PUBLIC

AUG - 1 1996

RESPONSE OF THE OFFICE OF THE CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 96-402-CC
State Street Bank and Trust Company
File No. 132-3

By letter dated July 29, 1996, you request our assurance that we would not recommend enforcement action to the Commission if, as more fully described in your letter, various plans ("457 Plans") meeting the definition of "eligible deferred compensation plan" in Section 457 of the Internal Revenue Code of 1986, as amended (the "Code"), participate in certain collective trust funds ("Funds") maintained by State Street Bank and Trust Company ("State Street") without registration of the Funds under the Investment Company Act of 1940 ("Investment Company Act") in reliance on Section 3(c)(11) of that Act, and without registration of the units of participation therein under the Securities Act of 1933 ("Securities Act") or the Securities Exchange Act of 1934 ("Exchange Act"), in reliance on Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act.

Facts

The State Street Bank and Trust Company Investment Funds for Tax Exempt Retirement Plans ("Trust") consists of the Funds. Units in the Funds currently are offered and sold exclusively to certain types of tax-qualified employee benefit plans, as well as to commingled investment vehicles containing assets of tax-qualified employee benefit plans.

State Street proposes to offer units in the Funds to 457 Plans established by various governmental entities described in Section 457(e)(1)(A) of the Code. You represent that the Plan documents of the 457 Plans investing in the Trust will provide that Plan assets will not be used for any purpose other than for the exclusive benefit of 457 Plan participants, except that Plan assets shall remain subject to the claims of general creditors of the employer to the extent necessary to comply with Section 457 of the Code. 1/ You also represent that the Investment Management Agreement ("Agreement") between State Street and the 457 Plan will specifically prohibit a participating employer from withdrawing Plan assets from the Trust, except for the following purposes:

(1) To transfer Plan assets to a trustee in bankruptcy in the event of the employer's insolvency or bankruptcy, or to any other agent independent of the employer authorized to act in such proceedings;

---

1/ If a 457 Plan's document does not contain such a provision, you represent that State Street will obtain a written representation to this effect from an authorized representative of the 457 Plan (the "Plan Administrator"). You further represent that in no event will State Street allow a 457 Plan to participate in the Trust if, in State Street's opinion, the Plan document contains any provision that would not permit it to be interpreted to require such "exclusive benefit" treatment.

(2) To satisfy the claims of the employer's general creditors in the event of the employer's insolvency or bankruptcy;

(3) To pay benefits to an employee participating in a 457 Plan;

(4) To transfer assets to a 457 Plan's custodian or other person designated by a sponsoring employer in case the Agreement is terminated or a withdrawal is made for the purpose of using another investment manager or investment arrangement;

(5) To distribute Plan assets to participating employees in the event a 457 Plan is terminated pursuant to a plan of liquidation; or

(6) To reimburse an employer for any 457 Plan benefits that the employer may have paid out of its other assets, or to correct an excess deferral or other mistaken investment in the Trust.

You state that the Agreement will define "insolvency" as a circumstance in which an employer is unable to pay its debts as they become due, or is subject to a pending proceeding under the United States Bankruptcy Code. Under the Agreement, a withdrawal based on a claim of insolvency must be premised on a determination made by the highest governing body of the employer, as well as its highest executive officer, after notice of a public hearing has been given and a public hearing has been held on the subject of the employer's insolvency.

You represent that the Agreement will require that any withdrawal request be accompanied by a written notification from the Plan Administrator explaining the reasons therefor. If the writing indicates that an employer wants to redeem units because it is insolvent, then such writing will describe the procedures that were followed in making the insolvency determination. If the writing indicates that an employer is redeeming units because it wants to terminate its investment management arrangement with State Street, or withdraw funds for the purpose of using another investment manager or investment arrangement, then such writing will contain a representation from the terminating employer naming the person to whom State Street would transfer such money and affirming that the Plan assets are not to be used for employer purposes. The Agreement also will provide that, in deciding whether to honor a withdrawal request, State Street may rely on any such writing it reasonably believes was submitted in good faith by a participating employer.

You also represent that State Street will give directly to all 457 Plan participants, or provide to each sponsoring employer for distribution to all participants, brochures that prominently disclose (a) that the amounts allocated to the Funds will be subject to the claims of the employer's general creditors as required by the Code, and (b) the potential risks (including access by general creditors of the employer to Plan assets) 2/ to participants posed by investing in 457 Plans. Finally, you represent that employee contributions to a particular 457 Plan will not be invested in securities of the sponsoring employer or its controlled or commonly controlled entities.

