled Funds. For those Client Plans invested in Commingled Funds, disclosure will be by the special procedure described in paragraph 14.

17. When a loan of securities by a Lender is collateralized with cash, BGI will transfer such cash to the trust or other investment vehicle for investment that the Client Plan has authorized, and will rebate a portion of the earnings on such collateral to the appropriate Borrower as agreed to in the securities lending agreement between Lender and the Borrower. BGI will share with the Client Plan the income earned on the investment of cash collateral for BGI's provision of lending services, which will reduce the income earned by the Client Plans (whether in a Commingled Fund or Separate Account) from the lending of securities. BGI may receive a separate management fee for providing cash collateral investment services. Where collateral other than cash is used, the Borrower will pay a fee to the Lender based on the value of the loaned securities. These fees will also be shared between the Client Plans (whether in a Commingled Fund or Separate Account) and BGI. Any income or fees shared will be net of cash collateral management fees and borrower rebate fees. The sharing of income and fees will be in accordance with the arrangements

approval before initially lending any securities to Borrowers on behalf of such Client Plan. BGI will submit the method for determining such minimum daily lending fees to an authorizing fiduciary of each Client Plan involved in or planning to invest in a Commingled Fund pursuant to the procedure described in paragraph 14, above.

<sup>30</sup> Separate maximum daily rebate rates will be established with respect to loans of securities within the designated classes identified above.

authorized by the Client Plan in advance of commencement of the lending program.

An authorizing fiduciary of the Client Plan also may authorize BGI to act as investment manager, custodian, and/or directed trustee of the Client Plan's Index or Model-Driven portfolio of securities available for lending whether in a Separate Account or Commingled Fund, and to receive a reasonable fee for such services.

18. BGI will negotiate rebate rates for cash collateral payable to each borrower, including Borrowers, on behalf of a Lender. The fees or rebate rates negotiated will be effected at arm's length terms, and such terms will be in no case less favorable to the Client Plan than the pricing established according to the schedule described in paragraph 16.

With respect to any loan to a Borrower, BGI, at the inception of such loan, will not negotiate and agree to a rebate rate with respect to such loan which it expects would produce a zero or negative return to the Lender over the life of the loan (assuming no default on the investments made by BGI where it has investment discretion over the cash collateral or on investments expected to be made by the Client Plan's designee, where BGI does not have investment discretion over cash collateral).

19. BGI may, depending on market conditions, reduce the lending fee or increase the rebate rate on any outstanding loan to a Borrower, or any other borrower. Except in the case of a change resulting from a change in the value of any third party independent index with respect to which the fee or rebate is calculated, such reduction in lending fee or increase in rebate shall not establish a lending fee below the minimum or a rebate above the maximum set in the schedule of fees and rebates described in paragraph 16. If BGI reduces the lending fee or increases the rebate rate on any outstanding loan from a Separate Account to a Borrower (except in the case of a change resulting from a change in the value of any third party independent index with respect to which the fee or rebate is calculated), BGI, by the close of business on the date of such adjustment, will provide the independent fiduciary of the Client Plan invested in the Separate Account with notice (including by electronic means) that it has reduced such fee or increased the rebate rate to such Borrower and that the Client Plan may terminate such loan at any time.

20. Except as otherwise expressly provided in the exemption, the applicants represent that all procedures

regarding the securities lending activities will, at a minimum, conform to the applicable provisions of PTE 81-6 and PTE 82-63, both as amended or superseded, as well as to applicable securities laws of the United States and the United Kingdom.

21. Barclays agrees to indemnify and hold harmless the Client Plans in the United States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with the Borrower so that the Lender does not have to litigate, in the case of BC UK, in a foreign jurisdiction, nor sue to realize on the indemnification. Such indemnification will be against any and all reasonably foreseeable losses, costs and expenses (including attorneys fees) which the Lender may incur or suffer arising from any impermissible use by a Borrower of the loaned securities, from an event of default arising from the failure of a Borrower to deliver loaned securities when due in accordance with the provisions of the Loan Agreement or from a Borrower's other failure to comply with the terms of the Loan Agreement, except to the extent that such losses are caused by the Client Plan's own negligence. The applicable Borrower will also be liable to the Lender for breach of contract for any failure by such Borrower to deliver loaned securities when due or to otherwise comply with the terms of the Loan Agreement.

If any event of default occurs to the extent that (i) liquidation of the pledged collateral or (ii) additional cash received from the Borrower does not provide sufficient funds on a timely basis, BGI, as securities lending agent, promptly and at its own expense, shall purchase or cause to be purchased for the account of the Lender, securities identical to the borrowed securities (or their equivalent). If the collateral and any such additional cash is insufficient to accomplish such purchase, Barclays, pursuant to the indemnification, will indemnify the Lender for any shortfall in the collateral plus interest on such amount and any transaction costs incurred (including attorneys' fees). Alternatively, if such replacement securities cannot be obtained in the open market, Barclays will pay the Lender the difference in U.S. dollars between the market value of the loaned securities and the market value of the related collateral as determined on the date of the Borrower's breach of the obligation to return the securities pursuant to the applicable Loan Agreement.

The "market value" of any securities listed on a national securities exchange

in the United States will be the last sales price on such exchange on the preceding business day or, if there is no sale on that day, the last sale price on the next preceding business day on which there is a sale on such exchange, as quoted on the consolidated tape. If the principal market for securities to be valued is the over-the-counter market, the securities' market value will be the closing sale price as quoted on the National Association of Securities Dealers Automated Quotation System (NASDAQ) on the preceding business day or the opening price on such business day if the securities are issues for which last sale prices are not quoted on NASDAQ. If the securities to be valued are not quoted on NASDAQ, their market value shall be the highest bid quotation appearing in The Wall Street Journal, National Quotation Bureau pink sheets, Salomon Brothers quotation sheets, quotation sheets of registered market makers and, if necessary, independent dealers' telephone quotations on the preceding business day. (In each case, if the relevant quotation does not exist on such day, then the relevant quotation on the next preceding business day in which there is such a quotation would be the market value.)

22. The Lender will be entitled to receive the equivalent of all distributions made to holders of the borrowed securities during the term of the loan, including but not limited to, interest and dividends, shares of stock as a result of a stock split and rights to purchase additional securities, or other distributions during the loan period.<sup>31</sup>

23. Further, prior to a Client Plan's authorization of a securities lending program, BGI will provide a Plan fiduciary with copies of the notice of proposed exemption and, if granted, the final exemption.

