

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

[Application No. D-10590, et al.]

**Proposed Exemptions; Bank of Oklahoma (the Bank) and First Tennessee National Corporation****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 request 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 request for a hearing (at least three copies) should be sent to the Pension and Welfare Benefits Administration, Office of Exemption Determinations, Room N-5649, U.S. Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210. Attention: Application No. \_\_\_, stated in each Notice of Proposed Exemption. 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-5638, 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.

**Bank of Oklahoma (the Bank) Located in Tulsa, OK**

[Application No. D-10590]

**Proposed Exemption**

Based on the facts and representations set forth in the application, the Department 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 in 29 CFR Part 2570, Subpart B (55 FR 32836, August 10, 1990).

**Section I. Covered Transactions**

If the exemption is granted, the restrictions of section 406(a) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (D) of the Code, shall not apply to the purchase or redemption of shares by an employee benefit plan (the Plan), in certain mutual funds that are either affiliated with the Bank (the Affiliated Funds) or are unaffiliated with the Bank (the Third Party Funds),<sup>1</sup> in connection with the participation by the Plan in the Bank-sponsored Foundations Program (the Foundations Program).

In addition, the restrictions of section 406(b) of the Act and the sanctions resulting from the application of section

<sup>1</sup> The Affiliated Funds and the Third Party Funds are collectively referred to herein as the Funds.

4975 of the Code, by reason of section 4975(c)(1)(E) and (F) of the Code, shall not apply to the provision, by the Bank, of asset allocation services to an independent fiduciary of a participating Plan (the Primary Independent Fiduciary) or to a participant (the Directing Independent Fiduciary) of a Plan that provides for participant investment direction (the Participant-Directed Plan), which may result in the selection of portfolios in the Foundations Program for the investment of Plan assets, by the Primary Independent Fiduciary or the Directing Independent Fiduciary, and the receipt of fees by the Bank and/or its affiliates.

This proposed exemption is subject to the conditions set forth below in Section II.

**Section II. General Conditions**

(a) The participation by a Plan in the Foundations Program is approved by a Primary Independent Fiduciary or a Directing Independent Fiduciary, in the case of a Participant-Directed Plan, and, no Plan covering employees of the Bank or any of its affiliates is eligible to participate in the Foundations Program.

(b) As to each Plan, the total fees that are paid to the Bank and its affiliates constitute no more than reasonable compensation for the services provided.

(c) With the exception of distribution-related fees that are paid to the Bank pursuant to Rule 12b-1 (the Rule 12b-1 Fees) of the Investment Company Act of 1940 (the Investment Company Act) which are offset, no Plan pays a fee or commission by reason of the acquisition or redemption of shares in the Funds.

(d) The terms of each purchase or redemption of shares in the Funds remain at least as favorable to an investing Plan as those obtainable in an arm's length transaction with an unrelated party.

(e) The Bank provides written documentation to each Plan's Primary Independent Fiduciary or Directing Independent Fiduciary of its recommendations, as well as on the design and parameters with respect to an asset allocation model (the Asset Allocation Model) based upon objective criteria that are uniformly applied.

(f) Any recommendation or evaluation made by the Bank to a Primary Independent Fiduciary or a Directing Independent Fiduciary is implemented only at the express direction of such fiduciary.

(g) The Bank retains an independent financial analyst (the Independent Financial Analyst) to—

(1) Review the investments of Plan assets in a Third Party Fund for purposes of performance and suitability;

(2) Review determinations by the Bank to add a Third Party Fund or replace an Affiliated Fund with a Third Party Fund; and

(3) Ensure that only one Fund fits an asset segment (the Asset Segment) such that there is no overlap between a Third Party Fund and an Affiliated Fund. Further, such Independent Financial Analyst may not derive more than 5 percent of its total annual revenues from the Bank and/or its affiliates.

(h) The quarterly fee that is paid by a Plan to the Bank and its affiliates for asset allocation and related services (the Wrap Fee) rendered to such Plan under the Foundations Program is offset by—

(1) All investment management fees (the Advisory Fees) that are paid to it and/or its affiliates by the Affiliated Funds;

(2) All non-advisory fees, including custodial fees, Rule 12b-1 Fees or subadministration fees (collectively, the Administrative Fees) that are paid to the Bank and/or its affiliates by the Affiliated Funds; and

(3) All Administrative Fees which include, but are not limited to, Rule 12b-1 Fees and sub-transfer agency fees, that are paid to the Bank and/or its affiliates by the Third Party Funds, such that the sum of the offset and the net Wrap Fee will always equal the aggregate Wrap Fee, thereby making the Bank's selection of Affiliated Funds or Third Party Funds for the Asset Allocation Models a "fee-neutral" decision.

(i) The Plan is automatically rebalanced on a quarterly basis (using net asset values of the affected Funds as of the close of business) on a pre-established date to the Asset Allocation Model previously prescribed by such fiduciary if authorized in writing by the Primary Independent Fiduciary, and if one or more Fund allocations deviates from the Asset Allocation Model prescribed by such fiduciary because—

(1) At least one transaction required to rebalance the Plan among the Funds involves a purchase or redemption of securities valued at \$100 or more; and

(2) The net asset value of the Fund affected would be more than 5 percent of the Plan's investment in such Fund.

(j) The Bank may make adjustments to the composition of the Asset Allocation Model (the Model Adjustments) unilaterally only within certain authorized parameters approved by the Primary Independent Fiduciary, or upon the consent of the Primary Independent Fiduciary, if the Bank proposes to exceed the parameters.

(1) If the Model Adjustment is made unilaterally pursuant to Section II(j) above, the Bank may only deviate from

the Normal Position of a given Asset Allocation Model within a specified range, not to exceed 15 percent (above and below) the Normal Position under Section III(1), which is applied to the Asset Allocation Model's entire allocation.

(2) With respect to a Model Adjustment requiring independent fiduciary consent, the Bank may not change the asset mix outside the limits authorized by the Primary Independent Fiduciary unless it provides the Primary Independent Fiduciary and the Directing Independent Fiduciary, upon the request of the Primary Independent Fiduciary, 30 days' advance written notice of the impending change.

(k) The notice referred to above in Section II(j) includes a termination advisory form (the Termination Advisory) which—

(1) Advises the Primary Independent Fiduciary of the right to withdraw from the Foundations Program or, in the case of the Directing Independent Fiduciary, of the right to transfer to a different Asset Allocation Model without penalty; and

(2) States that absent any affirmative action by the Primary Independent Fiduciary or the Directing Independent Fiduciary, the Plan will be reallocated within the revised Normal Positions for the Asset Allocation Model, effective as of a given date.

(1) The Bank provides the Termination Advisory to the Primary Independent Fiduciary and, if applicable, the Directing Independent Fiduciary, at least annually; and provides the Termination Advisory in all cases whenever the Bank—

(1) Makes a Model Adjustment where fiduciary consent is needed;

(2) Adds a new Fund to an Allocation Model;

(3) Removes an existing Fund within an Allocation Model; or

(4) Increases its Wrap Fee. Under such circumstances, the notice and Termination Advisory are provided at least 30 days prior to the implementation of the change.<sup>2</sup>

(m) With respect to its participation in the Foundations Program, prior to

<sup>2</sup> For an annual mailing of the Termination Advisory or in the event the Bank makes a Model Adjustment that is outside of current parameters or a Fund is added or substituted, the Termination Advisory will include language similar to that contained in Section II(k)(1) and (2). In the event the Bank proposes an increase in its Wrap Fee, the Termination Advisory will also include language similar to that contained in Section II(k)(1). However, under such circumstances, Section II(k)(2) will be modified state that absent any affirmative action by the Primary Independent Fiduciary or the Directing Independent Fiduciary, the revised Wrap Fee will be effective as of a specified date.

purchasing shares in the Affiliated Funds and the Third Party Funds, each Primary Independent Fiduciary, and, if applicable, each Directing Independent Fiduciary, receives the following written or oral disclosures from the Bank:

(1) A brochure describing the Foundations Program;

(2) A Foundations Program Asset Allocation Account Application;

(3) A Foundations Program Asset Allocation Account Purchase Order;

(4) A Foundations Program Account Agreement (the Account Agreement) providing detailed information on the Foundations Program; the fee structure of the Foundations Program; procedures and limitations imposed on the Bank with respect to Model Adjustments; rebalancing of a participating Plan investor's account; and the Bank's affiliation or non-affiliation with the Funds, including a copy of the executed Account Agreement between the Plan and the Bank, to the Primary Independent Fiduciary rather than to the Directing Independent Fiduciary;

(5) The Bank's Form ADV—Part II which contains a description of the Bank's affiliation, if any, with the sponsors, distributors, administrators, investment advisers, sub-advisers, custodians and transfer agents of each Affiliated Fund and Third Party Fund; and

(6) Copies of the proposed and final exemptions with respect to the exemptive relief described herein. (In the case of a Participant-Directed Plan, this information may be provided directly by the Bank to the Primary Independent Fiduciary for distribution to the Directing Independent Fiduciaries.)

(n) Having acknowledged receipt of the documents described in paragraph (m) of Section II, the Primary Independent Fiduciary submits a completed Account Agreement to the Bank and represents in writing to the Bank that such fiduciary is—

(1) Independent of the Bank and its affiliates;

(2) Knowledgeable with respect to the Plan in administrative matters;

(3) Able to make an informed decision concerning the Plan's participation in the Foundations Program; and

(4) Knowledgeable with respect to funding matters related to the Plan.

(o) In addition to the initial disclosures described above in paragraph (m) of this Section II, prior to investment in an Asset Allocation Model, the Primary Independent Fiduciary or, if applicable, the Directing Independent Fiduciary—

(1) Receives a written analysis from the Bank based on the fiduciary's Investor Profile as well as a description of the Asset Allocation Model recommended by a Bank's investment counselor which includes a description of the actual fee structure and the actual basis points to be rebated to such Plan fiduciary;

(2) Receives a prospectus for each Affiliated Fund and Third Party Fund in which the Plan may be invested and, upon such fiduciary's request, is provided a Statement of Additional Information which supplements the prospectus; and

(3) Acknowledges receipt of the foregoing documents in writing to the Bank.

(p) With respect to their ongoing participation in the Foundations Program, each Primary Independent Fiduciary and/or Directing Independent Fiduciary receives the following continuing disclosures from the Bank:

(1) Copies of applicable prospectuses;

(2) Written confirmations of each purchase or redemption of shares of an Affiliated Fund or a Third Party Fund, including transactions implemented as a result of a realignment of the Asset Allocation Model's investment mix or from the rebalancing of a Plan's investments in conformity with the selected Asset Allocation Model;

(3) Telephone quotations of such Plan's balance (or if relevant, individual account balances of Directing Independent Fiduciaries) under the Foundations Program;

(4) Periodic, but at least quarterly, account statements showing the Plan's value (or if relevant, individual account balances of Directing Independent Fiduciaries), a summary of purchase, sale and exchange activity and dividends received or reinvested and a summary of cumulative realized gain and/or loss;

(5) Semiannual or annual reports that include financial statements for the Funds as well as a description of the fees paid to the Bank and its affiliates;

(6) At least annually, a written or oral inquiry from the Bank to ascertain whether the information provided on the Investor Profile is still accurate and to determine if such information should be updated;

(7) A Termination Advisory provided on an annual basis as well as at other times noted in paragraph (1) of this Section II; and

(8) The Bank's investment advisory and other agreements with any Affiliated Fund as well as its distribution agreement pertaining to the Third Party Funds, upon request of the Primary Independent Fiduciary.

(Communications received from the Funds (e.g., prospectuses, annual reports, quarterly reports, notices regarding changes in Fund managers, proxy mailings, etc.) will be distributed to the Primary Independent Fiduciary, who may elect to pass them through to the Directing Independent Fiduciaries.)

(q) The Bank maintains, for a period of six years, the records necessary to enable the persons described in paragraph (r) of this Section II to determine whether the conditions of this 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 Bank 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 Bank 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 by paragraph (r) of this Section II below.

(r)(1) Except as provided in section (r)(2) of this paragraph and notwithstanding any provisions of subsections (a)(2) and (b) of section 504 of the Act, the records referred to in paragraph (q) of this Section II are unconditionally available at their customary location 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 Plan or any duly authorized representative of such fiduciary;

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

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

(r)(2) None of the persons described above in paragraphs (r)(1)(B)–(r)(1)(D) of this paragraph (r) are authorized to examine the trade secrets of the Bank or commercial or financial information which is privileged or confidential.

### Section III. Definitions

For purposes of this proposed exemption:

(a) The term "Bank" means the Bank of Oklahoma, N.A., a subsidiary of BOK Financial Corporation and any affiliate of the Bank, as defined in paragraph (b) of this Section III.

(b) An "affiliate" of the Bank includes—

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Bank.

(2) Any individual who is an officer, director or partner in the Bank or a person described in subparagraph (b)(1) of this Section III, and

(3) Any corporation or partnership of which the Bank or an affiliate or person described in subparagraphs (b)(1) or (b)(2) of this Section III, is a 10 percent or more partner or owner.

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

(d) The term "officer" means a president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), or any other officer who performs a policy-making function for the entity.

(e) The term "Plan" refers to an employee benefit plan which is eligible to participate under the Foundations Program. Such Plans are qualified under sections 401(a) and 501(a) of the Code and include Keogh plans (Keogh Plans); individual retirement accounts (IRAs); simplified employee pension plans (SEP-IRAs); Salary Reduction Simplified Employee Pensions (SARSEPs), provided that the SARSEP was established prior to January 1, 1996, the date as of which the Code provision authorizing such plans was repealed; and savings incentive match plans for employees (SIMPLEs); and, in the case of a Participant-Directed Plan, the individual account of a Directing Independent Fiduciary.

(f) The term "Directing Independent Fiduciary" means, as to a participating Plan, a participant in a Participant-Directed Plan that is authorized to direct the investment of his or her account balance.

(g) The "Administrative Fees" refer to custodial, Rule 12b–1 Fees, and sub-administration fees that are paid to the Bank or its affiliates from or on behalf of the Affiliated Funds on account of the Bank's services to the Affiliated Funds, as well as Rule 12b–1 Fees, sub-transfer agency fees and other fees that may be paid to the Bank or its affiliates on account of the investment of participating Plans in the Third Party Funds.

(h) The "Advisory Fees" refer to investment advisory fees that are paid by the Affiliated Funds to the Bank and its affiliates.

(i) The term "Affiliated Fund" means a portfolio of an investment company registered under the Investment Company Act for which the Bank or an affiliate of the Bank acts as the investment adviser, and may also serve as custodian or sub-administrator.

(j) The term "Asset Segment" refers to a subdivision of each asset class (the Asset Class) into which the Asset Allocation Model is divided (e.g., international equities is an Asset Segment under the Asset Class "stocks"). Asset Segments are determined by the Bank with reference to recognized investment objectives and styles established by independent mutual fund analysts such as Morningstar, Inc. (Morningstar) and Lipper Analytical Services, Inc. (Lipper).

(k) The "Investment Management Group" refers to a committee comprised of the Bank's senior investment professionals.

(l) The term "Model Adjustment" means an adjustment to the Normal Position of an Asset Allocation Model (i.e., a change in the Asset Allocation Model among the three Asset Classes, the division of the Asset Class into Asset Segments, and the identity of the Funds which represent the various Asset Segments).

(m) The "Normal Position" refers to the initial allocation of each Asset Allocation Model among the various Asset Classes, Asset Segments and Funds.

(n) The "Offset Fees" refer to the Advisory Fees and Administrative Fees that are paid by, or on behalf of, the Funds to the Bank and/or its affiliates and which are offset against the Wrap Fee.

(o) The term "Participant-Directed Plan" refers to a qualified Plan under which participants direct the investments of their individual accounts.

(p) The term "Primary Independent Fiduciary" refers to a plan fiduciary within the meaning of section 3(21)(A) of the Act who has (1) investment discretion and authority over the Plan's assets and (2) is not an affiliate of the Bank. Typically, the Primary Independent Fiduciary will be the plan administrator, the employer which sponsors the Plan, an investment committee appointed under the Plan document or an IRA account holder.