Analysis

Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act exempt from registration any interest or participation in a collective trust fund maintained by a bank, which interest or participation is issued in connection with a governmental plan as defined in Section 414(d) of the Code that has been "established by an employer for the exclusive benefit of its employees . . . if under such plan it is impossible . . . for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees." 3/ Section 3(c)(11) of the Investment Company Act excludes from the definition of "investment company" any collective trust fund maintained by a bank consisting solely of assets of such plans.

While Section 3(a)(2) does not explicitly refer to 457 Plans, such plans are deferred compensation plans established and maintained by state and local governments, and thus, you represent, are as a technical matter, "governmental plans" within Section 414(d) of the Code. Section 457(b)(6) of the Code, however, requires that all assets accumulated under a 457 Plan must remain solely the property of the sponsoring employer, "subject only to the claims of the employer's general creditors." Therefore, 457 Plans technically may not meet the requirement that it be impossible to use plan assets for "purposes other than the exclusive benefit" of employees.

You state that 457 Plan assets effectively will be administered for the "exclusive benefit" of participating employees because a sponsoring employer would not be permitted to withdraw plan assets for its own use except, in the event of the employer's insolvency or bankruptcy, to satisfy its general creditors. Although it is possible for the assets held in a 457 Plan to be used by the employer for its own purposes, you believe that the provisions contained in the Agreement and the Plan documents, along with the supplemental written representations made upon any withdrawal of Plan assets, should ensure that employer use remains only a remote possibility, and that the assets will be administered in a manner that substantially comports with the requirements applicable to qualified employee benefit plans.

---

2/ Telephone conversation on August 1, 1996 between Wendell Faria, counsel to State Street, and Karrie McMillan of the staff.

3/ Section 414(d) of the Code provides, in relevant part, that a "governmental plan means a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing."

You further state that, at all times, the Plan Administrator will exercise fiduciary responsibilities in seeking to ensure that the interests of 457 Plan participants are adequately protected.

In light of the foregoing, we would not recommend enforcement action to the Commission if State Street offers and sells units in the Funds to 457 Plans without registering the Funds as investment companies in reliance on Section 3(c)(11) of the Investment Company Act. The Division of Corporation Finance has asked us to inform you that it would not recommend enforcement action to the Commission if State Street, in reliance upon your opinion as counsel that the exemptions under Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act are available, offers units in the Funds to 457 Plans without registration under these Acts. The Division of Market Regulation has asked us to inform you that it concurs in this position with respect to the Exchange Act. The Divisions' positions are based on the facts and representations in your letter. You should note that any different facts or circumstances might require a different conclusion. Furthermore, this response represents only the Divisions' positions on enforcement action and does not purport to express any legal conclusions as to the questions presented.

Status of Prior Letters

The staff previously has issued a number of no-action letters relating to 457 plans. 4/ The positions taken in these letters were based largely on the general representation that plan assets would not be used for any purpose other than the exclusive benefit of participants except to the extent that plan assets must remain subject to the claims of general creditors of the employer to preserve the plan's qualification under Section 457 of the Code. The staff, however, now believes that this general representation no longer provides an adequate basis for no-action relief without specific additional restrictions on the

4/ *See, e.g.,* The Lincoln National Life Insurance Company (pub. avail. Oct. 26, 1992); Hartford Life Insurance Company (pub. avail. June 24, 1992); Pan American Life Insurance Company (pub. avail. Nov. 19, 1991); Standard Insurance Company (pub. avail. Sept. 11, 1991); Aetna Life Insurance and Annuity Company (pub. avail. Sept. 11, 1991); Principal Mutual Life Insurance Company (pub. avail. June 27, 1991); Metropolitan Life Insurance Company (pub. avail. June 6, 1991); Monarch Life Insurance Company (pub. avail. Apr. 3, 1991); The Travelers Insurance Company (pub. avail. Aug. 6, 1990); Great-West Life and Annuity Insurance Co. (pub. avail. Feb. 1, 1990); Fidelity Management Trust Company (pub. avail. Nov. 2, 1989); Aetna Life Insurance Company (pub. avail. Oct. 18, 1989); Nationwide Life Insurance Company (pub. avail. May 12, 1989); North Shore Savings and Loan Association (pub. avail. Dec. 8, 1988); Wells Fargo Bank, N.A. (pub. avail. Sept. 7, 1988).

ability of an employer to withdraw assets similar to those described in this letter. The prior no-action letters, therefore, no longer represent the staff's position on enforcement action in this area. 5/

Karrie McMillan

Karrie McMillan
Special Counsel

---

5/ The staff realizes that a number of banks and insurance companies may be permitting 457 Plans to invest in their collective trust funds or separate accounts in reliance on these prior letters. To facilitate an orderly transition to its current position, the staff will not recommend enforcement action to the Commission for a period of twelve months from the date of this letter if these persons continue to rely on the prior letters. At the end of that period, however, banks and insurance companies wishing to continue including 457 Plans in their collective trust funds or separate accounts should, for new contracts, enter into an agreement similar to that described above with the sponsor of each such 457 Plan, and for existing contracts, use reasonable efforts to amend plan documents and/or supporting contracts to conform to the agreement (or one similar to the one) described above.