24. In order to provide the means for monitoring lending activity in Separate Accounts and Commingled Funds, a quarterly report will be provided to an auditor selected by BGI who is independent of BGI (but may or may not be independent of the Client Plan). This report will show the fees or rebates (as applicable) on loans to Borrowers compared with loans to other borrowers, as well as the level of collateral on the loans. The applicants represent that the

quarterly report will show, on a daily basis, the market value of all outstanding security loans to Borrowers and to other borrowers as compared to the total collateral held for both categories of loans. Further, the quarterly report will state the daily fees where collateral other than cash is utilized and will specify the details used to establish the daily rebate payable to all borrowers where cash is used as collateral. The quarterly report also will state, on a daily basis, the rates at which securities are loaned to Borrowers compared with those at which securities are loaned to other borrowers.

The independent auditor will review the lending data on a quarterly basis and certify whether the loans have satisfied the criteria of this exemption, in that they appear no less favorable to the Separate Account or Commingled Fund than the pricing established in the schedule described in paragraph 16. Client Plans invested in Separate Accounts will receive both the quarterly report and the auditor's certification as described above. Client Plans invested in Commingled Funds will receive the auditor's certification and, upon request, will receive the quarterly report.

In the event an authorizing fiduciary of a Plan invested in a Commingled Fund submits a notice in writing to BGI objecting to the continuation of the lending program to the Borrowers, the Plan on whose behalf the objection was tendered will be given the opportunity to terminate its investment in the Commingled Fund, without penalty to the Plan, no later than 35 days after the notice of withdrawal is received.

25. To ensure that any lending of securities to a Borrower will be monitored by an authorizing fiduciary of above average experience and sophistication in matters of this kind, only Client Plans with total assets having an aggregate market value of at least \$50 million will be permitted to lend securities to the Borrowers.

However, in the case of two or more Client Plans which are maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a single master trust or any other entity the assets of which are "plan assets" under 29 CFR 2510.3-101 (the Plan Asset Regulation), which entity is engaged in securities lending arrangement with BGI, the foregoing \$50 million requirement will be deemed satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million; provided that if the fiduciary responsible for

making the investment decision on behalf of such master trust or other entity is not the employer or an affiliate of the employer, such fiduciary must have total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million. In the case of two or more Client Plans which are not maintained by the same employer, controlled group of corporations or employee organization, whose assets are commingled for investment purposes in a group trust or any other form of entity the assets of which are "plan assets" under the Plan Asset Regulation, which entity is engaged in securities lending arrangements with BGI, the foregoing \$50 million requirement will be satisfied if such trust or other entity has aggregate assets which are in excess of \$50 million (excluding the assets of any Client Plan with respect to which the fiduciary responsible for making the investment decision on behalf of such group trust or other entity or any member of the controlled group of corporations including such fiduciary is the employer maintaining such Plan or an employee organization whose members are covered by such Plan). However, the fiduciary responsible for making the investment decision on behalf of such group trust or other entity must have full investment responsibility with respect to plan assets invested therein, and must have total assets under its management and control, exclusive of the \$50 million threshold amount attributable to plan investment in the commingled entity, which are in excess of \$100 million. In addition, none of the entities described above may be formed for the sole purpose of making loans of securities.

26. With respect to any calendar quarter, at least 50 percent or more of the outstanding dollar value of securities loans negotiated on behalf of Lenders by BGI will be to borrowers unrelated to BGI. Thus, the competitiveness of the loan fee will be continuously tested in the marketplace. Accordingly, the applicants believe that loans to Borrowers should result in competitive fee income to the Lenders.

27. With respect to foreign Borrowers, the applicants represent that BC UK is regulated by the UK SFA and is, therefore, authorized to conduct an investment banking business in and from the United Kingdom as a broker-dealer. The proposed exemption will be applicable only to transactions effected by BC UK which is registered as a broker-dealer with the SFA and in compliance with Rule 15a-6 under the

<sup>31</sup> The applicants represent that dividends and other distributions on foreign securities payable to a Lender may be subject to foreign tax withholdings. Under these circumstances, the applicable Borrower, where necessary, will gross-up the in-lieu-of-payment (in respect of such dividend or distribution it makes) to the Lender so that the Lender will receive back what it otherwise would have received (by way of dividend or distribution) had it not loaned the securities.

Securities Exchange Act of 1934 (Rule 15a-6). The applicants represent that the role of a broker-dealer in a principal transaction in the United Kingdom is substantially identical to that of a broker-dealer in a principal transaction in the United States. The applicants further represent that registration of a broker-dealer with the SFA is equivalent to registration of a broker-dealer with the SEC under the 1934 Act. The applicants maintain that the SFA has promulgated rules for broker-dealers which are equivalent to SEC rules relating to registration requirements, minimum capitalization, reporting requirements, periodic examinations, fund segregation, client protection, and enforcement. The applicants represent that the rules and regulations set forth by the SFA and the SEC share a common objective: the protection of the investor by the regulation of securities markets. The applicants explain that under SFA rules, a person who manages investments or gives advice with respect to investments must be registered as a "registered representative." If a person is not a registered representative and, as part of his duties, makes commitments in market dealings or transactions, that person must be registered as a "registered trader." The applicants represent that the SFA rules require each firm which employs registered representatives or registered traders to have positive tangible net worth and to be able to meet its obligations as they fall due, and that the SFA rules set forth comprehensive financial resource and reporting/disclosure rules regarding capital adequacy. In addition to demonstration of capital adequacy, the applicants state that the SFA rules impose reporting/disclosure requirements on broker-dealers with respect to risk management, internal controls, and all records relating to a counterparty, and that all records must be produced at the request of the SFA at any time. The applicants state that SFA's registration requirements for broker-dealers are backed up by potential fines and penalties and rules which establish a comprehensive disciplinary system.