(q) The term "Termination Advisory" refers to the notice advising the Primary Independent Fiduciary or the Directing Independent Fiduciary of the right to withdraw from the Foundations Program without penalty. The Termination Advisory, which will

contain instructions on its use, will be provided to such participants on an annual basis, or whenever the Bank makes a Model Adjustment that is outside of a current Allocation Model, in the event a new Fund is added to an Allocation Model or an existing Fund is removed from an Allocation Model, or the Bank's Wrap Fee is increased. Depending on the circumstances precipitating its distribution, the Termination Advisory will include a provision advising the Primary Independent Fiduciary or the Directing Independent Fiduciary that absent any affirmative action by the Primary Independent Fiduciary or the Directing Independent Fiduciary, the authorization of the Plan's participation in the Foundations Program will continue, or the participating Plan will be reallocated in accordance with the revised Normal Position for the Asset Allocation Model in which the Plan's assets are invested, or the Bank's Wrap Fee will be increased. The Bank will provide the Termination Advisory to the Primary Independent Fiduciary and/or the Directing Independent Fiduciary at least 30 days prior to the implementation of the proposed change.

(r) A "Third Party Fund" is a portfolio of an investment company that is registered under the Investment Company Act for which neither the Bank nor any affiliate of the Bank acts as investment adviser, custodian and/or sub-administrator.

(s) The term "Wrap Fee" refers to the Plan or account-level fee the Bank, BOSC, Inc. (BOSC) and/or their affiliates charge each Plan for the asset allocation, custodial and related services under the Foundations Program.

(t) The term "Independent Financial Analyst" means an independent third party which has entered into a written contract with the Bank to (1) review the investment of Plan assets in a Third Party Fund, (2) review the Funds each time the Bank determines to add a Third Party Fund or replace an Affiliated Fund with a Third Party Fund, and (3) determine that only one Fund fits an Asset Segment such that there is no overlap between a Third Party Fund and an Affiliated Fund. The Independent Financial Analyst may not derive more than 5 percent of its total annual revenues from the Bank or its affiliates, including its fee for serving as the Independent Financial Analyst.

As for minimum credentials, the Independent Financial Analyst will be a Chartered Financial Analyst and will be employed by a firm which has at least a regional presence in the investment products and services industry. In addition, the individual assigned the

duties of the Independent Financial Analyst must alone, or with his or her employer, have a certain minimum number of years experience in the investment products and services industry and must not be affiliated with the Bank, BOSC or BISYS Fund Services, Inc. (BISYS). Should the Bank replace the Independent Financial Analyst, that entity must meet the same requirements applicable to the current Independent Financial Analyst. In addition, the Bank will be required to provide the Department with advance written notification of the change in Independent Financial Analysts and the qualifications of the successor. Unless the Department objects to the change, the Foundations Program will operate with the new Independent Financial Analyst.

#### *Summary of Facts and Representations*

##### *Description of the Parties*

1. The parties to the transactions discussed herein are described as follows:

(a) *The Bank* is a national bank headquartered in Tulsa, Oklahoma and a wholly owned subsidiary of BOK Financial Corporation, an Oklahoma corporation. The Bank maintains 60 branch banks in the Oklahoma City and Tulsa, Oklahoma metropolitan areas. It is the largest financial institution headquartered in Oklahoma and provides a full array of commercial banking and retail banking services while its non-bank subsidiaries engage in various bank-related services, including mortgage banking and providing credit life, accident and health insurance on certain loans originated by its subsidiaries. The Bank also offers a variety of trust and investment services for both corporate and individual customers. For corporate clients, these services include custodianship, trusteeship, management, administration and recordkeeping of pension plans, profit sharing plans (including 401(k) plans) and master trusts.

In addition, the Bank serves as custodian of IRAs, SEP-IRAs, SARSEPs and SIMPLE Plans and it sponsors non-standardized prototype plans. Further, the Bank and its subsidiaries provide investment advisory services to trust customers and mutual funds and they manage collective investment funds. As of December 31, 1999, the Bank and its affiliates had over \$8.1 billion in assets under management.

The Bank serves as each Affiliated Fund's investment adviser. Subject to the general supervision of the Affiliated Funds' Board of Trustees (the Trustees)

and in accordance with the investment objectives and restrictions of each Affiliated Fund, the Bank manages the Affiliated Funds, makes decisions with respect thereto, places orders for all purchases and sales of portfolio securities, and maintains each Affiliated Fund's records relating to such purchases. Neither the Bank nor any affiliate serves as the named distributor for any Fund.

(b) *BOSC* is a wholly owned subsidiary of the Bank and a full-service broker-dealer and investment adviser registered with the SEC and the National Association of Securities Dealers (NASD). The Bank utilizes members of *BOSC*'s sales force who have appropriate securities licenses to market the Foundations Program. However, *BOSC* will not perform any brokerage transactions on behalf of the Funds.

(c) *BISYS* and its wholly owned affiliate, *BISYS Fund Services Ohio, Inc.* (*BISYS Ohio*) are not affiliated with the Bank. *BISYS* is the administrator and distributor of each Affiliated Fund. *BISYS Ohio*, a registered transfer agent, serves as the transfer agent and performs fund accounting for the Affiliated Funds. For its administrative services, *BISYS* may receive, from the Affiliated Funds, an annualized fee of up to 0.20 percent of each Affiliated Fund's average daily net assets. Under each Affiliated Fund's Distribution and Shareholder Services Plan (the Distribution Plan), *BISYS* receives Rule 12b-1 Fees on a monthly basis. The current maximum annualized Rule 12b-1 Fees paid to *BISYS* is 0.25 percent of the average daily net assets of each Affiliated Fund. For its transfer agency and fund accounting services, *BISYS Ohio* may receive annual fees of up to 0.05 percent of each Affiliated Fund's average daily net assets.

(d) *CoreLink Financial, Inc. (CoreLink)* is an affiliate of *BISYS*. It is a full service broker-dealer and investment adviser registered with the SEC and the NASD. It is the clearing broker for all Foundations Program transactions and maintains custody of all of the securities held under the Foundations Program.

(e) *AMR Investments* of Fort Worth, Texas, has been retained by the Bank to serve as the Independent Financial Analyst for the Foundations Program. *AMR Investments* is a wholly owned subsidiary of *AMR Corporation*, the parent company of *American Airlines, Inc.* Incorporated in 1986, *AMR Investments* is directly responsible for the investment management and oversight of *AMR Corporation's* defined benefit and defined contribution plans, as well as fixed income investments.

*AMR Investments* also provides investment advisory services to institutional and retail clients and acts as manager of the *American AAdvantage Funds*, a family of diversified mutual funds. Further, *AMR Investments* offers customized fixed income portfolio management services. As a multibillion dollar asset management firm, *AMR Investments* has clients that include defined benefit plans, defined contribution plans, foundations, endowments, corporations and other institutional investors.

*AMR Investments* is not affiliated with the Bank, *BOSC* or *BISYS*. For services rendered to the Bank as the Independent Financial Analyst, *AMR Investments* may not derive more than 5 percent of its total annual revenues from the Bank and/or its affiliates, including its services as the Independent Financial Analyst.

(f) *The Plans* that are eligible to participate in the Foundations Program will consist of employee benefit plans that are qualified under sections 401(a) and 501(a) of the Code. The Plans will include Keogh Plans, IRAs, SEP-IRAs, SARSEPs (provided that the SARSEP was established prior to January 1, 1996, the date as of which the Code provision authorizing such plans was repealed) and SIMPLE plans as defined under 401(k)(11)(A) of the Code. The Bank may serve as an eligible Plan's trustee, custodian, recordkeeper or prototype sponsor. However, no Plan in which employees of the Bank or any of its affiliates participate will be eligible to invest in the Foundations Program.

#### The Funds

2. The Affiliated Funds consist of portfolios of the *American Performance Funds*, a diversified, open-end management investment company registered under the Investment Company Act. The Funds were organized as a Massachusetts business trust and began active operations in August 1990. Although the Affiliated Funds currently consist of ten separately-managed portfolios, it is represented that additional portfolios may be added in the future. Initially, eight Affiliated Fund portfolios will be available to investors under the Foundations Program.

Overall management and supervision of each Affiliated Fund rests with such Fund's Board of Trustees. Individual Trustees may be removed by the Board of Trustees or by the shareholders. The Trustees manage the Affiliated Funds in accordance with Massachusetts law governing business trusts. There are currently four Trustees, three of whom are not "interested persons." The

Trustees elect the officers of the Affiliated Funds who supervise such Funds' day-to-day operations. The members of the Board of Trustees receive fees and are reimbursed for their expenses in connection with each meeting of the Board of Trustees they attend, except that no Trustee who is an officer or employee of the Bank, any sub-adviser or *BISYS* receives any compensation from the Affiliated Fund for acting as a Trustee. The Affiliated Funds' officers receive no compensation from the Funds for performing the duties of their offices.

The Bank, in its capacity as investment adviser, and *BISYS*, in its capacity as administrator, bear all expenses incurred in connection with the performance of their duties, other than the cost of securities (including brokerage commissions) purchased for the Affiliated Funds. Such expenses may include, but are not limited to, taxes, interest, brokerage fees and commissions, fees and travel expenses for the Trustees of the Fund, SEC fees, state securities qualification fees, and the costs of preparing and printing prospectuses for regulatory purposes and for distribution to current shareholders.

3. The Third Party Funds are portfolios of diversified, open-end management investment companies registered under the Investment Company Act. They currently consist of the Federated Tax-Free Instruments, the Federated GNMA Trust, the Federated Bond Fund, Franklin Insured Tax-Free Income Fund, Federated Equity Income Fund, the Neuberger Berman Genesis Fund and the Templeton Foreign Fund. No Third Party Fund's sponsor, administrator, distributor, investment adviser or sub-adviser is affiliated with the Bank.

#### The Proposed Transactions

4. The Foundations Program is designed to make no-load Affiliated Funds and Third Party Funds available to an eligible Plan, thereby affording the Plan the opportunity to diversify its investments. The Foundations Program will also make professional asset allocation management available to a smaller Plan which may not have the benefit of such services. Moreover, by participating in the Foundations Program, a Primary Independent Fiduciary or a Directing Independent Fiduciary will receive a single, consolidated statement and pay a single asset management fee. Finally, all dealings between a Plan participating in the Foundations Program, the Funds and the Bank will remain on a basis which is at least as favorable to the Plan

as such dealings are with other shareholders of the Funds holding the same classes of shares as the Plan.

Accordingly, the Bank and BOSCO (together, the Applicants) request an administrative exemption from the Department in order to implement the Foundations Program for Plan investors. If granted, the exemption will provide relief from section 406(a) of the Act in order to permit the purchase or redemption of shares in the Affiliated Funds and the Third Party Funds by a Plan, in connection with the Plan's participation in the Foundations Program. In addition, the exemption will provide relief from section 406(b) of the Act to allow the Bank to provide asset allocation services to a Primary Independent Fiduciary or to a Directing Independent Fiduciary of a Participant-Directed Plan, which may result in the selection of portfolios by the Primary Independent Fiduciary or the Directing Independent Fiduciary in the Foundations Program for the investment of Plan assets and the receipt of fees by the Bank and/or its affiliates.

The Applicants are concerned that the Bank's fiduciary activities under the Foundations Program (*e.g.*, recommending an Asset Allocation Model, making a Model Adjustment or rebalancing a participating Plan's account) will cause the Plan to pay additional fees (*i.e.*, Advisory Fees and Administrative Fees) to the Bank or an affiliate of the Bank or cause the Bank or a Bank affiliate to receive consideration from a third party in connection with a transaction involving the Plan. The Applicants are concerned that the combination of services the Bank will provide under the Foundations Program, particularly, recommending an Asset Allocation Model, making Model Adjustments and rebalancing participating Plan accounts, may be deemed to constitute prohibited acts of self-dealing in violation of section 406(b)(1) of the Act. Therefore, the Applicants request exemptive relief from the Department for the transactions that are described above.

#### Operation of the Foundations Program

5. An eligible Plan's Primary Independent Fiduciary may decide to enroll a Plan in the Foundations Program. The minimum investment required to establish an account in the Foundations Program is \$10,000. In the case of a Participant-Directed Plan, the minimum applies to each account in the participating Plan. From time to time, however, the Bank may lower or waive the minimum investment amount.

At any time, a Primary Independent Fiduciary or a Directing Independent

Fiduciary may add or withdraw assets of a Plan to or from the Foundations Program (subject to a \$100 minimum redemption and purchase requirement per participating Plan which will continue to apply after the first year). In the case of a Participant-Directed Plan, the \$100 limit will apply to each account in the Plan and the contributions will be held in the American Performance U.S. Treasury Fund, an Affiliated Fund, until such amounts reach \$1,000,<sup>3</sup> at which time the contributions will be liquidated and the proceeds invested pursuant to the appropriate Asset Allocation Model.<sup>4</sup> The \$100 limit will not apply if the participating Plan is completely liquidated (*e.g.*, the participant terminates employment with the plan sponsor).

6. Each participating Plan's Primary Independent Fiduciary or Directing Independent Fiduciary will complete an Investor Profile and submit it to an investment counselor employed by the Bank or an affiliate who will interact with the Plan investor. The Investor Profile is a written questionnaire designed by BISYS and the Bank to assess such fiduciary's risk tolerance and financial objectives as they apply to the participating Plan. In the case of a single-participant Plan such as an IRA, the Bank will distribute the Investor Profile and other materials directly to the Primary Independent Fiduciary. In the case of a Participant-Directed Plan, the Bank will provide Investor Profiles and other information on the Foundations Program, at the Primary Independent Fiduciary's discretion, either to the Primary Independent Fiduciary for distribution to the Directing Independent Fiduciary or, directly to the Directing Independent Fiduciary. If requested by a Primary Independent Fiduciary, the Bank may also provide additional information or documentation that is provided to such Primary Independent Fiduciary to the Directing Independent Fiduciaries.

The responses to the Investor Profile will be analyzed by investment counselors, employed by the Bank or an affiliate, utilizing software developed and maintained by BISYS. Applying objective criteria to the results of the analysis, the Bank will recommend a

<sup>3</sup> Because of the regularly scheduled rebalancing of each Plan investor's account, the \$1,000 threshold for contributions will not apply each year to new employer or employee contributions.

<sup>4</sup> The Department is not providing, nor have the Applicants requested relief from the provisions of section 404(c) of the Act with respect to the Bank's temporary holding of contributions by a Participant-Directed Plan in the American Performance U.S. Treasury Fund.

particular Asset Allocation Model which is appropriate for the participating Plan. The Asset Allocation Model will also describe the fee structure to be applied and the actual number of basis points to be rebated to the Plan investor and will use a spreadsheet to show how the rebate is determined.

In conjunction with the recommendation, the Bank will provide each Primary Independent Fiduciary or Directing Independent Fiduciary with written materials explaining (a) market risk, (b) what to consider when assessing one's own risk tolerance and investment objectives, (c) historical risk and return characteristics of various Asset Classes and Asset Segments, (d) the advantage of diversifying to reduce market risk, and (e) historical risk and return characteristics of various strategically-allocated portfolios. The Bank, through the investment counselor, may also describe other Asset Allocation Models that are available to the Plan and provide additional educational materials to the Primary Independent Fiduciary or the Directing Independent Fiduciary.

Before participating in the Foundations Program, each Primary Independent Fiduciary or Directing Independent Fiduciary will also be shown the historical performance of the recommended Asset Allocation Model, including the number of years in which it has produced a negative return, the average loss in each such year, the average annual return, and the performance during the Model's five best and worst years. The Primary Independent Fiduciary or the Directing Independent Fiduciary may then accept the Bank's recommendation or invest the Plan in another Asset Allocation Model. The Plan will not be permitted to invest under the Foundations Program until the Primary Independent Fiduciary or the Directing Independent Fiduciary affirmatively directs the Bank to invest Plan assets under a particular Asset Allocation Model.

At any time, a Primary Independent Fiduciary or a Directing Independent Fiduciary may submit a new Investor Profile or choose a different Asset Allocation Model. At least annually, the Bank will ask each Primary Independent Fiduciary or Directing Independent Fiduciary, in writing, whether any information included on the Investor Profile has changed. The Bank will analyze and respond to a new Investor Profile in the same manner that it responds to the original Investor Profile.

7. Currently, the Bank has developed five Asset Allocation Models. They are the Capital Preservation Model, the

Income Model, the Growth & Income Model, the Growth Model and the Aggressive Growth Model. In addition to the present Asset Allocation Models, the Bank proposes to add more Asset Allocation Models to the Foundations Program in the future.