LAW OFFICES OF
PAUL, HASTINGS, JANOFSKY & WALKER
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
TENTH FLOOR
1299 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20004-2400
TELEPHONE: (202) 508-9500
FACSIMILE: (202) 508-9700

COUNSEL
LEE G. PAUL
ROBERT P. HASTINGS
LEONARD S. JANOFSKY
CHARLES M. WALKER

LOS ANGELES OFFICE
555 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90071-2371
TELEPHONE (213) 683-6000

ORANGE COUNTY OFFICE
695 TOWN CENTER DRIVE
COSTA MESA, CALIFORNIA 92626-1924
TELEPHONE (714) 668-6200

WEST LOS ANGELES OFFICE
1299 OCEAN AVENUE
SANTA MONICA, CALIFORNIA 90401-1078
TELEPHONE (310) 319-3300

ATLANTA OFFICE
SUITE 2400
600 PEACHTREE STREET, N.E.
ATLANTA, GEORGIA 30308-2222
TELEPHONE (404) 815-2400

CONNECTICUT OFFICE
1055 WASHINGTON BOULEVARD
STAMFORD, CONNECTICUT 06901-2217
TELEPHONE (203) 961-7400

NEW YORK OFFICE
399 PARK AVENUE
NEW YORK, NEW YORK 10022-4697
TELEPHONE (212) 318-6000

TOKYO OFFICE
ARK MORI BUILDING, 30TH FLOOR
P.O. BOX 577
12-32, AKASAKA 1-CHOME
MINATO-KU, TOKYO 107
TELEPHONE (03) 3586-4711

WRITER'S DIRECT DIAL NUMBER
(202) 508-9574

July 29, 1996

21066.70725

| | |
|---|---|
| Act | ICA |
| Section | 3(C)(11) |
| Rule | |
| Public Availability | 8/1/96 |

Section 3(a)(2) of the Securities Act of 1933;
Section 3(a)(12) of the Securities Exchange Act of 1934;
Section 3(c)(11) of the Investment Company Act of 1940

**VIA MESSENGER**

Jack W. Murphy, Esq.
Associate Director and Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Martin P. Dunn, Esq.
Chief Counsel
Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: State Street Bank and Trust Company: Section 457 Plan No-Action Letter Request

Ladies and Gentlemen:

We are writing on behalf of our client, State Street Bank and Trust Company ("State Street"), to respectfully request that the Staff (the "Staff") of the

Securities and Exchange Commission (the "Commission") agree not to recommend enforcement action to the Commission if various plans meeting the definition of "eligible deferred compensation plan" in Section 457 of the Internal Revenue Code of 1986, as amended, ("Code") were to participate in certain collective trust funds maintained by State Street without registering the funds or the offering of units of participation therein under the federal securities laws.

More particularly, we respectfully request that the Staff concur in our opinion that units in the collective trust funds may be offered to Section 457 governmental plans (i.e., governmental plans established pursuant to Section 457 of the Code) in reliance on the exemptions from registration afforded under Section 3(a)(2) of the Securities Act of 1933 ("Securities Act") and Section 3(a)(12) of the Securities and Exchange Act of 1934 ("Exchange Act"), and the exception from regulation as an investment company afforded under Section 3(c)(11) of the Investment Company Act of 1940 ("Investment Company Act").1/

---

1/ For convenience, we occasionally refer in this letter to the exception from regulation as an investment company afforded in Section 3(c)(11) of the Investment Company Act as an "exemption."

# I.

## STATEMENT OF FACTS

### A. Background

State Street is a trust company established in 1891 under the laws of The Commonwealth of Massachusetts and is a wholly-owned subsidiary of State Street Boston Corporation, a federal bank holding company. State Street is subject to the supervision and examination of the Massachusetts Commissioner of Banks and the Federal Deposit Insurance Corporation, which insures State Street's deposits. State Street is also a member of the Federal Reserve System and subject to supervision and examination by the Board of Governors of the Federal Reserve System. As of December 31, 1995, State Street and its affiliates world-wide had over $2.3 trillion of assets in trust or under custody and over $226 billion of assets under management.

