

PTE 86-128
Executing Securities Transactions and Recapture of Commissions

Section I: Definitions and Special Rules

The following definitions and special rules apply to this exemption:

- (a) The term “person” includes the person and affiliates of the person.
- (b) An “affiliate” of a person includes the following:
 - (1) Any person directly or indirectly controlling, controlled by, or under common control with, the person;
 - (2) Any officer, director, partner, employee, relative (as defined in section 3(15) of ERISA), brother, sister, or spouse of a brother or sister, of the person;
 - (3) Any corporation or partnership of which the person is an officer, director or partner.

A person is not an affiliate of another person solely because one of them has investment discretion over the other’s assets. The term “control” means the power to exercise a controlling influence over the management or policies of a person other than an individual.
- (c) An “agency cross transaction” is a securities transaction in which the same person acts as agent for both any seller and any buyer for the purchase or sale of a security.
- (d) The term “covered transaction” means an action described in section II (a), (b) or (c) of this exemption.
- (e) The term “effecting or executing a securities transaction” means the execution of a securities transaction as agent for another person and/or the performance of clearance, settlement, custodial or other functions ancillary thereto.
- (f) A plan fiduciary is independent of a person only if the fiduciary has no relationship to or interest in such person that might affect the exercise of such fiduciary’s best judgment as a fiduciary.
- (g) The term “profit” includes all charges relating to effecting or executing securities transactions, less reasonable and necessary expenses including reasonable indirect expenses (such as overhead costs) properly allocated to the performance of these transactions under generally accepted accounting principles.
 - (h) The term “securities transaction” means the purchase or sale of securities.
- (i) The term “nondiscretionary trustee” of a plan means a trustee or custodian whose powers and duties with respect to any assets of the plan are limited to (1) the provision of nondiscretionary trust services to the plan, and (2) duties imposed on the trustee by any provision or provisions of the Act or the Code. The term “nondiscretionary trust services” means custodial services and services ancillary to

custodial services, none of which services are discretionary. For purposes of this exemption, a person does not fail to be a nondiscretionary trustee solely by reason of having been delegated, by the sponsor of a master or prototype plan, the power to amend such plan.

Section II: Covered Transactions

Effective the later of December 18, 1986, or the date on which the Office of Management and Budget approves the information collection requests contained in this exemption under the Paperwork Reduction Act of 1980, if each condition of section III of this exemption is either satisfied or not applicable under section IV, the restrictions of section 406(b) of ERISA and the taxes imposed by sections 4975 (a) and (b) of the Code by reason of section 4975(c)(1) (E) or (F) or the Code shall not apply to—

- (a) A plan fiduciary's using its authority to cause a plan to pay a fee for effecting or executing securities transactions to that person as agent for the plan, but only to the extent that such transactions are not excessive, under the circumstances, in either amount or frequency;
- (b) A plan fiduciary's acting as the agent in an agency cross transaction for both the plan and one or more other parties to the transaction; or
- (c) The receipt by a plan fiduciary of reasonable compensation for effecting or executing an agency cross transaction to which a plan is a party from one or more other parties to the transaction.

(d) *Exception. No relief from the restrictions of ERISA 406(b) and the taxes imposed by Code sections 4975(a) and (b) by reason of Code sections 4975(c)(1)(E) and (F) is available for the receipt of compensation as a result of the provision of investment advice within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) and regulations thereunder.*

Section III: Conditions

Except to the extent otherwise provided in section IV of this exemption, section II of this exemption applies only if the following conditions are satisfied:

- (a) The person engaging in the covered transaction is not a trustee (other than a nondiscretionary trustee) or an administrator of the plan, or an employer any of whose employees are covered by the plan. Notwithstanding the foregoing, this condition does not apply to a trustee (other than a nondiscretionary trustee) that satisfies Section III(h) and (i) of this exemption.
- (b) The covered transaction is performed under a written authorization executed in advance by a fiduciary of each plan whose assets are involved in the transaction, which plan fiduciary is independent of the person engaging in the covered transaction.
- (c) The authorization referred to in paragraph (b) of this section is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice of termination. A form expressly providing an election to terminate the authorization described in paragraph (b) of this section with instructions on the use of the form must be supplied to the authorizing fiduciary no less than annually. The instructions for such form must include the following information:
 - (1) The authorization is terminable at will by the plan, without penalty to the plan, upon receipt by the authorized person of written notice from the authorizing fiduciary or other plan official having authority to terminate the authorization; and
 - (2) Failure to return the form will result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the plan.
- (d) Within three months before an authorization is made, the authorizing fiduciary is furnished with any reasonably available information that the person seeking authorization reasonably believes to be necessary for the authorizing fiduciary to determine whether the authorization should be made, including (but not limited to) a

copy of this exemption, the form for termination of authorization described in section III(c), a description of the person's brokerage placement practices, and any other reasonably available information regarding the matter that the authorizing fiduciary requests.