Each Asset Allocation Model will allocate a participating Plan's assets among three major Asset Classes: cash equivalents, bonds and stocks. For example, the Bank's Capital Preservation Model is invested in Asset Classes in the following percentages: Cash Equivalents (15 percent), Bonds (60 percent) and Stocks (25 percent). Each Asset Class will be further allocated into one or more Asset Segments, each of which represents a class of investment that the Bank believes is necessary to achieve the proper mix of risk and return in an Asset Class. To this end, the Bank will use a current list of mutual fund investment objectives and investment styles developed by Morningstar and Lipper, independent mutual fund analysts to determine the appropriate Asset Segments for a particular Asset Class.<sup>5</sup> The Bank will utilize Morningstar to classify equity Asset Segments and Lipper to classify fixed-income Asset Segments (including money market funds which Morningstar does not classify). For example, the Stock Asset Class under the Bank's Capital Preservation Model will include investments in three Funds (the Templeton Foreign Fund, the American Performance Equity Fund and the American Performance Growth Equity Fund) representing three Asset Segments (international stocks, income-producing stocks and growth equity stocks), respectively.

The Bank's Investment Management Group, which is comprised of the Bank's senior investment professionals, will determine the allocation of each Asset Allocation Model among the major Asset Classes, as well as the allocation of the major Asset Classes among the Asset Segments. In effect, the Investment Management Group will follow the classification systems devised by Morningstar and/or Lipper in order to fill particular Affiliated Funds or Third Party Funds within the given Asset Segments.

#### Model Adjustments

8. The Bank's Investment Management Group creates and monitors the composition of the Asset

Allocation Models and reviews each Model's composition at least monthly. As noted in Representation 7, the Investment Management Group also determines the Asset Allocation Model's division among the three Asset Classes, the division of each Asset Class into Asset Segments and the allocation of each Asset Segment among the Affiliated Funds and the Third Party Funds.<sup>6</sup> The breakdown among the Asset Classes and the Funds which comprise those classes when a participating Plan is first invested pursuant to the Asset Allocation Model is the Model's "Normal Position." The Investment Management Group may adjust the Normal Position periodically as dictated by changing economic and market conditions. There are two types of Model Adjustments: (a) Those that the Bank may make unilaterally and (b) those that require the consent of the Primary Plan fiduciary. Any deviation from the Normal Position will apply to the Plan assets invested pursuant to the Asset Allocation Model both prior to and after the deviation (*i.e.*, both old and new money).<sup>7</sup>

A Model Adjustment does not include the substitution of a Fund but is deemed necessary to effect a change to an Allocation Model due to market

<sup>6</sup> As discussed in Representation 11, the Investment Management Group will select a Third Party Fund to fill an Asset Segment only when (a) an Affiliated Fund representing that Asset Segment does not exist or (b) an Affiliated Fund representing the Asset Segment exists but it is not an "equivalent" to the Third Party Fund. To be equivalent to a Third Party Fund, an Affiliated Fund must have been publicly offering shares for at least one year. The total return performance for the Affiliated Fund must be equal to or exceed the total return performance of the Third Party Fund for either the most recent one year reporting period or the annualized three, five or ten year reporting periods. Further, the total expense ratio for the Affiliated Fund, determined in accordance with SEC rules for performance, must not be higher than the relevant Third Party Fund. In addition, as noted above, the Bank will determine which Fund fits within an Asset Segment based upon criteria developed by Morningstar and Lipper as to what type of Fund should fill that Asset Segment. As discussed in Representation 13, the Independent Financial Analyst, using Morningstar or Lipper classification criteria, will compare the Third Party Funds with the Affiliated Funds.

<sup>7</sup> In this regard, once the Normal Position is adjusted, the revised Normal Position will be applied to the entire Plan rather than only to amounts contributed to the Plan after the effective date of the adjustment. For example, assume that a Plan has invested \$100,000 in Asset Allocation Model X, which is equally divided between Funds A and B. Because the Plan has been rebalanced, it has almost equal amounts invested in Funds A and B, despite their uneven earnings. When Asset Allocation Model X is adjusted to provide for a 55 percent investment in Fund A and a 45 percent allocation to Fund B, the entire \$100,000 in the plan will be invested, accordingly—*i.e.*, \$55,000 in Fund A and \$45,000 in Fund B. Future contributions to the Plan will be allocated in a similar manner.

conditions. The Bank anticipates that Funds will be substituted only under extraordinary circumstances (see Representation 14) whereby advance notice will be given to the Primary Independent Fiduciary to effect the change. Accordingly, a Model Adjustment and a Fund substitution are treated as a separate process by the Bank.

With respect to unilateral Model Adjustments, the Account Agreement entered into by each Primary Independent Fiduciary will authorize the Bank to deviate from the Normal Position of a given Asset Allocation Model within a specified range, not exceeding 15 percent above or below the Normal Position. The Model Adjustment will be made for all clients having the same Asset Allocation Model. The percentage will be applied to the Model's entire allocation, so the adjusted stock position of, for example, the Capital Preservation Model (the Normal Position of which has 25 percent invested in stocks), could range from 10 percent to 40 percent. The specified range may be higher for a deviation from the Asset Allocation Model's cash position which will be governed by the Account Agreement. Any change to an Asset Class will be separately allocated among the Asset Segments.

A corresponding decrease in an Asset Class must also fall within the authorized deviation parameters. Further, the original Normal Position will remain the standard for determining whether future Model Adjustments fall within the acceptable range.

9. The Bank may not change the Normal Position (*i.e.*, deviate more than the range specified in the Account Agreement) without providing the Primary Independent Fiduciary of each participating Plan that is invested pursuant to the affected Asset Allocation Model with a written notice of the impending change at least 30 days in advance of its effective change. If requested by the Primary Independent Fiduciary of a Participant-Directed Plan, the Bank will provide this notice to each Directing Independent Fiduciary. The 30 day notice period is intended to give the Primary Independent Fiduciary or the Directing Independent Fiduciary time to withdraw from the Foundations Program if he or she elects not to have the change made. The notice will include a Termination Advisory which will advise the Primary Independent Fiduciary or the Directing Independent Fiduciary (a) of his or her right to withdraw from the Foundations Program without penalty and (b) that

<sup>5</sup> The Bank will use the classification services provided by Morningstar and Lipper unless circumstances beyond its control require that the Bank select another independent, established mutual fund analyst.



absent affirmative action by the Primary or Directing Independent Fiduciary, the Plan will be reallocated in accordance with the revised Normal Positions for the Asset Allocation Model, effective as of a given date.

If the Bank makes a Model Adjustment outside of the specified limits, the new allocation percentages will become the revised Normal Position for the Asset Allocation Model. The Account Agreement will then authorize the Bank to again deviate within the specified ranges and will require the 30 day notice and Termination Advisory described above for a shift outside the revised Normal Position.

#### Rebalancing

10. After a participating Plan is invested in an Asset Allocation Model, varying performance results among the Funds that comprise the Asset Allocation Model will eventually cause a Plan to fail to meet the Normal Position set forth in the applicable Asset Allocation Model. Therefore, prior to the end of each calendar quarter, the Bank will review each participating Plan to determine whether its allocation among the Funds will be materially out of line with the parameters prescribed by the Asset Allocation Model. The Bank will apply the net asset value of the affected Funds as of the end of each calendar quarter. A Plan is materially out of line with the Asset Allocation Model parameters if at least one transaction required to rebalance the participating Plan among the Funds (a) would involve a purchase or sale of securities valued at \$100 or more, or (b) the net asset value of the Fund affected would represent more than 5 percent of the Plan's investment in such Fund. If a participating Plan is rebalanced, the Bank will buy and sell Fund shares from the distributor at net asset value, as of the close of business on a pre-established date within 5 business days prior to the end of the calendar quarter, in the amounts necessary to bring the participating Plan back into conformity with the appropriate Asset Allocation Model at the Asset Segment level. There will be no cross-trading of securities between the Funds. Neither the Bank nor its affiliates will receive commissions from such sales and the participating Plans will not be charged a redemption fee.

The Account Agreement will disclose the circumstances under which a participating Plan will be rebalanced and the date on which the necessary trades will occur. It is represented that rebalancing will not involve the exercise

of any investment discretion by the Bank.

The Primary Independent Fiduciary or the Directing Independent Fiduciary will not be given the option of not having their account in the Plan rebalanced because this, according to the Bank, will undermine the Asset Allocation Model concept. As noted herein, each Primary Independent Fiduciary or Directing Independent Fiduciary will, however, have the option of selecting another Asset Allocation Model or withdrawing from the Foundations Program.

#### Fund Monitoring

11. The Bank's Investment Management Group will select and periodically review the performance and continued suitability of the Affiliated and Third Party Funds that are included within each Asset Allocation Model. The Investment Management Group will select an Affiliated Fund to fill an Asset Segment when there is an appropriate Affiliated Fund but will select Third Party Funds when (a) an Affiliated Fund representing that Asset Segment does not exist or (b) an Affiliated Fund representing the Asset Segment exists but it is not an "equivalent" of the Third Party Fund. As noted above, an Affiliated Fund is deemed the equivalent of a Third Party Fund if (a) the Affiliated Fund has been publicly offering shares for at least one year, (b) total return performance of the Affiliated Fund is equal to or exceeds the total return performance of the Third Party Fund for either the most recent one year reporting period or the annualized three, five or ten year reporting periods, and (c) the total expense ratio, determined in accordance with SEC rules for performance, is not higher than the relevant Third Party Fund.<sup>8</sup>

12. To review the selection by the Investment Management Group of a Third Party Fund to fill an Asset Segment, the Bank will retain the Independent Financial Analyst. As stated previously, the Independent Financial Analyst may not derive more than 5 percent of its total annual revenues from the Bank or its affiliates, including its fee for serving as the Independent Financial Analyst. As for minimum credentials, the Independent Financial Analyst must be a Chartered Financial Analyst and employed by a

firm which has at least a regional presence in the investment products and services industry. In addition, the individual assigned the duties of the Independent Financial Analyst must alone, or with his or her employer, have a certain minimum number of years experience in the investment products and services industry and must not be affiliated with the Bank, BOSC or BISYS.

Should the Bank replace the Independent Financial Analyst, that entity must meet the same requirements applicable to the current Independent Financial Analyst. Under such circumstances, the Bank will be required to inform the Department 60 days in advance of the change. In addition, the Bank will also be required to describe the qualifications of the successor. Unless the Department objects to the change within 60 days of notification, the Foundations Program will continue to operate with the new Independent Financial Analyst.

13. On an annual basis, the Independent Financial Analyst will determine whether the use of a Third Party Fund during the previous year has satisfied the selection criteria set forth in Representation 11. (To recap, no Affiliated Fund is in existence and if in existence, the Affiliated Fund is not equivalent to the Third Party Fund.) The Independent Financial Analyst will also determine that the Third Party Fund considered by the Bank represents the correct Asset Segment based upon Morningstar or Lipper classifications. If the Independent Financial Analyst determines that a Third Party Fund has been used under circumstances which do not satisfy these criteria, an appropriate Affiliated Fund will be substituted after appropriate notice (*i.e.*, the Termination Advisory) is given to the Primary Independent Fiduciary or the Directing Independent Fiduciary, if applicable. (See Representation 14.)

Additionally, the Independent Financial Analyst will review the Funds each time the Bank determines to add a Third Party Fund or replace an Affiliated Fund with a Third Party Fund. In this regard, the Independent Financial Analyst will be required to certify that the proposed change satisfies the "in existence" and "equivalence" criteria set forth above in Representation 11 before the effective date of the change.

Further, the Independent Financial Analyst will be required to determine that for an Asset Segment there is no overlap between a Third Party Fund and an Affiliated Fund. Specifically, the Independent Financial Analyst will determine (a) that the array of Third

<sup>8</sup> As noted previously, assuming there are 75 Small Cap International Funds within the universe of Third Party Funds, the Independent Financial Analyst will examine all of the relevant Funds using the Morningstar or Lipper classification systems.



Party and Affiliated Funds does not include two or more Funds which are in the same classification under both the Morningstar and Lipper classification systems; and (b) that no Third Party Fund which is to be added is in the same Asset Class as an existing Affiliated Fund under both the Morningstar and Lipper classification systems.

14. If the Investment Management Group determines that an Affiliated Fund or a Third Party Fund should be replaced with another Fund, the Bank will give written notice to the Primary Independent Fiduciary of each participating Plan which is invested in the affected Asset Allocation Model at least 30 days in advance of the effective date of the Fund change. If requested by the Primary Independent Fiduciary, the Bank will also provide this notice to each Directing Independent Fiduciary. The notice will also include a Termination Advisory that will advise the Primary Independent Fiduciary of the right to withdraw from the Foundations Program or allow the Directing Independent Fiduciary to transfer to a different Asset Allocation Model without penalty.

#### Fee Structure

15. As to each investing Plan, the total fees that are paid to the Bank and its affiliates will constitute no more than reasonable compensation for the services provided to the participating Plans. In this regard, the Bank and its affiliates will receive four types of fees: (a) Advisory Fees from the Affiliated Funds,<sup>9</sup> (b) Non-Advisory Fees from the Affiliated Funds (*i.e.*, Administrative Fees), (c) Administrative Fees from the Third Party Funds, and (d) the Wrap Fee paid by each participating Plan at the Plan-level. All fees received from sources other than the participating Plan or the Plan's sponsor will be applied to offset the Plan's legal obligation to the Bank and its affiliates. Under no circumstances will such fees increase the compensation received by the Bank or its affiliates.<sup>10</sup>

<sup>9</sup> It should be noted that Advisory Fees may also be paid by the Affiliated Funds to unrelated sub-advisers who may be retained by the Bank in the future to perform investment management and/or advisory services to Plans investing under the Foundations Program. These sub-advisory fees are not applied to offset the Plan's legal obligation to the Bank and should be considered by the appropriate Plan fiduciary in evaluating the appropriateness of the Foundations Program.

<sup>10</sup> The fact that certain transactions and fee arrangements are the subject of an administrative exemption does not relieve the fiduciaries of the Plans from the general fiduciary responsibility provisions of section 404 of the Act. Thus, the Department cautions Primary Independent Fiduciaries of Plans investing in the Funds that

(a) *Advisory Fees.* The annualized Advisory Fees of the Affiliated Funds, which range from 0.40 percent to 0.69 percent, are calculated daily and paid monthly on the Affiliated Fund's average daily net assets. However, the Bank may, from time to time, waive all or a portion of the Advisory Fee. Each fee arrangement between the Bank and an Affiliated Fund must be approved by the Board of Trustees of the Affiliated Fund, including a majority of the Trustees who are not "interested persons."

(b) *Administrative Fees from the Affiliated Funds and BISYS.* The Bank is compensated for acting as custodian to the Affiliated Funds. For its custodial services, the Bank currently receives an annual fee of 0.03 percent of the average daily net assets of each of the Affiliated Funds.

In addition, the Bank may receive Administrative Fees from BISYS in the form of annualized Rule 12b-1 Fees, pursuant to each Affiliated Fund's Distribution Plan. Such Rule 12b-1 Fees will not exceed 0.25 percent of the average daily net assets of each Affiliated Fund.<sup>11</sup>

Further, BISYS currently retains the Bank as sub-administrator to the Affiliated Funds. BISYS presently pays the Bank an annualized fee of 0.05 percent of each Affiliated Fund's daily net assets.

(c) *Administrative Fees from the Third Party Funds.* The Third Party Funds may pay Administrative Fees such as Rule 12b-1 Fees or similar fees to the Bank or its affiliates for shareholder services (*e.g.*, fund recordkeeping, accounting in connection with a participating Plan's purchase or redemption of shares of the Third Party Fund, processing purchase and redemption transactions involving the Plans and providing mutual fund enrollment material to Primary or Directing Independent Fiduciaries). The

they have an ongoing duty under section 404 of the Act to monitor the services provided to the Plans to assure that the services remain appropriate and that the fees paid by the Plans for such services are reasonable in relation to the value of the services provided. In considering whether to enter into the arrangement for the provision of asset allocation services, the Department emphasizes that it expects the Primary Independent Fiduciary to fully understand the operation of the Foundations Program and the compensation paid thereunder, following disclosure by the Bank of all relevant information pertaining to the Program.