State Street has established various collective trust funds under the State Street Bank and Trust Company Investment Funds for Tax Exempt Retirement Plans (all such collective trust funds referred to hereafter as "Trust"). The Trust is offered and sold to employee benefit plans qualified for favorable tax treatment under Section 401(a) of the Code, and to governmental plans defined in Code Section 414(d) which also qualify for favorable federal tax treatment. Employee benefit plans for self-employed individuals within the meaning of Code Section 401(c)(1) ("Keogh Plans") also may participate in the Trust, but only to the extent the interests in such plans, and the interests of any such plans in pooled investment vehicles in which they invest, are exempt from registration in reliance on Rule 180 under the Securities Act. Commingled investment vehicles containing only assets of some or all of the employee benefit plans eligible for participating directly in the Trust, also may invest in the Trust. Individual retirement account plans established pursuant to Code Section 408(a), however, and tax-sheltered arrangements established pursuant to Code Section 403(b), may not participate in the Trust.

The Trust is operated in reliance on various exemptions under the federal securities laws. Trust units are offered and sold to qualified participants in reliance on the exemption from registration afforded by Section 3(a)(2) of the Securities Act and the corresponding exemption from registration afforded by Section 3(a)(12) of the Exchange Act. In addition, the Trust operates in reliance on the exception from regulation as an investment company afforded under Section 3(c)(11) of the Investment Company Act.

B. Proposal

State Street proposes to offer units in the Trust to Section 457 plans established by various governmental units described in Code Section 457(e)(1)(A) ("Section 457 Plan" or "Plan")[2/], in reliance on the exemptions from registration afforded under the Securities Act, the Exchange Act, and the Investment Company Act.[3/] As here relevant and fully in accordance with the requirements of Section 457(b)(6) of the Code, a Section 457 Plan participating in the Trust will provide, among other requirements, that all assets accumulated under the Plan shall remain "solely the property and rights of the [sponsoring] employer . . . subject only to the claims of the employer's general creditors." In addition, and also fully in accordance with the provisions of Treasury Regulations § 1.457-1(b) and § 1.457-2(j), a participating Section 457 Plan may permit an employee participating thereunder to direct the investment of contributions and amounts accumulated on such person's

---

2/ Section 457(e)(1)(A) defines the term "eligible employer", for purposes of the definition of "eligible deferred compensation plan" in Section 457(b), to mean any "State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State."

3/ State Street is requesting that the Staff grant no-action assurance only with respect to future investment arrangements involving Section 457 plans.

behalf, even though such amounts are considered the "property and rights" of the sponsoring employer.

Participation in the Trust by a Section 457 Plan will be evidenced by an Investment Management Agreement ("Agreement") executed between State Street and an authorized representative of such Plan (referred to herein as the "Plan Administrator"). This Agreement will contain a number of provisions intended to ensure that the assets of a participating Plan will be administered for the exclusive benefit of Plan participants, subject to the requirements of Section 457(b)(6) of the Code and interpretations thereof.[4/]

As an initial matter, the Agreement will prohibit a Section 457 Plan from participating in the Trust unless the Plan document contains a provision (or is interpreted in a manner) that requires Plan assets to be administered for the exclusive benefit of Plan participants, except to the extent necessary to satisfy the provisions of Section 457(b)(6) of the Code. In the event the Plan document, in State Street's opinion, does not provide for administering

---

4/ The Internal Revenue Service has issued Revenue Procedure 92-64, 26 CFR 601.201, 1992 IRB LEXIS 380, 1992-33 I.R.B. 11 (Aug. 17, 1992), which affords a "safe harbor" for unfunded deferred compensation plans that use a "Rabbi Trust" in the manner described in that ruling. Although State Street's proposed investment arrangement does not involve use of a Rabbi Trust, State Street believes that the terms of its proposed arrangement generally are consistent with the terms and conditions of Revenue Procedure 92-64.

Plan assets for the exclusive benefit of participants (consistent with federal tax law), the Agreement will authorize State Street to obtain from a Plan Administrator a writing explaining that the Plan document is to be interpreted in this manner. State Street represents that in no event will it allow a Section 457 Plan to participate in the Trust if, in State Street's opinion, the Plan document contains any provision that would not permit it to be interpreted to require such "exclusive benefit" treatment.

Consistent with this "exclusive benefit" condition and the requirements of federal tax law, the Agreement will contain provisions that prohibit an employer from withdrawing Plan assets from the Trust except for one or more of the following reasons:

(1) to transfer Plan assets to a trustee in bankruptcy in the event of the employer's insolvency or bankruptcy, or to any other agent independent of the employer authorized to act in such proceedings;

(2) to satisfy the claims of general creditors of the employer in the event of the employer's insolvency or bankruptcy;

(3) to pay benefits to an employee participating under a Plan;

(4) to transfer assets to a Plan custodian or other person designated by a sponsoring employer in case the Agreement is terminated or a withdrawal is made for the purpose of using another investment manager or investment arrangement;

(5) to distribute Plan assets to participating employees in the event a Plan is terminated pursuant to a plan of liquidation; or

(6) to meet the following miscellaneous expenses related to Plan administration: (a) to reimburse an employer for any Plan benefits that may have been paid by the employer out of its other assets, or (b) to correct an excess deferral or other mistaken investment in the Trust.