28. In addition to the protections afforded by registration with the SFA, the applicants represent that BC UK will comply with the applicable provisions of Rule 15a-6 (described below). The applicants represent that compliance by BC UK with the requirements of Rule 15a-6 will offer additional protections in lieu of registration with the SEC. The applicants represent that Rule 15a-6 provides an exemption from U.S. broker-dealer registration for a foreign

broker-dealer that induces or attempts to induce the purchase or sale of any security (including over-the-counter equity and debt options) by a "U.S. institutional investor" or a "major U.S. institutional investor," provided that the foreign broker-dealer, among other things, enters into these transactions through a U.S. registered broker-dealer intermediary. The term "U.S. institutional investor", as defined in Rule 15a-6(b)(7), includes an employee benefit plan within the meaning of the Act if (a) the investment decision is made by a plan fiduciary, as defined in section 3(21) of Act, which is either a bank, savings and loan association, insurance company or registered investment advisor, (b) the employee benefit plan has total assets in excess of \$5,000,000, or (c) the employee benefit plan is a self-directed plan with investment decisions made solely by persons that are "accredited investors" as defined in Rule 501(a)(1) of Regulation D of the Securities Act of 1933, as amended. The term "major U.S. institutional investor" is defined as a person that is a U.S. institutional investor that has, or has under management, total assets in excess of \$100 million, or is an investment adviser registered under section 203 of the Investment Advisers Act of 1940 that has total assets under management in excess of \$100 million. The applicants represent that the intermediation of the U.S. registered broker-dealer imposes upon the foreign broker-dealer the requirement that the securities transaction be effected in accordance with a number of U.S. securities laws and regulations applicable to U.S. registered broker-dealers.

The applicants represent that, under Rule 15a-6, a foreign broker-dealer that induces or attempts to induce the purchase or sale of any security by a U.S. institutional or major U.S. institutional investor in accordance with 15a-6 must, among other things:

- a. Consent to service of process for any civil action brought by, or proceeding before, the SEC or any self-regulatory organization;
- b. Provide the SEC with any information or documents within its possession, custody or control, any testimony of any foreign associated persons,<sup>32</sup> and any assistance in taking

<sup>32</sup> A foreign associated person is defined in Rule 15a-6(b)(2) as any natural person domiciled outside the United States who is an associated person, as defined in section 3(a)(18) of the 1934 Act, of the foreign broker or dealer, and who participates in the solicitation of a U.S. institutional investor or a major U.S. institutional investor under Rule 15a-6(a)(3).

the evidence of other persons, wherever located, that the SEC requests and that relates to transactions effected pursuant to Rule 15a-6; and

c. Rely on the U.S. registered broker-dealer through which the transactions with the U.S. institutional and major U.S. institutional investors are effected to (among other things):

1. Effect the transactions, other than negotiating their terms;
2. Issue all required confirmations and statements;
3. As between the foreign broker-dealer and the U.S. registered broker-dealer, extend or arrange for the extension of credit in connection with the transactions;
4. Maintain required books and records relating to the transactions, including those required by Rules 17a-3 (Records to be Made by Certain Exchange Members) and 17a-4 (Records to be Preserved by Certain Exchange Members, Brokers and Dealers) of the 1934 Act;
5. Receive, deliver and safeguard funds and securities in connection with the transactions on behalf of the U.S. institutional investor or major U.S. institutional investor in compliance with Rule 15c3-3 of the 1934 Act (Customer Protection-Reserves and Custody of Securities); and
6. Participate in all oral communications (e.g., telephone calls) between a foreign associated person and the U.S. institutional investor (other than a major U.S. institutional investor), and accompany the foreign associated person on all visits with both U.S. institutional and major U.S. institutional investors. By virtue of this participation, the U.S. registered broker-dealer would become responsible for the content of all these communications.

All collateral will be maintained in United States dollars or U.S. dollar-denominated securities or letters of credit. All collateral will be held in the United States and BGI will maintain the situs of the Loan Agreements (evidencing the Lender's right to return of the loaned securities and the continuing interest in and lien on or title to the collateral) in the United States under an arrangement that complies with the indicia of ownership requirements under section 404(b) of the Act and the regulations promulgated under 29 CFR 2550.404(b)-1.

Prior to a transaction involving a foreign Borrower, the foreign Borrower will (a) agree to submit to the jurisdiction of the courts of the United States; (b) agree to appoint a Process Agent for service of process in the United States, which may be an affiliate; (c) consent to service of process on the

Process Agent; and (d) agree that enforcement by a Client Plan of the indemnity provided by Barclays may occur in the United States Courts.

29. In summary, the applicants represent that the proposed transactions will satisfy the statutory criteria for an exemption under section 408(a) of the Act because:

a. For each Client Plan, neither BGI nor any affiliate (except as expressly permitted in the exemption) will have or exercise discretionary authority or control with respect to the investment of the assets of Client Plans involved in the transaction or will render investment advice with respect to such assets, including decisions concerning a Client Plan's acquisition or disposition of securities available for loan, except to the extent that BGI exercises discretionary authority or control or renders investment advice in connection with an Index Fund or Model-Driven Fund managed by BGI in which Client Plans invest.

b. Any arrangement for BGI to lend securities will be approved in advance by a Plan fiduciary who (except in the case of a Barclays Plan) is independent of BGI.

c. The terms of each loan of securities by a Lender to a Borrower will be at least as favorable to such Separate Account or Commingled Fund as those of a comparable arm's length transaction between unrelated parties.

d. Upon termination of a loan, the Borrowers will transfer securities identical to the borrowed securities (or the equivalent thereof) to the Lender within one of the following time periods, whichever is least: (1) The customary delivery period for such securities; (2) five business days; or (3) the time negotiated for such delivery by the Client Plan, in a Separate Account, or by BGI, as lending agent to a Commingled Fund, and the Borrowers.

e. The Lender will receive from each Borrower collateral consisting of U.S. currency, securities issued or guaranteed by the United States Government or its agencies or instrumentalities, irrevocable bank letters of credit issued by a U.S. bank (other than Barclays Bank PLC or any subsequent parent corporation of BGI, BC NY, BC UK and BGIS, or an affiliate thereof, or any combination thereof) or other collateral permitted under PTE 81-6 (as amended or superseded), which will be held in a depository account separate from the Borrower.

f. In return for lending securities, the Lender either will receive a reasonable fee, which is related to the value of the borrowed securities and the duration of the loan, or will have the opportunity to

derive compensation through the investment of cash collateral.

g. Barclays agrees to indemnify and hold harmless the Client Plans in the United States (including the sponsor and fiduciaries of such Client Plans) for any transactions covered by this exemption with a Borrower so that the Client Plans do not have to litigate, in the case of BC UK, in a foreign jurisdiction nor sue to realize on the indemnification.

h. All loans involving foreign Borrowers will involve Borrowers that are registered as broker-dealers subject to regulation by the SFA and that are in compliance with all applicable provisions of Rule 15a-6.

i. Prior to a transaction involving a foreign Borrower, the foreign Borrower will: agree to submit to the jurisdiction of the United States; agree to appoint a Process Agent in the United States; consent to service of process on the Process Agent; and agree that enforcement by a Client Plan of the indemnity provided by Barclays may occur in the United States courts.