<sup>11</sup> Under each Affiliated Fund's Distribution Plan, the Fund pays BISYS Rule 12b-1 Fees on a monthly basis [see Representation 1(c)] in order to provide distribution assistance to, or compensate financial intermediaries, broker-dealers or similar entities (including the Bank and affiliates or subsidiaries of BISYS and/or the Bank) for providing shareholder services.

annualized Administrative Fees range from 0.08 percent to 0.50 percent.

(d) *The Plan-Level Wrap Fee.* For their asset allocation, custodial and related services, the Bank, BOSCO, and/or their affiliates will charge each participating Plan an annual investment fee (*i.e.*, the Wrap Fee). If the Plan's average daily value (including amounts invested in either the Third Party Funds or Affiliated Funds) is less than \$25,000, the Wrap Fee will equal 1.80 percent of \$25,000, unless the minimum investment amount is lowered, in which case the Wrap Fee will equal 1.80 percent of the minimum investment. For balances greater than the minimum investment, the fee will be calculated as follows: 1.80 percent on \$1-\$99,999; 1.55 percent on \$100,000-\$249,999; and 1.45 percent on any balance above \$250,000. Breakpoints will be calculated on a per-participating Plan basis rather than on each account in that Plan.

From time to time, the Bank may increase or reduce the Wrap Fee. In the event of a Wrap Fee increase, the Bank will notify the Primary Independent Fiduciary or, if applicable, the Directing Independent Fiduciary, of the impending increase at least 30 days prior to its effective date of the change. The written notification will include a Termination Advisory and remind the Primary Independent Fiduciary of the impending increase at least 30 days prior to its effective date. The written notification will include a Termination Advisory which will (a) advise the Primary Independent Fiduciary or the Directing Independent Fiduciary of the right to withdraw from the Foundations Program without penalty; and (b) state that absent any affirmative action by the Primary Independent Fiduciary or the Directing Independent Fiduciary, the new Wrap Fee will be effective no earlier than 30 days after the receipt of the notice and the Termination Advisory.

The Wrap Fee is assessed quarterly in arrears on the Plan's average daily net asset value during the quarter. The Wrap Fee will be deducted directly from the Plan.

#### Fund Fees and Offset

16. As noted in Representation 15, the Bank and its affiliates may receive, either directly or indirectly, various fees from the Affiliated Funds and the Third Party Funds which will be fully disclosed to investors in applicable prospectuses. The Bank proposes to offset all Advisory Fees, Administrative Fees and Rule 12b-1 Fees that are paid to it and its affiliates with respect to a Plan's investment in a Fund (collectively, the Offset Fees), from the

quarterly Wrap Fee charged to that Plan. The Bank believes that the offset will eliminate any conflict of interest which may exist as a result of the fact that an investment in certain Funds would generate higher overall fees for the Bank and its affiliates, and will also eliminate any indirect benefit that the Bank may gain by including Funds that pay higher Advisory or Administrative Fees in the Asset Allocation Models.

The Bank will deduct the Offset Fees as follows. At the end of each quarter, the Bank will calculate the revenues that it received during the quarter in the form of Offset Fees on a *pro rata* basis for each Plan invested in the

Foundations Program. These figures will be a percentage of the average daily net value of participating Plan assets in each Affiliated and Third Party Fund. The Bank will reduce the Wrap Fee charged to each Plan for that quarter by that Plan's allocable portion of the Offset Fees for the Asset Allocation Model in which the Plan's assets were invested during the quarter. Thus, the sum of the Wrap Fee which the Bank and its affiliates actually receive with respect to each Plan (following the offset) and the Offset Fees will always equal the total Wrap Fee to which the Primary Independent Fiduciary agreed to in the Account Agreement and the

selection of Affiliated or Third Party Funds will always be revenue-neutral.

17. The Bank has provided the following example to demonstrate how the Offset Fee mechanism will work:

Mr. Smith meets with a Bank investment counselor on April 3, 2000. After going through the education, profiling and recommendation process, he decides to invest his IRA through the Foundations Program. Mr. Smith accepts the Bank's recommendation that, based on the results of his Investor Profile, the Growth and Income Model is the appropriate vehicle for the IRA. So, on April 3, 2000, Mr. Smith invests \$47,928.76 in that Asset Allocation Model. This initial investment is allocated as follows:

Fund	Allocation (percent)	Dollar amount	Price	Shares
American Performance Treasury Money Market .....	5	\$2,396.44	\$1.00	2,396.440
American Performance Short-Term Income Fund .....	10	4,792.88	10.02	478.331
American Performance Intermediate Bond Fund .....	5	2,396.44	10.36	231.317
American Performance Bond Fund .....	5	2,396.44	9.53	251.463
Federated GNMA Fund .....	10	4,792.88	11.32	423.399
Federated Bond Fund .....	10	4,792.88	10.05	476.903
Federated Equity Income Fund .....	9	4,313.59	19.21	224.549
American Performance Equity Fund .....	29	13,899.34	17.96	773.905
American Performance Growth Equity Fund .....	9	4,313.57	12.12	355.905
Templeton Foreign Fund .....	3	1,437.86	11.10	129.537
Neuberger & Berman Genesis Assets Fund .....	5	2,396.44	14.33	167.232
Total .....	100	47,928.76	.....	.....

#### Wrap Fee

Three business days prior to the end of the calendar quarter (*i.e.*, June 28, 2000), the Bank takes the following steps to calculate the fee charged to Mr. Smith's account for the second quarter of 2000:

- The Bank calculates the average balance of Mr. Smith's account during the quarter as \$48,124.44.

- The annual Wrap Fee on accounts of up to \$99,000 is 1.80 percent. Therefore, the quarterly fee is 45 basis points or 0.45 percent of the average daily balance during the quarter. Mr. Smith's quarterly Wrap Fee is \$216.56 ( $\$48,124.44 \times 0.45\%$ ). This amount is deducted from the account based on the Fund/fee hierarchy.<sup>12</sup> The Fund/fee hierarchy determines which position(s) will be liquidated to pay fees. Because Mr. Smith

has enough assets in the American Performance Treasury Money Market Fund to pay the fee, a liquidation of \$216.56 is posted to this Fund.

#### Offset Fees

- The Bank prepares a spreadsheet detailing the annualized compensation it received from the Affiliated Funds and the Third Party Fund during the quarter. For example,

Fund	Allocation (percent)	Basis points received
American Performance Treasury Money Market .....	5	2
American Performance Short-Term Income Fund .....	10	1
American Performance Intermediate Bond Fund .....	5	3
American Performance Bond Fund .....	5	3
Federated GNMA Fund .....	10	3
Federated Bond Fund .....	10	3
Federated Equity Income Fund .....	9	2
American Performance Equity Fund .....	29	24
American Performance Growth Equity Fund .....	9	7
Templeton Foreign Fund .....	3	1
Neuberger & Berman Genesis Assets Fund .....	5	3
Total .....	100	52

<sup>12</sup> It is represented that Funds are liquidated to pay fees in the following order: American Performance U.S. Treasury Fund, American Performance Intermediate Bond Fund, American Performance Bond Fund, Federated Bond Fund, Federated GNMA Trust Fund, Federated Equity Income Fund, American Performance Equity Fund, Templeton Foreign Fund, Neuberger and Berman

Genesis Asset Fund and the American Performance Aggressive Growth Fund.

Because each Asset Allocation Model, other than the Aggressive Growth Model, includes an investment in a money market fund, the Bank anticipates that almost all of the Wrap Fee will be taken from the American Performance Treasury Money Market Fund. An Account's entire holding in a particular Fund will be liquidated before any

portion of the next Fund in the hierarchy is liquidated. If the liquidation is more than \$1,000, the Account automatically will be rebalanced. If the liquidation is for \$100 to \$1,000, the Account will be rebalanced at the next quarter's end. If the liquidation is for less than \$100, the Account will not be rebalanced on account of the fee payment, although it may be rebalanced in the regular course of the Foundations Program.

• The rebate to be credited to Mr. Smith's account is calculated by multiplying his average daily balance (\$48,124.44) by the basis points received (52) and then dividing the result by 4. The rebate [\$62.56]  $[(\$48,124.44 \times 0.52\%/4)]$  is credited to the American Performance Treasury Money Market Fund.<sup>13</sup>

#### Disclosures

18. Aside from the Investor Profile described in Representation 6, Primary Independent Fiduciaries and Directing Independent Fiduciaries will receive several types of disclosures: (a) Initial disclosures which are made to the Primary Independent Fiduciary and, if applicable, the Directing Independent Fiduciary before a Plan is enrolled under the Foundations Program; (b) subsequent disclosures which are made exclusively to the Primary Independent Fiduciary; (c) specific disclosures which are made to the Primary Independent Fiduciary or the Directing Independent Fiduciary; and (d) continuing disclosures that are made to the Primary Independent Fiduciary or the Directing Independent Fiduciary throughout the time that the participating Plan is enrolled under the Foundations Program.

(a) *Initial Disclosures for the Primary Independent Fiduciary or the Directing Independent Fiduciary.* Before a Plan's assets are invested under the Foundations Program, the Primary Independent Fiduciary or, if applicable, the Directing Independent Fiduciary, will receive a brochure describing the Foundations Program, a Foundations

Asset Allocation Account Application, a Foundations Asset Allocation Purchase Order, and a Foundations Program Account Agreement. The Account Agreement will provide detailed information on the Foundations Program, including the way in which fees are calculated and charged, the procedure for and limitations on the Bank's ability to make Model Adjustments and its rebalancing of a participating Plan, and the procedure to be followed in the event that the Primary or Directing Independent Fiduciary objects to a Model Adjustment. In addition, the Bank will disclose, through the Form ADV-Part II, its affiliation or non-affiliation with the Funds to the Primary Independent Fiduciary prior to such fiduciary's enrolling an eligible Plan in the Program. Further, the Bank will provide to the Primary Independent Fiduciary the executed Account Agreement and copies of the proposed exemption and the grant notice. Assuming the Bank provides copies of the proposed exemption and the grant notice directly to the Primary Independent Fiduciary, such disclosures may be distributed by the Primary Independent Fiduciary to the Directing Independent Fiduciaries.

To participate in the Foundations Program, the Primary Independent Fiduciary will submit a completed Account Agreement to the Bank. In addition, the Primary Independent Fiduciary will be required to represent in writing that such fiduciary is (1) independent of the Bank and its affiliates; (2) knowledgeable with respect to the Plan in administrative matters; (3) able to make an informed decision concerning the participating Plan's participation in the Foundations Program; and (4) knowledgeable with respect to funding matters related to the Plan.

Once the Plan is enrolled in the Foundations Program, the Primary Independent Fiduciary or, if applicable, the Directing Independent Fiduciary, will complete an Investor Profile and submit it to an investment counselor in the manner described herein in Representation 6.

(b) *Subsequent Disclosures Exclusively for the Primary Independent Fiduciary.* In addition to the initial disclosures described above in Representation 18(a), the Bank will provide each Primary Independent Fiduciary with the following materials and/or oral disclosures: (1) A copy of the executed Account Agreement between the Plan and the Bank; and (2) a description of the Bank's affiliation, if any, with the sponsors, distributors, administrators, investment advisers,

sub-advisers, custodians and transfer agents of each Affiliated and Third Party Fund. In addition, the Primary Independent Fiduciary will acknowledge in writing that he or she has received copies of the aforementioned documents prior to investing in the Foundations Program.

(c) *Specific Disclosures for the Primary Independent Fiduciary or the Directing Independent Fiduciary.* The Bank will provide each Primary Independent Fiduciary or Directing Independent Fiduciary with the following materials and/or oral disclosures prior to investing in an Asset Allocation Model: (1) a written analysis based on such fiduciary's Investor Profile, (2) a description of the Asset Allocation Model recommended by the Bank's investment counselor, which includes a description of the actual fee structure and the actual number of basis points that will be rebated to such Plan fiduciary; (3) a prospectus for each Affiliated Fund and Third Party Fund in which the Plan may be invested, showing, among other things, the internal fees for the Fund; and (4) upon the request of the Primary Independent Fiduciary or the Directing Independent Fiduciary, a Statement of Additional Information which supplements the prospectus. The Primary Independent Fiduciary or the Directing Independent Fiduciary will also acknowledge in writing to the Bank that he or she has received copies of the aforementioned documents prior to the Plan's investment in an Asset Allocation Model.

(d) *Continuing Disclosures for the Primary Independent Fiduciary or the Directing Independent Fiduciary.* In addition to the disclosures described above, the Bank will provide each Primary Independent Fiduciary and Directing Independent Fiduciary with the following continuing disclosures: (1) Copies of applicable prospectuses; (2) written confirmation of each purchase and redemption of shares of an Affiliated Fund or a Third Party Fund, including transactions implemented as a result of a realignment of the Asset Allocation Model's investment mix or from the rebalancing of a participating Plan's investments in conformity with the selected Asset Allocation Model; (3) telephone quotations of the Plan's balance under the Foundations Program; (4) periodic, but at least quarterly, account statements showing the Plan's value, a summary of purchase, sale and exchange activity and dividends received or reinvested, a summary of cumulative realized gain and/or loss, and rebated amounts; (5) semiannual or annual reports that include financial

<sup>13</sup> For each Fund represented in the foregoing Asset Allocation Model, the Bank will determine the total number of basis points received on an annual basis from all fee sources within that Fund. As noted above, these fees include Rule 12b-1 Fees, Advisory Fees and Administrative Fees. For example, for the American Performance Equity Fund, the total annual basis points received is 83.

The Bank will then multiply this amount (83) by the percentage of the Fund contained in the Asset Allocation Model. In this Asset Allocation Model, 29 percent of the investor's money is allocated to the American Performance Equity Fund. Accordingly, under the Bank's fee-offset arrangement, 29 percent of 83 basis points (or 24 basis points) will be rebated to Mr. Smith's account.

The Bank represents that this method of allocation will be repeated for all Funds shown in this particular Asset Allocation Model. The total rebated amounts attributable to each Fund will be added together to arrive at the total number of basis points that will be rebated to investors in this Asset Allocation Model. Accordingly, Mr. Smith and other investors in this Asset Allocation Model, will be rebated 52 basis points on an annual basis.

In addition, Mr. Smith and other investors will receive full disclosure from the Bank regarding the fees and the fee-offset arrangement, including the actual number of basis points to be rebated under an applicable Allocation Model. To show how the rebate is calculated, a spreadsheet will be utilized. Finally, an investor will see rebated amounts in their performance statements. (See also Representations 6 and 18.)

statements for the Funds, as well as a description of the fees that are paid by the Funds to the Bank and its affiliates; (6) at least annually, a written or oral inquiry from the Bank to ascertain whether information provided on the Investor Profile is still accurate and to determine if such information should be updated; (7) an annual Termination Advisory; and (8) the Bank's investment advisory and other agreements with any Affiliated Fund as well as its distribution agreement pertaining to the Third Party Funds, upon request. Communications received from the Funds will be distributed to the Primary Independent Fiduciary, who may elect to pass this information through to Directing Independent Fiduciaries.

Finally, for a period of six years, the Bank will maintain records necessary to enable the Department, Plan fiduciaries, participants and others to determine whether the conditions of the requested exemption have been met.

#### More Steering Concerns

19. The Applicants state that the Asset Allocation Models used in the Foundations Program were designed to meet very specific risk tolerances and investment objectives developed by Morningstar and Lipper. The Applicants note that each Asset Segment in an Asset Allocation Model performs a role in addressing those tolerances and objectives. In this regard, the Applicants explain that each Asset Segment is represented by only one Fund—an Affiliated Fund or a Third Party Fund. Therefore, the Applicants state that the Bank cannot steer assets within an Asset Allocation Model to a Third Party Fund rather than an Affiliated Fund representing the same Asset Segment.

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

(a) The investment of a Plan's assets under the Foundations Program will be made by a Primary Independent Fiduciary or a Directing Independent Fiduciary who is independent of the Bank and its affiliates such that the Plan fiduciary will maintain complete discretion with respect to participating under the Foundations Program.

(b) No Plan will pay a fee or commission by reason of the acquisition or redemption of shares of the Funds.

(c) As to each Plan, the total fees that are paid to the Bank and its affiliates will constitute no more than reasonable compensation for the services provided.