The Agreement will define "insolvency", for purposes of clauses (1) and (2) above, as a circumstance in which an employer is unable to pay its debts as they become due or is subject to a pending proceeding as a debtor under the United States Bankruptcy Code.[5/] In this regard, the Agreement will require a Plan Administrator to represent that a withdrawal based on a claim of insolvency will be premised on a determination made by the highest governing body of the employer, as well as its highest executive officer, after notice of public hearing has been given and a public hearing has been held.

With respect to the conditions contained in clauses (4) and (5) above, the Agreement will contain a representation from the Plan Administrator that in no event will an employer be permitted to use Plan assets for its purposes when assets are withdrawn for the reasons stated in those clauses.

---

5/ This definition is consistent with the definition of "insolvency" contained in Revenue Procedure 92-64. See Section 3(a) of Rev. Proc. 92-64.

In addition, the Agreement will require a withdrawal request made for any of the reasons stated above in clauses (1) - (6) to be accompanied by written notification from the Plan Administrator explaining the reasons therefor. If the writing indicates that an employer wants to redeem units because it is insolvent, then such writing, in accordance with the provisions stated above for determining insolvency, will describe the procedures that were followed in making this determination. If the writing indicates that an employer is redeeming units because it wants to terminate its investment management arrangement with State Street, in whole or in part, then such writing will contain a representation from the terminating employer naming the person to whom such money should be transferred by State Street and affirming that the assets are not to be used for employer purposes. Under the Agreement, State Street will not be obligated to and will not release the proceeds of a withdrawal unless an employer includes this representation in its writing. The Agreement will also provide that, in deciding whether to honor a withdrawal request, State Street may rely on any such writing it reasonably believes was submitted in good faith by a participating employer.

State Street does not intend, by the foregoing provisions to be included in the Agreement, that any participant or beneficiary will have a vested or secured interest in the assets of the Trust, or any claim under a Plan, other than as a general creditor of an employer participating in the Trust.

## II.

## DISCUSSION

### A. Relevant Statutory Authority Under the Federal Securities Laws

The federal securities laws do not expressly provide an exemption for interests in a Section 457 governmental plan or to the plan itself, or for commingled investment funds that permit participation by such plans. The exemption from registration contained in Section 3(a)(2) of the Securities Act, on its face, limits the availability of the exemption to

> a governmental plan as defined in Section 414(d) of [the] Code which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries . . . .

Substantially similar provisions relating to governmental plans are contained in Section 3(a)(12) of the Exchange Act and, by reference to Section 3(a)(2)(C) of the

Securities Act, in Section 3(c)(11) of the Investment Company Act.

The governmental plan exemptions contained in Section 3(a)(2) of the Securities Act, Section 3(a)(12) of the Exchange Act, and Section 3(c)(11) of the Investment Company Act were added by the Small Business Investment Incentive Act of 1980 (the "1980 Amendments").[6/] A Commission Memorandum submitted to the United States Senate in support of the 1980 Amendments, and which was later made part of the legislative record, explained the reasons for enacting these provisions. In pertinent part, the Memorandum explained:

> Section 414(d) of the Internal Revenue Code provides special tax treatment for state and local employee benefit plans, and was added to the Code in 1978 in recognition of the fact that it is often difficult if not impossible for such plans to meet all the qualification requirements of Section 401, particularly the anti-discrimination requirements of Section 401(a), because the statutes establishing such plans prescribe a shorter vesting period for elected and appointed officials than for other covered employees in recognition of the reality of political life. [T]he Bill would make exemption from registration for bank and insurance company funding of public pension plans turn upon the plans' compliance with the substance of Section 401 as it is material to the operation of the securities laws, rather than on their compliance with all the technical requirements of that Section. Thus, it would provide an exemption from registration for bank and insurance company funding of Section 414(d) plans which have been established for the exclusive purpose of providing retirement benefits to employees

---

6/ See Pub. L. No. 96-477, §§ 701-03, 94 Stat. 2275, 2294-96 (1980).