**FOR FURTHER INFORMATION CONTACT:** Karen Lloyd of the Department, telephone (202) 693-8540. (This is not a toll-free number).

#### **Carl Mundy, Jr. Defined Benefit Plan (the Plan)**

*Located in Alexandria, Virginia*

[Application No. D-11043]

#### **Proposed Exemption**

The Department is considering granting an exemption under the authority of 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). If the exemption is granted, the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (E) of the Code, shall not apply to the proposed contribution(s) (the Contribution(s)) to the Plan of shares (the Shares) of Schering-Plough Corporation (Schering-Plough) to be received annually by Carl Mundy, Jr. (Mr. Mundy), a disqualified person with respect to the Plan<sup>33</sup> as compensation in the form of Shares in lieu of cash, provided that the following conditions are met:

(a) The Shares are valued at its fair market value at the time of each Contribution;

(b) The Shares represent no more than 20% of the total assets of the Plan following each Contribution;

(c) The Plan will not pay any commissions, costs or other expenses in connection with the Contributions;

(d) Mr. Mundy, who is the only person affected by the transactions, believes that the transactions are appropriate for the Plan and desires that the transactions be consummated.

#### **Summary of Facts and Representations**

1. The Plan is a defined benefit plan covering only Mr. Mundy, who is the Plan's sponsor, administrator and trustee. Mr. Mundy is a sole proprietor engaged in the business of being a member of the board of directors for several companies.

2. Mr. Mundy's annual earned income derives principally from services rendered as a member of the board of directors of various corporations. In this regard, Mr. Mundy serves as a member of the board of directors of Schering-Plough. Thirty percent of his annual earned income is received from the receipt of the Shares in lieu of cash compensation. The Shares are valued by Schering-Plough on the day of the Contribution, reported to the Securities and Exchange Commission as a company stock transaction, and subsequently, to the IRS on form 1099 as taxable, cash compensation.

3. At the time of each Contribution, the Shares will represent no more than less than 20% of the Plan's assets. The Shares will be contributed in subsequent Plan years only to the extent that the fair market value of all the Shares in the Plan will not exceed 20% of the total value of the Plan's assets at the time of the Contribution.

4. The applicant states that his Federal income tax deduction for the Contribution will not exceed the fair market value of the Shares at the time of the Contribution. In addition, the Plan will not incur any sales commissions or other expenses in connection with the Contributions.

5. Mr. Mundy believes that the proposed exemption will enable Mr. Mundy to utilize earned compensation received in a form different than cash, but reported, treated, and taxed as cash, as a cash equivalent contribution to the Plan.

6. Mr. Mundy represents that there is little chance of there being a Plan participant other than himself. However, in the future if there is a new employee. Mr. Mundy will establish a separate defined benefit plan for such employee containing provisions comparable to those contained in the Plan.

<sup>33</sup> Since Mr. Mundy is a sole proprietor and the only participant in the Plan, there is no jurisdiction under Title I of the Act pursuant to 29 CFR 2510.3-3(b). However, there is jurisdiction under Title II of the Act pursuant to section 4975 of the Code.



7. In summary, the applicant represents that the proposed transaction satisfies the statutory criteria of section 4975(c)(2) of the Code because:

(a) The Shares will be valued at its fair market value at the time of each Contribution;

(b) The Shares will represent no more than 20% of the total assets of the Plan following each Contribution;

(c) The Plan will not pay any commissions, costs or other expenses in connection with the Contributions; and

(d) Mr. Mundy, who is the only person affected by the transactions, believes that the transactions are appropriate for the Plan and desires that the transactions be consummated.

*Notice to Interested Parties:* Because Mr. Mundy is the only participant in the IRA, it has been determined that there is no need to distribute the notice of proposed exemption (the Notice) to interested persons. Comments and requests for a hearing are due thirty (30) days after publication of the Notice in the **Federal Register**.

**FOR FURTHER INFORMATION CONTACT:**

Khalif Ford of the Department, telephone (202) 693-8540 (this is not a toll-free number).

**HSBC Holdings plc**

*Located in London, England*

[Exemption Application No.: D-11057]

**Proposed Exemption**

The Department of Labor is considering granting an exemption under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth 29 CFR part 2570, subpart B (55 FR 32836, 32847, August 10, 1990).<sup>34</sup> If the exemption is granted, HSBC Asset Management Americas, Inc. (AMUS), HSBC Asset Management Hong Kong, Ltd. (AMHK), HSBC Bank USA (Bank USA), and any current affiliate of HSBC Holdings plc (HSBC) that is eligible to serve or becomes eligible to serve as a qualified professional asset manager (a QPAM), as defined in Prohibited Transaction Class Exemption 84-14 (PTCE 84-14),<sup>35</sup> HSBC, itself, if in the future it becomes a QPAM, and any newly acquired or newly established affiliate of HSBC that is a QPAM or in the future becomes a QPAM, other than Republic New York Securities Corporation (RNYSC), shall not be precluded from functioning as a

<sup>34</sup> For purposes of this exemption, references to specific provisions of Title I of the Act, unless otherwise specified, refer to the corresponding provisions of the Code.

<sup>35</sup> 49 FR 9494 (March 13, 1984), *as amended*, 50 FR 41430 (October 10, 1985).

QPAM, pursuant to the terms and conditions of PTCE 84-14, for the period beginning on December 17, 2001, and ending ten (10) years from the date of the publication of the final exemption in the **Federal Register**, solely because of a failure to satisfy Section I(g) of PTCE 84-14, as a result of an affiliation with RNYSC; provided that:

(a) RNYSC has not in the past acted, nor does it now act, nor will it act as a fiduciary with respect to any employee benefit plans subject to the Act;

(b) This exemption is not applicable if HSBC and/or any successor or affiliate is affiliated with or becomes affiliated with any person or entity convicted of any of the crimes described in Section I(g) of PTCE 84-14, other than RNYSC; and

(c) This exemption is not applicable if HSBC and/or any successor or affiliate is convicted of any of the crimes described in Section I(g) of PTCE 84-14, including any such crimes subsequently committed by RNYSC.