(d) Prior to investing under the Foundations Program, each Primary Independent Fiduciary or Directing

Independent Fiduciary will receive offering materials and disclosures from the Bank which set forth all material facts concerning the purpose, fee structure, rebate arrangement, operation, rebalancing, risks and participation in such Program.

(e) The Bank will provide written documentation to a Primary Independent Fiduciary or a Directing Independent Fiduciary of its recommendations based upon objective criteria that will be uniformly applied.

(f) The quarterly Wrap Fee that is paid by a Plan to the Bank for asset allocation and related services rendered to such Plan under the Portfolio Advisor Program will be offset by—(1) All Advisory Fees received by the Bank and/or its affiliates from the Affiliated Funds; (2) all Administrative Fees that are received by the Bank from the Affiliated Funds; and (3) all Administrative Fees that are paid by the Third Party Funds to the Bank and/or its affiliates, such that the sum of the Wrap Fee and the Offset Fees will always equal the total Wrap Fee and the selection of Affiliated or Third Party Funds will always be revenue-neutral.

(g) No Plan assets will be invested according to a Model Adjustment without the consent of the Primary Independent Fiduciary if the Model Adjustment is outside the range specified in the Account Agreement.

(h) The periodic rebalancing of a Plan investor's account will not involve an exercise of discretionary management or control over the Plan by the Bank.

(i) The Bank will retain the Independent Financial Analyst to (1) review the investment of Plan assets in a Third Party Fund to ensure adequate performance and suitability, (2) review the Funds each time the Bank determines to add a Third Party Fund or replace an Affiliated Fund with a Third Party Fund; and (3) ensure that there is no overlap between the Funds.

(j) Although the Primary Independent Fiduciary or the Directing Independent Fiduciary may withdraw from the Foundations Program at any time, any authorizations made by such Plan investors with respect to increases in the Wrap Fee, Model Adjustments that are outside of an Asset Allocation Model, the addition or substitution of a Fund, will be terminable at will and without penalty to the Plan.

(k) Each Primary Independent Fiduciary or Directing Independent Fiduciary will receive ongoing disclosures from the Bank regarding the continued participation of the Plan in the Foundations Program.

(l) All dealings between a Plan, the Funds and the Bank will remain on a

basis which is at least as favorable to the Plan as such dealings are with other shareholders of the Funds holding the same classes of shares as the Plan.

#### Notice to Interested Persons

The Applicants represent that because potentially interested participants and beneficiaries of eligible Plans which might choose to participate in the Foundations Program cannot be identified at this time, the only practical means of notifying such participants and beneficiaries of this proposed exemption is by publication of the notice of pendency in the **Federal Register**. Therefore, comments and requests for a hearing must be received by the Department no later than 30 days from the date of the publication of this notice of proposed exemption in the **Federal Register**.

**For Further Information Contact:** Ms. Jan D. Broady of the Department, telephone (202) 219-8881. (This is not a toll-free number.)

#### First Tennessee National Corporation Located in Memphis, Tennessee

[Application No. D-10898]

#### Proposed Exemption

##### I. Transactions

A. The restrictions of sections 406(a) and 407(a) of the Act and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A) through (D) of the Code shall not apply to the following transactions involving trusts and certificates evidencing interests therein:

(1) The direct or indirect sale, exchange or transfer of certificates in the initial issuance of certificates between the sponsor or underwriter and an employee benefit plan when the sponsor, servicer, trustee or insurer of a trust, the underwriter of the certificates representing an interest in the trust, or an obligor is a party in interest with respect to such plan;

(2) The direct or indirect acquisition or disposition of certificates by a plan in the secondary market for such certificates; and

(3) The continued holding of certificates acquired by a plan pursuant to subsection I.A.(1) or (2).

Notwithstanding the foregoing, section I.A. does not provide an exemption from the restrictions of sections 406(a)(1)(E), 406(a)(2) and 407 for the acquisition or holding of a certificate on behalf of an Excluded Plan by any person who has discretionary authority or renders investment advice

with respect to the assets of that Excluded Plan.<sup>14</sup>

B. The restrictions of sections 406(b)(1) and 406(b)(2) of the Act, and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(E) of the Code, shall not apply to:

(1) The direct or indirect sale, exchange or transfer of certificates in the initial issuance of certificates between the sponsor or underwriter and a plan when the person who has discretionary authority or renders investment advice with respect to the investment of plan assets in the certificates is (a) an obligor with respect to 5 percent or less of the fair market value of obligations or receivables contained in the trust, or (b) an affiliate of a person described in (a); if:

(i) The plan is not an Excluded Plan;

(ii) Solely in the case of an acquisition of certificates in connection with the initial issuance of the certificates, at least 50 percent of each class of certificates in which plans have invested is acquired by persons independent of the members of the Restricted Group and at least 50 percent of the aggregate interest in the trust is acquired by persons independent of the Restricted Group;

(iii) A plan's investment in each class of certificates does not exceed 25 percent of all of the certificates of that class outstanding at the time of the acquisition; and

(iv) Immediately after the acquisition of the certificates, no more than 25 percent of the assets of a plan with respect to which the person has discretionary authority or renders investment advice are invested in certificates representing an interest in a trust containing assets sold or serviced by the same entity.<sup>15</sup> For purposes of this paragraph B.(1)(iv) only, an entity will not be considered to service assets contained in a trust if it is merely a subservicer of that trust;

(2) The direct or indirect acquisition or disposition of certificates by a plan in the secondary market for such certificates, provided that the conditions set forth in paragraphs B.(1)(i), (iii) and (iv) are met; and

(3) The continued holding of certificates acquired by a plan pursuant to subsection I.B.(1) or (2).

C. The restrictions of sections 406(a), 406(b) and 407(a) of the Act, and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c) of the Code, shall not apply to transactions in connection with the servicing, management and operation of a trust, provided:

(1) Such transactions are carried out in accordance with the terms of a binding pooling and servicing arrangement; and

(2) The pooling and servicing agreement is provided to, or described in all material respects in, the prospectus or private placement memorandum provided to investing plans before they purchase certificates issued by the trust.<sup>16</sup>

Notwithstanding the foregoing, section I.C. does not provide an exemption from the restrictions of section 406(b) of the Act, or from the taxes imposed by reason of section 4975(c) of the Code, for the receipt of a fee by a servicer of the trust from a person other than the trustee or sponsor, unless such fee constitutes a "qualified administrative fee" as defined in section III.S.

D. The restrictions of sections 406(a) and 407(a) of the Act, and the taxes imposed by sections 4975(a) and (b) of the Code by reason of sections 4975(c)(1)(A) through (D) of the Code, shall not apply to any transactions to which those restrictions or taxes would otherwise apply merely because a person is deemed to be a party in interest or disqualified person (including a fiduciary) with respect to a plan by virtue of providing services to the plan (or by virtue of having a relationship to such service provider described in section 3(14)(F), (G), (H) or (I) of the Act or section 4975(e)(2)(F), (G), (H) or (I) of the Code), solely because of the plan's ownership of certificates.

## II. General Conditions

A. The relief provided under Part I is available only if the following conditions are met:

(1) The acquisition of certificates by a plan is on terms (including the certificate price) that are at least as

favorable to the plan as they would be in an arm's-length transaction with an unrelated party;

(2) The rights and interests evidenced by the certificates are not subordinated to the rights and interests evidenced by other certificates of the same trust;

(3) The certificates acquired by the plan have received a rating from a rating agency (as defined in section III.W.) at the time of such acquisition that is in one of the three highest generic rating categories;

(4) The trustee is not an affiliate of any other member of the Restricted Group. However, the trustee shall not be considered to be an affiliate of a servicer solely because the trustee has succeeded to the rights and responsibilities of the servicer pursuant to the terms of a pooling and servicing agreement providing for such succession upon the occurrence of one or more events of default by the servicer;

(5) The sum of all payments made to and retained by the underwriters in connection with the distribution or placement of certificates represents not more than reasonable compensation for underwriting or placing the certificates; the sum of all payments made to and retained by the sponsor pursuant to the assignment of obligations (or interests therein) to the trust represents not more than the fair market value of such obligations (or interests); and the sum of all payments made to and retained by the servicer represents not more than reasonable compensation for the servicer's services under the pooling and servicing agreement and reimbursement of the servicer's reasonable expenses in connection therewith;

(6) The plan investing in such certificates is an "accredited investor" as defined in Rule 501(a)(1) of Regulation D of the Securities and Exchange Commission under the Securities Act of 1933; and

(7) In the event that the obligations used to fund a trust have not all been transferred to the trust on the closing date, additional obligations as specified in subsection III.B.(1) may be transferred to the trust during the pre-funding period (as defined in section III.BB.) in exchange for amounts credited to the pre-funding account (as defined in section III.Z.), provided that:

(a) The pre-funding limit (as defined in section III.AA.) is not exceeded;

(b) All such additional obligations meet the same terms and conditions for eligibility as those of the original obligations used to create the trust corpus (as described in the prospectus or private placement memorandum and/or pooling and servicing agreement for

<sup>14</sup> Section I.A. provides no relief from sections 406(a)(1)(E), 406(a)(2) and 407 for any person rendering investment advice to an Excluded Plan within the meaning of section 3(21)(A)(ii) and regulation 29 CFR 2510.3-21(c).

<sup>15</sup> For purposes of this proposed exemption, each plan participating in a commingled fund (such as a bank collective trust fund or insurance company pooled separate account) shall be considered to own the same proportionate undivided interest in each asset of the commingled fund as its proportionate interest in the total assets of the commingled fund as calculated on the most recent preceding valuation date of the fund.

<sup>16</sup> In the case of a private placement memorandum, such memorandum must contain substantially the same information that would be disclosed in a prospectus if the offering of the certificates were made in a registered public offering under the Securities Act of 1933. In the Department's view, the private placement memorandum must contain sufficient information to permit plan fiduciaries to make informed investment decisions.

such certificates), which terms and conditions have been approved by a rating agency. Notwithstanding the foregoing, the terms and conditions for determining the eligibility of an obligation may be changed if such changes receive prior approval either by a majority of the outstanding certificateholders or by a rating agency;

(c) The transfer of such additional obligations to the trust during the pre-funding period does not result in the certificates receiving a lower credit rating from a rating agency upon termination of the pre-funding period than the rating that was obtained at the time of the initial issuance of the certificates by the trust;

(d) The weighted average annual percentage interest rate (the average interest rate) for all of the obligations in the trust at the end of the pre-funding period will not be more than 100 basis points lower than the average interest rate for the obligations which were transferred to the trust on the closing date;

(e) In order to ensure that the characteristics of the receivables actually acquired during the pre-funding period are substantially similar to those which were acquired as of the closing date, the characteristics of the additional obligations will be either monitored by a credit support provider or other insurance provider which is independent of the sponsor, or an independent accountant retained by the sponsor will provide the sponsor with a letter (with copies provided to the rating agency, the underwriter and the trustees) stating whether or not the characteristics of the additional obligations conform to the characteristics of such obligations described in the prospectus, private placement memorandum and/or pooling and servicing agreement. In preparing such letter, the independent accountant will use the same type of procedures as were applicable to the obligations which were transferred as of the closing date;

(f) The pre-funding period shall be described in the prospectus or private placement memorandum provided to investing plans; and

(g) The trustee of the trust (or any agent with which the trustee contracts to provide trust services) will be a substantial financial institution or trust company experienced in trust activities and familiar with its duties, responsibilities and liabilities as a fiduciary under the Act. The trustee, as the legal owner of the obligations in the trust, will enforce all the rights created in favor of certificateholders of such trust, including employee benefit plans subject to the Act.

B. Neither any underwriter, sponsor, trustee, servicer, insurer, nor any obligor, unless it or any of its affiliates has discretionary authority or renders investment advice with respect to the plan assets used by a plan to acquire certificates, shall be denied the relief provided under Part I, if the provision of subsection II.A.(6) above is not satisfied with respect to acquisition or holding by a plan of such certificates, provided that (1) such condition is disclosed in the prospectus or private placement memorandum; and (2) in the case of a private placement of certificates, the trustee obtains a representation from each initial purchaser which is a plan that it is in compliance with such condition, and obtains a covenant from each initial purchaser to the effect that, so long as such initial purchaser (or any transferee of such initial purchaser's certificates) is required to obtain from its transferee a representation regarding compliance with the Securities Act of 1933, any such transferees will be required to make a written representation regarding compliance with the condition set forth in subsection II.A.(6) above.

### III. Definitions

For purposes of this proposed exemption:

A. "Certificate" means:

(1) A certificate—

(a) That represents a beneficial ownership interest in the assets of a trust; and

(b) That entitles the holder to pass-through payments of principal, interest, and/or other payments made with respect to the assets of such trust; or

(2) A certificate denominated as a debt instrument—

(a) that represents an interest in a Real Estate Mortgage Investment Conduit (REMIC) or a Financial Asset Securitization Investment Trust (FASIT) within the meaning of section 860D(a) or section 860L, respectively, of the Internal Revenue Code of 1986; and

(b) That is issued by, and is an obligation of, a trust; with respect to certificates defined in (1) and (2) above for which FTNC or any of its affiliates is either (i) the sole underwriter or the manager or co-manager of the underwriting syndicate, or (ii) a selling or placement agent.

For purposes of this proposed exemption, references to "certificates representing an interest in a trust" include certificates denominated as debt which are issued by a trust.

B. "Trust" means an investment pool, the corpus of which is held in trust and consists solely of:

(1)(a) Secured consumer receivables that bear interest or are purchased at a discount (including, but not limited to, home equity loans and obligations secured by shares issued by a cooperative housing association); and/or

(b) Secured credit instruments that bear interest or are purchased at a discount in transactions by or between business entities (including, but not limited to, qualified equipment notes secured by leases, as defined in section III.T); and/or

(c) Obligations that bear interest or are purchased at a discount and which are secured by single-family residential, multi-family residential and commercial real property (including obligations secured by leasehold interests on commercial real property); and/or

(d) Obligations that bear interest or are purchased at a discount and which are secured by motor vehicles or equipment, or qualified motor vehicle leases (as defined in section III.U); and/or

(e) "Guaranteed governmental mortgage pool certificates," as defined in 29 CFR 2510.3-101(i)(2); and/or

(f) Fractional undivided interests in any of the obligations described in clauses (a)–(e) of this section B.(1);

(2) Property which had secured any of the obligations described in subsection B.(1);

(3)(a) Undistributed cash or temporary investments made therewith maturing no later than the next date on which distributions are to be made to certificateholders; and/or

(b) Cash or investments made therewith which are credited to an account to provide payments to certificateholders pursuant to any yield supplement agreement or similar yield maintenance arrangement to supplement the interest rates otherwise payable on obligations described in subsection III.B.(1) held in the trust, provided that such arrangements do not involve swap agreements or other notional principal contracts; and/or

(c) Cash transferred to the trust on the closing date and permitted investments made therewith which:

(i) Are credited to a pre-funding account established to purchase additional obligations with respect to which the conditions set forth in clauses (a)–(g) of subsection II.A.(7) are met and/or;

(ii) Are credited to a capitalized interest account (as defined in section III.X.); and

(iii) Are held in the trust for a period ending no later than the first distribution date to certificateholders occurring after the end of the pre-funding period.

For purposes of this clause (c) of subsection III.B.(3), the term "permitted investments" means investments which are either: (i) direct obligations of, or obligations fully guaranteed as to timely payment of principal and interest by the United States, or any agency or instrumentality thereof, provided that such obligations are backed by the full faith and credit of the United States or (ii) have been rated (or the obligor has been rated) in one of the three highest generic rating categories by a rating agency; are described in the pooling and servicing agreement; and are permitted by the rating agency; and

(4) rights of the trustee under the pooling and servicing agreement, and rights under any insurance policies, third-party guarantees, contracts of suretyship, yield supplement agreements described in clause (b) of subsection III.B.(3) and other credit support arrangements with respect to any obligations described in subsection III.B.(1).

Notwithstanding the foregoing, the term "trust" does not include any investment pool unless: (i) the investment pool consists only of assets of the type described in clauses (a) through (f) of subsection III.B.(1) which have been included in other investment pools, (ii) certificates evidencing interests in such other investment pools have been rated in one of the three highest generic rating categories by a rating agency for at least one year prior to the plan's acquisition of certificates pursuant to this proposed exemption, and (iii) certificates evidencing interests in such other investment pools have been purchased by investors other than plans for at least one year prior to the plan's acquisition of certificates pursuant to this proposed exemption.