- (e) The person engaging in a covered transaction furnishes the authorizing fiduciary with either:
- (1) a confirmation slip for each securities transaction underlying a covered transaction within ten business days of the securities transaction containing the information described in Rule 10b-10(a)(1-7) under the Securities Exchange Act of 1934, 17 CFR 240.10b-10; or
 - (2) at least once every three months and not later than 45 days following the period to which it relates, a report disclosing:
 - (A) A compilation of the information that would be provided to the plan pursuant to subparagraph (e)(1) of this section during the three-month period covered by the report;
 - (B) the total of all securities transaction related charges incurred by the plan during such period in connection with such covered transactions; and
 - (C) the amount of the securities transaction-related charges retained by such person and the amount of such charges paid to other persons for execution or other services.

For purposes of this paragraph (e), the words "incurred by the plan" shall be construed to mean "incurred by the pooled fund" when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

- (f) The authorizing fiduciary is furnished with a summary of the information required under paragraph (e)(1) of this section at least once per year. The summary must be furnished within 45 days after the end of the period to which it relates, and must contain the following:
- (1) The total of all securities transaction-related charges incurred by the plan during the period in connection with covered securities transactions.
 - (2) The amount of the securities transaction-related charges retained by the authorized person and the amount of these charges paid to other persons for execution or other services.
 - (3) A description of the person's brokerage placement practices, if such practices have materially changed during the period covered by the summary.
 - (4)
 - (i) A portfolio turnover ratio, calculated in a manner which is reasonably designed to provide the authorizing fiduciary with the information needed to assist in discharging its duty of prudence. The requirements of this paragraph (f)(4)(i) will be met if the "annualized portfolio turnover ratio", calculated in the manner described in paragraph (f)(4)(ii), is contained in the summary.
 - (ii) The "annualized portfolio turnover ratio" shall be calculated as a percentage of the plan assets consisting of securities or cash over which the authorized person had discretionary investment authority, or with respect to which such person rendered, or had any responsibility to render, investment advice (the "portfolio") at any time or times ("management period(s)") during the period covered by the report. First, the "portfolio turnover ratio" (not annualized) is obtained by dividing (A) the lesser of the aggregate dollar amounts of purchases or sales of portfolio securities during the management period(s) by (B) the monthly average of the market value of the portfolio securities during all management period(s). Such monthly average is calculated by totaling the market values of the portfolio securities as of the beginning and end of each management period and as of the end of each month that ends within such period(s), and dividing the sum by the number of valuation dates so used. For purposes of this calculation, all debt securities whose maturities

at the time of acquisition were one year or less are excluded from both the numerator and the denominator.

The “annualized portfolio turnover ratio” is then derived by multiplying the “portfolio turnover ratio” by an annualizing factor. The annualizing factor is obtained by dividing (C) the number twelve by (D) the aggregate duration of the management period(s) expressed in months (and fractions thereof).

Examples of the use of this formula are provided in section V of this exemption.

- (iii) The information described in this paragraph (f)(4) is not required to be furnished in any case where the authorized person has not exercised discretionary authority over trading in the plan’s account during the period covered by the report.

For purposes of this paragraph (f), the words “incurred by the plan” shall be construed to mean “incurred by the pooled fund” when such person engages in covered transactions on behalf of a pooled fund in which the plan participates.