**EFFECTIVE DATE:** If granted, this proposed exemption will be effective for the period beginning on December 17, 2001, the date on which the U.S. Attorney for the Southern District of New York filed an Information and Government's Memorandum (the Information) outlining the charges against RNYSC and on which RNYSC entered a plea of guilty to the criminal charges set forth in the Information, and ending ten (10) years from date of the publication of the final exemption in the **Federal Register**.

**Summary of Facts and Representations**

1. HSBC, a publicly owned holding company headquartered in London, England, is a U.K. corporation the shares of which are listed and traded on stock exchanges in New York, London, and Hong Kong. HSBC, together with its subsidiaries and affiliates, provides a wide range of banking and financial services in 79 countries. HSBC had consolidated assets, as of December 31, 2000, of approximately \$673 billion.

The exemption is requested for affiliates of HSBC, AMUS, AMHK, and Bank USA that currently qualify as QPAMs, as well as for any current affiliate of HSBC that now or in the future becomes eligible to serve as a QPAM, HSBC, itself, if it becomes a QPAM, and any newly acquired or newly established affiliate of HSBC that is a QPAM or in the future becomes a QPAM (collectively, the Applicants), other than RNYSC.

One of the Applicants, Bank USA, an affiliate of HSBC, located in Buffalo, New York, currently conducts business as a QPAM in compliance with the

requirements of PTCE 84-14 and other applicable exemptions. Bank USA is a New York state-chartered banking corporation and the principal U.S. bank subsidiary of HSBC. As such, Bank USA is subject to regulation and supervision by the Federal Reserve Bank of New York (FRBNY) and the New York State Banking Department (NYSBD). Bank USA has equity capital in excess of \$1,000,000 and is a bank as defined in section 202(a)(2) of the Investment Advisers Act of 1940 (the Advisers Act). As such, Bank USA is subject to the anti-fraud provisions of the Advisers Act, as well relevant state law. Bank USA has approximately \$7.1 billion in assets under management of which approximately \$448 million can be attributed to business with plans subject to the Act. Accordingly, the Applicants represent that Bank USA qualifies as a QPAM, pursuant to section V(a)(1) of PTCE 84-14.

Two other Applicants, AMUS and AMHK are corporations organized, respectively, under the laws of the state of New York and the Peoples Republic of China. AMUS maintains offices on Fifth Avenue in New York, NY, while AMHK is located in Hong Kong. Both AMUS and AMHK are indirectly owned by HSBC and are investment advisers registered under the Advisers Act. As such, both are subject to the jurisdiction of the Securities and Exchange Commission (the SEC) and to the substantive requirements of the Advisers Act. In this regard, AMUS and AMHK must make annual disclosure filings with the SEC and are subject to unannounced audits by the SEC to ensure compliance with the requirements of the Advisers Act.

As of December 31, 2001, AMUS and AMHK have total assets under management and control well in excess of \$50,000,000 (\$8.5 billion and \$13.5 billion, respectively). It is represented that both AMUS and AMHK are each currently qualified to serve as a QPAM.<sup>36</sup>

2. The Applicants have requested the proposed exemption apply with respect to the following employee benefit plans for which either AMUS or AMHK currently serve as investment managers: (i) The National Fuel and Gas Company Employee Thrift Plan—1996; (ii) The National Fuel and Gas Company Employee Thrift Plan—2002; (iii) The ITT Master Retirement Trust; and (iv) The Northrop Employee Benefit Plan.<sup>37</sup>

<sup>36</sup> The Department expresses no opinion as to whether AMUS, AMHK, or Bank USA qualify as a QPAM for purposes of PTCE 84-14.

<sup>37</sup> In their application for exemption, the Applicants also requested relief for transactions

The Applicants have also requested that the proposed exemption apply to any employee benefit plans for which the Applicants in the future serve as investment managers but which could not definitely be identified at the time the application was filed. The employee benefit plans for which the Applicants now or in the future serve as investment managers are referred to herein, collectively, as the Plan Clients. It is represented that consistent with the requirements of PTCE 84-14, a fiduciary independent of the Applicants is or will be involved in the appointment of any of the Applicants to serve as a QPAM with respect to the assets of any of the Plan Clients that are or will be affected by this proposed exemption.

3. Beginning in 1995 and continuing over a period of four (4) years, RNYSC allegedly engaged in certain wrongful conduct. The conduct arose out of the involvement of the Futures Division of RNYSC with certain of its customers which were various special purpose entities and out of the involvement of the Futures Division of RNYSC with the founder and chairman of these entities, Martin Armstrong (Mr. Armstrong). It is alleged that Mr. Armstrong, through such entities, issued promissory notes with a face value of approximately \$3 billion which were sold to certain Japanese investors (the Japanese Investors). The proceeds of such sales were deposited in certain custodial accounts (the Accounts) maintained at the Futures Division of RNYSC. Marketing materials provided to the Japanese Investors allegedly contained misrepresentations or misleading statements concerning the investment program and how such investors' money would be held. In addition, at least some the Japanese Investors were allegedly provided by Mr. Armstrong with letters issued by employees of RNYSC on RNYSC letterhead that substantially overstated the net asset value of the balances in the Accounts.

involving certain employee benefit plans sponsored by the Applicant and managed in-house (the In-House ERISA Plan Clients) and certain collective investment funds managed by Bank USA (the ERISA Collective Investment Fund Clients). Subsequently, in a letter dated February 4, 2002, the Applicants withdrew their request for relief for the In-House ERISA Plan Clients and the ERISA Collective Investment Fund Clients. In the case of the In-House ERISA Plan Clients, the Applicants represent that they will rely on the terms of Prohibited Transaction Class Exemption 96-23 for party in interest in-house transactions. In the case of the ERISA Collective Investment Fund Clients, the Applicants represent that they will rely on the terms of Prohibited Transaction Class Exemption 91-38, regarding transactions involving bank collective investment funds.

The Department expresses no opinion as to whether the Applicants satisfy the requirements of these class exemptions.

In late August 1999, while in the process of obtaining approval to acquire RNYC, HSBC was informed by RNYC that the Financial Supervisory Agency (FSA) of Japan had launched an investigation into the Tokyo branch of one of Mr. Armstrong's affiliated companies. On August 18, 1999, RNYSC informed HSBC that it had begun an internal investigation of the Accounts based on receipt of the notice from the FSA. It is represented that HSBC immediately notified the staff of the agencies whose approval of the acquisition was required, that it would await the results of RNYC's internal investigation before deciding whether to proceed with the proposed acquisition.