C. "Underwriter" means:

(1) First Tennessee National Bank (the Bank) or First Tennessee Securities Corporation (FTSC);

(2) Any person directly or indirectly, through one or more intermediaries, controlling, controlled by or under common control with FTNC; or

(3) Any member of an underwriting syndicate or selling group of which FTNC or a person described in (2) is a manager or co-manager with respect to the certificates.

D. "Sponsor" means the entity that organizes a trust by depositing obligations therein in exchange for certificates.

E. "Master Servicer" means the entity that is a party to the pooling and servicing agreement relating to trust assets and is fully responsible for servicing, directly or through subservicers, the assets of the trust.

F. "Subservicer" means an entity which, under the supervision of and on behalf of the master servicer, services obligations contained in the trust, but is not a party to the pooling and servicing agreement.

G. "Servicer" means any entity which services obligations contained in the trust, including the master servicer and any subservicer.

H. "Trustee" means the trustee of the trust, and in the case of certificates which are denominated as debt instruments, also means the trustee of the indenture trust.

I. "Insurer" means the insurer or guarantor of, or provider of other credit support for, a trust. Notwithstanding the foregoing, a person is not an insurer solely because it holds securities representing an interest in a trust which are of a class subordinated to certificates representing an interest in the same trust.

J. "Obligor" means any person, other than the insurer, that is obligated to make payments with respect to any obligation or receivable included in the trust. Where a trust contains qualified motor vehicle leases or qualified equipment notes secured by leases, "obligor" shall also include any owner of property subject to any lease included in the trust, or subject to any lease securing an obligation included in the trust.

K. "Excluded Plan" means any plan with respect to which any member of the Restricted Group is a "plan sponsor" within the meaning of section 3(16)(B) of the Act.

L. "Restricted Group" with respect to a class of certificates means:

- (1) Each underwriter;
- (2) Each insurer;
- (3) The sponsor;
- (4) The trustee;
- (5) Each servicer;
- (6) Any obligor with respect to

obligations or receivables included in the trust constituting more than 5 percent of the aggregate unamortized principal balance of the assets in the trust, determined on the date of the initial issuance of certificates by the trust; or

(7) Any affiliate of a person described in (1)–(6) above.

M. "Affiliate" of another person includes:

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

(2) Any officer, director, partner, employee, relative (as defined in section 3(15) of the Act), a brother, a sister, or a spouse of a brother or sister of such other person; and

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

N. "Control" means the power to exercise a controlling influence over the management or policies of a person other than an individual.

O. A person will be "independent" of another person only if:

(1) Such person is not an affiliate of that other person; and

(2) The other person, or an affiliate thereof, is not a fiduciary who has investment management authority or renders investment advice with respect to any assets of such person.

P. "Sale" includes the entrance into a forward delivery commitment (as defined in section Q below), provided:

(1) The terms of the forward delivery commitment (including any fee paid to the investing plan) are no less favorable to the plan than they would be in an arm's-length transaction with an unrelated party;

(2) The prospectus or private placement memorandum is provided to an investing plan prior to the time the plan enters into the forward delivery commitment; and

(3) At the time of the delivery, all conditions of this proposed exemption (if granted) applicable to sales are met.

Q. "Forward delivery commitment" means a contract for the purchase or sale of one or more certificates to be delivered at an agreed future settlement date. The term includes both mandatory contracts (which contemplate obligatory delivery and acceptance of the certificates) and optional contracts (which give one party the right but not the obligation to deliver certificates to, or demand delivery of certificates from, the other party).

R. "Reasonable compensation" has the same meaning as that term is defined in 29 CFR 2550.408c-2.

S. "Qualified Administrative Fee" means a fee which meets the following criteria:

(1) The fee is triggered by an act or failure to act by the obligor other than the normal timely payment of amounts owing in respect of the obligations;

(2) The servicer may not charge the fee absent the act or failure to act referred to in (1);

(3) The ability to charge the fee, the circumstances in which the fee may be charged, and an explanation of how the fee is calculated are set forth in the pooling and servicing agreement; and

(4) The amount paid to investors in the trust will not be reduced by the amount of any such fee waived by the servicer.

T. "Qualified Equipment Note Secured By A Lease" means an equipment note:



(1) Which is secured by equipment which is leased;

(2) Which is secured by the obligation of the lessee to pay rent under the equipment lease; and

(3) With respect to which the trust's security interest in the equipment is at least as protective of the rights of the trust as would be the case if the equipment note were secured only by the equipment and not the lease.

U. "Qualified Motor Vehicle Lease" means a lease of a motor vehicle where:

(1) The trust owns or holds a security interest in the lease;

(2) The trust owns or holds a security interest in the leased motor vehicle; and

(3) The trust's security interest in the leased motor vehicle is at least as protective of the trust's rights as would be the case if the trust consisted of motor vehicle installment loan contracts.

V. "Pooling and Servicing Agreement" means the agreement or agreements among a sponsor, a servicer and the trustee establishing a trust. In the case of certificates which are denominated as debt instruments, "Pooling and Servicing Agreement" also includes the indenture entered into by the trustee of the trust issuing such certificates and the indenture trustee.

W. "Rating Agency" means Standard & Poor's Structured Rating Group (S&P's), Moody's Investors Service, Inc. (Moody's), Duff & Phelps Credit Rating Co. (D & P) or Fitch IBCA, Inc. (Fitch), or their successors.

X. "Capitalized Interest Account" means a trust account: (i) which is established to compensate certificateholders for shortfalls, if any, between investment earnings on the pre-funding account and the pass-through rate payable under the certificates; and (ii) which meets the requirements of clause (c) of subsection III.B.(3).

Y. "Closing Date" means the date the trust is formed, the certificates are first issued and the trust's assets (other than those additional obligations which are to be funded from the pre-funding account pursuant to subsection II.A.(7)) are transferred to the trust.

Z. "Pre-Funding Account" means a trust account: (i) which is established to purchase additional obligations, which obligations meet the conditions set forth in clauses (a)–(g) of subsection II.A.(7); and (ii) which meets the requirements of clause (c) of subsection III.B.(3).

AA. "Pre-Funding Limit" means a percentage or ratio of the amount allocated to the pre-funding account, as compared to the total principal amount of the certificates being offered which is less than or equal to 25 percent.

BB. "Pre-Funding Period" means the period commencing on the closing date and ending no later than the earliest to occur of: (i) the date the amount on deposit in the pre-funding account is less than the minimum dollar amount specified in the pooling and servicing agreement; (ii) the date on which an event of default occurs under the pooling and servicing agreement; or (iii) the date which is the later of three months or 90 days after the closing date.

CC. "FTNC" means First Tennessee National Corporation, a Tennessee corporation, and its affiliates.

The Department notes that this proposed exemption is included within the meaning of the term "Underwriter Exemption" as it is defined in section V(h) of Prohibited Transaction Exemption 95–60 (60 FR 35925, July 12, 1995), the Class Exemption for Certain Transactions Involving Insurance Company General Accounts (see 60 FR at 35932).

#### *Summary of Facts and Representations*

1. FTNC, a Tennessee corporation, is a Memphis, Tennessee based bank holding company, which has assets of over \$18 billion and through its subsidiaries, including the Bank, operates 419 branches in various cities in Tennessee, Arkansas and Mississippi. FTNC also owns and operates subsidiaries that engage in trust, brokerage, investment management, mortgage banking and consumer finance, including First Tennessee ABS, Inc.

FTSC is a subsidiary of the Bank. On April 12, 1999, the Office of the Controller of the Currency (OCC) granted approval for the Bank to establish FTSC as a wholly-owned subsidiary of the Bank. The OCC approval permitted FTSC to engage in certain securities activities which are permissible for national banks to engage in directly, and also to underwrite and deal in municipal revenue bonds. On January 28, 2000, the OCC granted approval for FTSC to expand its activities in underwriting and dealing activities with respect to all types of debt and equity securities other than interests in open-end investment companies. On March 13, 2000, the OCC approved a certification and notice filed by the Bank for FTSC to become a "financial subsidiary" as permitted by the Gramm-Leach-Bliley Act (G–L–B Act) and OCC regulation. As a financial subsidiary, FTSC may conduct securities activities which are permissible for the Bank to engage in directly as well as securities activities which the G–L–B Act has defined as "financial in nature," such as

underwriting, dealing in, and making a market in, all types of securities, including interests in open-end investment companies.

#### *Trust Assets*

2. FTNC seeks exemptive relief to permit plans to invest in pass-through certificates representing undivided interests in the following categories of trusts: (1) Single and multi-family residential or commercial mortgage investment trusts;<sup>17</sup> (2) motor vehicle receivable investment trusts; (3) consumer or commercial receivables investment trusts; and (4) guaranteed governmental mortgage pool certificate investment trusts.<sup>18</sup>

3. Commercial mortgage investment trusts may include mortgages on ground leases of real property. Commercial mortgages are frequently secured by ground leases on the underlying property, rather than by fee simple interests. The separation of the fee simple interest and the ground lease interest is generally done for tax reasons. Properly structured, the pledge of the ground lease to secure a mortgage provides a lender with the same level of security as would be provided by a pledge of the related fee simple interest. The terms of the ground leases pledged to secure leasehold mortgages will in all cases be at least ten years longer than the term of such mortgages.<sup>19</sup>

#### *Trust Structure*

4. Each trust is established under a pooling and servicing agreement

<sup>17</sup> The Department notes that PTE 83–1 [48 FR 895, January 7, 1983], a class exemption for mortgage pool investment trusts, would generally apply to trusts containing single-family residential mortgages, provided that the applicable conditions of PTE 83–1 are met. FTNC requests relief for single-family residential mortgages in this exemption because it would prefer one exemption for all trusts of similar structure. However, FTNC has stated that it may still avail itself of the exemptive relief provided by PTE 83–1.

<sup>18</sup> Guaranteed governmental mortgage pool certificates are mortgage-backed securities with respect to which interest and principal payable is guaranteed by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC), or the Federal National Mortgage Association (FNMA). The Department's regulation relating to the definition of "plan assets" (29 CFR 2510.3–101(i)) provides that where a plan acquires a guaranteed governmental mortgage pool certificate, the plan's assets include the certificate and all of its rights with respect to such certificate under applicable law, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying such certificate. The applicant is requesting exemptive relief for trusts containing guaranteed governmental mortgage pool certificates because the certificates in the trusts may be plan assets.

<sup>19</sup> Trust assets may also include obligations that are secured by leasehold interests on residential real property. See PTE 90–32 involving Prudential-Bache Securities, Inc. (55 FR 23147, June 6, 1990 at 23150).

between a sponsor, a servicer and a trustee.<sup>20</sup> The sponsor or servicer of a trust selects assets to be included in the trust.<sup>21</sup> These assets are receivables which may have been originated by a sponsor or servicer of the trust, an affiliate of the sponsor or servicer, or by an unrelated lender and subsequently acquired by the trust sponsor or servicer.<sup>22</sup>

Typically, on or prior to the closing date, the sponsor acquires legal title to all assets selected for the trust, establishes the trust and designates an independent entity as trustee. On the closing date, the sponsor conveys to the trust legal title to the assets, and the trustee issues certificates representing fractional undivided interests in the trust assets. Typically, all receivables to be held in the trust are transferred as of the closing date, but in some transactions, as described more fully below, a limited percentage of the receivables to be held in the trust may be transferred during a limited period of time following the closing date, through the use of a pre-funding account.

FTNC, alone or together with other broker-dealers, acts as underwriter or placement agent with respect to the sale of the certificates. All of the public offerings of certificates presently contemplated are to be underwritten by FTNC on a firm commitment basis. In addition, FTNC anticipates that it may privately place certificates on both a

firm commitment and an agency basis. FTNC may also act as the lead underwriter for a syndicate of securities underwriters.

Certificateholders will be entitled to receive distributions of principal and/or interest, or lease payments due on the receivables, adjusted, in the case of payments of interest, to a specified rate—the pass-through rate—which may be fixed or variable. These distributions will be made monthly, quarterly, semi-annually, or at such other intervals and dates as specified in the related prospectus or private placement memorandum.

When installments or payments are made on a semi-annual basis, funds are not permitted to be commingled with the servicer's assets for longer than would be permitted for a monthly-pay security. A segregated account is established in the name of the trustee (on behalf of certificateholders) to hold funds received between distribution dates. The account is under the sole control of the trustee, who invests the account's assets in short-term securities which have received a rating comparable to the rating assigned to the certificates. In some cases, the servicer may be permitted to make a single deposit into the account once a month. When the servicer makes such monthly deposits, payments received from obligors by the servicer may be commingled with the servicer's assets during the month prior to deposit. Usually, the period of time between receipt of funds by the servicer and deposit of these funds in a segregated account does not exceed one month. Furthermore, in those cases where distributions are made semi-annually, the servicer will furnish a report on the operation of the trust to the trustee on a monthly basis. At or about the time this report is delivered to the trustee, it will be made available to certificateholders and delivered to or made available to each rating agency that has rated the certificates.

5. Some of the certificates will be multi-class certificates. FTNC requests exemptive relief for two types of multi-class certificates: "strip" certificates and "fast-pay/ slow-pay" certificates. Strip certificates are a type of security in which the stream of interest payments on receivables is split from the flow of principal payments and separate classes of certificates are established, each representing rights to disproportionate payments of principal and interest.<sup>23</sup>

<sup>23</sup> It is the Department's understanding that where a plan invests in REMIC "residual" interest certificates to which this exemption applies, some of the income received by the plan as a result of

"Fast-pay/slow-pay" certificates involve the issuance of classes of certificates having different stated maturities or the same maturities with different payment schedules. Interest and/or principal payments received on the underlying receivables are distributed first to the class of certificates having the earliest stated maturity of principal, and/or earlier payment schedule, and only when that class of certificates has been paid in full (or has received a specified amount) will distributions be made with respect to the second class of certificates. Distributions on certificates having later stated maturities will proceed in like manner until all the certificateholders have been paid in full. The only difference between this multi-class pass-through arrangement and a single-class pass-through arrangement is the order in which distributions are made to certificateholders. In each case, certificateholders will have a beneficial ownership interest in the underlying assets. In neither case will the rights of a plan purchasing a certificate be subordinated to the rights of another certificateholder in the event of default on any of the underlying obligations. In particular, if the amount available for distribution to certificateholders is less than the amount required to be so distributed, all senior certificateholders then entitled to receive distributions will share in the amount distributed on a pro rata basis.<sup>24</sup>

6. The trust will be maintained as an essentially passive entity. Therefore, both the sponsor's discretion and the servicer's discretion with respect to assets included in a trust are severely limited. Pooling and servicing agreements provide for the substitution of receivables by the sponsor only in the event of defects in documentation discovered within a short time after the issuance of trust certificates (within 120 days, except in the case of obligations having an original term of 30 years, in which case the period will not exceed two years). Any receivable so substituted is required to have characteristics substantially similar to

such investment may be considered unrelated business taxable income to the plan, which is subject to income tax under the Code. The Department emphasizes that the prudence requirement of section 404(a)(1)(B) of the Act would require plan fiduciaries to carefully consider this and other tax consequences prior to causing plan assets to be invested in certificates pursuant to this proposed exemption.

<sup>24</sup> If a trust issues subordinated certificates, holders of such subordinated certificates may not share in the amount distributed on a pro rata basis with the senior certificateholders. The Department notes that the proposed exemption does not provide relief for plan investment in such subordinated certificates.

<sup>20</sup> The Department is of the view that the term "trust" includes a trust: (a) the assets of which, although all specifically identified by the sponsor or the originator as of the closing date, are not all transferred to the trust on the closing date for administrative or other reasons but will be transferred to the trust shortly after the closing date, or (b) with respect to which certificates are not purchased by plans until after the end of the pre-funding period at which time all receivables are contained in the trust.

<sup>21</sup> It is the Department's view that the definition of "trust" contained in section III.B. includes a two-tier structure under which certificates issued by the first trust, which contains a pool of receivables described above, are transferred to a second trust which issues securities that are sold to plans. However, the Department is of the further view that, since the exemption provides relief for the direct or indirect acquisition or disposition of certificates that are not subordinated, no relief would be available if the certificates held by the second trust were subordinated to the rights and interests evidenced by other certificates issued by the first trust.