- (g) If an agency cross transaction to which section IV(b) does not apply is involved, the following conditions must also be satisfied:

- (1) The information required under section III(d) or IV(d)(1)(B) of this exemption includes a statement to the effect that with respect to agency cross transactions the person effecting or executing the transactions will have a potentially conflicting division of loyalties and responsibilities regarding the parties to the transactions;
- (2) The summary required under section III(f) of this exemption includes a statement identifying the total number of agency cross transactions during the period covered by the summary and the total amount of all commissions or other remuneration received or to be received from all sources by the person engaging in the transactions in connection with those transactions during the period;
- (3) The person effecting or executing the agency cross transaction has the discretionary authority to act on behalf of, and/or provide investment advice to, either (A) one or more sellers or (B) one or more buyers with respect to the transaction, but not both.
- (4) The agency cross transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available; and
- (5) The agency cross transaction is executed or effected at a price that is at or between the independent bid and independent ask prices for the security prevailing at the time of the transaction.

- (h) A trustee [other than a nondiscretionary trustee] may only engage in a covered transaction with a plan that has total net assets with a value of at least \$50 million and in the case of a pooled fund, the \$50 million requirement will be met if 50 percent or more of the units of beneficial interest in such pooled fund are held by plans having total net assets with a value of at least \$50 million.

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

- (i) The trustee (other than a nondiscretionary trustee) engaging in a covered transaction furnishes, at least annually, to the authorizing fiduciary of each plan the following:

- (1) the aggregate brokerage commissions, expressed in dollars, paid by the plan to brokerage firms affiliated with the trustee;

- (2) the aggregate brokerage commissions, expressed in dollars, paid by the plan to brokerage firms unaffiliated with the trustee;
- (3) the average brokerage commissions, expressed as cents per share, paid by the plan to brokerage firms affiliated with the trustee; and
- (4) the average brokerage commissions, expressed as cents per share, paid by the plan to brokerage firms unaffiliated with the trustee.

For purposes of this paragraph (i), the words “paid by the plan” shall be construed to mean “paid by the pooled fund” when the trustee engages in covered transactions on behalf of a pooled fund in which the plan participates.

Section IV: Exceptions From Conditions

- (a) *Certain plans not covering employees.* Section III of this exemption does not apply to covered transactions to the extent they are engaged in on behalf of individual retirement accounts meeting the conditions of 29 CFR 2510.3-2(d), or plans, other than training programs, that cover no employees within the meaning of 29 CFR 2510.3-3.
- (b) *Certain agency cross transactions.* Section III of this exemption does not apply in the case of an agency cross transaction, provided that the person effecting or executing the transaction:
 - ~~(1) Does not render investment advice to any plan for a fee within the meaning of section 3(21)(A)(ii) of ERISA with respect to the transaction;~~
 - (1) ~~(2)~~ is not otherwise a fiduciary who has investment discretion with respect to any plan assets involved in the transaction, see 29 CFR 2510.3-21(d); and
 - (2) ~~(3)~~ does not have the authority to engage, retain or discharge any person who is or is proposed to be a fiduciary regarding any such plan assets.
- (c) *Recapture of profits.* ~~Section~~Sections III(a), III(h), and III(i) of this exemption ~~does do~~ not apply in any case where the person engaging in a covered transaction returns or credits to the plan all profits earned by that person in connection with the securities transactions associated with the covered transaction.
- (d) *Special rules for pooled funds.* In the case of a person engaging in a covered transaction on behalf of an account or fund for the collective investment of the assets of more than one plan (pooled fund):

(1) Sections III (b), (c) and (d) of this exemption do not apply if—

- (A) The arrangement under which the covered transaction is performed is subject to the prior and continuing authorization, in the manner described in this paragraph (d)(1), of a plan fiduciary with respect to each plan whose assets are invested in the pooled fund who is independent of the person. The requirement that the authorizing fiduciary be independent of the person shall not apply in the case of a plan covering only employees of the person, if the requirements of section IV(d)(2) (A) and (B) are met.
- (B) The authorizing fiduciary is furnished with any reasonably available information that the person engaging or proposing to engage in the covered transactions reasonably believes to be necessary to determine whether the authorization should be given or continued, not less than 30 days prior to implementation of the arrangement or material change thereto, including (but not limited to) a description of the person’s brokerage placement practices, and, where requested, any reasonably available information regarding the matter upon the reasonable request of the authorizing fiduciary at any time.

(C) In the event an authorizing fiduciary submits a notice in writing to the person engaging in or proposing to engage in the covered transaction 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 pooled fund, without penalty to the plan, within such time as may be necessary to effect the withdrawal in an orderly manner that is equitable to all withdrawing plans and to the nonwithdrawing plans. In the case of a plan that elects to withdraw under this subparagraph (d)(1)(C), the 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.