On September 1, 1999, when U.S. authorities seized the Accounts, approximately \$49 million remained in those Accounts and approximately \$1 billion in face value of notes were outstanding. On September 13, 1999, Mr. Armstrong was charged with mail and wire fraud.

Before learning of the involvement of the Futures Division of RNYSC with Mr. Armstrong and his affiliated companies, it is represented HSBC had performed substantial regulatory and corporate due diligence of RNYC and its subsidiaries. It is represented that this due diligence revealed nothing regarding RNYSC's wrongful conduct. After learning of such misconduct, HSBC performed additional due diligence on the operations of RNYC with a view to satisfying itself that there were no other matters which might cause it to reconsider the proposed acquisition of RNYC.

These steps were designed by HSBC to satisfy itself that there was no systemic breakdown at RNYC that might have led to serious exposures to risks in other business lines or that could not be prospectively cured to HSBC's satisfaction with the introduction of HSBC's internal controls following the acquisition. In this regard, HSBC arranged for, and evaluated the results of several reviews of the worldwide operations of RNYC, all of which were meant to consider the compatibility of the operations of RNYC with those of HSBC. This due diligence included reviews of certain of RNYC's non-U.S. operations, including its relationships with hedge funds, and various of its U.S. businesses, including its precious metals business, retail brokerage operations, and private banking activities. HSBC also reviewed certain of RNYSC's branch office operations, policies and procedures, including reports from its subsidiary bank's internal auditors. Based on the results of these reviews, along with RNYC's report

on its internal investigation, senior management concluded that, aside from the conduct of RNYSC in connection with the misconduct of the Futures Division of RNYSC, the operations of RNYC and its affiliates and subsidiaries were otherwise sound. Therefore, HSBC with the approval of the Federal Reserve Board, the FRBNY and the NYSBD, proceeded with the acquisition.

On December 31, 1999, HSBC acquired all of the outstanding shares of Republic New York Corporation (RNYC), the then parent holding company of Republic National Bank of New York (Republic Bank) and numerous other subsidiaries, including RNYSC. Immediately following the acquisition, the Republic Bank was merged with Bank USA (formerly, the Marine Midland Bank). HSBC also acquired at the same time the outstanding shares that were not already owned by RNYC of Safra Republic Holdings SA, a Luxemburg holding company and parent of various European private banking operations.

4. On December 17, 2001, the United States Attorney filed the Information in the United States District Court for the Southern District of New York (the Court) alleging that RNYSC had engaged in conspiracy in violation of 18 U.S.C. 371 and securities fraud in violation of 15 U.S.C. 78j(b) and 78ff. On the same date, RNYSC entered a plea of guilty to the charges in the Information, pursuant to a written cooperation and plea agreement (the Plea Agreement). In the Plea Agreement, RNYSC agreed to the entry of a restitution order totaling in excess of approximately \$600 million to compensate certain of the Japanese Investors. Pursuant to the terms of the Plea Agreement, HSBC USA Inc. (HSBC USA), RNYSC's parent company and an indirect wholly-owned subsidiary of HSBC, also agreed to compensate the Japanese Investors to the extent that the amount of the restitution exceeds the capital of RNYSC. In exchange for the payments by RNYSC and HSBC USA, the Japanese Investors opting to receive restitution agreed to dismiss their pending civil lawsuits.

As a result of the events leading to the Plea Agreement, on December 17, 2001, the same date on which the Information was filed with the Court, the Commodity Futures Trading Commission (CFTC) entered an administrative order and simultaneously settled an enforcement action against RNYSC alleging violations of the Commodity Exchange Act, as amended. Pursuant to the settlement with the CFTC, RNYSC's registrations as a Futures Commissions Merchant and as a Commodity Trading

Advisor were revoked. Further, among other things, RNYSC was ordered to pay a civil money penalty in the amount of \$5 million.

Also, as a result of the events leading to the Information and the Plea Agreement on December 17, 2001, the SEC entered an administrative order and simultaneously settled an enforcement action against RNYSC alleging violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. Pursuant to the settlement with the SEC, RNYSC registration as a broker dealer was revoked. On December 17, 2001, HSBC and certain of its subsidiaries and affiliates, as a result of their affiliation with RNYSC, filed an application with the SEC for a temporary and permanent order exempting them from section 9(a) of the Investment Company Act of 1940, pursuant to section 9(2) of such act. The SEC granted the temporary order on December 17, 2001, and the permanent order on January 14, 2002.

5. The Applicants have requested that the proposed exemption, if granted, would permit each of them to continue to function as a QPAM, pursuant to the terms and conditions of PTCE 84-14. PTCE 84-14, in general, permits various parties in interest with respect to an employee benefit plan to engage in certain transactions involving plan assets, if, among other conditions, the assets are managed by a QPAM who is independent and who meets specified financial standards and other conditions. In this regard, the requested exemption would apply to a full range of transactions that can be executed by investment managers which qualify as QPAMS.

6. The Applicants represent that it would not be uncommon for one of the Applicants, as a fiduciary for one of the Plan Clients, to engage in a transaction that involves a party in interest, as defined under section 3(14) of the Act. Although such parties in interest can be identified when a specific transaction is contemplated, it is not practical for the Applicants to identify all the parties in interest that might be involved in transactions covered by the requested exemption, given the size, number, and changing identity of such Plan Clients, the large number of service providers (particularly financial institutions) that such Plan Clients engage, the breadth of the definition of "party in interest" under the Act, and the wide array of services offered by the Applicants. Accordingly, the Applicants have requested that the proposed exemption apply to all current and future parties in interest transactions with respect to the Plan Clients.