<sup>22</sup> It is the view of the Department that section III.B.(4) includes within the definition of the term "trust" rights under any yield supplement or similar arrangement which obligates the sponsor or master servicer, or another party specified in the relevant pooling and servicing agreement, to supplement the interest rates otherwise payable on the obligations described in section III.B.(1), in accordance with the terms of a yield supplement arrangement described in the pooling and servicing agreement, provided that such arrangements do not involve swap agreements or other notional principal contracts.

the replaced receivable and will be at least as creditworthy as the replaced receivable.

In some cases, the affected receivable would be repurchased, with the purchase price applied as a payment on the affected receivable and passed through to certificateholders.

In some cases the trust will be maintained as a Financial Asset Securitization Investment Trust ("FASIT"), a statutory entity created by the Small Business Job Protection Act of 1996, adding sections 860H, 860J, 860K and 860L to the Code. In general, a FASIT is designed to facilitate the securitization of debt obligations, such as credit card receivables, home equity loans, and auto loans, and thus, allows certain features such as revolving pools of assets, trusts containing unsecured receivables and certain hedging types of investments. A FASIT is not a taxable entity and debt instruments issued by such trusts, which might otherwise be recharacterized as equity, will be treated as debt in the hands of the holder for tax purposes. However, a trust which is the subject of the proposed exemption will be maintained as a FASIT only where the assets held by the FASIT will be comprised of secured debt; revolving pools of assets or hedging investments will not be allowed unless specifically authorized by the exemption, if granted, so that a trust maintained as a FASIT will be maintained as an essentially passive entity.

#### Trust Structure With Pre-Funding Account

##### *Pre-Funding Accounts:*

7. As described briefly above, some transactions may be structured using a pre-funding account or a capitalized interest account. If pre-funding is used, cash sufficient to purchase the receivables to be transferred after the closing date will be transferred to the trust by the sponsor or originator on the closing date. During the pre-funding period, such cash and temporary investments, if any, made therewith will be held in a pre-funding account and used to purchase the additional receivables, the characteristics of which will be substantially similar to the characteristics of the receivables transferred to the trust on the closing date. The pre-funding period for any trust will be defined as the period beginning on the closing date and ending on the earliest to occur of (i) the date on which the amount on deposit in the pre-funding account is less than a specified dollar amount, (ii) the date on which an event of default occurs under the related pooling and servicing agreement or (iii) the date which is the

later of three months or ninety (90) days after the closing date. Certain specificity and monitoring requirements described below will be met and will be disclosed in the pooling and servicing agreement and/or the prospectus or private placement memorandum.

For transactions involving a trust using pre-funding, on the closing date, a portion of the offering proceeds will be allocated to the pre-funding account generally in an amount equal to the excess of (i) the principal amount of certificates being issued over (ii) the principal balance of the receivables being transferred to the trust on such closing date. In certain transactions, the aggregate principal balance of the receivables intended to be transferred to the trust may be larger than the total principal balance of the certificates being issued. In these cases, the cash deposited in the pre-funding account will equal the excess of the principal balance of the total receivables intended to be transferred to the trust over the principal balance of the receivables being transferred on the closing date.

On the closing date, the sponsor transfers the assets to the trust in exchange for the certificates. The certificates are then sold to an underwriter for cash or to the certificateholders directly if the certificates are sold through a placement agent. The cash received by the sponsor from the certificateholders (or the underwriter) from the sale of the certificates issued by the trust in excess of the purchase price for the receivables and certain other trust expenses, such as underwriting or placement agent fees and legal and accounting fees, constitutes the cash to be deposited in the pre-funding account. Such funds are either held in the trust and accounted for separately, or are held in a sub-trust. In either event, these funds are not part of assets of the sponsor.

Generally, the receivables are transferred at par value, unless the interest rate payable on the receivables is not sufficient to service both the interest rates to be paid on the certificates and the transaction fees (*i.e.*, servicing fees, trustee fees and fees to credit support providers). In such cases, the receivables are sold to the trust at a discount, based on an objective, written, mechanical formula which is set forth in the pooling and servicing agreement and agreed upon in advance between the sponsor, the rating agency and any credit support provider or other insurer. The proceeds payable to the sponsor from the sale of the receivables transferred to the trust may also be reduced to the extent they are used to pay transaction costs (which typically

include underwriting or placement agent fees and legal and accounting fees). In addition, in certain cases, the sponsor may be required by the rating agencies or credit support providers to set up trust reserve accounts to protect the certificateholders against credit losses.

The pre-funding account of any trust will be limited so that the percentage or ratio of the amount allocated to the pre-funding account, as compared to the total principal amount of the certificates being offered (the pre-funding limit) will not exceed 25%. The pre-funding limit (which may be expressed as a ratio or as a stated percentage or a combination thereof) will be specified in the prospectus or the private placement memorandum.

Any amounts paid out of the pre-funding account are used solely to purchase receivables and to support the certificate pass-through rate (as explained below). Amounts used to support the pass-through rate are payable only from investment earnings and are not payable from principal. However, in the event that, after all of the requisite receivables have been transferred into the trust, any funds remain in the pre-funding account, such funds will be paid to the certificateholders as principal prepayments. Upon termination of the trust, if no receivables remain in the trust and all amounts payable to certificateholders have been distributed, any amounts remaining in the trust would be returned to the sponsor.

A dramatic change in interest rates on the receivables held in a trust using a pre-funding account would be handled as follows. If the receivables (other than those with adjustable or variable rates) had already been originated prior to the closing date, no action would be required as the fluctuations in the market interest rates would not affect the receivables transferred to the trust after the closing date. In contrast, if interest rates fall after the closing date, loans originated after the closing date will tend to be originated at lower rates, with the possible result that the receivables will not support the certificate pass-through rate. In such situations, the sponsor could sell the receivables into the trust at a discount, and more receivables would be used to fund the trust in order to support the pass-through rate. In a situation where interest rates drop dramatically and the sponsor is unable to provide sufficient receivables at the requisite interest rates, the pool of receivables would be closed. In this latter event, under the terms of the pooling and servicing agreement, the certificateholders would receive a

repayment of principal from the unused cash held in the pre-funding account. In transactions where the certificate pass-through rates are variable or adjustable, the effects of market interest rate fluctuations are mitigated. In no event will fluctuations in interest rates payable on the receivable affect the pass-through rate for fixed rate certificates.

The cash deposited into the trust and allocated to the pre-funding account is invested in certain permitted investments (see below), which may be commingled with other accounts of the trust. The allocation of investment earnings to each trust account is made periodically as earned in proportion to each account's allocable share of the investment returns. As pre-funding account investment earnings are required to be used to support (to the extent authorized in the particular transaction) the pass-through amounts payable to the certificateholders with respect to a periodic distribution date, the trustee is necessarily required to make periodic, separate allocations of the trust's earning to each trust account, thus ensuring that all allocable commingled investment earnings are properly credited to the pre-funding account on a timely basis.

*The Capitalized Interest Account:*

8. In certain transactions where a pre-funding account is used, the sponsor and/or originator may also transfer to the trust additional cash on the closing date, which is deposited in a capitalized interest account and used during the pre-funding period to compensate the certificateholders for any shortfall between the investment earnings on the pre-funding account and the pass-through interest rate payable under the certificates.

The capitalized interest account is needed in certain transactions since the certificates are supported by the receivables and the earnings on the pre-funding account, and it is unlikely that the investment earnings on the pre-funding account will equal the interest rates on the certificates (although such investment earnings will be available to pay interest on the certificates). The capitalized interest account funds are paid out periodically to the certificateholders as needed on distribution dates to support the pass-through rate.

In addition, a portion of such funds may be returned to the sponsor from time to time as the receivables are transferred into the trust and the need for the capitalized interest account diminishes. Any amounts held in the capitalized interest account generally will be returned to the sponsor and/or

originator either at the end of the pre-funding period or periodically as receivables are transferred and the proportionate amount of funds in the capitalized interest account can be reduced. Generally, the capitalized interest account terminates no later than the end of the pre-funding period. However, there may be some cases where the capitalized interest account remains open until the first date distributions are made to certificateholders following the end of the pre-funding period.

In other transactions, a capitalized interest account is not necessary because the interest paid on the receivables exceeds the interest payable on the certificates at the applicable pass-through rate and the fees of the trust. Such excess is sufficient to make up any shortfall resulting from the pre-funding account earning less than the certificate pass-through rate. In certain of these transactions, this occurs because the aggregate principal amount of receivables exceeds the aggregate principal amount of certificates.

*Pre-Funding Account and Capitalized Interest Account Payments and Investments:*

9. Pending the acquisition of additional receivables during the pre-funding period, it is expected that amounts in the pre-funding account and the capitalized interest account will be invested in certain permitted investments or will be held uninvested. Pursuant to the pooling and servicing agreement, all permitted investments must mature prior to the date the actual funds are needed. The permitted types of investments in the pre-funding account and capitalized interest account are investments which are either: (i) Direct obligations of, or obligations fully guaranteed as to timely payment of principal and interest by, the United States or any agency or instrumentality thereof, provided that such obligations are backed by the full faith and credit of the United States or (ii) have been rated (or the obligor has been rated) in one of the three highest generic rating categories by a rating agency, as set forth in the pooling and servicing agreement and as required by the rating agencies. The credit grade quality of the permitted investments is generally no lower than that of the certificates. The types of permitted investments will be described in the pooling and servicing agreement.

The ordering of interest payments to be made from the pre-funding and capitalized interest accounts is pre-established and set forth in the pooling and servicing agreement. The only principal payments which will be made from the pre-funding account are those

made to acquire the receivables during the pre-funding period and those distributed to the certificateholders in the event that the entire amount in the pre-funding account is not used to acquire receivables. The only principal payments which will be made from the capitalized interest account are those made to certificateholders if necessary to support the certificate pass-through rate or those made to the sponsor either periodically as they are no longer needed or at the end of the pre-funding period when the capitalized interest account is no longer necessary.

*The Characteristics of the Receivables Transferred During the Pre-Funding Period:*

10. In order to ensure that there is sufficient specificity as to the representations and warranties of the sponsor regarding the characteristics of the receivables to be transferred after the closing date:

(i) All such receivables will meet the same terms and conditions for eligibility as those of the original receivables used to create the trust corpus (as described in the prospectus or private placement memorandum and/or pooling and servicing agreement for such certificates), which terms and conditions have been approved by a rating agency. However, the terms and conditions for determining the eligibility of a receivable may be changed if such changes receive prior approval either by a majority vote of the outstanding certificateholders or by a rating agency;

(ii) The transfer to the trust of the receivables acquired during the pre-funding period will not result in the certificates receiving a lower credit rating from the rating agency upon termination of the pre-funding period than the rating that was obtained at the time of the initial issuance of the certificates by the trust;

(iii) The weighted average annual percentage interest rate (the average interest rate) for all of the obligations in the trust at the end of the pre-funding period will not be more than 100 basis points lower than the average interest rate for the obligations which were transferred to the trust on the closing date;

(iv) The trustee of the trust (or any agency with which the trustee contracts to provide trust services) will be a substantial financial institution or trust company experienced in trust activities and familiar with its duties, responsibilities, and liabilities as a fiduciary under the Act. The trustee, as the legal owner of the obligations in the trust, will enforce all the rights created in favor of certificateholders of such

trust, including employee benefit plans subject to the Act.

In order to ensure that the characteristics of the receivables actually acquired during the pre-funding period are substantially similar to receivables that were acquired as of the closing date, the characteristics of the additional obligations subsequently acquired will be either: (i) Monitored by a credit support provider or other insurance provider which is independent of the sponsor; or (ii) an independent accountant retained by the sponsor will provide the sponsor with a letter (with copies provided to the rating agency, FTNC and the trustee) stating whether or not the characteristics of the additional obligations acquired after the closing date conform to the characteristics of such obligations described in the prospectus, private placement memorandum and/or pooling and servicing agreement. In preparing such letter, the independent accountant will use the same type of procedures as were applicable to the obligations which were transferred as of the closing date.

Each prospectus, private placement memorandum and/or pooling and servicing agreement will set forth the terms and conditions for eligibility of the receivables to be included in the trust as of the related closing date, as well as those to be acquired during the pre-funding period, which terms and conditions will have been agreed to by the rating agencies which are rating the applicable certificates as of the closing date. Also included among these conditions is the requirement that the trustee be given prior notice of the receivables to be transferred, along with such information concerning those receivables as may be requested. Each prospectus or private placement memorandum will describe the amount to be deposited in, and the mechanics of, the pre-funding account and will describe the pre-funding period for the trust.

#### Parties to Transactions

11. The *originator* of a receivable is the entity that initially lends money to a borrower (obligor), such as a home owner or automobile purchaser, or leases property to a lessee. The originator may either retain a receivable in its portfolio or sell it to a purchaser, such as a trust sponsor.

Originators of receivables included in the trusts will be entities that originate receivables in the ordinary course of their businesses, including finance companies for whom such origination constitutes the bulk of their operations, financial institutions for whom such origination constitutes a substantial part

of their operations, and any kind of manufacturer, merchant, or service enterprise for whom such origination is an incidental part of its operations. Each trust may contain assets of one or more originators. The originator of the receivables may also function as the trust sponsor or servicer. The originator may be an affiliate of FTNC.

12. The *sponsor* will be one of three entities: (i) A special-purpose or other corporation unaffiliated with the servicer, (ii) a special-purpose or other corporation affiliated with the servicer, or (iii) the servicer itself. Where the sponsor is not also the servicer, the sponsor's role will generally be limited to acquiring the receivables to be included in the trust, establishing the trust, designating the trustee, and assigning the receivables to the trust.

13. The *trustee* of a trust is the legal owner of the obligations in the trust. The trustee is also a party to or beneficiary of all the documents and instruments deposited in the trust, and as such is responsible for enforcing all the rights created thereby in favor of certificateholders.

The trustee will be an independent entity, and therefore will be unrelated to FTNC, the trust sponsor, the servicer or any other member of the Restricted Group (as defined in section III.L.). FTNC represents that the trustee will be a substantial financial institution or trust company experienced in trust activities. The trustee receives a fee for its services, which will be paid by the servicer or sponsor or out of the trust assets. The method of compensating the trustee which is specified in the pooling and servicing agreement will be disclosed in the prospectus or private placement memorandum relating to the offering of the certificates.

14. The *servicer* of a trust administers the receivables on behalf of the certificateholders. The servicer's functions typically involve, among other things, notifying borrowers of amounts due on receivables, maintaining records of payments received on receivables and instituting foreclosure or similar proceedings in the event of default. In cases where a pool of receivables has been purchased from a number of different originators and deposited in a trust, the receivables may be "subserviced" by their respective originators and a single entity may "master service" the pool of receivables on behalf of the owners of the related series of certificates. Where this arrangement is adopted, a receivable continues to be serviced from the perspective of the borrower by the local subservicer, while the investor's perspective is that the entire pool of

receivables is serviced by a single, central master servicer who collects payments from the local subservicers and passes them through to certificateholders.

Receivables of the type suitable for inclusion in a trust invariably are serviced with the assistance of a computer. After the sale, the servicer keeps the sold receivables on the computer system in order to continue monitoring the accounts. Although the records relating to sold receivables are kept in the same master file as receivables retained by the originator, the sold receivables are flagged as having been sold. To protect the investor's interest, the servicer ordinarily covenants that this "sold flag" will be included in all records relating to the sold receivables, including the master file, archives, tape extracts and printouts.

The sold flags are invisible to the obligor and do not affect the manner in which the servicer performs the billing, posting and collection procedures related to the sold receivables. However, the servicer uses the sold flag to identify the receivables for the purpose of reporting all activity on those receivables after their sale to investors.

Depending on the type of receivable and the details of the servicer's computer system, in some cases the servicer's internal reports can be adapted for investor reporting with little or no modification. In other cases, the servicer may have to perform special calculations to fulfill the investor reporting responsibilities. These calculations can be performed on the servicer's main computer, or on a small computer with data supplied by the main system. In all cases, the numbers produced for the investors are reconciled to the servicer's books and reviewed by public accountants.