(D) In the case of a plan whose assets are proposed to be invested in the pooled fund subsequent to the implementation of the arrangement and that has not authorized the arrangement in the manner described in subparagraphs (d)(1) (B) and (C) of this section, the plan’s investment in the pooled fund is subject to the prior written authorization of an authorizing fiduciary who satisfies the requirements of subparagraph (d)(1)(A).

(2) Section III(a) of this exemption, to the extent that it prohibits the person from being the employer of employees covered by a plan investing in a pool managed by the person does not apply if—

(A) The person is an “investment manager” as defined in section 3(38) of ERISA, and

(B) Either (i) the person returns or credits to the pooled fund all profits earned by the person in connection with all covered transactions engaged in by the person on behalf of the fund, or (ii) the pooled fund satisfies the requirements of paragraph IV(d)(3).

(3) A pooled fund satisfies the requirements of this paragraph for a fiscal year of the fund if—

(A) On the first day of such fiscal year, and immediately following each acquisition of an interest in the pooled fund during the fiscal year by any plan covering employees of the person, the aggregate fair market value of the interests in such fund of all plans covering employees of the person does not exceed twenty percent of the fair market value of the total assets of the fund; and

(B) The aggregate brokerage commissions received by the person, in connection with covered transactions engaged in by the person on behalf of all pooled funds in which a plan covering employees of the person participates, do not exceed five percent of the total brokerage commissions received by the person from all sources in such fiscal year.

Section V: Examples Illustrating the Use of the Annualized Portfolio Turnover Ratio Described in Section III(f)(4)(ii)

(a) A, an investment manager affiliated with a brokerdealer that A uses to effect securities transactions for the accounts that it manages, exercises investment discretion over the account of plan P for the period January 1, 1987, through June 30, 1987, after which the relationship between A and P ceases. The market values of P’s account with A at the relevant times (excluding debt securities having a maturity of one year or less at the time of acquisition) are:

Date	Market
January 1, 1987	10.4
January 31, 1987	10.2
February 28, 1987	9.9
March 31, 1987	10.0
April 30, 1987	10.6
May 31, 1987	11.5

June 30, 1987	12.0
Sum of market value	74.6

Aggregate purchases during the 6-month period were \$850,000; aggregate sales were \$1,000,000, excluding in each case debt securities having a maturity of one year or less at the time of acquisition.

For purposes of section III(f)(4) of this exemption, A computes the annualized portfolio turnover as follows:

A= \$850,000 (lesser of purchases or sales)

B= \$10,657,143 (\$74.6 million divided by 7, i.e., the number of valuation dates)

Annualizing factor = $CD = 12/6 = 2$

Annualized portfolio turnover

ratio = $2 \times (850,000 /$

$10,657,143) = 0.160 = 16.0$ percent

(b) Same facts as (a), except that A manages the portfolio through July 15, 1987 and, in addition, resumes management of the portfolio on November 10, 1987 through the end of the year. The additional relevant valuation dates and portfolio values are:

Date	Market
July 15, 1987	12.2
November 10, 1987	9.4
November 30, 1987	9.6
December 31, 1987	9.8
Sum of Market Values	41.0

During the periods July 1, 1987 through July 15, 1987, and November 10, 1987 through December 31, 1987, there were an additional \$650,000 of purchases and \$400,000 of sales. Thus, total purchases were \$1,500,000 (i.e., \$850,000+\$650,000) and total sales were \$1,400,000 (i.e., \$1,000,000+\$400,000) for the management periods.

A now computes the annualized portfolio turnover as follows:

A = \$1,400,000 (lesser of aggregate purchases or sales)

B = \$10,509,091 (\$115.6 million divided by 11)

Annualizing factor = $C / D = 12 / (6.5 + 1.67) = 1.47$

annualized portfolio turnover

ratio = $1.47 \times (1,400,000 /$

$10,509,091) = 0.196 = 19.6$ percent.

Section VI. Effective Dates and Transitional Rule

(a) The effective date of Prohibited Transaction Exemption 86-128 is February 12, 1987.

(b) PTE 79-1 and PTE 84-46 are revoked effective June 1, 1987.

Summary report:	
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