> or their beneficiaries and whose funds are segregated and cannot be diverted to other purposes. The two requirements contained in the amendment are based upon Section 401(a)(1) and Section 401(a)(2) respectively, which are two of the three central provisions of Section 401.[7/]

As is evident from the foregoing, the Congressional policy underlying the employee benefit plan exemptions of the federal securities laws, as they relate to governmental plans, is that government employees generally receive adequate protection from their employers in connection with retirement plans established for their exclusive benefit, and that the protections afforded by registration under the federal securities laws are, therefore, unnecessary. Congress assured such protection for participants in a governmental plan relying on these exemptions by incorporating into Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act (and, by implication, Section 3(c)(11) of the Investment Company Act) the provisions of Sections 401(a)(1) and 401(a)(2) of the Code. These provisions effectively require a governmental plan to be administered for the exclusive benefit of participants, typically under trusteed or insured

---

7/ See 126 Cong. Rec. S 27272-74 (cum. ed. Sept. 25, 1980). The legislative history of the changes to the employee benefit plan exemptions to add governmental plans is recounted in Securities Act Release No. 33-6281 (Jan. 23, 1981).

arrangements, in order to receive tax-favored treatment. "Exclusive benefit" treatment is assured by requiring the trustee or insurer, as the case may be, to administer plan assets in a way that makes it impossible to use such assets unless the benefits owed to participants are first satisfied.

There is no indication in the legislative history that Congress, in describing the types of "governmental plans" that could rely on the employee benefit plan exemptions under the federal securities laws, attached any particular significance to the inclusion of the clause "as defined in section 414(d) of [the] Code" in the text of these exemptions. Nor is there anything, in the definition of "governmental plan" under Section 414(d) of the Code, that would be relevant in distinguishing such plan from other "governmental plans" defined elsewhere in the Code in determining the scope of these exemptions. In fact, as a technical matter, a "governmental plan" established by a State (or agency or instrumentality thereof) pursuant to Section 457 of the Code is a "governmental plan" (or, more accurately, an "eligible deferred compensation plan") established by such State (or agency or instrumentality thereof) pursuant to Section 414(d) of the Code.[8/] Operationally, however, the two types of plans could be very different depending on the extent to which the Section 414(d) plan provides for "exclusive benefit" treatment for participants under such plan and the extent to which the Section 457 Plan, consistent with federal tax law, could provide essentially for such treatment.

In light of the foregoing, it appears reasonable, in determining whether the employee benefit plan exemptions should be made available to Section 457 Plans and the pooled vehicles in which they invest, to focus appropriately on the extent to which "exclusive benefit" treatment would be afforded to participants in such plans under the State Street investment arrangement.

B. Applying the "Exclusive Benefit" Clause of the Employee Benefit Plan Exemptions to Section 457 Plans

A Section 457 governmental plan may not be administered for the "exclusive benefit" of participants, in the way that is expressly set forth in the employee benefit

---

8/ "Governmental plan" is defined in Section 414(d) of the Code simply as a "plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." The definition also includes "any plan to which the Railroad Retirement Act of 1935 or 1937 applies . . . and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act. . . ."

plan exemptions (i.e., by making it impossible to use plan assets unless the benefits owed to participants are first satisfied), without resulting in significant adverse tax consequences to participants in such plan. As noted, in order to qualify for favorable tax treatment, a Section 457 plan must be operated in accordance with the requirements of Section 457(b)(6) of the Code. In this regard, the assets held under such plan must remain at all times the "property and rights" of the sponsoring employer and must be reachable by general creditors of such employer.

The Congressional policy underlying the enactment of Section 457(b)(6) appears to be based mainly on the doctrine of "constructive receipt" of income. Under this doctrine, an employee is prohibited from acquiring a present interest in the contributions made to, or the assets held in, a Section 457 plan. Before the enactment of Section 457, sponsors of such plans had sought and obtained favorable rulings from the Internal Revenue Service allowing employees, under certain conditions predicated on the "constructive receipt" doctrine, to postpone their tax liability on deferred compensation until actual receipt under the plan. This doctrine was later incorporated into the Code in Section 457.

Although it is possible for the assets held in a Section 457 Plan to be used for employer purposes, we believe that the provisions State Street proposes to include in its Investment Management Agreement will ensure that this remains only a remote possibility, and that, as a practical matter, such assets will be administered substantially in accordance with the "exclusive benefit" provision of the employee benefit plan exemptions. In this regard, the Congressional policy underlying these exemptions will not be frustrated and will be substantially met under a State Street investment arrangement.