The *underwriter* (i.e., FTNC, its affiliate, or a member of an underwriting syndicate or selling group of which FTNC or its affiliate is a manager or co-manager) will be a registered broker-dealer that acts as underwriter or placement agent with respect to the sale of the certificates. Public offerings of certificates are generally made on a firm commitment basis. Private placement of certificates may be made on a firm commitment or agency basis. It is anticipated that the lead and co-managing underwriters will make a market in certificates offered to the public.

In some cases, the originator and servicer of receivables to be included in a trust and the sponsor of the trust (although they may themselves be related) will be unrelated to FTNC. In

other cases, however, affiliates of FTNC may originate or service receivables included in a trust or may sponsor a trust.

#### Certificate Price, Pass-Through Rate and Fees

15. In some cases, the sponsor will obtain the receivables from various originators pursuant to existing contracts with such originators under which the sponsor continually buys receivables. In other cases, the sponsor will purchase the receivables at fair market value from the originator or a third party pursuant to a purchase and sale agreement related to the specific offering of certificates. In other cases, the sponsor will originate the receivables itself.

As compensation for the receivables transferred to the trust, the sponsor receives certificates representing the entire beneficial interest in the trust, or the cash proceeds of the sale of such certificates. If the sponsor receives certificates from the trust, the sponsor sells all or a portion of these certificates for cash to investors or securities underwriters.

16. The price of the certificates, both in the initial offering and in the secondary market, is affected by market forces, including investor demand, the pass-through interest rate on the certificates in relation to the rate payable on investments of similar types and quality, expectations as to the effect on yield resulting from prepayment of underlying receivables, and expectations as to the likelihood of timely payment.

The pass-through rate for certificates is equal to the interest rate on receivables included in the trust minus a specified servicing fee.<sup>25</sup> This rate is generally determined by the same market forces that determine the price of a certificate. The price of a certificate and its pass-through, or coupon, rate together determine the yield to investors. If an investor purchases a certificate at less than par, that discount augments the stated pass-through rate; conversely, a certificate purchased at a premium yields less than the stated coupon.

17. As compensation for performing its servicing duties, the servicer (who may also be the sponsor or an affiliate thereof, and receive fees for acting in that capacity) will retain the difference between payments received on the receivables in the trust and payments

payable (at the pass-through rate) to certificateholders, except that in some cases a portion of the payments on receivables may be paid to a third party, such as a fee paid to a provider of credit support. The servicer may receive additional compensation by having the use of the amounts paid on the receivables between the time they are received by the servicer and the time they are due to the trust (which time is set forth in the pooling and servicing agreement). The servicer typically will be required to pay the administrative expenses of servicing the trust, including in some cases the trustee's fee, out of its servicing compensation.

The servicer is also compensated to the extent it may provide credit enhancement to the trust or otherwise arrange to obtain credit support from another party. This "credit support fee" may be aggregated with other servicing fees, and is either paid out of the interest income received on the receivables in excess of the pass-through rate or paid in a lump sum at the time the trust is established.

18. The servicer may be entitled to retain certain administrative fees paid by a third party, usually the obligor. These administrative fees fall into three categories: (a) Prepayment fees; (b) late payment and payment extension fees; and (c) expenses, fees and charges associated with foreclosure or repossession, or other conversion of a secured position into cash proceeds, upon default of an obligation.

Compensation payable to the servicer will be set forth or referred to in the pooling and servicing agreement and described in reasonable detail in the prospectus or private placement memorandum relating to the certificates.

19. Payments on receivables may be made by obligors to the servicer at various times during the period preceding any date on which pass-through payments to the trust are due. In some cases, the pooling and servicing agreement may permit the servicer to place these payments in non-interest bearing accounts maintained with itself or to commingle such payments with its own funds prior to the distribution dates. In these cases, the servicer would be entitled to the benefit derived from the use of the funds between the date of payment on a receivable and the pass-through date. Commingled payments may not be protected from the creditors of the servicer in the event of the servicer's bankruptcy or receivership. In those instances when payments on receivables are held in non-interest bearing accounts or are commingled with the servicer's own funds, the servicer is required to deposit these

payments by a date specified in the pooling and servicing agreement into an account from which the trustee makes payments to certificateholders.

20. The underwriter will receive a fee in connection with the securities underwriting or private placement of certificates. In a firm commitment underwriting, this fee would consist of the difference between what the underwriter receives for the certificates that it distributes and what it pays the sponsor for those certificates. In a private placement, the fee normally takes the form of an agency commission paid by the sponsor. In a best efforts underwriting in which the underwriter would sell certificates in a public offering on an agency basis, the underwriter would receive an agency commission rather than a fee based on the difference between the price at which the certificates are sold to the public and what it pays the sponsor. In some private placements, the underwriter may buy certificates as principal, in which case its compensation would be the difference between what it receives for the certificates that it sells and what it pays the sponsor for these certificates.

#### Purchase of Receivables by the Servicer

21. The applicant represents that as the principal amount of the receivables in a trust is reduced by payments, the cost of administering the trust generally increases, making the servicing of the trust prohibitively expensive at some point. Consequently, the pooling and servicing agreement generally provides that the servicer may purchase the receivables remaining in the trust when the aggregate unpaid balance payable on the receivables is reduced to a specified percentage (usually 5 to 10 percent) of the initial aggregate unpaid balance.

The purchase price of a receivable is specified in the pooling and servicing agreement and will be at least equal to: (1) the unpaid principal balance on the receivable plus accrued interest, less any unreimbursed advances of principal made by the servicer; or (2) the greater of (a) the amount in (1) or (b) the fair market value of such obligations in the case of a REMIC, or the fair market value of the receivables in the case of a trust that is not a REMIC.

#### Certificate Ratings

22. The certificates will have received one of the three highest ratings available from a rating agency. Insurance or other credit support (such as surety bonds, letters of credit, guarantees, or overcollateralization) will be obtained by the trust sponsor to the extent necessary for the certificates to attain

<sup>25</sup> The pass-through rate on certificates representing interests in trusts holding leases is determined by breaking down lease payments into "principal" and "interest" components based on an implicit interest rate.

the desired rating. The amount of this credit support is set by the rating agencies at a level that is a multiple of the worst historical net credit loss experience for the type of obligations included in the issuing trust.

#### Provision of Credit Support

23. In some cases, the master servicer, or an affiliate of the master servicer, may provide credit support to the trust (*i.e.* act as an insurer). In these cases, the master servicer, in its capacity as servicer, will first advance funds to the full extent that it determines that such advances will be recoverable (a) out of late payments by the obligors, (b) from the credit support provider (which may be the master servicer or an affiliate thereof) or, (c) in the case of a trust that issues subordinated certificates, from amounts otherwise distributable to holders of subordinated certificates, and the master servicer will advance such funds in a timely manner. When the servicer is the provider of the credit support and provides its own funds to cover defaulted payments, it will do so either on the initiative of the trustee, or on its own initiative on behalf of the trustee, but in either event it will provide such funds to cover payments to the full extent of its obligations under the credit support mechanism. In some cases, however, the master servicer may not be obligated to advance funds but instead would be called upon to provide funds to cover defaulted payments to the full extent of its obligations as insurer. Moreover, a master servicer typically can recover advances either from the provider of credit support or from future payments on the affected assets.

If the master servicer fails to advance funds, fails to call upon the credit support mechanism to provide funds to cover delinquent payments, or otherwise fails in its duties, the trustee would be required and would be able to enforce the certificateholders' rights, as both a party to the pooling and servicing agreement and the owner of the trust estate, including rights under the credit support mechanism. Therefore, the trustee, who is independent of the servicer, will have the ultimate right to enforce the credit support arrangement.

When a master servicer advances funds, the amount so advanced is recoverable by the master servicer out of future payments on receivables held by the trust to the extent not covered by credit support. However, where the master servicer provides credit support to the trust, there are protections in place to guard against a delay in calling upon the credit support to take advantage of the fact that the credit

support declines proportionally with the decrease in the principal amount of the obligations in the trust as payments on receivables are passed through to investors. These safeguards include:

(a) There is often a disincentive to postponing credit losses because the sooner repossession or foreclosure activities are commenced, the more value that can be realized on the security for the obligation;

(b) The master servicer has servicing guidelines which include a general policy as to the allowable delinquency period after which an obligation ordinarily will be deemed uncollectible. The pooling and servicing agreement will require the master servicer to follow its normal servicing guidelines and will set forth the master servicer's general policy as to the period of time after which delinquent obligations ordinarily will be considered uncollectible;

(c) As frequently as payments are due on the receivables included in the trust (monthly, quarterly or semi-annually, as set forth in the pooling and servicing agreement), the master servicer is required to report to the independent trustee the amount of all past-due payments and the amount of all servicer advances, along with other current information as to collections on the receivables and draws upon the credit support. Further, the master servicer is required to deliver to the trustee annually a certificate of an executive officer of the master servicer stating that a review of the servicing activities has been made under such officer's supervision, and either stating that the master servicer has fulfilled all of its obligations under the pooling and servicing agreement or, if the master servicer has defaulted under any of its obligations, specifying any such default. The master servicer's reports are reviewed at least annually by independent accountants to ensure that the master servicer is following its normal servicing standards and that the master servicer's reports conform to the master servicer's internal accounting records. The results of the independent accountants' review are delivered to the trustee; and

(d) The credit support has a "floor" dollar amount that protects investors against the possibility that a large number of credit losses might occur towards the end of the life of the trust, whether due to servicer advances or any other cause. Once the floor amount has been reached, the servicer lacks an incentive to postpone the recognition of credit losses because the credit support amount thereafter is subject to reduction only for actual draws. From the time

that the floor amount is effective until the end of the life of the trust, there are no proportionate reductions in the credit support amount caused by reductions in the pool principal balance. Indeed, since the floor is a fixed dollar amount, the amount of credit support ordinarily increases as a percentage of the pool principal balance during the period that the floor is in effect.

#### Disclosure

24. In connection with the original issuance of certificates, the prospectus or private placement memorandum will be furnished to investing plans. The prospectus or private placement memorandum will contain information material to a fiduciary's decision to invest in the certificates, including:

(a) Information concerning the payment terms of the certificates, the rating of the certificates, and any material risk factors with respect to the certificates;

(b) A description of the trust as a legal entity and a description of how the trust was formed by the seller/servicer or other sponsor of the transaction;

(c) Identification of the independent trustee for the trust;

(d) A description of the receivables contained in the trust, including the types of receivables, the diversification of the receivables, their principal terms, and their material legal aspects;

(e) A description of the sponsor and servicer;

(f) A description of the pooling and servicing agreement, including a description of the seller's principal representations and warranties as to the trust assets, including the terms and conditions for eligibility of any receivables transferred during the pre-funding period and the trustee's remedy for any breach thereof; a description of the procedures for collection of payments on receivables and for making distributions to investors, and a description of the accounts into which such payments are deposited and from which such distributions are made; a description of permitted investments for any pre-funding account or capitalized interest account; identification of the servicing compensation and any fees for credit enhancement that are deducted from payments on receivables before distributions are made to investors; a description of periodic statements provided to the trustee, and provided to or made available to investors by the trustee; and a description of the events that constitute events of default under the pooling and servicing contract and a description of the trustee's and the investors' remedies incident thereto;



(g) A description of the credit support;  
 (h) A general discussion of the principal federal income tax consequences of the purchase, ownership and disposition of the pass-through securities by a typical investor;

(i) A description of the underwriters' plan for distributing the pass-through securities to investors;

(j) Information about the scope and nature of the secondary market, if any, for the certificates; and

(k) A statement as to the duration of any pre-funding period and the pre-funding limit for the trust.

25. Reports indicating the amount of payments of principal and interest are provided to certificateholders at least as frequently as distributions are made to certificateholders. Certificateholders will also be provided with periodic information statements setting forth material information concerning the underlying assets, including, where applicable, information as to the amount and number of delinquent and defaulted loans or receivables.

26. In the case of a trust that offers and sells certificates in a registered public offering, the trustee, the servicer or the sponsor will file such periodic reports as may be required to be filed under the Securities Exchange Act of 1934. Although some trusts that offer certificates in a public offering will file quarterly reports on Form 10-Q and Annual Reports on Form 10-K, many trusts obtain, by application to the SEC, a complete exemption from the requirement to file quarterly reports on Form 10-Q and a modification of the disclosure requirements for annual reports on Form 10-K. If such an exemption is obtained, these trusts normally would continue to have the obligation to file current reports on Form 8-K to report material developments concerning the trust and the certificates and copies of the statements sent to certificateholders. While the SEC's interpretation of the periodic reporting requirements is subject to change, periodic reports concerning a trust will be filed to the extent required under the Securities Exchange Act of 1934.

27. At or about the time distributions are made to certificateholders, a report will be delivered to the trustee as to the status of the trust and its assets, including underlying obligations. Such report will typically contain information regarding the trust's assets (including those purchased by the trust from any pre-funding account), payments received or collected by the servicer, the amount of prepayments, delinquencies, servicer advances, defaults and foreclosures, the amount of any

payments made pursuant to any credit support, and the amount of compensation payable to the servicer. Such report also will be delivered to or made available to the rating agency or agencies that have rated the trust's certificates.

In addition, promptly after each distribution date, certificateholders will receive a statement prepared by the servicer or trustee summarizing information regarding the trust and its assets. Such statement will include information regarding the trust and its assets, including underlying receivables. Such statement will typically contain information regarding payments and prepayments, delinquencies, the remaining amount of the guaranty or other credit support and a breakdown of payments between principal and interest.

#### Forward Delivery Commitments

28. FTNC may contemplate entering into forward delivery commitments in connection with the offering of pass-through certificates. The utility of forward delivery commitments has been recognized with respect to offering similar certificates backed by pools of residential mortgages, and FTNC may find it desirable in the future to enter into such commitments for the purchase of certificates.

#### Secondary Market Transactions

29. FTNC may attempt to make a market for securities for which it is lead or co-managing underwriter, although it is under no obligation to do so. At times, FTNC will facilitate sales by investors who purchase certificates if FTNC has acted as agent or principal in the original private placement of the certificates and if such investors request FTNC's assistance.

#### Summary

30. In summary, the applicant represents that the transactions for which exemptive relief is requested satisfy the statutory criteria of section 408(a) of the Act due to the following:

(a) The trusts contain "fixed pools" of assets. There is little discretion on the part of the trust sponsor to substitute receivables contained in the trust once the trust has been formed;

(b) In the case where a pre-funding account is used, the characteristics of the receivables to be transferred to the trust during the pre-funding period will be substantially similar to the characteristics of those transferred to the trust on the closing date, thereby giving the sponsor and/or originator little discretion over the selection process, and compliance with this requirement

will be assured by the specificity of the characteristics and the monitoring mechanisms contemplated under the proposed exemption. In addition, certain cash accounts will be established to support the certificate pass-through rate and such cash accounts will be invested in short-term, conservative investments; the pre-funding period will be of a reasonably short duration; a pre-funding limit will be imposed; and any Internal Revenue Service requirements with respect to pre-funding intended to preserve the passive income character of the trust will be met. The fiduciary of the plans making the decision to invest in certificates is thus fully apprised of the nature of the receivables which will be held in the trust and has sufficient information to make a prudent investment decision.

(c) Certificates in which plans invest will have been rated in one of the three highest rating categories by a rating agency. Credit support will be obtained to the extent necessary to attain the desired rating;

(d) All transactions for which FTNC seeks exemptive relief will be governed by the pooling and servicing agreement, which is made available to plan fiduciaries for their review prior to the plan's investment in certificates;

(e) Exemptive relief from sections 406(b) and 407 for sales to plans is substantially limited; and

(f) FTNC anticipates that it will make a secondary market in certificates (although it is under no obligation to do so).

#### Notice to Interested Persons

The applicant represents that because those potentially interested participants and beneficiaries cannot all be identified, the only practical means of notifying such participants and beneficiaries of this proposed exemption is by the publication of this notice in the **Federal Register**. Comments and requests for a hearing must be received by the Department not later than 30 days from the date of publication of this notice of proposed exemption in the **Federal Register**.

**FOR FURTHER INFORMATION CONTACT:** Mr. J. Martin Jara of the Department, telephone (202) 219-8881. (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 30th day of June, 2000.

**Ivan Strasfeld,**

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

[FR Doc. 00-17065 Filed 7-6-00; 8:45 am]

**BILLING CODE 4510-29-P**