The transactions with parties in interest for which relief has been requested by the Applicants include, but are not limited to sale and exchange transactions, derivative transactions, leasing and other real estate transactions, foreign currency trading transactions, and transactions involving the furnishing of goods, services, and facilities to an investment fund managed on a discretionary basis. It is represented that many of these types of transactions comprise an important component of the Applicants' business activities. It is represented that such transactions typically would have been evaluated by the Applicants, consistent with their fiduciary responsibilities under the Act, on the merits of such transactions, without regard to the involvement of a party in interest and that the terms of any material transactions with a party in interest are consistent with an arm's length standard at the time such terms are agreed to.<sup>38</sup>

7. In all but one respect, the terms and conditions of the proposed exemption are identical to those, as set forth in PTCE 84-14. However, section I(g) of PTCE 84-14, requires that the QPAM and any affiliate of the QPAM must not have been convicted of certain felonies within a ten (10) year period preceding each transaction covered by the class exemption. The term, "felony," as set forth in section I(g) of PTCE 84-14 includes:

any felony involving abuse or misuse of such person's employee benefit plan position or employment, or position or employment with a labor organization: any felony arising out of the conduct of the business of a broker, dealer, investment adviser, bank, insurance company, or fiduciary: income tax evasion: any felony involving the larceny, theft, robbery, extortion, forgery, counterfeiting,

<sup>38</sup> The Department notes that the general standards of fiduciary conduct under the Act would apply to the investment transactions permitted by this proposed exemption, and that satisfaction of the conditions of this proposed exemption should not be viewed as an endorsement of any particular investment by the Department. Section 404 of the Act requires, among other things, that a fiduciary discharge his duties with respect to a plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion. Accordingly, the manager or other plan fiduciary must act prudently with respect to the decision to enter into an investment transaction, as well as to the negotiation of the specific terms under which the plan will engage in such transaction. The Department further emphasizes that it expects a manager or other plan fiduciary to fully understand the benefits and risks associated with engaging in a specific transaction. In addition, such manager or plan fiduciary must be capable of periodically monitoring the investment, including any changes in the value of the investment and the creditworthiness of the issuer or other party to the transaction. Thus, in considering whether to enter into a transaction, a fiduciary should take into account its ability to provide adequate oversight of the particular investment.

fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; conspiracy or attempt to commit any such crimes or a crime in which any of the foregoing crimes is an element; or any other crimes described in section 411 of the Act.

Section V(d) of PTCE 84-14, defines an "affiliate" of a person to mean—

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the person, (2) Any director of, relative of, or partner in, any such person, (3) Any corporation, partnership, trust, or unincorporated enterprise of which such person is an officer, director, or a 5 percent (5%) or more partner or owner, and (4) Any employee or officer of the person who —(A) Is a highly compensated employee (as defined in section 4975(e)(2)(H) of the Code) or officer (earning 10 percent (10%) or more of the yearly wages of such person), or (B) Has direct or indirect authority, responsibility or control regarding the custody, management, or disposition of plan assets.

Section V(e) of PTCE 84-14 states that the term, "control," means the power to exercise a controlling influence over the management or policies of a person other than an individual.

8. Upon the acquisition of RNYC by HSBC in December 31, 1999, the Applicants became affiliated with RNYC and RNYSC, pursuant to the definition of "affiliate," as set forth in section V(d) of PTCE 84-14. Further, because RNYSC on December 17, 2001, entered a plea of guilty with respect to a felony, as described in section I(g) of PTCE 84-14, the Applicants, as affiliates of RNYSC, as of that date, could no longer satisfy section I(g) of PTCE 84-14. Furthermore, as of the same date, any of the Applicants which had qualified as a QPAM (e.g., AMUS, AMHK, and Bank USA) were precluded from continuing to act as a QPAM. Accordingly, Applicants seek retroactive relief from the restrictions of section 406(a)(1)(A)-(D), and 406(b)(1), and 406(b)(2), of the Act, as well as the corresponding provisions of the Code. The Applicants further request that the exemption be effective as of December 17, 2001, the date on which RNYSC signed the Plea Agreement.

9. The Applicants maintain that the requested exemption should be granted notwithstanding the guilty plea entered by RNYSC. In support of their position, the Applicants state that all of the activity covered by the RNYSC guilty plea occurred before RNYSC became affiliated with HSBC. It is represented that none of the acts underlying the guilty plea involved any investment management activities of the

Applicants, nor did such activity affect any assets of any plan subject to the Act.

HSBC and its subsidiaries fully cooperated with the U.S. Attorney's Office, the SEC and the CFTC in their investigations in the matters that form the basis of the Information and were cited by the U.S. Attorney for their exemplary degree of cooperation.

The former employees of RNYSC who were identified by RNYSC and HSBC as being responsible for the matter out of which the Plea Agreement arose were terminated in 1999 and 2000 and are no longer employed by RNYSC. Further, it is represented that the individuals responsible for RNYSC's misconduct are not now nor will they be employees of HSBC or any of its affiliates.

The Applicants maintain that the charges related to the guilty plea in no way reflect upon the Applicants' ability to serve as independent investment managers. After the acquisition, RNYSC ceased active operations and is now a dormant corporation. All of the executives of RNYSC who were associated with RNYSC's misconduct were terminated in 1999 and 2000. There are currently only two officers of RNYSC, neither of whom were connected with the activities that gave rise to RNYSC's guilty plea and both of whom were appointed by HSBC to administer the dormant operations of RNYSC. Neither RNYSC nor its employees will be involved in investment management activities relating to plans subject to the Act, nor will such parties influence or control the management or policies of the Applicants in the future.

HSBC and its U.S. subsidiaries have implemented steps designed to prevent future violations of applicable laws and regulations similar to those that are the subject of the Information. In addition to winding down RNYSC, HSBC promptly brought RNYC and its subsidiaries under the rigorous policies and procedures, internal controls, audit procedures, and compliance regime that applies to all subsidiaries of HSBC world wide. It is represented that these measures are designed, among other things, to identify and prevent conduct similar to the criminal conduct which is the basis for the criminal charges set forth in the Information.

10. The Applicants maintain that the requested exemption is protective of the rights of participants. In this regard, the proposed exemption contains safeguards similar to those provided in PTCE 84-14. Specifically, all of the conditions imposed by PTCE 84-14 would apply to this proposed exemption, except that section I(g) of PTCE 84-14 would not apply to the

violations giving rise to RNYSC's guilty plea. Further, it is represented that many of the Applicants' Plan Clients have significant assets, and hence have the sophistication and the access to resources necessary to monitor effectively the performance of such plans' investment managers.

The proposed exemption also contains conditions, in addition to those imposed by PTCE 84-14, which are designed to ensure the presence of adequate safeguards to protect the interests of the Plan Clients against wrongdoers now and in the future. In this regard, the proposed exemption will not be applicable if any of the Applicants is convicted of or is affiliated with or becomes affiliated with any person or entity convicted of any of the crimes described in section I(g) of PTCE 84-14, including any such crimes subsequently committed by RNYSC.