(1) <u>The Agreement Provisions Will Ensure That the Plan Will be Operated Fundamentally for the Benefit of Employees</u>

As noted, the Agreement will contain provisions which are intended to ensure that a Section 457 Plan participating in the Trust will be administered for the "exclusive benefit" of Plan participants (subject only to the requirements of federal tax law). Under the Agreement, the Plan document itself must provide for administering the Plan in this manner. If the Plan document does not contain such a provision, State Street will obtain a writing to this effect from a Plan Administrator, provided that the Plan document does not contain any provision which, in the opinion of State Street, would be deemed inconsistent with such treatment. These provisions, in our opinion, will ensure that, as a matter of fundamental Plan administration, an employer will not be permitted to use Plan assets for its own purposes.

Further towards this end, as noted previously, the Agreement will specify the limited cases in which the sponsor of a Section 457 Plan participating in the Trust will be permitted to make withdrawals from the Trust. As is evident from examining these cases, a withdrawal will be permitted only if it benefits a participating employee or if it is warranted because a sponsoring employer has been declared insolvent, after following certain procedures described in the Agreement, or has filed a petition for bankruptcy. In no other event will an employer be allowed to use Plan assets. A withdrawal based upon a partial or complete termination of the Agreement will be permitted only if the Plan Administrator affirms in writing that the employer does not intend to use Plan assets for its own purposes. In the opinion of State Street, these provisions will ensure that so long as a Section 457 Plan remains invested in the Trust, and even upon a termination of the Agreement, an employer could not use Plan assets to meet operating expenses.

(2) The Congressional Policy Underlying the Employee Benefit Plan Exemptions Will Not Be Frustrated

The proposed provisions to be included in the Agreement also will ensure that the fundamental

Congressional policy underlying the employee benefit plan exemptions of the federal securities laws would not be frustrated if a Section 457 Plan were to invest in the Trust. A participating Section 457 Plan will operate substantially along the lines of a Section 414(d) governmental plan that is administered in accordance with the "exclusive benefit" clause of the employee benefit plan exemptions (except, of course, to the extent necessary to retain tax qualification under Section 457 of the Code). In this regard, there will always be someone (such as the Plan Administrator, a designated trustee, or an insurer) charged with exercising fiduciary responsibilities in seeking to protect the interests of participants in the Plan.

Except in the unlikely event of insolvency or bankruptcy, and so long as a Section 457 Plan sponsor remains a "going concern", employee participation in the Plan will be very much like participating in a Section 414(d) governmental plan that is administered in accordance with the "exclusive benefit" clause of the employee benefit plan exemptions. As noted, depending on the provisions of a particular Plan, an employee, consistent with the provisions for qualifying as a Section 457 plan, may instruct its employer how to allocate contributions, including the earnings thereon, among available investment options. In addition, an employee eligible to receive benefits under the

Plan will receive benefits in a manner that would be indistinguishable from the manner of paying benefits under a Section 414(d) governmental plan properly relying on the employee benefit plan exemptions. The Plan Administrator, acting on behalf of employees in such cases, would perform his or her duties, for federal securities law purposes, in a manner that would be indistinguishable from the performance of such person's duties under a Section 414(d) governmental plan (administered in a manner that provides for "exclusive benefit" treatment for participants).

C. Previous No-Action Positions Taken by the SEC Staff Support this Request for Relief

Our request for no-action assurance is supported by positions taken by the Staff in several letters over the last ten years.9/ In those letters, the Staff agreed not to

---

9/ See, e.g., Wells Fargo Bank, N.A. (avail. Sept. 7, 1988); North Shore Savings & Loan Association (avail. Dec. 8, 1988) Nationwide Life Insurance Company (avail. May 12, 1989); Aetna Life Insurance Company (avail. Oct. 18, 1989); Fidelity Management Trust Company (avail. Nov. 2, 1989); Great West Life Annuity Insurance Co. (avail. Feb. 1, 1990); The Travelers Insurance Company (avail. Aug. 6, 1990); Hartford Life Insurance Company (avail. Jun. 24, 1992); The Lincoln National Life Insurance Company (avail. Oct. 26, 1992).

In addition to the foregoing, the Staff on previous occasions has granted no-action relief to Section 457 plans and their funding media in analogous circumstances. See, e.g., ICMA Retirement Trust (avail. Feb. 7, 1983) (offering of interests in a trust for commingled investment of Section 457 plans exempt under Section 3(a)(2) of the Securities Act and Section 2(b) of the Investment
(continued...)

recommend enforcement action to the Commission if various Section 457 plans sponsored by state or local governments were to participate in collective investment funds or in insurance company separate accounts relying on the employee benefit plan exemptions. The Staff's position in many of these letters, particularly the more recent, was premised on compliance with the following general conditions:

(1) the funding vehicle will be used for no purpose other than to fund one or more plans qualifying under Section 401(a) or Section 404(a)(2) of the Code;