11. The Applicants represent that the requested exemption is administratively feasible because the relief would not impose any administrative burdens either on the Applicants or on the Department which are not already imposed by PTCE 84-14. In the opinion of the Applicants, the administrative feasibility of the requested exemption is further demonstrated by the fact that the Department has previously granted other individual exemptions for a variety of similarly situated entities under substantially the same circumstances.<sup>39</sup>

12. Without the requested relief, the Plan Clients may be forced to incur greater transaction costs and increased credit risks, if certain transactions are effected through unrelated parties, rather than through parties in interest.

13. Denial of the exemption, in the opinion of the Applicants, would be

<sup>39</sup>In connection with the anticipated acquisition of the Bangkok Metropolitan Bank (BMB), the Applicants filed an application for an administrative exemption (D-10910) on June 16, 2000. The Department published in the **Federal Register** a proposed exemption on October 11, 2000, at 65 FR 60666. Subsequently, the Department published in the **Federal Register** a final exemption (Prohibited Transaction Exemption 2000-70) on December 21, 2000, at 65 F.R. 80461. By letter dated, January 9, 2001, the Applicants informed the Department that the acquisition of BMB did not take place, because final terms acceptable to both parties could not be reached.

Other cases similar to the proposed exemption include: (a) Bankers Trust Co., BT Alex Brown, Inc., and Deutsche Bank, Prohibited Transaction Exemption 99-29, 64 F.R. 40623 (July 22, 1999); (b) PanAngora Management, Inc., Prohibited Transaction Exemption 97-10, 62 F.R. 4813 (Jan. 31, 1997); (c) American Express Company and Affiliates, Prohibited Transaction Exemption 94-34, 59 F.R. 19247 (April 22, 1994); and (d) CS Holding and its Worldwide Affiliates, Prohibited Transaction Exemption 94-31, 59 FR 17590 (April 13, 1994).

unduly and disproportionately severe as applied to Plan Clients for which the Applicants serve as investment managers. In this regard, in the absence of the requested relief, the Applicants would be required to examine each transaction involving Plan Clients to determine whether it involves a party in interest, no matter how remote, with respect to such plans. Even with careful screening procedures for each transaction, the Plan Clients may have to forgo certain transactions in order to avoid the possibility of engaging inadvertently in a prohibited transaction. The Applicants point out that although individual exemptions may be obtained for transactions for which no existing class exemption applies, the application process can be expensive and time consuming. In the opinion of the Applicants, the proposed exemption, if granted, would eliminate both the potential for certain inadvertent prohibited transactions and avoid needless expenses and time delays.

14. In summary, the Applicants represent that the proposed transactions satisfy the statutory criteria for an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code because, among other things:

(a) no entity affiliated with HSBC, other than RNYSC, was involved in the conduct that formed the basis of the guilty plea;

(b) RNYSC is now a dormant company and the employees of RNYSC who engaged in the conduct that formed the basis of the guilty plea are no longer employees of HSBC or its affiliates;

(c) neither RNYSC nor its employees will be involved in investment management activities relating to plans subject to the Act, nor will such parties influence or control the management or policies of the Applicants in the future;

(d) all of the conduct that formed the factual basis of the guilty plea occurred before the date that HSBC acquired control of RNYSC;

(e) absent the proposed exemption, the Plan Clients may have to forgo attractive investment opportunities or incur greater transaction costs and risks;

(f) AMUS and AMHK, as investment advisors registered under the Advisers Act, are subject to the jurisdiction of the SEC and the requirements of the Advisers Act;

(g) Bank USA is a commercial bank, as defined in section 202(a)(2) of the Advisers Act, and is subject to the anti-fraud provisions of the Advisers Act, as well as relevant state law;

(h) RNYSC will not be involved in investment management activities relating to the Plan Clients, nor will

RYNASC influence or control the management or policies of HBSC;

(i) other than section I(g) of PTCE 84-14, the conditions of PTCE 84-14 will apply to the transactions covered by this exemption, and such conditions are sufficient under the circumstances to ensure that the best interest of the Plan Clients and their participants are served;

(j) the Plan Clients will be able to engage in a broader variety of investment opportunities;

(k) RNYSC has not in the past acted, nor does it now act, nor will it act as a fiduciary with respect to any employee benefit plans subject to the Act;

(l) this exemption, if granted, would not be applicable if any of the Applicants now, or in the future, becomes affiliated with any person or entity convicted of any of the crimes described in section I(g) of PTCE 84-14, other than RNYSC; and

(m) this exemption, if granted, would not be applicable if any of the Applicants now, or in the future, becomes convicted of any of the crimes described in section I(g) of PTCE 84-14, including such crimes subsequently committed by RNYSC.

#### Notice to Interested Persons

The Applicants will deliver by hand or by first class mail a copy of the Notice of Proposed Exemption (the Notice) along with the supplemental statement (the Supplemental Statement), described at 29 CFR 2570.43(b)(2), to the investment fiduciary or trustee for each of the current Plan Clients for which one or

more of the Applicants might potentially act as a QPAM.

The Notice and the Supplemental Statement will be delivered by hand delivery or first class mail, within fifteen (15) days of the publication of the Notice in the **Federal Register**. Comments and requests for a hearing are due on or before 45 days from the date of publication of the Notice in the **Federal Register**.

A copy of the final exemption, if granted, will also be provided to the investment fiduciary or trustee of each of the current Plan Clients who receive a copy of the Notice.

#### FOR FURTHER INFORMATION CONTACT:

Angelena C. Le Blanc of the Department telephone (202) 693-8551. (This is not a toll-free number.)

#### 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/or 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/or 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, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interest of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(b) of the Act; nor does it affect the requirement of section

401(a) of the Code that the plan must 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/or section 4975(c)(2) of the Code, the Department must find that the exemption is administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan;

(3) The proposed exemptions, if granted, will be supplemental to, and not in derogation of, any other provisions of the Act and/or the Code, including statutory or administrative exemptions and transitional rules. 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; and

(4) The proposed exemptions, if granted, will be subject to the express condition that the material facts and representations contained in each application are true and complete, and that each application accurately describes all material terms of the transaction which is the subject of the exemption.

Signed at Washington, DC, this 20th day of February, 2002.

**Ivan Strasfeld,**

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

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