(2) no assets held by the investment vehicles will be attributable to individual retirement accounts qualifying under Section 408 of the Code or to retirement plans qualifying under Section 403(b) of the Code;

(3) in the opinion of counsel, the plan will be a "governmental plan" within the meaning of the employee benefit plan exemptions under the federal securities laws;

(4) plan assets will not be used for any purpose other than for the exclusive benefit of plan participants, except that plan assets shall remain subject to the claims of general creditors of the employer to the extent necessary to preserve qualification of the plan under Section 457 of the Code; and

(5) the sponsor of the investment vehicle will give directly to all plan participants, or provide to each plan sponsor for actual distribution to all

---

9/ (...continued)
Company Act as an "instrumentality" of the government); Equitable Life Assurance Society (avail. Dec. 12, 1980) (offering of interests in a group annuity contract held in trust to Section 457 plans not subject to registration under the Securities and Investment Company Acts).

participants, brochures that prominently disclose (a) that the amounts allocated to the investment vehicle will be subject to the claims of general creditors of the employer under current tax law, and (b) the consequences to participants of this arrangement.[10/]

State Street will comply with each of the foregoing conditions as well as the additional conditions listed previously in this letter. In addition, State Street represents that employee contributions to a particular Section 457 Plan will not be invested in securities of the sponsoring employer or its controlled or commonly controlled entities. Taken together, these conditions would serve to bring a participating Plan as close as possible to the operation of a Section 414(d) governmental plan, which is being administered exclusively for the benefit of participants in such plan, without resulting in immediate taxation of employees participating thereunder.

D. No Apparent Policy Reason Supports A Need for Registration

Our request for no-action assurance also is supported by the absence of any cogent policy reason to require registration of the Trust or the offering of units therein in the circumstances. No legitimate investor protection concern apparently will be advanced in such case.

---

10/ This last condition has appeared in the most recent Section 457 no-action letters. See, e.g., The Lincoln National Life Insurance Company (avail. Oct. 26, 1992); Hartford Life Insurance Company (avail. Jun. 24, 1992).

First, it is questionable whether participants will receive any more disclosure than they currently receive if registration under the federal securities laws were required. Under current law, an issuer of units sold in a registered offering to Section 457 plans is required only to deliver prospectuses to the sponsor of such plan.[11/] A plan participant, therefore, in the case of a registered offering, is not certain to receive a statutory prospectus. Under the terms of this no-action request, by contrast, such persons will be assured of receiving some disclosure since State Street has undertaken in the Agreement to deliver brochures directly to plan participants, or to have such brochures delivered to such persons.

Second, it is questionable whether Plan participants would be any more protected by regulation under the Investment Company Act than if they were invested in a governmental plan that contained the "exclusive benefit" clause referred to previously. As noted, the provisions State Street proposes to include in the Agreement would

---

11/ We recognize, of course, that the Staff of the Division of Investment Management has recommended that the Commission seek legislation to require the delivery of prospectuses to employees in participant-directed, defined contribution plans. See Division of Investment Management, SEC, "Pooled Investment Vehicles for Employee Benefit Plan Assets," Protecting Investors: A Half Century Of Investment Company Regulation (1992) ("Protecting Investors Report"). It is not certain, however, whether the Division's recommendation covers the offering of units to Section 457 plans.

require the Plan to be administered exclusively for the benefit of participants in the Plan (subject, of course, to the requirements of federal tax law) and would require someone, such as the Plan Administrator, to exercise fiduciary responsibilities with respect to the assets of such Plan. Participants in such Plan, therefore, would have many of the substantive protections that ordinarily would be provided by registration under the Investment Company Act or, at least, many of the protections afforded under a governmental plan operated exclusively for the benefit of participants. Regulation under the Investment Company Act would, at best, provide marginal incremental protection to Plan participants.

## III.

## REQUESTED STAFF POSITION

On the basis of the foregoing, it is our opinion that the interests in the Trust to be issued to Section 457 Plans, in the manner described above, are exempt securities both under Section 3(a)(2) of the Securities Act and Section 3(a)(12) of the Exchange Act, and that the Trust would not be required to register under the Investment Company Act by virtue of the exemption afforded by Section 3(c)(11) thereof.

We would appreciate your advice that the Staff will not recommend to the Commission that any action be taken if State Street proceeds with its proposed offering without compliance with the various registration requirements of the federal securities laws. If, however, the Staff considers denying our no-action request, we would like to arrange a conference to discuss these issues. If you require additional information, please contact the undersigned at (202) 508-9574, or Robert E. Carlson at (213) 683-6299.

Sincerely,

Wendell M. Faria

Wendell M. Faria
for Paul, Hastings, Janofsky & Walker